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Suggestions for USAID/Mozambique Activities in Microfinance

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Contents

I Microfinance in USAID/Mozambique's Strategy

This report suggests a strategy for USAID/Mozambique to follow in the area of rural and microfinance As an introduction, this first section establishes a basic perspective from which microfinance will be viewed in the context of USAID/Mozambique's SO1 *increased rural household income in the target area* of Mozambique Within that broad objective, microfinance is positioned within IR 1 2, *expanded rural enterprises* and is specifically expressed as *strengthened access to financial services* In order to turn this succinct formulation into a strategy, we begin by defining the target population and identifying their need for financial services

The report is structured in four parts As just noted, Part I briefly identifies the basic principles for USAID to apply in approaching this sector, combining the aims of USAID/Mozambique's SO1 with the principles of microfinance development Part II reviews the current status of financial services in Mozambique with an emphasis on rural microfinance Part III examines the environment in which microfinance is developing including the legal and regulatory environment as well as technical and financial support for microfinance programs In Part IV a strategic discussion is presented regarding likely sources of increased supply of services, ending with a series of action suggestions for USAID/Mozambique

A Relevant Population

Microfinance is here defined as the development of financial services – mainly savings and credit – for the low income population of the country That low income population includes households that earn their living from microenterprises and from agricultural production It includes people in both urban and rural areas, and is broadly synonymous with the smallholder farmer population plus the informal sector

A strict application of USAID/Mozambique's strategy would include only people living in the rural areas and small towns of the target provinces However, for practical reasons financial services typically begin in significant population centers even in cases where the people they serve are rural As experience is gained, services reach out to more rural locations Mozambique, which has very few rural financial services relatively low population density and poor infrastructure, is at the beginning of such a process Accordingly a financial services strategy will need to assume that the target population includes both rural areas and the portion of urban areas that have strong rural linkages[1]

USAID's official definition of microenterprise excludes crop production However that

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[1] In addition it is assumed that USAID s strategy though it has a geographic focus [illegible] such as policy dialogue that contribute to the development of microfinance generally [illegible] specific provincial focus

definition may be changed soon and should not constrain USAID/Mozambique which rightly focuses on agriculture because of its importance to incomes in Mozambique Thus in this paper agriculturalists are considered as part of the microfinance target population

Nevertheless most microfinance services are primarily aimed at microenterprises (particularly on the lending side), for reasons having to do with income streams and risk diversification Because many of the households that are involved with microenterprises are also farming households, the provision of financial services to those households supports both enterprise and farm activities

The rural sector also contains a number of strategically important larger actors whose activities contribute to increased incomes among smallholder farmers and microenterprises These actors include agroprocessing enterprises, small/medium scale merchants providing inputs, traders/buyers, and a few other small/medium enterprises Through the efforts of PVOs such as CLUSA, the medium-scale actors also include farmer associations acting as enterprises of their own

B Paths to Income Growth for Rural and Microenterprises

Mozambique today offers strong economic prospects for growth among its low income populations in rural and urban areas The major factors contributing to Mozambique's economic growth – political and macroeconomic stability, post-war rehabilitation and the transition to a market economy – all create positive prospects for investments, even the small investments that low income people make The rebound in agricultural production as well as growth in other sectors, appears to be broadly based In a gradual upward spiral the resulting increased income among the population creates demand for the goods and services provided by the same population Thus, even though current incomes are very low, economic opportunities are expanding In response informal markets in cities are burgeoning, and increasing numbers of microenterprises are appearing in rural areas

According to Michigan State University (MSU) surveys, a very large share of the income of rural residents (73 percent) comes from subsistence agriculture (Benefica) The other major income sources are the sale of agricultural production (15 percent) and microenterprises (10 percent) Wage labor is a negligible 2 percent MSU's surveys showed about one third of all rural households to be involved in a microenterprise Involvement in microenterprise was significantly correlated with increased household income (though the direction of causality could not be established)

In the future most income growth will arise from increases in agricultural sales and microenterprise revenues Growth in agricultural production sold will be made possible by increased access to markets, as trading connections develop, and by increased production through the use of productivity-enhancing inputs such as fertilizer and improved seed Micro and small enterprises have an important role to play (though they are certainly not the only players) in providing inputs and marketing products The linkages between farm and non-farm enterprises are well documented showing that microenterprises will grow as demand for simple goods and services increases and as households begin to have surpluses that they can invest in non-farm as well as on-farm income-earning opportunities wherever returns are highest

C The Value of Financial Services

Financial services can facilitate these growth processes USAID/Mozambique's strategy and this paper approach financial services as a means to increase household incomes and thus it is important to begin with a view of how financial services contribute to household well being

- Consumption smoothing people save or borrow to maintain adequate consumption through seasons or years in which incomes are below normal
- Emergency and social finance major expenses, particularly those that arise at unpredictable times medical emergencies weddings, funerals
- Household investments particularly education and housing
- Short term business opportunities working capital for purchase of inputs inventory
- Business investment capital equipment, premises

Importantly this list includes both household and enterprise/farm needs Because money is fungible, and because the financial needs of households and enterprises are intertwined efforts by providers to designate financial services for particular uses often fail People use finance for whatever provides them the greatest benefits Moreover even household-based uses contribute to household income when they enable family members to be better prepared for their economic tasks

The important point is that at the household/enterprise level it is difficult to trace an exact path from financial services to income growth Unlike seeds, which can only be used to grow one crop financial services work by increasing options

For those who rely mainly on subsistence agriculture, financial needs center around risk protection and consumption-smoothing These families use savings and credit services to help them maintain consumption during the hungry season, and to store value during periods of plenty This can only be done if some portion of production can be marketed For those involved in sales of agricultural products, financial services support both consumption smoothing and emergency needs, as well as purchase of inputs and possibly storage after harvest Microfinance aims to provide broadly applicable financial services that can respond to this variety of needs rather than to a particular segment of the market

There may be a gap at the mid-level, which would include farmer associations (as associations rather than collections of households) and medium-sized agriculturally related businesses Such specialized needs are not addressed separately in this paper as to do so would require deeper knowledge about the associations and businesses their governance and their relationships to the formal banking system

D Sustainability and Institution-Building

Mozambique is no longer in its relief and rehabilitation phase but is in a market development phase USAID/Mozambique places the highest priority on sustainability and the development of private markets and institutions that work without ongoing donor intervention It is challenging its grantees to respond to these requirements

Microfinance is strongly associated with an institution-building approach to finance It aims to create financial institutions (and/or financial services embedded in existing institutions) that will be able to serve the low income population on a sustainable basis becoming an integral part of the country's financial system In Mozambique the financial sector is at such a rudimentary level that it is often difficult to see how interventions that are possible now will contribute to the creation of a permanent financial system Often we must invest in activities that do not yet meet the ideal, or that require a painfully slow timetable However even these initial investments must be done in light of their contribution to the overall evolution of the financial system Activities that disregard this long run perspective (such as traditional subsidized credit schemes) have been shown to postpone the development of self-sufficient financial institutions

