PROCEEDINGS

THE COMMERCIALIZATION OF MICROFINANCE

NAIROBI, KENYA MAY 11-14, 1998

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT
BRITISH DEPARTMENT FOR INTERNATIONAL DEVELOPMENT
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WORLD BANK

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ACRONYMS

ABSA	Amalgamated Banks of South Africa
AgDB	Agricultural Development Bank
BOG	Bank of Ghana
BOK	Bank of Kenya
BOT	Bank of Tanzania
BOU	Bank of Uganda
BRI	Bank Rakyat Indonesia
CBZ	Commercial Bank of Zimbabwe
CGAP	Consultative Group to Assist the Poorest
CERUDEB	Centenary Rural Development Bank
CWE	Credit with Education
DFID	British Department for International Development
FFBS	Family Finance Building Society
FFH	Freedom from Hunger
K-Rep	Kenya Rural Enterprise Programme
MFI	Microfinance Institution
MIFU	Microfinance Institutions of Uganda
MIS	Management Information Systems
NGO	Non-Governmental Organization
NRB	Nsoatreman Rural Bank
PVO	Private Voluntary Organization
ROA	Return on Assets
ROE	Return on Equity
SAS	Smart Application Systems
UCB	Uganda Commercial Bank
USAID	United States Agency for International Development

INTRODUCTION

In May of 1998, the U.S. Agency for International Development (USAID), the British Department for International Development (DFID), Citicorp Foundation and the World Bank sponsored "The Commercialization of Microfinance" conference held in Nairobi, Kenya. Representatives from commercial banks, regulated non-bank financial institutions and unregulated microfinance institutions from Ghana, Kenya, Namibia, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe attended. They came to discuss the business opportunities represented by microfinance. On day one and two of the conference, the profitability of microfinance in Africa was a central issue of discussion, and methodological and organizational innovations used by bankers to tap the microfinance market were shared. On the day three, central bankers from Ghana, Uganda, Kenya, Zambia and Tanzania joined the conference to discuss regulatory issues affecting microfinance.

Conference participants totaled almost 120. Of these, 45 were representatives from regulated financial institutions, 15 from unregulated microfinance institutions and 12 from central banks. Participants acted as moderators; presented the microfinance experiences of their institutions in break-out sessions; and spoke freely in plenary discussions debating such issues as interest rates, the trade off between profitability and reaching the poor, and the value of microfinance services to economic development.

The sponsors convened this bankers conference in recogni-tion of the growing and potential role that regulated financial institutions can play in scaling up and commercializing microfinance in Africa. Financial institutions all over Africa realize the market represented by micro savers, and a smaller number have begun developing strategies, often in conjunction with NGOs, to lend to micro business people. In a number of countries, NGOs have led the way by pioneering lending methodologies, management information systems and technological innovations, often adapted from other regions. In Ghana, TechnoServe developed an inventory credit product that the Agricultural Development Bank has successfully marketed. Also in Ghana, Freedom From Hunger has worked with rural banks to demonstrate how to lend to informal groups. In other countries, such as South Africa and Uganda, banks themselves have developed savings and lending products that they have profitably marketed to poor clients.

The sponsors invited central bankers from around the region to explore how regulations affect or will affect the development of microfinance in Africa. In Ghana and Uganda, regulators are in dialogue with representatives of banks, non-banks and microfinance institutions to better understand their concerns and the legal framework needed to allow microfinance to grow in a prudent manner. In South Africa, the Usury Act has created disincentives for banks to enter the micro credit market and created incentives for banks to concentrate on savings and consumer loans. Central bankers pointed to regional meetings as a possible forum for information sharing, and exploring the best options for promoting microfinance while ensuring sound banking practices, protection of consumer interests, and adherence to financial sector policies.

This document represents the proceedings of "The Commercialization of Microfinance" conference. It is divided into three parts. The first chapter is a record of the conference, including panel topics, moderators and lists of presenters, syntheses of panel presentations and briefs on each break-out session. Chapter Two focuses on issues raised in the plenary discussions that were both philosophical and, at times, controversial. Drawing from the rich and spontaneous plenary discussions, this chapter attempts to capture the core of the debates and to provide the resolution offered by facilitators and participants. Chapter Three consists of institutional profiles of 13 African banks and non-banks engaged in microfinance. While USAID, DFID and the World Bank have previously disseminated reports assessing the performance of several of these institutions, Chapter Three reviews the microfinance activities of a number of banks and non-banks which are not well known to the worldwide microfinance community.

The sponsors hope that these proceedings shed light on the issues that financial institutions are grappling with in forging commercial microfinance initiatives in Africa. While the proceedings record the technical discussions on methodology and innovation, they also highlight the particular concerns of African banks, non-banks and NGOs in commercializing microfinance. Conference participants made clear that the interest rate issue is still unsettled in the minds of those concerned about poverty. At the same time, commercial bankers were especially aware of the importance of the "bottom line" in making the case for microfinance to their boards. Debates focused on how to ensure that microfinance alleviates poverty, while developing methodologies and adapting innovations to ensure profitability.

The sponsors would like to thank Mr Bethuel Kiplagat for his thoughtful keynote opening, and to Elisabeth Rhyne and Robert Christen for facilitating the conference and guiding the debates in both interesting and constructive directions. Many thanks are also extended to moderators including Kimanthi Mutua, Roland Pearson, Lascelles Chen, Hugh Scott, Rashid Malima, and Francis Bienpuo for their conscientious work in shaping the panel discussions, and to Jeanne Downing and Katrena Henderson for their hard work as conference organizers. Finally, Point of View, a Kenyan firm, deserves much appreciation for their excellent job at organizing the conference logistics.

The proceedings were written by Jeanne Downing with assistance from Katrena Henderson and Shannon Johnson and under the direction of Heather Clark from the Office of Microenterprise Development. Elisabeth Rhyne edited the proceedings making important substantive contributions, while Dina Towbin edited the text to ensure that the writing flowed appropriately.

CHAPTER 1: CONFERENCE AGENDA

I. INTRODUCTION

The May 1998 Nairobi "Commercialization of Microfinance" conference, sponsored by the U.S. Agency for International Development (USAID) Office of Microenterprise Development, the British Department for International Development (DFID), Citicorp Foundation, and the World Bank, was designed as a bankers forum to explore the opportunities and risks associated with microfinance in Africa. The sponsors recognized the potential role that banks can play is scaling up microfinance in Africa and elsewhere. While non-governmental organizations (NGOs) will remain important players and continue to generate innovative techniques, the sponsors view banks as having the capacity to reach significantly larger numbers of clients than NGOs.

Representatives from commercial banks, regulated non-bank financial institutions, and other microfinance institutions from across Anglophone Africa — Ghana, Kenya, Namibia, South Africa, Swaziland, Tanzania, Uganda, Zambia, and Zimbabwe — gathered for three days in Nairobi, to discuss the business opportunities represented by microfinance, the potentially vast microfinance market, and strategies and obstacles to tapping this market on a profitable basis.