II The Status of Microfinance in Mozambique

A Financial Sector Distance from Microfinance

Before 1995 government owned all banking institutions in Mozambique and ran them in the socialist way as means of directing funds to state-owned enterprises rather than as allocators of risk-based credit Two government banks, BCM and BPD were privatized in 1995 and 1997 respectively In the same period, additional banks/financial institutions were created A bank supervision function was established at the Bank of Mozambique and a new Banking Law was enacted

Mozambique now has six commercial banks, one leasing company and one credit cooperative all private Further entry is expected in 1998 The new basis on which the financial sector is being built is positive Asset growth was significant in 1997 and most of the institutions showed a positive return on assets However returns on equity remain low in the range of 4 percent to 23 percent for the profitable institutions These newly established institutions have not been operating long enough to determine how successful they will be

This history of recent transition from nationalized to private banking explains the serious underdevelopment that characterizes Mozambique's financial services today Services are few and generally of poor quality In many areas of the country, there are virtually no formal financial services At present the banks are concentrating on low-risk or fee-based services, such as money transfers and short term import/export finance They invest much of their money offshore While credit to the private sector is expanding (by 48 percent from March 1997 to March 1998), it remains a relatively low percentage of the assets of most banks At the level of indigenous businesses very little credit is available from banks and virtually none is available at the micro level

On the savings side, minimum balance requirements, high charges, and the scarcity of banking outlets means that most people have no place to save money While competition for time deposits is beginning to appear, it is aimed at large depositors and products such as passbook savings, suitable for ordinary households, do not exists (possible exception BPD) Given that most banks are currently lending a relatively small proportion of their assets and are overly liquid, credit can continue to expand for some time before it will put pressure on banks for greater deposit mobilization Currently high charges and low interest rates place incentives on formal sector savers to place money outside Mozambique while lack of any services create the necessity for informal sector savers to keep cash or save in-kind

Interest rates remain fairly high, despite the fact that the Bank of Mozambique has dropped the rediscount rate below 10 percent This results from a combination of credit controls high administrative costs, and (at least for the privatized institutions) an overhang of bad debt Commercial bank rates are in the range of roughly 18 to 25 percent

Taken together these factors suggest that formal financial institutions are not likely to be pushing to penetrate low income and/or rural markets anytime soon despite the existence of a potential market there particularly on the savings side In various public and private fora several banks have expressed an interest in microfinance, particularly in teaming with NGOs While such statements may reflect a desire for a good public image rather than a serious intent banks should be challenged to explore the possibilities

B Microfinance Lending

Mozambique is at an interesting juncture in the development of microcredit institutions characterized by many institutions and few clients Recent attempts to identify microfinance institutions have counted as many as 39 organizations that identify themselves as providers of microcredit (Chidzero et al) However in considering the future of microfinance -- in other words, who is going to be providing credit to the poorer segments of the population during the next decade -- most of these projects (perhaps as many as two thirds) can be disregarded due to their lack of scale and sustainability Only one program World Relief has achieved a significant scale (4 100 active clients) and level of cost recovery (75 percent, excluding expatriate costs) It alone accounts for over half of the nationwide number of active clients identified (6,000, Chidzero et al) Excluding World Relief, the average number of clients per program is roughly 100 truly negligible by international standards and by reference to market potential

Nevertheless, recent and prospective new entry is set to change the microfinance scene in Mozambique rapidly A handful of programs have the prospects to grow significantly [illegible] d appear to be laying the foundations for sustainability (for example, Care's Cresce program Iram's CCCP program, SOCREMO, and MEDA) Most of the programs in this smaller group are run by international NGOs, though there are a few local institutions that may develop These programs are generally based on good practice Finally new projects have just been funded or are on the verge of receiving funding including World Vision in Zambezia, Care/Clusa in Nampula, and others If these programs grow as projected the number of clients served nationwide will increase exponentially in the next [illegible] years

Summary assessments of some of the more important programs follow [illegible] programs, the following parameters are used

- level of operations (number of active clients, type of clients [illegible])
- financial performance (cost recovery, reporting portfolio quality [illegible] rates) and
- institutional strength (institutional type, experience of providers [illegible] institutional challenges, funding)

In view of these parameters a general evaluation of future prospects is made based on the author's judgment

1 World Relief (Gaza, Xai-Xai)

The World Relief village banking program in Gaza is clearly the leading Mozambican program at present By international standards, it would be considered a good moderate-sized program still in a relatively formative stage of development It has 4 100 active clients and a portfolio of $220,000 The average loan balance is approximately $55 It targets very poor clients, mostly women who are vendors and some who are petty manufacturers operating in a relatively densely populated and prosperous location (a region in which local income is supplemented by remittances from South Africa) The program provides health and other messages as part of its methodology and also has a savings component (discussed in the next section)

The program is making progress toward financial viability It covers about 75 percent of its operating costs excluding the costs of the expatriate director (who works part time on the project) and international technical assistance This performance is good for a fairly young program with such a low average loan size, and is due to the effective interest rate of 102 percent, and to good repayment performance (97 percent on-time) It is evidence that the program is competently run Nevertheless, the program will probably have to make some significant adjustments in order to reach its goal of full financial viability

Institutionally, the program faces several significant tasks The highest priority is the training of local senior and middle managers to a point at which the intensity of expatriate assistance can diminish Because this task is so central to the sustainability of the institution, it is important that World Relief take the time to concentrate on it during the next couple of years At the same time, it should be possible to pursue transition to a local institution Although World Relief has stated its intent to spin the program off as a local institution, it is still at the start of such a process This program was recently awarded a USAID Matching Grant from BHR/PVC, which will bring in $1 8 million ($328 000 from USAID and $1,526,000 from the PVO), thus allowing the program to operate on an expansion path for the next five years The Matching Grant proposal calls for geographical expansion, including the opening of a new branch managed separately in one of USAID's target provinces in northern Mozambique

World Relief worldwide is a solid village bank PVO, with good programs in Cambodia Honduras and other countries It has proven its ability to develop its program into local institutions and it is strong in financial reporting Only its Honduras program has reached full financial viability None of its programs have yet become independent of donor support

2 CARE (Cresce/Manica, Angoche, Nampula)

CARE is moving rapidly into microfinance in several locations using a variety of methodologies and funding sources Its oldest program, Cresce in Chimoio has been lending for less than two years, and has 441 clients, and a portfolio of $30 000 with an average loan balance of about $70 (as of 12/97) Cresce's clients, like those of World Relief are largely urban and town-based vendors, though a much smaller proportion of all clients (34 percent) are women Cresce uses a solidarity group methodology CARE is also starting a new program in Quelimane, which may eventually merge with Cresce as they expand toward each other

CARE's program in Angoche has not been successful It has experienced serious repayment problems, and will not be expanded CARE will instead concentrate on developing a new program in Nampula, together with CLUSA This program will have two products credit to the farmer associations CLUSA has developed and credit for the itinerant traders (ambulantes) who purchase agricultural products from local farmers Both of these products are specialized They require larger loan sizes and somewhat different methodologies from standard village banking or solidarity group programs They will require a higher skill level on the part of credit officers

Financial performance information is available only on the Cresce program It is said to be covering 30 percent of its operating costs (this figure probably excludes expatriate costs) and has high repayments, with only 1 1 percent of the portfolio at risk It charges interest at 35 percent per year flat (effective rate about 60 percent) It is expanding steadily each month

The Cresce program is judged to be off to a good start, applying sound practices and reporting good results It is just moving out of what might be considered the start-up phase into an expansion and consolidation phase CARE plans to expand the program to Beira, and to spin it off as a local institution However, it does not currently have the funding to do this If the CARE/CLUSA program succeeds, CARE would have developed a national network of microfinance institutions, covering three provinces It is also planning to launch small savings and credit activities in Inhambane and Maputo In microfinance worldwide CARE is known for methodological innovation particularly in work with pre-existing community groups It has shown creativity in linking microfinance to both informal and formal organizations (e g ROSCAs and commercial ba[illegible]) However, there are few instances of CARE programs evolving into freestanding sustainable local institutions

3 World Vision

World Vision has been experimenting in a small way with microfinance in [illegible] to now The real beginning of its program is marked by the recent arrival o[illegible] microfinance specialists who are in the process of introducing new methodologies and setting up systems World Vision is currently operating in Nampula and Zambezia using solidarity group and individual methodologies with about 180 active clients charging an effective interest rate of about 65 percent It is also starting a separate village banking program funded by DFID in Zambezia

World Vision is not known worldwide as a leading microfinance PVO While it does support microfinance programs in various countries, most of these are small and not self-sufficient Recently however, World Vision has been making a specific effort to develop its expertise and programming in microfinance

4 MEDA (Maputo)

MEDA is operating one program in Maputo, using solidarity group loans to reach market vendors in Chiquelene market This program began lending in October 1997 and has been moving slowly in part due to a lack of substantial funding As of July 1998 it has roughly 250 active clients In February 1998, its average loan size was reported to be $85 There was little or no delinquency, and the 45 percent flat interest rate with fees translates into an 85 percent effective rate (Chidzero et al) As a new program financial performance data is not yet available MEDA has just been awarded a USAID Matching Grant which will allow it to expand the Maputo program

This program is run as a project of MEDA, but intends to become a local institution As different from most of the other international NGOs, MEDA is considering setting up the local institution as a for-profit financial institution The challenges MEDA faces in the near and mid term involve establishing an effective operation of significant scale with competent staff and efficient systems The operation is still in its critical initial phase in which management is all-important Worldwide, MEDA sponsors some very strong microfinance programs particularly its programs in Haiti and Nicaragua It is known for its businesslike approach to microfinance, which includes a commitment to moving beyond donor dependence at an early stage However, MEDA's recent entry into Africa has been plagued with problems It has had significant difficulties in Zimbabwe and Tanzania and the program in Mozambique started off with a management that MEDA had to replace The current manager is one of the most knowledgeable and creative people working in microfinance in Mozambique However, he is only available to the program p[illegible]

5 Tchuma (Maputo)

Tchuma is a local organization with strong backers (Graca Machel and [illegible]) which is organizing itself as a credit cooperative and planning to begin lending [illegible] 1998 It is essentially starting from scratch, after a failed pilot effort A new team has been brought in to develop new systems and methodologies, taking into account lessons from the original pilot Given that the new team is untested and operations have not yet begun, it is too early to say anything about the prospects that Tchuma will succeed

However it appears to be the only local organization basing its operations clearly on best practice principles

C Savings Mobilization

The demand for savings services among low income people in Mozambique is widely thought to equal or exceed the demand for credit Incomes are rising and households are building up assets Currently, however, there is virtually no supply of savings services other than traditional informal mechanisms xitiques, moneykeepers and in-kind savings (particularly livestock) It is believed that some families resort to burying cash as a way to save money safely Formal deposit services are not available to the poor because of excessive bank charges and the lack of convenient bank outlets

Savings mobilization is in some ways more straightforward than credit the institution accepts funds depositors bring it, having no need for detailed information about the client or complex systems for tracking and following up late payments Savings mobilization is instead a matter of ensuring that the institution offering the services is safe and trustworthy No matter how great the demand for savings, it is crucial to prohibit institutions that cannot meet safety and soundness standards from being savings mobilizers NGOs should not be allowed to mobilize savings from the public (i e from non-borrowers), while banks and credit unions should be allowed to mobilize savings only under strict financial management and performance guidelines and with adequate supervision This section now turns to the current and future prospects of savings mobilization from these three sources -- NGOs, credit unions, and banks

1 Banks

Formal financial institutions -- banks and the one credit cooperative Credicoop -- are the most obvious place to look for savings services These institutions currently offer demand and time deposits but most have not developed savings deposit products that can serve poor and informal sector clients Demand accounts require prohibitively large minimum balances, pay no returns, and may include costly fees for withdrawals Time deposits also require large minimum balances and restrict access to funds Outside Maputo the banks have very few outlets The one bank with many outlets, BPD, is reported to be intent on closing many of those outlets and not to be interested in serving the bottom end of the market Nevertheless there are some signs that interest is awakening in competing for deposits Credicoop, for example, is negotiating with the Post Office TDM and several NGOs regarding cooperating in using the outlets of these organizations as posts for savings mobilization It has opened an office in a rural location identified as a prime location for agriculture-related deposits and South African remittances Other banks are also opening new branches Given the rapid entry of banks in the Mozambique market (a total of 9 institutions expected to be operating by year end), it is likely that one or more banks will identify low-end deposit mobilization as an attractive market niche

2 NGOs

Several of the NGOs in Mozambique offering microcredit have a compulsory savings requirement in which borrowers must save a specified amount in order to be eligible for loans of various sizes Of the organizations reviewed above, only World Relief currently uses such a requirement though others (CARE, World Vision) are establishing programs in which savings requirements will probably feature In these cases, all savers are borrowers, and are in a net borrowing position vis a vis the NGO most of the time (except at the end of their repayment schedules and before they have received a follow-on loan) From the borrower's point of view, such funds do not fill the role of ordinary savings services they cannot be accessed on demand or used to meet emergencies In some cases clients never see the funds again -- they are simply a contribution to the organization -- a disguised fee or a guarantee fund In other programs particularly village banking programs additional savings are mobilized beyond the requirements and these may be re-lent by or to village bank members This does not yet appear to be happening in Mozambique but is an important future element of the IRAM program and of a small CARE project to be launched in Inhambane There may be creative ways to involve NGOs in savings mobilization through links with banks MEDA and Credicoop are considering opening a Credicoop deposit-taking window in the MEDA office in Chiquelene Market to serve MEDA borrowers and others in the market