II. CONFERENCE AGENDA

Bob Christen and Beth Rhyne, two of the foremost technical experts in the field, facilitated the conference. Each day, the conference agenda covered a different microfinance issue:

Day one:	**Can Microfinance be Profitable in Africa?**
Day two:	**Innovations Required to Make Microfinance Profitable**
Day three:	**Policies and Regulations Affecting Microfinance**

In speaking to the profitability question, Bob Christen explained that the opportunity to become profitable requires answering a basic operational question. Can that special culture required for micro credit for microentrepreneurs be made compatible with commercial banking structures? Methodological, technological, and organizational innovations are needed to make microfinance profitable. In addressing these innovations, Bob Christen asked, "Can micro credit be organized in a way that could be commercially viable? Are there organizational and/or technological innovations in the commercial banking world that could be brought to bear on microfinance?"

If banks are to get involved in microfinance on a commercial basis, they will have to confront the banking regulations in their respective countries. Banking regulations in most countries are not appropriate for microfinance. In fact, microfinance could not be profitable if the full range of regulations was applied to banks that specialize in microfinance. If microfinance is to be commercialized, changes in regulations are needed.

On the last day of the conference, central bankers from the region were invited to discuss regulations in their respective countries with microfinance institutions and experts.

III. IS MICROFINANCE A GOOD BUSINESS OPPORTUNITY IN AFRICA?

Keynote Address by Bethuel Kiplagat, K-Rep Chairman

In his keynote address, Mr. Bethuel Kiplagat, a renown senior statesman and chairman of Kenya Rural Enterprise Programme (K-Rep), told the story of K-Rep's evolution from a credit-driven microenterprise program to a financially self-sufficient program that is in the process of becoming a specialized microfinance bank. Mr. Kiplagat used the K-Rep example to illustrate the demand for microfinance services, the viability of banking with the poor, and the possibility of achieving profitability in Africa. K-Rep's history mirrored in many respects the evolution of the microfinance field from its focus on enterprise development to credit provision to an emphasis on providing a full range of cost-effective financial services tailored to the needs of the poor.

The keynote speaker concluded with an expanded vision of microfinance that goes beyond providing credit to micro-entrepreneurs, beyond the task of motivating clients to repay their loans, and beyond providing basic financial services to the poor. His expanded vision includes microfinance institutions (MFIs) that can meet the enormous demand for financial services that exists in Africa today. It includes meeting the poor's needs not only for enterprise credit, but also deposit services, health insurance, financing for school fees, and consumer credit. According to Mr. Kiplagat, between 75 and 80 percent of the Kenyan population are engaged in economic activities but are excluded from the formal banking system. This population represents the potential microfinance market. To bring these people into the banking system should be an important goal for MFIs and for national development. Kenya cannot afford to be "a nation of rich and poor," where the majority poor are excluded from financial services. Greater cooperation is needed among central banks, commercial banks, and MFIs to have the impact envisioned by Mr. Kiplagat.

IV. WHAT DO WE KNOW ABOUT THE PROFITABILITY OF MICROFINANCE?

Speaker: Beth Rhyne

Objective: To ensure that the audience shared a common definition of microfinance profitability, Beth Rhyne, the former Director of USAID's Office of Microenterprise Development, gave an overview of the key elements of profitability: client demand, efficient operations, portfolio quality; and portfolio yield.

Synthesis: Client demand accrues from a dynamic informal sector consisting of traditional microentrepreneurs, urban and rural households, and many other non-salaried people who need loans for working capital. Like Mr. Kiplagat, Ms. Rhyne estimates the market for microfinance services in Africa to be vast, given the informal sector's size and importance in most African countries.

Efficiency is also key to profitability and related to the MFIs' internal structure — which is different than the structure of commercial banking operations. The challenge for most MFIs is to reduce their operational costs by using methodological, organizational, and technological innovations.

While all banks are concerned about portfolio quality, microfinance requires greater and more aggressive follow up on delinquent loans as well as incentive programs for staff responsible for collecting repayments.

Portfolio yield is synonymous with revenue generation. To be profitable, MFIs must charge interest rates that cover relatively high administrative costs associated with doing microfinance.

In closing, Beth Rhyne noted the advantage that banks have over NGOs in meeting the challenges of profitability. Banks have the infrastructure in place to deliver financial services, and they understand banking services and operations. The question is whether that knowledge can be creatively turned to good effect in serving a new clientele. The African banks represented at the conference will present — in the sessions that follow — their experiences in providing microfinance services.

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V. DAY ONE: THE PROFITABILITY OF MICROFINANCE IN AFRICA

A. Successful Commercial Experiences in Microfinance

Panelists: Hermann Krutzfeldt, Banco Sol
Jarot Eko Winarno, Bank Rakyat Indonesia
Adrian Sibo, Centenary Rural Development Bank
Norma Russell, Workers Savings and Loan Bank

Objective: To establish that microfinance can be profitable, panelists from Banco Sol in Bolivia, Bank Rakyat Indonesia (BRI), Centenary Rural Development Bank (CERUDEB) in Uganda, and Workers Savings and Loan in Jamaica were invited to share the obstacles they faced and the strategies they used to achieve profitability. This panel was designed to set the stage for the next three days by demonstrating how profitability can be achieved. Discussion topics included:

- Motivations for getting involved in microfinance
- Perceived and real risks of getting involved
- Obstacles bankers had to overcome and
- The length of time it took to achieve profitability

Synthesis: In 1991, the subsidies that BRI received from the government were halted as a result of a financial crisis. A decision had to be made whether to stop lending operations or to transform the bank's operations. BRI decided to turn this crisis into an opportunity by continuing operations but on a commercial basis. By charging interest rates sufficient to cover operating costs and loan losses, BRI, a government-owned bank, took on the challenge of commercializing its microfinance activities so as to obviate the need for subsidies and develop the capacity for profitability. Workers Bank and Banco Sol, originally an NGO called PRODEM, were also motivated by a perceived opportunity. Workers saw the opportunity of piggy-backing on post office outlets as a strategy for expanding its market to reach a significant number of postal customers with financial services. Banco Sol took advantage of the vacuum created by an insolvent banking system.

In transforming from an NGO to a bank, Banco Sol perceived some real risks. Would they be able to generate funds from the private sector for lending? Would the private sector market be willing to risk investing in this new kind of bank? Would customers who had banked with an NGO be willing to borrow and save from a microfinance bank? Banco Sol soon discovered that these risks were more perceived than real.

The greatest challenge for Workers was garnering support from and convincing the board that new systems would be required to enter the microfinance market. New policies, procedures, and methodologies would be needed —including collateral substitutes, different staff qualifications, adjustments in credit policies, and repayment schedules Workers Savings and Loan is not yet profitable. The bank expects to reach operational sustainability by the end of 1998. The key to achieving the institution's sustainability will be to efficiently complete the implementation of its expansion program, increase loan turnover, lower loan delinquency rates, and increase staff efficiency.

BRI's approach to developing new systems was to keep them simple: a simple methodology, simple technology, and simple procedures.

For Banco Sol, managing growth was a challenge. Maintaining the quality of their loan portfolio, while expanding almost exponentially was achieved through discipline and commitment on the part of employees. Because of its unique early strategic alliance with PRODEM, Banco Sol was profitable from its inception.

CERUDEB had to overcome ineffective management and an unclear mission established by a board that initially was conflicted between their religious and social values, and the requirements of profitability. By changing its methodology, CERUDEB transformed itself and went from a delinquency rate of near 60 percent to profitability. According to Mr. Sibo, in 1993, CERUDEB adopted a new lending methodology that incorporated strict attention to repayment and a new management team. The board of directors developed policies and manuals to turn the organization around. By 1995, the bank had reached a break-even point.