3 Credit Unions

Credit unions appear to be an attractive way to get started with savings mobilization in Mozambique credit unions can be started small and led by savings contributors There are major barriers to the development of credit unions, however Mozambique is one of the few countries in the world -- and the only country in the region -- that lacks a network of savings and credit societies In one sense this is good Mozambique does not have to contend with the accumulated baggage that weighs down most credit union systems -- a history of political interference, inappropriate supervision by ministries of cooperative development interest rate policies unfavorable to savers, etc On the other hand it means that the task of launching credit unions in Mozambique is much the same as the task of starting a new NGO program It will be slow and risky Moreover it comes with the additional complication of the need to develop a legal and regulatory framework suited to the unique characteristics of credit unions Development of credit unions would require the entry of one of the international organizations promoting savings and credit societies such as WOCCU or des Jardins The local IRAM program, while it shares some features with credit unions is a credit-led approach, which differs importantly from true credit unions Savings will not be introduced in IRAM's groups for two or three years

It is crucial to recognize that savings mobilization programs must be developed hand in hand with capacity to supervise the institutions that offer savings The basic principles to guide action are described in more detail in Section III but they are summarized here in Table 1 As USAID considers the possibility of supporting savings mobilization it should ensure that it works within this framework

Table 1 Dr Beth's Guide to Safe Savings

Grassroots Groups	• Grassroots groups, village banks small credit unions and the like should not be restricted from accepting savings from their members or subject to government regulation as long as they are of a size in which members know each other personally and join the group voluntarily
NGOs	• Only extraordinarily successful and experienced NGOs should be allowed to accept deposits and use for lending and only under strict conditions and supervision Not an option for Mozambique in current level of NGO development • Lending NGOs with compulsory savings requirements are generally safe These should not be regarded as true savings Similarly, village bank programs in which only members handle savings do not require intervention • NGOs may be able to collect savings safely in partnership with banks under agent relationships
Credit Unions	• Credit unions need clear regulatory framework for operating, covering acceptable financial structure (e g capital adequacy), information disclosure and governance • Development of a credit union system requires a capable supervisory structure Supervisors can be outside regular bank supervision, but must be competent authoritative and more interested in safety than in promotion
Banks	• If banks are to be supported to mobilize savings it s necessary to ensure that they are safe institutions need to know the financial status of each bank and the competence/effectiveness of bank supervisors

III The Environment for Microfinance and Mechanisms for Support

A Legal and Regulatory Policies Affecting Microfinance

In most countries with well-developed microfinance, financial services for the poor have arisen outside the mainstream financial system, through NGOs credit unions and other specialized institutions In most countries, the legal and regulatory framework governing the financial sector has allowed these operations to develop, and serious issues concerning the regulation of microfinance operations have only been met after the institutions have reached significant scale and maturity

Mozambique is different The legal framework governing financial operations already poses barriers even at this early stage Three elements of the existing framework pose near-term barriers

- The process for establishing non-profit, non-governmental organizations is time-consuming and a source of confusion among both applicants and officials (Garvey Fumo)
- Current law limits the extension of credit (and savings) to formal financial institutions, rendering non-governmental organization programs technically "illegal"
- Current law offers a framework that is less than adequate for the development of small savings-based organizations, such as savings and credit societies

In the longer run, it may also be necessary to examine the general framework governing savings mobilization the evolution of non-profit microfinance operations into formal institutions and the treatment of microfinance within banks The Banco de Moçambique has recognized the need to take some action to permit microfinance to develop and is planning to enact changes in regulation and law

1 Registration of NGOs

Most of the microfinance programs USAID is supporting are projects of international NGOs If they are to emerge as sustainable microfinance institutions they [illegible] will have to become locally registered organizations They will need to become independent paving the way for the eventual exit of the international sponsors In addition [illegible] NGOs are increasingly sponsoring microfinance programs

The process for registering such organizations is currently not well understood According to Fumo most local NGOs operate with no legal recognition [illegible] seek such regulation find that it takes years rather than months to complete the process

The steps required are complicated and subject to confusion and the discretion given to government in the process means that approval cannot be assured Additional uncertainties and red tape are required to obtain tax exempt status Many organizations operate without registration but they are vulnerable, government could challenge their operation they have no legal rights, individual members are liable for the finances of the organization, and the organization usually cannot even open a bank account in its name In this environment, it can be expected that international NGOs will move only slowly to establish local organizations

Moreover questions arise about the suitability for microcredit of the main legal form of non-profit organization used in Mozambique, the association Associations are membership-based organizations, with a presumed identity between association members and the beneficiaries of the association's activities This may effectively mean client control In international experience, such an organizational structure has not proved effective for credit-based microfinance programs clients have tended to value short-term payout over long term maintenance of the organization's capital Under such conditions donors are reluctant to provide additional capital If Mozambican associations can operate more like traditional non-profit organizations, which are more corporate than collective such problems can be avoided The organizational form of foundation which is available here, though rarely used may be suitable Foundations are intended to be established for the management of a sum of money devoted to social purposes Microcredit would seem to fit that definition

For international NGOs, although current operations are covered by agreements with the Ministry of Foreign Affairs, political sensitivities surrounding them mean that the international NGOs cannot regard their positions as fully stable

2 Legality of NGO Credit Operations

In most countries, the government does not consider itself to have a regulatory interest in organizations that provide credit as long as those organizations do not raise funds as participants in the financial system (i e on the interbank market) or as deposit-takers They consider their regulatory interest to be confined to protecting depositors and the soundness of the interbank system Mozambique's Banking Law, however limits the extension of loans to licensed financial institutions Accordingly, the Government of Mozambique officially considers microcredit programs illegal While it has permitted such programs to operate, it is increasingly uncomfortable with this situation and wishes to regularize it The Bank of Mozambique is in the process of developing both a decree on microfinance (a regulation requiring approval of the Council of Ministers) and a revision to the Banking Law (requiring action by the National Assembly) Provision of a legal basis for microcredit will lay a significant part of the foundation for microfinance

In crafting these regulations one of the principal issues is whether the Bank of Mozambique should require all credit-extending institutions to register with it, giving the Bank the ability to decide on a case-by-case basis whether any given microcredit program would be allowed to operate In most countries central banks do not take on such a role This approval would add steps to the approvals currently needed to obtain legal registration as a local association or permission to operate as an international NGO

A related issue is whether to require that all microfinance programs submit financial performance reports on a regular basis to the Bank of Mozambique The rationale behind such a requirement is that it will contribute to improved financial standards It should directly increase the quality of financial information produced and should have an indirect effect in causing programs to scrutinize their financial performance and improve it A question about such systems, however, concerns the plans of the receiving organization in this case the Bank of Mozambique, for analyzing the information and using or publishing it in a way that will contribute to the objective of improved standards Only if the information can be used constructively is it worth collecting

3 Legality of Savings Operations

On the savings mobilization side, nearly everyone agrees that government has a regulatory interest In considering the foundations for microfinance, it is necessary to determine exactly where the boundaries of that interest lie There are several levels and kinds of activity to consider (a) small voluntary, grassroots operations (b) microcredit programs with compulsory savings features, (c) mobilization of savings from the public by non-profit institutions (d) savings-based organizations like credit unions and (e) licensed financial institutions including banks

> (a) It is generally agreed that small grassroots organizations mobilizing savings from their members should be allowed to operate without regulation and supervision The amounts of funds they handle are small enough not to matter to the broader financial system Moreover, as a voluntary association small enough that most members know each other, informal mechanisms of accountability are considered sufficient The question is defining the threshold beneath which there will be no regulation/supervision Under current Mozambican law no provisions allow such grassroots organizations to operate, although as no one attempts to regulate them, they do exist informally Moreover, several programs such as IRAM, World Relief, and a new project by CARE, are in the business of creating and advising such groups Through these projects, small groups are becoming an important part of the overall microfinance picture
>
> (b) Many microcredit programs involve compulsory savings as a requirement for obtaining a loan Typically, the borrower is required to keep fraction of the total loan amount (usually 10-20 percent) on deposit for at least the duration of the loan In general, such requirements are better regarded as features of the loan terms rather than true savings, and therefore, not subject to regulation/supervision

aimed at depositor protection [2] Mozambican law makes no explicit provision for such practices and it is not clear whether authorities would consider them genuine savings

(c) Non-profit organizations, such as NGOs and associations are rarely appropriate institutions to mobilize savings from the public They lack proper accountability structures needed to ensure that equity is safeguarded notably owners who have put their own capital at risk to protect depositors Moreover if they are not profitable, their capital is eroded each year, so that depositors are only protected if donors continue to inject fresh capital It may be possible to construct rules under which non-profits could accept deposits from the public such as requiring very high capital asset ratios and several years of a strong track record Even then, supervisors would have to be vigilant in their monitoring At present in Mozambique, no microcredit programs are profitable, and the supervisory capacity of the Bank of Mozambique is already stretched thin in overseeing the mainstream banks Thus it would not be prudent for the Bank of Mozambique to open the way for savings mobilization from NGOs at present

(d) However, one form of association, a true credit union, can be structured in a way that is more appropriate for savings mobilization True credit unions are for-profit membership organizations, in which savings are mobilized from members loans are provided to members using those savings, and members collectively control the organization Credit unions have generally been established with the help of promotional organizations, such as WOCCU or des Jardins which establish self-regulatory structures (federations) supplemented by state regulation most often through ministries of cooperatives Confusion arises in Mozambique over the differences and similarities between the Mozambican category of institution credit cooperative, and true credit unions In Mozambique credit cooperatives must be structured as public stock companies (corporations) but they are also membership organizations The key question is whether all members have an equal say in the organization as opposed to control by the founding member/shareholders In practice, the one active credit cooperative in Mozambique Credicoop, operates more like a bank than a credit union More work is needed to establish whether current law is conducive to the creation of credit unions

e) Licensed banks are clearly set up for the purpose of capturing deposits from the public However their interest in collecting deposits from the poor appears to be minimal

In summary, for the promotion of safe savings, regulatory action is needed to [illegible] that grassroots savings groups and compulsory savings of lending operators [illegible]

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[2] In certain cases compulsory savings requirements may need supervision primarily wh[illegible] keeps the amounts across several loan cycles and uses them to expand lending

without supervision and further exploration is needed concerning the framework for development of credit unions

4 Supervisory Capacity

In considering what changes should be made to laws and regulations a paramount concern is the capacity of the Bank of Mozambique to supervise the institutions it authorizes Bank supervision is a post-reform function in the financial sector, and has therefore only been developing for a few years The number of banks and their rapid growth means that bank supervisors have their hands full They cannot afford to place a high priority on microfinance Thus, the following events are quite likely even if the Bank operates with the best of intentions

- It may not be able to process applications quickly prolonging the approval process for types of organizations requiring their approval and limiting the number approved
- It may not spend much time analyzing the financial reports that they require losing the chance to use the reports for improving standards
- It may not be able to supervise institutions closely creating vulnerabilities

These issues are not confined to Mozambique They appear in nearly every country where the regulation and supervision of microfinance is contemplated Solutions require either regulations written to avoid taxing supervisory capacity, or a program to increase that capacity -- and to set some capacity aside specifically for microfinance It is not clear that the Bank of Mozambique is ready to embark on a capacity building program in this area given its other priorities

B Training for Microfinance Operations

In Mozambique the lack of direct exposure to strong microfinance programs makes training more important than it might be in other countries Training needs can be identified at three broad levels

1 Policy makers and others in positions of authority need to be informed about microfinance generally -- the principles that make it work international experience and the difference between good and bad practice At this level it is also important to understand the value of the informal sector and the role of financial services Such people make resource allocation decisions and may make policy decisions with direct effects on microfinance If they lack exposure to best practice, their decisions may undermine the evolution of sustainable institutions This level also includes the key backers of microfinance institutions, such as board members Estimated potential demand over three years Government 50, private sector 25 board members 25

2 Senior managers of microfinance programs need to learn more about managing a successful microfinance institution This level of training covers topics such as are provided through the CGAP training delinquency control interest rates accounting and financial management It also includes institutional development topics, such as managing personnel, working with boards of directors, etc , and topics relating to delivery of services to the target market Clients for such courses may also include auditors of microfinance institutions or providers of computer support who need to be able to understand the specifics of microfinance operations Estimated potential three-year demand 3-5 per institution times 25 institutions 75-100

3 Middle and junior level staff of microfinance organizations need more basic training in how to perform their jobs -- how to form client groups how to assess borrower repayment capacity, how to maintain records and use MIS reports what to do when a client misses a payment Estimated 3 year demand 10 loan officers per institution times 15 institutions 150

At present only the second level of training is being addressed through the CGAP training program Microfinance programs are of necessity also providing the third level of training to their own staff However, given the generally weak capacity of the microfinance operations in Mozambique today, there is probably greater justification for developing an outside source of such training than would usually be the case

Development of training capacity requires training materials, trainers capable of applying the materials, and an institutional home Each of these poses challenges for Mozambique

During the next year the CGAP training efforts will form a base from which additional training can be developed Courses will be provided regularly during the course of the next year and a half, funded jointly by CGAP and DFID This project aims to have as outputs (in addition to trained participants) a small cadre of trainers capable of giving high quality financial management training in microfinance, and materials in Portuguese that have been adapted to fit the Mozambican scene These efforts will constitute a significant beginning in addressing the need for materials and trainers, but will not involve much progress in developing an institutional home Moreover, it will only serve one of the three levels of trainees managers of institutions The next step would be to develop additional training aimed at trainee levels one and three above and to institutionalize the provision of training The aim would be to develop a company and/or institution(s) who regularly o[illegible] training services, so that the availability of services is not dependent on the decision of a particular donor to fund a course now and again