B. Can Microfinance be Profitable in Africa?

Objective: To answer this question, bankers from Ghana, Kenya, South Africa, Uganda, and Zimbabwe were invited to speak on the profitability of their microfinance activities. Six case studies were presented by bank representatives, and resource people from donor organizations, microfinance projects, competing banks, and technical assistance organizations were asked to participate in the panel discussion. The case studies and panelists included the following:

Case Study 1: Kenya Family Finance Building Society (FFBS)

Panelists: S.G. Kariuki, FFBS
D.N. Gachuche, FFBS
Barbara Steenstrup, Price Waterhouse

Synthesis: Kenya FFBS registered as a deposit-taking building society in October 1984. In the 1980s, its objective was to mobilize long- and short-term deposits for short-term lending to businesses and long-term lending for mortgages. When the society realized that clients did not seek long-term mortgages, FFBS turned its attention to lending to small and micro businesses, including women's groups. Today, FFBS has a network of six branches and a client base of 10,000 borrowers and savers. Lending capital is fully funded by mobilized savings, and loans are made at market interest rates. The FFBS microfinance portfolio began generating a profit in 1993, and in 1997, produced earnings amounting to Ksh 11.7 million. According to the FFBS Operations Manager, Mr. S.G. Kariuki, this success can be attributed to tailoring services to meet customers' needs. As compared to its competitors, FFBS provides its customers with greater access to money, allowing for easy withdrawal of deposited funds, advances on checks, emergency loans, and financing for school fees.

Case Study 2: Co-operative Bank of Uganda

Panelists: Lascelles Chen, Co-op Bank of Uganda
Jim Gohary, USAID
Anne Ritchie, PRESTO

Synthesis: The Co-operative Bank of Uganda initiated its microfinance unit only two years ago with the objective of opening six "microenterprise agencies" or windows within the bank's existing branch network. These agencies would provide micro loans and deposit services to poor clients on a commercial basis. The bank's most successful microenterprise agency, located at Kampala's largest market, made over 4,000 loans valued at more than $700,000, and registered over 5,000 savers. This agency expects to reach a break-even point within 12 months, one year ahead of schedule. While the Co-op Bank's Microfinance Agency, as it is called, is still relatively new, according to the Agency's Manager, it has succeeded in developing an excellent model for replication. It plans to "roll out" this model in five additional bank branches, and to replicate the first agency's profitability throughout the branch network. This expectation is justified by its experience with a three-month old agency that has already mobilized $113,000 from 1,000 savers. Although the bank has received subsidies for developing its model, it can now cover its loan portfolio with locally-mobilized funds.

Case Study 3: Nsoatreman Rural Bank (NRB)

Panelists: Yaw Sarpong, Nsoatreman Rural Bank
Eric Osei-Bonsu, Association of Rural Banks
Francis Bienpuo, Freedom From Hunger/Ghana,

Synthesis: NRB is one of 130 rural banks in Ghana established by the government to stimulate economic development. Rural banks are owned by local communities and intermediate local capital by mobilizing local savings for on-lending to local people to raise their income levels. NRB, with its five branches, registered almost 15,000 depositors in 1997, 74 percent of whom are women. In 1996, NRB entered into a three-year collaboration with Freedom From Hunger (FFH) —a U.S.-based NGO — to implement Credit with Education (CWE) loans to rural women's groups. By the end of 1997, CWE loans outstanding totaled about $210,000, and composed 9 percent of the bank's loan portfolio, and 15 percent of its loan clients. Moreover, the CWE program broke even 16 months after it was launched, 8 months earlier than projected. NRB's microfinance portfolio has grown 121 percent every 6 months, according to Mr. Sarpong, the NRB Manager. CWE is one of four loan products offered by the bank; NRB also provides individual loans, averaging US $331 in size, to traders and other service providers in the local area, and deposit services, consisting of voluntary demand deposits, savings deposits, and time deposits. As of March 1998, NRB held about US $846,000 in deposits for 18,678 depositors, had lent to 17,247 borrowers, and had a total outstanding loan portfolio of US $907,295.

Case Study 4: Co-operative Bank of Kenya Ltd and K-Rep

Panelists: Erastus Mureithi, Co-op Bank of Kenya
Aleke Dondo, K-Rep
Hugh Scott, DFID

Synthesis: K-Rep is in the process of transitioning into a specialized microfinance bank, to mobilize deposits. Becoming a regulated financial institution will address one of K-Rep's current constraints, which is access to lending capital. Currently K-Rep obtains lending capital from the Co-operative Bank of Kenya. Donors have provided the Co-op Bank with a loan guarantee as collateral against capital lent to K-Rep at a subsidized interest rate. This arrangement allowed K-Rep to generate profits of Ksh 31 million in 1996. Upon becoming a bank with the ability to mobilize deposits, K-Rep expects to be able to maintain the interest rate it currently charges and continue to generate profits.

Case Study 5: Commercial Bank of Zimbabwe (CBZ)

Panelists: Nyasha J. Makuvise, CBZ
Dyson Mandivenga, CBZ
John Lwande, CARE

Synthesis: The Zimbabwean government took over CBZ, which was associated with the bankrupt BCCI, when the bank was on the verge of insolvency. In 1995, CBZ initiated a turnaround program and, in August 1997, was successfully privatized. Government stockholding was reduced from 100 to 20 percent. To effect the turnaround, CBZ needed to mobilize funds and be able to compete in an increasingly crowded market. While other banks were vying for corporate clients, CBZ saw microfinance as a largely untapped niche market. In April 1996, CBZ launched its Community Banking Pilot Scheme, with start-up funding from DFID and technical assistance from CARE/Zimbabwe. While still at a very early stage, the scheme has performed beyond expectations. As of March 1998, the scheme had nearly 800 active clients with projections of 2,000 clients by the end of 1998. CBZ forecasts that it will reach a break-even point with 2,000 clients. As of March 1998, the value of loans outstanding amounted to Z $2.2 million and the value of savings deposits equaled Z $2.9 million. The program has a 98 percent overall repayment rate, and the savings deposits mobilized under the scheme continue to surpass the amount of outstanding loans granted. At present, the portfolio's income and fees cover 75 percent of the scheme's operating costs. This percentage, however, does not take into account start-up, MIS, and on-going technical assistance costs. Nonetheless, CBZ is very encouraged about its early successes and plans to expand the program this year to additional branches.

Case Study 6: Nubank, South Africa

Panelists: Mutle Mogase, Nubank
Barry Coetzee, King Finance Corp
Roy Polkinghorne, Standard Bank of South Africa, Ltd.

Synthesis: Nubank was formed by the Amalgamated Banks of South Africa (ABSA)—the largest banking group on the African continent — which grew out of a 1992 merger of two building societies and four banks. Soon after its formation, ABSA began assessing the market segments that it intended to target, against the backdrop of political upheaval, and the recognition that black people had generally been excluded from banking services. Nubank was formed to meet the financial service needs of the poor. When Nubank started operations in February 1996, it planned to focus on micro-enterprise and consumer loans. However, a vast array of constraints, including the weight of ABSA's cost structure and pressure to generate profits, led Nubank to concentrate largely on consumer loans. Only 10 percent of its portfolio is devoted to microenterprise loans. To date, Nubank has about 7,000 clients, most of whom are black. These clients have either microenterprise or consumer loans. While ABSA does provide deposit services, Nubank's model, (which it is the process of "rolling out"), is solely credit based. Regarding profitability, Nubank's Manager stated, "We went through a two-year period where we had to stabilize systems and procedures. We went through a growth period. Then we stopped when we experienced problems. Now we have sorted out most of those problems and we are going into a growth phase." Nubank has not yet reached operational self-sufficiency.

VI. DAY TWO: INNOVATIONS REQUIRED TO MAKE MICROFINANCE SUCCESSFUL

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A. Lending Methodologies & Products

Panelists: Hermann Krutzfeldt, Banco Sol
Dirk Van Hook, Centenary Rural Development Bank
Francis Bienpuo, Freedom From Hunger/Ghana
Miles Emerson, Smart Application Systems

Objective: A key question was asked regarding lending methodologies and the extent to which banks in Africa have used group vs. individual lending as a means of reaching microentrepreneurs. Panelists also addressed each methodology's relative costs and profitability.

Synthesis: The lending methodologies discussion involved three organizations: Banco Sol, CERUDEB, and FFH. The Smart Application Systems (SAS) representative discussed its "smart card" technology that was neither a lending methodology nor a lending product, but rather a tool for reducing a bank's transactions costs (this technology is discussed in the next chapter). Of the three organizations involved in lending either directly or indirectly, only CERUDEB specializes in individual lending. While Banco Sol is primarily engaged in group lending, it does provide individual loans to its clients with a proven track record. On the other hand, CERUDEB's management has been discussing initiating group lending as a strategy for increasing outreach especially in rural areas. FFH promotes group lending as a means of providing financial services and health education.

According to the CERUDEB representative, group lending has not been less expensive than individual lending as is typically assumed. CERUDEB's competition — consisting of NGOs and the Co-op Bank — charge a significantly higher interest rate for their group loans than CERUDEB charges for individual loans. Each CERUDEB loan officer manages 150 to 200 borrowers. At Banco Sol, which specializes in group loans, credit officers handle 300 to 450 clients, and some loan officers have as many as 700 clients. While Banco Sol considers group lending a lower risk, its main competition specializes in individual loans and reports lower costs.

Panelists generally agreed that accurately measuring the relative costs of group vs. individual lending was difficult and depended on whether other costs (such as training, group formation, and/or loan monitoring) were factored into the calculation. While CERUDEB claimed that individual lending in Uganda was proving to be less expensive than group lending, CERUDEB's average loan size tended to be larger than that of its competition. FFH used groups as a mechanism for educating rural women about health and nutrition, and thus it was difficult to compare costs with MFIs that provide minimalist credit, such as Banco Sol and CERUDEB.

B. Savings Methodologies & Products

Panelists: *Jarot Eko Winarno, BRI*
Norma Russell, Workers Savings and Loan Bank
Roy Polkinghorne, Standard Bank of South Africa, Ltd.
Alphonse Kihwele, Tanzania Postal Bank
Ngambura Koigi, Kenya Post Office Savings Bank

Objective: The ability to mobilize savings and reduce capital costs are important advantages that regulated financial institutions have over non-regulated NGOs. Moreover, in Africa, the deposit services market has been estimated as 10 times larger than the microcredit market. The panel on savings methodologies and products explored the strategies adopted by banks in Africa, Indonesia, and Jamaica to provide deposit services to large numbers of small savers.

Synthesis: Bankers noted that products that allow for small minimum deposits and extensive outreach to reduce savers' transaction costs are key to attracting large numbers of low-income clients. The banks represented offer a variety of savings products from standard passbook savings to specialized accounts that require regularized deposits and provide structure and discipline for the client. The Kenya Postal Bank, for instance, offers a "save-as-you-want" account that requires customers to commit to saving for a specified period, such as one to two years. Aimed at self-employed or unemployed clients, this product requires a very low minimum deposit to open an account and provides a bonus on top of interest earned at the end of the savings term. Similarly, Workers Savings and Loan has developed two new products for its low-income clients. The Gold Stamp is a basic savings product that includes insurance in the event of the depositor's death. The minimum opening balance required is US $1.40. Partner Savings is another product, designed for the informal sector and modeled after the merry-go-round concept. Though the bank replaces the group, like "merry-go-rounds," Partner Savings requires that the depositor make regular deposits for a specified period of time, with the time periods decided by the depositor. Minimum weekly deposits are US $5.50.

Most of the banks on the panel used a tiered interest rate that varied with the size of the account. Interest rates paid to a typical micro saver varied from 3 percent at Standard Bank of South Africa, to 15 percent at the Tanzania Postal Bank, to a range of 10 to 20 percent — depending on the size of the account — paid by Workers Savings and Loan.

Workers, the Kenya Postal Bank, and the Tanzania Postal Bank were able to achieve substantial outreach through the post-office and/or collaboration with postal outlets. BRI and Standard Bank of South Africa mobilized savings through a branch network that numbered in the thousands. In addition, Standard Bank developed a savings product that used more than 5,000 ATMs located throughout South Africa. The Kenya Postal Bank was in the processing of exploring a technology somewhat similar to the SAS smart cards. Increasingly innovative technologies are being used by these banks to decrease costs and increase scale and outreach.

C. Organizational Innovations for Banks in Microfinance

Objective: The organizational innovations panel focused on three models: specialized microfinance banks that have transitioned from NGOs to regulated financial institutions; banks that have integrated their microfinance operations into their regular banking activities; and banks that have created specialized units for their microfinance portfolio. The issues addressed by representatives of these three models included: corporate culture and leadership, the structure and location of branches, and human resources with a focus on staff incentives. Organizational innovations were discussed in three concurrent sessions, made up of three panelists representing one of the three organizational models.

Panel #1

Panelists: Hermann Krutzfeldt, Banco Sol
Lascelles Chen, Co-op Bank of Uganda
S.G. Kariuki, FBBS

Synthesis: Banco Sol perhaps more than the Co-op Bank of Uganda or FFBS has had to address issues of corporate culture because of its transition from an NGO — with a clear social mission — to a bank with a commercial and social mission. Because of lingering revolutionary sentiments in Bolivia, it was difficult for some staff to adopt commercial attitudes. On the other hand, FFBS — which has integrated microfinance into its normal banking operations — has historically targeted a market of rural producers who are unable to gain access to formal financial institutions. While the Co-op Bank of Uganda has a specialized microfinance unit, it hired managers for its microfinance agencies who were in line for promotion to become branch managers. Consequently the agency managers for the microfinance portfolio understood the culture and thinking of branch managers who are in charge of regular banking activities.

Both Banco Sol and FFBS have relatively flat organizational structures, facilitating decentralized management and decision making. Both banks have an extensive branch network managed by a small staff. As a much more formal bank, the Co-op Bank has a hierarchical structure, however, inherited from the past. And while those in upper management positions tend to be conservative, the relationship between branch and agency managers, and the agencies' early demonstration of profitability facilitated the communication between the Co-op Bank's Agency Program and the upper echelon bank managers.

All panelists sought employees that had some balance of business and "people" skills. While Banco Sol gave priority to people and communication skills, the Co-op Bank and FFBS looked for graduates with economics, education, or business degrees. With the microfinance market's growth in Bolivia, Uganda, and Kenya, staff drawn to the field were seeking to be part of the excitement of this new growth area in the banking industry. In a number of cases, this "excitement" was more important than salary.