C Support Services MIS, Audit, and Accounting

As microfinance institutions grow in size and become more professional, they [illegible]quire services that support their operation as financial institutions These include computer support for management information systems (MIS), accounting services a[illegible] [illegible]dit [illegible] most countries professional companies such as computer and accounting firms provide such services However the microfinance business is sufficiently different from other financial businesses that professionals in these firms need to understand how microfinance works in order to assist institutions effectively Because microfinance is not yet a profitable market, however, it may be appropriate for donors to support the development of professional services aimed at microfinance institutions

Microfinance institutions must have effective MIS systems (manual or computerized) if they are to process a high volume of transactions while maintaining high portfolio quality Yet MIS systems have probably created more headaches for managers of microfinance institutions than any other aspect of management Up to now most microfinance institutions have found it necessary to create their own systems Off-the-shelf packages have not been available More recently a few such packages have been developed (Microbanker, DBS systems, IPC, and the systems of several international NGOs) Most organizations that have experimented with off-the-shelf packages have found it very difficult to customize the systems to fit the particular needs of their organization They find that the cost of the package itself is the lowest part of the overall cost Customization and system maintenance are much more expensive

A number of microfinance institutions in Mozambique have been working together to try to share the costs of purchasing MIS systems and having them translated into Portuguese They are betting that recent progress in software development will mean that the lessons of past experience no longer apply While it is true that the day of off-the-shelf programs may be coming, it does not yet appear to be here Based on brief discussions with these NGOs, they have seriously under-budgeted the cost of obtaining a good MIS system because they have not included the cost of customization and maintenance The best way to help such organizations develop well-functioning MIS systems is to invest in a few computer support people who can learn the basics of microfinance and can get to know the programs well One such professional could support several NGOs There are several computer systems firms in Maputo that could provide such support

The area of audit and accounting bears some similarities to the MIS situation Standard audits (and USAID A-133 audits) are designed for purposes far removed from microfinance Standard audits verify that books are being kept accurately while A-133 audits verify that U S government funds are being properly used Neither type of audit looks in depth at the main vulnerability of microfinance programs, the loan portfolio Accordingly, a clean audit cannot insure that a program has a healthy loan portfolio and is free of employee fraud The process of dealing with this problem is just beginning at the international level The first step has been the development by CGAP [illegible] auditors (not yet in print) In Mozambique, it would be worthwhile to [illegible] audit/accounting firm with an interest in microfinance and support the development of a few professionals who understand microfinance well enough to provide [illegible]

D Donor Involvement in Microfinance

Most of the major donors working in Mozambique are either already supporting microfinance activities or have well-developed plans to do so (Detailed information on donor activities is available in Chidzero et al and in Branks) We consider donors here from three points of view as funders of microfinance operations, as funders of general technical support/capacity building, and as participants in policy dialogue

1 Funding of Microfinance Operations

It is most relevant for our purposes to focus on new funding and planned funding expected to come on stream within a year

- The EU has funded a new CARE solidarity group program in Zambezia
- The UK has funded a new World Vision village banking project also in Zambezia
- USAID/W has just approved funding for expansion of the World Relief and MEDA projects
- Canadian Microfinance Fund Canada will put in place a US$3 5 million fund by late 1998 It will be administered by a Canadian organization and will make grants and loans to established microfinance programs throughout Mozambique that demonstrate best practices A portion of this fund will be set aside for technical support and capacity building Thus, it is likely that perhaps 5 organizations could receive substantial assistance (if each receives $500 000) through this fund There is some chance Sweden will join this fund with a contribution of equal size
- The Netherlands has recently approved a project for Nampula province in which CARE will work with the farmer associations begun by CLUSA, providing credit to the associations as well as direct microcredit to traders Estimated size US$2 million
- UNCDF is on the verge of issuing an RFP to fund a village banking program in Nampula The proposed amount is $1 8 million
- UNDP is discussing launching Microstart in Mozambique which would be another fund this one providing small amounts of money to [illegible]
- The EU is planning additional funding, possibly for SOCREMO
- This list is probably incomplete

Given the short supply of institutional capacity in Mozambique at present [illegible] represent an overabundance of funds and are the main reason this report does not recommend that USAID/Mozambique provide funding for microcredit programs [illegible] be most important to ensure quality in the programs supported

2 Funding for Technical Support for Microfinance Development

At present virtually no technical support for microfinance exists The Swiss funded Action Research Program managed by CARE and the CGAP training programs are the only ongoing initiatives

A number of new possibilities are under discussion

- The proposed Canadian fund will include a significant technical support component The design of that component is being left to the bidders
- The UNCDF project will have a very small portion of funds designated for capacity building for local NGOs in Nampula
- The World Bank's new private sector development project may include a small fund to support capacity building in microfinance, although this prospect is looking less likely as time goes on The project is scheduled for appraisal at the end of 1998
- If UNDP's Microstart project begins in Mozambique it will include a technical support component aimed at its own grantees
- CGAP is expected to expand its support for training, as a joint CGAP/DFID program for Eastern and Southern Africa comes on line in 1999 (as described above)
- Extension of the CARE-managed Action Research Program is now being explored

As most of these efforts are small or are only speculative at present there is still large scope for technical support This is an area where USAID could be helpful

3 Donor Involvement in Policy Dialogue

As different from major established sectors, such as agriculture formal mechanisms have not evolved through which the donors coordinate with each other and with government The informal working group which has been meeting for about a year consists largely of donor and practitioners though one or two government representatives particularly from INDER, usually attend This group is effective as a forum for exchanging views and opinion and it is playing a vital role in raising the level of dialogue abou[illegible] and in developing greater understanding among the participants However [illegible] is not a formal means of communicating positions on key issues Neither [illegible] practitioners nor donors can use it as a mechanism for official exchanges

A more formal mechanism would chiefly be useful as a way to promote [illegible] movement toward consensus on two issues

- Principles for the development of microfinance in Mozamb[illegible] standards best practices and the roles of various actors

- The legal and regulatory framework for microfinance who can engage in lending and savings mobilization and under what conditions

In the short run it is important for donors to talk among themselves to establish common principles for their funding decisions It is in the interests of donors and practitioners alike for donors to agree on such principles Donors want practitioners to take their signals about best practices seriously, so that they will have attractive proposals to support and so that the value of their investments in microfinance are maximized Practitioners want to be sure that their programs are not undermined by the entry of operations that do not apply good practices (i e provide subsidized loans or tolerate high delinquency) Steps in this direction are being initiated by USAID and other donors now

IV Findings and Recommendations

A Strategic Considerations in Microfinance for Mozambique

This section seeks to identify strategic entry points for USAID based on a view of how development of financial services for the poor is likely to occur in Mozambique Key points are highlighted in bullet form