Panel #2

Panelists: Steven Mirero, K-Rep
Nyasha J. Makuvise, CBZ
Dirk Van Hook, CERUDEB

Synthesis: While K-Rep is in the process of developing a board and attracting shareholders as it prepares to transition into a specialized microfinance bank, CBZ and CERUDEB have shareholders who expect dividend payments. Thus despite their social missions, these banks are structured so as to lower costs and increase profits.

CBZ, a full-fledged commercial bank, created a specialized unit for its community banking or microfinance program. But while the microfinance unit has a specialized methodology and loan officers, its upper level management is integrated within the CBZ, as is the physical structure for delivering financial services. As a result, microfinance services are provided in the same building as regular banking services. While CERUDEB's microfinance portfolio is fully integrated into its regular banking operations, the bank's clients are primarily small and micro entrepreneurs. To illustrate, the bank's definition of a large loan is US $5,000, and its average loan size is US $833.

K-Rep operates out of five area offices which are staffed with 60 credit officers; these officers are expected to have good communication and banking skills. CBZ has special requirements for its community banking as compared to its corporate banking staff. While community banking staff "should be able to do a bit of credit analysis," they need communication skills to able to explain the methodology to low-income clients.

By integrating its various banking activities, CERUDEB has been able to use a single staff person to oversee several functions simultaneously and thus realize economies. Moreover, new credit officers start out making small loans, as is normal in commercial banks; as they gain experience, they are trained in corporate banking operations.

This panel debated the advantages and disadvantages of integration versus creating a specialized unit. Those who favored integration argued the importance of education in microfinance at all management levels. Without this, microfinance is not well understood by those in top decision-making positions. On the other hand, those who favored specialized units argued that the staff requirements and methodology required to make microfinance successful were too different from regular banking operations and could best be managed in a separate unit.

Panel #3

Panelists: James Karashani, National Microfinance Bank
Barry Coetzee, King Finance Corp
B.B.C. Kyara, Kilimanjaro Co-operative Bank

Synthesis: The National Microfinance Bank (NMB) of Tanzania is one of three institutions created from the dismantling of the National Bank of Commerce to serve low-income clients. At present, the bank is government owned and focuses on taking deposits. While there are plans for micro lending, they have not yet been implemented. The board is made up of government appointees. The Kilimanjaro Co-operative Bank grew out of the government imposed cooperative movement, but has operated in its present form for a period of three and a half years. It aims to serve poor farmers, many of whom grow coffee in Kilimanjaro Region. The Co-op Bank is a village-owned and operated grassroots institution that both mobilizes deposits and lends to its rural members. The chairman and other board members are elected by village-level cooperative societies. King Finance Corporation is a privately-owned, non-bank that specializes in consumer loans for salaried workers and is not allowed to take deposits. The structure of this non-bank, which serves 110,000 clients, includes a CEO, 5 regional managers, and 44 branches with 3 staff per branch.

The National Microfinance Bank inherited an extensive branch network and nearly 1,000 people on staff. King Finance Corporation has 44 branches around the country and 155 people on staff. Both Kilimanjaro Co-op Bank and King Finance have relatively lean operations, decentralized decision making, and staff that specialize in serving micro clients. The Co-op Bank has only 17 staff members.

The staff of Tanzania's National Microfinance Bank are not trained in microfinance; the bank is awaiting funding to begin possibly hiring new staff and conducting microfinance training. Both King Finance Corporation and Kilimanjaro Co-op Bank seek staff with no previous banking experience. For instance, the Co-op Bank refuses to hire staff that have been employed by any other bank in Tanzania; instead, they look for new graduates to train. Similarly, King Finance Corporation looks for staff from the community they will be serving who typically have no previous banking experience but excellent customer relations skills.

D. Innovative Strategies for Delivering Microfinance Products

Panelists: Mark Owusuansah, Agricultural Development Bank
Christine Dadson, Citi Savings and Loan
Norma Russell, Workers Savings and Loan

Objective: Banks and non-bank financial institutions have developed innovative strategies for delivering microfinance products. Delivery mechanisms that panelists used included channeling products through post office outlets, linkages with NGOs, and wholesaling to susu collectors and outgrower schemes.

Synthesis: Banks involved in microfinance have used both retail and wholesale mechanisms for delivering microfinance products. Banks that directly retail microfinance products typically increase their scale and outreach through branch networks. The large majority of the banks at the conference rely on their branch network to penetrate the market. The banks represented on this panel, however, used the already existing infrastructure of other entities with linkages to large numbers of microentrepreneurs.

The Agricultural Development Bank (AgDB) in Ghana developed partnerships with TechnoServe and privately-owned companies involved in the production of cash crops, such as cotton and rubber, through outgrower schemes.

Through a relationship with TechnoServe, the AgDB launched an inventory credit product targeted to maize farmer groups. TechnoServe developed the product and then secured a loan guarantee for the AgDB to eliminate any risk associated with marketing the product. During the three-year pilot project, the AgDB was able to recover 100 percent of the loans disbursed. Since then, the bank has marketed this product to additional commercial grain dealers, cashew and coffee exporters, and other private companies.

The AgDB has also developed wholesaling arrangements with outgrower schemes. The bank has provided loans to large private companies that, in turn, on-lend loan funds to small-scale outgrowers. In many cases, farmers are obligated to sell their harvest to the company. However, the AgDB launched a new product that allows farmers to sell to alternative markets. These wholesaling arrangements have enabled the AgDB to cost-effectively reach thousands of small producers.

Citi Savings and Loan in Ghana on-lends to rotating savings and credit associations, called susu clubs. The typical operations of susus, which consist largely of women micro-entrepreneurs, involve collecting deposits and disbursing these funds to members over 100-week cycles. By providing loans to susu clubs, Citi Savings and Loan can help susu clubs reduce the 100-week cycles and thus increase women's access to working capital in advance of their savings.

To expand it customer base, Workers Savings and Loan in Jamaica initiated a micro credit scheme two ago. Using post office outlets through which the bank channeled its savings products to 10,000 clients, Workers began marketing an "early draw" loan product. For clients considered marginal, their savings is used as loan collateral. Workers discovered a positive correlation between its savings and lending products, i.e. increased credit access tended to increase their clients' propensity to save.

The major challenge in wholesaling microfinance products relates to the margins charged along the chain of actors from the retail bank to the wholesale institution to the end user. Everyone in the chain must make money to make the delivery mechanism viable. Issues arise over how to distribute the margin along the chain and over the resultant product price to the end user. Not all MFIs in Ghana are able to charge a margin sufficient to be profitable. In fact, it appears that susu collectors are not passing on their costs to their customers, though it was noted that further research is needed to understand the costs and margins of susu collectors.

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VII. DAY THREE: POLICIES AND REGULATIONS AFFECTING MICROFINANCE

A. Keynote Addresses: Government Policies and Regulations for Microfinance

Morris Kanga, Director for Research and Chief Economist, Central Bank of Kenya, noted that the Central Bank of Kenya is working to provide constructive government policies and create an enabling environment for microfinance institutions. Steps the Central Bank is taking to register, monitor, and supervise these types of institutions include:

- Working with other government bodies to find the most effective way to supervise the sector while not hampering its development

- Reviewing and amending the legal and regulatory framework to incorporate microfinance institutions. In collaboration with the Kenya Bankers Association, the Central Bank is working to find a way to strategically mesh the MFIs' needs with the existing banking system

- Encouraging the conversion of MFIs into banks while still maintaining microfinance as the core of that bank's business

Grace Rubambey, Director of Banking, Bank of Tanzania, stated that in 1995, the Bank of Tanzania (BOT) became aware that much of the nation's poor did not have access to financial services. In response, the BOT — with the World Bank — launched a study to assess the status of Tanzania's microfinance industry. The study listed a number of recommendations and preliminary guidelines for the BOT to follow and included a proposed regulatory and supervisory framework.

To date, the BOT has taken the following steps to establish an enabling environment for microfinance in Tanzania:

- The establishment of a focal point in the government to coordinate donor and government interventions in the sector

- The development of a national microfinance policy that will guide all interventions in this sector. The BOT is acting as a key advisor to the government on microfinance policies

- The education of lawmakers in microfinance terminology and issues. As part of this program, the BOT has taken senior officials in many different government branches to BRI to see firsthand a successful microfinance program.

The BOT recognizes that it has limited capacity to regulate all aspects of the microfinance sector. This limited capacity has forced BOT to think strategically about how and what types of institutions to regulate. BOT decided to limit regulation to those institutions that take deposits and to leave the oversight of non-deposit taking MFIs to the donors.

Peter Harris, Citibank's Regional Head for East Africa, represented Citicorp Foundation, a major conference sponsor. In his luncheon speech, Mr. Harris noted that the Foundation recognizes microfinance as a vital sector where it can make a significant contribution. The foundation provided US $10 million to the "Banking on Enterprise" initiative and additional financial support to the 1997 Micro Credit Summit and the 1998 Latin American Micro Credit Conference in Mexico. As part of its effort to support the microfinance industry, Citicorp Foundation established a micro credit task force to leverage Citibank's resources and expertise to strengthen microfinance institutions around the world. The task force's objectives are to:

- Explore how Citicorp Foundation can expand its role in the microfinance field beyond philanthropy

- Assess how best MFIs can be incorporated into Citibank's client segment and integrated into Citibank's local market strategy, and

- Recommend strategies that will meet Citibank's commercial and philanthropic objectives

With locations in 100 countries worldwide, Citibank is in a unique position to provide a variety of services to this market. From Dhaka to Santo Domingo, Citibank is working to include microfinance within its operations, develop innovations and technologies, and build a better relationship with and linkages to the microfinance industry.

B. Creating an Enabling Environment for Microfinance

Panelists: Stuart Grobler, The Banking Council, South Africa
Roy Polkinghorne, Standard Bank of South Africa
Clare Wavumuno, Bank of Uganda
Anne Ritchie, PRESTO

Objective: Creating an enabling environment for microfinance includes a regulatory framework that allows banks and MFIs to charge interest rates that cover costs. In Uganda, interest rates were liberalized in 1994 and as a result, the microfinance industry has bloomed in recent years. In South Africa, however, the Usury Act has established an interest rate ceiling that has hampered the indigenous microfinance industry. This panel explored interest rate policies in these two countries and their implications for banks in microfinance.

Synthesis: The Usury Act was enacted in South Africa in 1968 with the claimed objective of protecting the poor from being exploited. By capping interest rates, however, this Act has limited credit access for the poor by making it practically impossible for lenders to recover the costs of making micro loans. As a result, the poor have been forced into the informal financial market or into commercial credit where the retailer can be compensated for real costs, and where the consumer will pay a higher price for credit.

In 1993, the government announced an exemption to the Usury Act whereby interest rates on loans under R 6,000 were somewhat liberalized, with the conditions that loans had to be repaid within a 3-year period. Moreover, credit cards and overdrafts were excluded from the exemption. Nonetheless, the R 6,000 ceiling has not changed since 1993, despite the fact that inflation has eroded the ceiling value. While the Usury Act has severely limited microenterprise loans, consumer credit has been exempted from the Act. As a result, consumer lending has grown dramatically, and while this benefits salaried workers, microentrepreneurs in the informal sector are left with limited access to financial services.

In Uganda, on the other hand, interest rates were fully liberalized in 1994. Since then the microfinance industry has mushroomed. The Co-operative Bank of Uganda began a pilot activity to test a microfinance model that has proven to be profitable within months of start up. Becoming profitable has been possible because the bank has been able to charge interest rates that fully cover costs. With this profitability, the Board of Directors are now planning to extend the program to all 24 bank branches. Similarly, Centenary Rural Development Bank launched a microfinance program, and its success has motivated the bank to expand this program. Meanwhile, a plethora of NGOs have begun providing services, and some are now pressuring the Bank of Uganda to allow them to collect deposits.

The cases of South Africa and Uganda highlight the impact of interest rate policies on microfinance development.

The concern in South Africa has been that the poor will be exploited by very high interest rates. While interest rates in Uganda have been very high, they are beginning to come down with greater competition and as the banks realize economies of scale. As one panelist noted, this situation mirrors the evolution of microfinance in Indonesia, where in the early stages, BRI charged interest rates close to 90 percent but was able to reduce these rates substantially over time as the program grew and economies of scale were achieved.

C. Regulating Banks and Non-Banks in Microfinance

Panelists: Henry Kibirige, Bank of Uganda
David Andah, Bank of Ghana
Grace Rubambey, Bank of Tanzania
J.K. Murugu, Bank of Kenya

Objective: Central bankers from four countries —Ghana, Kenya, Tanzania, and Uganda — explored effective ways of regulating the microfinance portfolio of banks and non-banks, so as to protect the interests of small savers while providing prudent oversight to financial institutions. All these countries underwent financial reform programs that liberalized interest rates.

Synthesis: According to Mr. Kibirige of the Bank of Uganda (BOU), the effects of the 1990 financial reform program were not felt until 1993, when interest rates ceilings were lifted. This resulted in dramatic growth of MFIs, which were previously relatively few in number and circumscribed in terms of impact. The government became interested in the microfinance industry with the restructuring of the government-owned Uganda Commercial Bank (UCB), which was pared down from 189 to 64 branches, leaving many rural districts without access to financial services. The microfinance industry was seen as a means of filling the gap left by the UCB. At the same time, the BOU recognized that existing banking legislation did not contain specific provisions for MFI regulation. In collaboration with others in the microfinance industry, the BOU initiated discussions on regulatory issues.

MFIs were interested in regulatory changes so as to be able to mobilize deposits. Dialogue led to the formation of the Association of Microfinance Institutions of Uganda (MIFU) — a single body with which the government could confer with the industry — as well as a project to develop a rating system for collecting information on MFIs. Through collaborative consultations, decisions have been made to regulate all MFIs, including those that are credit-only and those that mobilize deposits. Additionally, an agreement has been reached regarding a host of regulatory issues, including reporting and capital adequacy requirements, accounting standards, governance guidelines, and provisions for arrears.