Up to now, in the realm of rural and microfinance, the dominant relief and rehabilitation orientation led to a client-based approach Under the client-based approach donors identify groups being served by its projects who face financial constraints and then create mechanisms to finance them However, Mozambique is now clearly in a market development phase The starting point for this phase is a vision of how the market is likely to evolve in the country and what interventions can hasten that evolution or ensure that it evolves in an effective way Such a strategy may or may not point toward specific groups of clients, and may have benefits that are more general than the geographic target area or than *expanded rural enterprises* The recommendations that follow come from a market development perspective They assume that USAID's ultimate objective is the sustainable provision of financial services on a large scale basis to poor households and informal enterprises

If there is to be a significant increase in supply, where is it likely to come from and how can it be enhanced? The reality of rural and microfinance in Mozambique at present is that it must begin where the country is, at a simple level Table 2 summarizes some of the advantages and disadvantages of different potential suppliers

The formal banking system offers inefficient services and aims at formal sector businesses located in major urban areas It plays a role in financing major import and export businesses, but offers little to smaller traders Its deposit services are not suitable for low income clients In countries where both microfinance and the financial system are well developed such as Bolivia, Chile, and Colombia, microfinance is rapidly moving into the formal system and NGOs are receding into secondary roles Ultimately this is what we can expect to happen here as well It is already beginning in South Africa Zimbabwe and Uganda, and may begin here in a few years However, in the Mozambique of 1998 the financial sector is not mature or competitive enough to be greatly concerned with increasing its outreach to the poorer segments of society, and the NGO sector has yet to produce a profitable microfinance or small enterprise finance program sufficiently convincing to attract private sector attention

- If banks evidence interest in microfinance, it would be appropriate for USAID to support technical assistance and start-up costs for them However, it is warned against trying to "bribe" them into the market if a serious interest is lacking

Microfinance programs run by local and international NGOs are many but negligible in terms of level of service provision Only one has any scale In other countries at this stage international organizations have played a critical role, bringing in expertise and building institutions Unfortunately, with only a few exceptions, the international organizations that have been operating in Mozambique to date have not brought top quality expertise into the country

One of the basic questions for the development of microfinance in Mozambique is whether to concentrate on building the outreach and sustainability of existing NGOs or whether to bring in new expertise Experience over many years in many countries (much of it USAID experience) has shown that institutions which begin without the fundamentals necessary to become large sustainable operations are very difficult to turn around Many projects have offered funding and technical assistance to NGOs on the assumption that such inputs were all that was lacking Most of these projects have failed The hard lesson is that the only institutions that become sustainable and to reach significant numbers of clients are those founded with a strong vision of scale and sustainability and with the technical wherewithal to implement that vision

Table 2 Likely Contribution of Various Types of Institutions to Rural Financial Services in Mozambique

Source	Likely Contribution
International microfinance NGOs (existing)	++ likely to grow reach significant numbers of clients c r e ly largest source of services + moderate sustainability (some high, some low) + ongoing commitment to clients + can access know-how and resources - do not (and should not) address savings - lacking in spin-off strategies - in some cases started on wrong track reorientat [illegible]
International microfinance NGOs (start-up)	++ can begin with clear conception of becoming la[illegible] nd sustainable, spin-off planned from the start + access to expertise and resources + likely strategy for reaching poorest segments/women - start-up always risky - do not (and should not) address savings
Local NGOs	− local ownership from the beginning - very weak organizationally - lack knowledge of microfinance or financial m[illegible]t
Credit Unions	++ savings and credit ++ uses own funds, not donor funds - would have to start network from scratch slow [illegible] (similar to international NGO start-up) - lack of clear legal framework, - government lacks capacity to regulate/supervise

Banks and Financial Institutions	+ more likely to contribute in savings than in credit +savings-funded -- doesn't require donor loan capital + most banks have outlets outside Maputo + likely strategy for reaching middle level -- lack of interest in serving microfinance can't force genuine interest - new institutions, still developing competence

The international community uses the jargon of "best practices" to refer to the institutions founded on such a basis but it important to note that there is a significant difference between organizations that follow basic rules of good practice and those that are moving strongly toward becoming significant, independent institutions

- The vision and technical know-how of a few top-notch international organizations will be needed to demonstrate the potential of microfinance to achieve scale and sustainability

On the other hand this is an awkward time for USAID to fund the entry of new organizations The newly-started operations just mentioned need to be given some time to demonstrate their potential and several donors are on the brink of new funding for several other organizations USAID/Mozambique is advised to add to this proliferation only if it has strong confidence that a new entrant it funds would achieve greater scale and sustainability than existing operations and would provide a substantial demonstration effect Such confidence might be generated by examining the achievements of prospective organizations in other countries, particularly in Africa

If the international experience is played out in Mozambique, donor funds poured into the majority of the institutions here today will spark marginal improvements at best The exceptions to this statement are the few institutions that have been founded with a vision of scale and sustainability but which are still in the early stages of operation Accordingly, this report does not recommend a strategy based on providing additional funding or intensive technical assistance for existing microfinance operations

- Efforts should be made within existing funding relationships to ensure that current programs apply best practices Such a move with both enhance the value of funds already obligated and help ensure a better operating environment for serious providers

The side of microfinance where initiatives are not proliferating at present is in savings mobilization The reasons why it is difficult to move forward in savings have been examined at length However, USAID may be well-positioned to spark controlled experimentation in this area, and certainly it is an area almost entirely neglected by other donors An emphasis on savings fits well with the findings from surveys in rural Mozambique that more people are interested in savings services than in credit

- An important entry point for USAID/Mozambique is to support creative development of savings products, within the framework of safe and legal operations

Another basic question for microfinance in Mozambique is how to build local organizations At the present time local organizations are very weak have negligible outreach and are generally not applying best practices There will be no getting around the need for international expertise in the next few years However this does not mean that the development of local organizations should be neglected

- Every international organization working in microfinance should have a strategy for institutionalizing its programs in a local organization either by partnering with local organizations or by creating new local organizations and it should pursue this strategy actively from the day it begins operating

At the same time as donors should be emphatic in their insistence on creating local institutions they must be realistic about how long international relationships will be needed Even some of the most successful microfinance programs in the world such as BancoSol in Bolivia and Bank Rakyat Indonesia, still maintain close working relationships with the external sources of expertise that helped them in the early stages (Accion International and HIID respectively)

Finally, USAID in many countries has been the only donor to view microfinance from a system-wide perspective, as opposed to simply funding individual operations The situation here is similar There is much to be done to create a supportive framework for microfinance in the areas of policy and regulation, training, support services and donor coordination Such activities help develop a framework within which microfinance can evolve, and will serve the country well over a longer period of time USAID has access to the expertise needed to pursue these areas[3] A few such interventions can provide a [illegible] contribution with minimal funding Action in this area is particularly relevant if USAID wants to support the credit side of microfinance through means other than direct funding of individual programs

- USAID should support the development of a conducive environment for microfinance in Mozambique