In Ghana, MFIs include the Agricultural Development Bank, 135 rural banks, credit unions, savings and loan companies registered since 1993, and NGOs. Legislation has been in place since 1976 governing rural banks, savings and loans, and credit unions which are considered non-bank financial institutions. Within the Bank of Ghana (BOG), non-banks are supervised by a separate department created for this purpose, and technical support is provided by the BOG Rural Finance Department and the Association of Rural Banks. Credit unions have an association that regulates credit union members. The savings and credit companies have been allowed to register only since 1993, and are licensed and supervised by the BOG. The NGOs are not licensed. While the BOG has laws for banks and non-banks, there are no specific laws for MFIs. As in Uganda, the BOG is working with the microfinance community in Ghana to develop a microfinance strategy (as discussed in the next panel).

In Tanzania, the Bank of Tanzania Act makes provisions for the regulation of banks and non-banks and gives the BOT power to regulate any organization engaged in financial intermediation and, in doing so, covers MFIs engaged in deposit mobilization. However, most of the MFIs in Tanzania are NGOs and specialize in credit. Nonetheless, the larger NGOs are lobbying for permission to mobilize deposits. The BOT — in consultation with MFIs — is in the process of developing policies governing MFIs, both those that mobilize deposits and those that provide only credit. While still in the midst of developing a legal, regulatory, and supervisory framework for the microfinance industry, the BOT has made the decision to regulate deposit-taking MFIs and leave oversight of credit-only MFIs to donors.

According to Mr. Murugu of the Bank of Kenya (BOK), the bank's attention has been focused on the entire financial system's critical instability. In 1993, inflation grew to more than 100 percent, and a number of banks and non-banks collapsed. This crisis focused the BOK on efforts to control inflation and stabilize the financial system. As a result, little time has been given to the microfinance industry's regulatory needs. While the BOK understands the importance of the informal sector to economic development, it currently requires that MFIs involved in financial intermediation satisfy the existing regulations governing the operations of commercial banks. At present, no special microfinance provisions exist, though Mr. Murugu is aware of the importance of developing a proper framework for regulating MFIs.

To conclude this discussion, Beth Rhyne underscored a number of key points made and questions raised by the four central bankers' presentations:

- The willingness of central banks to dialogue with practitioners is impressive.
- Should savings-taking and non-deposit taking MFIs be regulated? Would regulation of both types of MFIs overwhelm the central bank's supervisory capacity? How much regulation is needed to protect the public interest?
- While regulators would like to create a level playing field for all types of financial institutions, does this mean that a simple regulatory framework can be effective for the range of financial institutions or do different types of institutions require different types of regulations?
- A number of central banks have expressed the desire to promote standards and use the central bank's authority to help develop standards and circulate them throughout the industry.
- Is there a correlation between the relative importance placed on regulation and supervision, and the microfinance industry's development and advancement?
- Are regulations the driving force for the industry's success or must the industry itself push for advancement?

Regarding the last point, Beth Rhyne argued that the microfinance industry itself is the driving force behind its own success.

D. The Case of Ghana: Creating a National Strategy to Support Microfinance

Panelists: David Andah, Bank of Ghana
Yaw Sarpong, Nsoatreman Rural Bank
Joe Aidoo, Lower Pra Rural Bank
Matthew Kayang, Nandom Rural Bank

Objective: The panel discussed Ghana's National Microfinance Strategy, developed through a cooperative effort with the Ministry of Finance, the Bank of Ghana, and microfinance practitioners, and aimed at establishing a supportive policy and regulatory environment for the microfinance industry in Ghana.

Synthesis: With support from the President of Ghana and bolstered by Vision 2020, aimed at developing a financial system to mobilize capital for development, the Ministry of Finance established a microfinance desk to address the financial needs of the small and micro enterprise sector. The Ministry microfinance desk, in collaboration with donors and MFIs, began an effort to formulate a National Strategic Framework to support and build the capacity of rural MFIs throughout Ghana. This framework included MFI forums to share information, establishing industry standards, meeting with the government on various problems and issues, and advocacy efforts that supported microfinance activities.

The "case of Ghana" is noteworthy in both the level of collaboration among government, donors, banks, non-banks, and NGOs, and the cooperation marshaled to support the microfinance industry. Ghana's strategy is aimed at meeting the needs of microfinance practitioners to improve their capacity and performance. Its effectiveness is demonstrated by the identification of training as a crucial need for MFIs and the quick response on the part of donors that stepped in to pro-vide training to 21 MFIs. Progress was also made in creating an environment for a large number of rural banks to operate more efficiently and profitably.

With support from the World Bank and CGAP, a Microfinance Network of microfinance practitioners was established to facilitate information sharing among MFIs, disseminate best practices, build capacity, and conduct research. Through the network, CGAP has helped disseminate MFI understanding of standards, and provided training to MFIs to help them conform to these standards. To apply for donor funds, MFIs must now undergo an assessment of their compliance to standards.

The Microfinance Network has also played an important role in dialoguing with the Ministry of Finance regarding regulations. The Ministry has developed a list of requirements needed to support the microfinance industry. The list includes:

- Collaboration with the BOG on policy and the institutional framework needed for prudent operations
- Institution-building support to assist in training and providing technical support
- Building apex bodies to create dialogue, assist in prioritizing MFIs' needs, and foster a common approach to microfinance
- Information dissemination to share ideas and best practices

VIII. NEXT STEPS

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At the end of the conference, participants were asked what steps could be taken to further improve the regulatory environment for microfinance in Africa. Participants —including central bankers and microfinance practitioners— proposed the following:

- Develop partnerships between commercial banks and MFIs to administer loan portfolios
- Establish standards for supervision and regulation through collaborative consultations
- Meet on a regular basis to discuss how best to standardize supervision and regulation, and coordinate efforts
- Build microfinance networks for efficiently providing training and technical assistance
- Establish a formalized, regional, central bank network to standardize regulations
- Develop methods for risk-based supervision to replace risk-based compliance. Study management techniques that are working
- Create a bankers' network in each country and organize regional network meetings to share information and disseminate best practices
- Use bank networks to source funds
- Create an enabling environment to facilitate entry into sector
- Disseminate information about microfinance to boards of commercial banks to encourage entry by banks into the microfinance market

CHAPTER 2: MICROFINANCE ISSUES

INTRODUCTION

The Commercialization of Microfinance conference was designed to explore the microfinance experience of commercial banks and other regulated financial institutions in Anglophone Africa.

Conference participants were particularly concerned about three issues: (a) microfinance profitability and institutional sustainability; (b) the high interest rates charged by microfinance institutions (MFIs) and their impact on the poor, and (c) microfinance's role in economic development in Africa. In plenary discussions, participants grappled with these issues. While there was a high degree of interest in microfinance among participants, many voiced questions about whether sustainability was possible, whether cost-recovery interest rates were appropriate, and how important microfinance could be to Africa relative to other means of boosting economic development and alleviating poverty.

This chapter summarizes the three main issues debated at the conference — profitability, interest rates, and microfinance's contribution to economic development — and their impact on African financial institutions already working in microfinance as well as those interested in entering the field. Responses and comments from partricipants and facilitators form the foundation for the presentation of the three issues.

A. PROFITABILITY

Profitability was a key issue discussed at the conference. While panel discussions focused on strategies and methodologies for reaching full cost recovery, the plenary discussion raised concerns about elevating profitability above the objective of poverty alleviation. There were questions about how long it takes to become profitable in Africa, and whether institutional sustainability was an adequate indicator of success. Those concerned with institutional sustainability questioned the role played by subsidies in achieving profitability.