B Action Suggestions for USAID/Mozambique

This section outlines six main recommended activities for USAID/Mozambique to undertake in microfinance They range considerably in complexity and funding requirements In addition to its own resources, it is clear that USAID/W (G/EG/MD [illegible])

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[3] Examples of such support by USAID include the PRESTO project in Uganda and [illegible] in Kenya

would be prepared to assist in the provision of technical and financial support if desired

The first three recommendations are modest tasks that should be undertaken even if USAID decides to do nothing else in microfinance They require few funds to implement and are entirely within the bounds of USAID/Mozambique's existing activities Three suggestions are provided for larger scale action

1 Increase application of best practices in microfinance activities receiving USAID funds

The recent study of microfinance in Mozambique found that many operators in the country are not applying best practices in their programs This includes operations carried out by international NGOs The study recommended the development of self-regulatory standards to embody those best practices and the national seminar on microfinance informally endorsed this concept Advantages of developing and applying standards include improving the credit culture in the country, avoiding competition between donors to give bigger subsidies that undermine financial discipline, and pushing forward the level of competence among program operators Yet mechanisms to move this agenda forward are slow to emerge

USAID is probably in the best position of any donor to exert influence in this matter with the international NGO community A large number of individual microcredit activities are taking place in Mozambique funded either by USAID or by organizations for which USAID is a major funder (even if the microcredit uses other funds) Some among these programs apply best practices and some do not USAID has been asked several times recently by organizations with existing cooperative agreements for permission to include microcredit activities in their programs In responding to such requests it would be helpful for USAID to have a set of standards to apply

USAID should ask each organization it is funding to conduct a self-assessment of whether it applies best practices -- or USAID could conduct such assessments itself or through consultants The list of requirements at this stage would need to be rather simple effective product design, appropriate interest rate policy, low arrears ability to report on basic indicators of outreach, portfolio quality and financial viability and active plans toward becoming a locally-established organization On the basis of such assessments USAID would require or recommend revisions (depending on the particulars of USAID's contractual relationship with the organization) In some cases it might assist the NGOs to make revisions

The benefit of such a program of assessments and follow-up would be a strong leverage effect in moving beyond the stage in Mozambique of talking about best practices to a stage of applying them This would be one of the most cost effective actions USAID could take in microfinance For a minimal expense it could go a long way toward "putting its own house in order" and because of the number and position of the organizations it supports that process would influence both the donor community and the NGOs

2 Include USAID/Washington-funded programs in USAID/Mozambique's general microfinance "family"

USAID is the main funder of the most successful microfinance program in Mozambique World Relief However, USAID/Mozambique has had relatively little to do with this program because its funding has come from Washington, and because it operates outside USAID's focus provinces Now that MEDA has been awarded a Matching Grant its situation will be similar This recommendation does not involve any specific actions but rather a general attitude in favor of developing a closer relationship with these two programs Each may be able to provide something of value to USAID/Mozambique's overall strategy, and USAID/Mozambique's proximity may enable it to help ensure that these organizations succeed (which BHR/PVC cannot do) If the programs go well USAID/Mozambique might consider providing additional expansion funding a couple of years from now

3 Continue taking a leading role in promoting standards among donors

USAID has already begun meeting with donors to address the need to agree on standard practices for donors to apply in funding microfinance programs This process is an important step in ensuring that the large amount of funding scheduled to enter Mozambique for microenterprise programs promotes the development of sustainable institutions The Guiding Principles for Donors should be the starting point for such a discussion, though each point should be considered for its relevance to Mozambique Of particular importance here would be a proposition that all microfinance programs should have active plans to become a local institution or transfer operations to a local institution (of whatever form -- bank, association or cooperative) These plans need not be rushed -- it may take more than one project funding cycle to achieve this end -- but they should be clearly articulated and active

The next two recommendations are possible larger scale programs that USAID could support, with emphasis on the development of savings services Given the recent and pending influx of funds for microcredit, it is not recommended that USAID develop a new project funding initiative on the credit side

4 Pilot Project Creative Approaches to Savings Mobilization

The section on savings (above) concluded that credit unions (or savings and credit societies) are one of the mechanisms through which the need for savings services can be addressed However, it will require the entry of expert promoters of credit unions and will be a large, slow undertaking The number of institutions that could play the promotional role is limited WOCCU is the only U S entity The feasibility of its implementation of such a project would depend on WOCCU's other priorities -- i e how fully extended it is WOCCU has had relatively little experience promoting credit unions where none exist so it would be difficult to estimate the outcome of such a project It would be necessary to carry out further analysis of the legal environment for credit unions prior to launching such a project and to include a component of the project dealing with the regulatory framework and supervisory capacity

Alternatively USAID could sponsor a competition among both NGOs and banks to develop savings services for the poor USAID could offer a grant for feasibility and product development work and some start-up subsidy for initial operations Bidders for the assistance would have to show 1) how they would safeguard depositor funds and 2) how the savings products would be made relevant and convenient for the poor A range of proposals would likely appear, such as grassroots savings and credit societies (CARE) links between banks and NGOs (MEDA/Credicoop), or innovations by banks

5 Project to Build Training Programs for Microfinance in Mozambique

As stated above the particular history of microfinance in Mozambique, coupled with its low level of education language, and serious personnel constraints suggests that the provision of training for prospective staff of microfinance programs will be more important than it has been in other countries The CGAP program of training represents one vehicle for providing training courses and training a small number of trainers However, it addresses only one of several training levels, and lacks an ongoing institutional home Some other donor initiatives include funding for training but not in a systematic way

A more systematic approach is clearly needed, and USAID could be well-positioned to apply it A program could build on the CGAP courses, and could use as a model the process through which USAID helped establish the Microfinance Training Program in Boulder was established This process involved covering start-up costs for developing an institutional home for courses, and transitioning the type of support to guaranteed tuition coverage for students and finally to reducing the number of students covered

6 Support for Improved Regulatory and Supervisory Framework

The process of developing a regulatory and supervisory framework for [illegible] Mozambique will take several years The current draft decree will be a step [illegible] direction but it will be a first step Moreover, it is a temporary action [illegible] significant revision of the Banking Law Further work will need to be done and [illegible] work will need to evolve as microfinance evolves At least as important [illegible] framework, supervisory capacity will need to keep pace USAID could support the Bank of Mozambique, INDER and/or practitioner groups to develop strong [illegible] supervisory systems Possible mechanisms include advisory services such as a more detailed study of the regulatory framework or framework for savings and credit societies exposure of government officials to countries where microfinance is well-developed and bank supervisors have worked extensively on the issue (e g , Bolivia) participation of government officials in international meetings on this issue which are now being planned and training of government staff who are to be responsible for supervision of microfinance institutions The starting point for any such program, however is the interest in the government in pursuing it Thus, the first step would be to engage relevant policymakers in a dialogue to ascertain how interested they might be in pursuing a systematic program in microfinance

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