1. The Profitability of Microfinance

To ensure that the profitability discussion was based on a shared understanding of its meaning, Beth Rhyne gave a presentation entitled, "What Do We Know about the Profitability of Microfinance?" The presentation data came from The MicroBanking Bulletin, a project report aimed at developing a database to help MFI managers better understand their institution's performance by providing data from MFIs worldwide. To date, most of the data relates to the performance of Latin American institutions, both commercial institu-tions and NGOs. Moreover, the data is skewed toward the credit side of microfinance.

The profitable institutions in the Bulletin's database showed a return on assets (ROA) averaging 4.5 percent for all institutions and 2.5 percent for commercial banks, a very respectable figure for any banking operation. This same group of profitable MFIs had a respectable return on equity (ROE) of around 15 to 16 percent, and a portfolio at risk averaging 2.9 percent.

Achieving these profitability levels requires attention to four key elements: client demand, efficient operations, high portfolio quality and yield on portfolio.

2. Obstacles to Profitability in Africa

Ms. Rhyne discussed how microfinance's costs and structure can be obstacles to profitability in Africa. Her main points are summarized below:

1. Microfinance requires an expensive cost structure that is completely different from the internal structure of most commercial banking operations. It requires a spread between 17 and 20 percent of assets to break even. In addition, MFIs must pay a high cost for the technology, technical assistance, and infrastructure needed to reach a dispersed and low-density population

2. The largest expense tends to be staff salaries. Salary costs — a function of a particular country's labor market — can represent a significant obstacle to achieving profitability. Salaries in Africa are high in comparison to those in other regions. For example, in Asia, salaries are so low such that the Grameen Bank can afford to make many very small loans at moderate interest rates. In Africa, loans tend to be very small but salaries tend to be high. As a result, African MFIs must adopt innovations, technologies, and/or other systems to reduce costs.

3. Administrative costs are also high due to the infrastructure costs of maintaining retail outlets that are convenient to clients.

4. Portfolio quality is another key element to profitability. Successful microfinance institutions should keep loan losses to about 1.2 to 1.4 percent of ongoing expenses; this must be covered by interest rates. Maintaining a high portfolio quality requires a lot of effort, with immediate follow-up on delinquencies and the ability to track them instantly. An effective management information system (MIS) can be essential.

The last element of profitability is revenue, to which interest rates are closely tied. Beth Rhyne noted that, "successful microfinance institutions charge their clients interest rates that cover their administrative costs and the cost of money."

Conference participants gave evidence of the obstacles to profitabitlity in Africa raised by Ms. Rhyne. The Commerical Bank of Zimbabwe representative stated that salaries represent 70 percent of the bank's operational costs, however, since loan officers are not yet handling the "optimum" client level due to the nascent state of the microfinance portfolio, the bank expects the ratio of salary costs to full operational costs to decline. Moreover, CBZ has yet to identify an effective MIS to track the costs of its microfinance program; as a result, CBZ cannot deliver a monthly profit-and-loss report on its microfinance portfolio.

According to a Nubank representative, Nubank also faces high personnel costs, partly because of its subsidiary relationship with ABSA. Nubank is required to abide by ABSA's minimum salary standards. In addition, Nubank incurs the high costs of reaching a widely-dispersed clientele and, because of the high crime rate, of providing personnel with vehicles. Nubank's high costs have forced it to focus on consumer loans, where the risks are minimal, and to de-emphasize microenterprise loans. Furthermore, because Nubank is a subsidiary of a commercial bank, it is required to use systems — which are more costly than it might otherwise choose — that meet regulatory standards.

Another participant raised the issue of meeting the microfinance needs of Africa's large rural population when many microfinance programs are located in urban areas. Locating outlets convenient to rural market places can require a significant investment, and infrastructure, both roads and communication systems, are relatively undeveloped adding to additional expenses. Lowering these costs requires creative approaches and technological innovations.

The Co-operative Bank of Uganda representative illustrated his bank's automated techniques for reducing costs per transaction:

> You have to have a good computer system and appropriate software. In (one rural area), we are processing about 200 transactions every five minutes. This is done by a specialized computer program and use of a technique called transaction posting, a program that tracks the list of all clients, their transactions, and the amount owed at each payment period. So technology, automation, and training are key.

Standard Bank of South Africa developed a technology for microsavers, called "E-Bank," which builds on the extensive ATM network in South Africa and is targeted to low-income clients. E-Bank was designed in response to findings from Standard Bank's market surveys; clients wanted a secure and accessible vehicle for savings and funds needed for frequent transactions. At the same time, Standard wanted to address the problem of customers crowding the "banking halls" on payday. E-Bank aims both to meet the needs of a huge market and to generate profits in the competitive banking industry. While still in an early stage, E-Bank represents an innovative technological approach to meet the demands of a large pool of low-income clients, while allowing the bank to expand its market share in a cost-effective manner.

Smart Application Systems (SAS) is another technology developed for the microfinance market that promises to reduce the cost of tracking many small transactions. SAS technology, or "smart cards," is not a product or a lending methodology; it is essentially a complement to a given methodology or product. This transaction vehicle can help organizations that need to reach scale in remote areas that lack physical infrastructure, or that need to combine and collect information that otherwise would be cumbersome, if not impossible, to collect manually. Smart cards do not require computers or even telephones; they store and condense data in card form for later downloading into a computerized accounting system. To be cost effective, smart cards require a minimum of 5,000 clients, a network of branches in remote areas, more than 10,000 transactions per month, and competition with other banks or MFIs.

Smart cards were tested in Swaziland and Indonesia, with BRI. In Swaziland, the client base of 2,000 was too small for a successful demonstration, however, at BRI, with clients that number in the millions and more than 3,000 branches, the smart card proved to be more effective. SAS has been working with Harvard Institute for International Development and BRI to develop strategies for implementing smart cards in Indonesia. At BRI, as in any bank, a linkage is required to allow customers to conduct transactions at any branch. Normally this would necessitate inter-branch, on-line links, which can be very expensive. Smart cards, however, allow customers to conduct transactions at any BRI branch by a data transfer to the branch where the account is held. This capability keeps costs low for BRI and provides a more convenient system for customers.

Smart cards and other technologies coming into the microfinance market allow banks to expand their scope and scale, and — by reducing costs — increase profitability. The terms of trade in Africa, however, tend to make technology imports such as computers costly.

New technologies still under development may allow for cost-effective tracking and accounting of the many small transactions inherent in microfinance. While these technologies show promise for reducing costs, they can mean expensive investments in technical assistance, computers and software, training, and other infrastructure. These investments and/or infrastructure needs represent an ongoing hurdle to achieving profitability for some MFIs and commercial banks.

3. The Role of Subsidies in Achieving Profitability

Many questions were asked about subsidies. While a number of participants agreed that microfinance could be profitable in Africa, they were less sure if it required a subsidy to become profitable. As Bob Christen noted, "The word subsidy has a bad connotation, and since subsidies were typically used for up-front costs of developing a model for microfinance for replication— “start-up costs” is a more accurate description." While a number of bankers were concerned about the subsidies provided to microfinance programs, Mr. Christen suggested the following:

> All businesses and/or new products require up-front investments; they can be likened to R&D costs associated with developing a model for replication. The size of start-up costs varies widely depending on local circumstances, the MFIs' comparative advantage, and the opportunity locally to develop these services inexpensively. The State Bank of Chile, which is the latest entrant into the market of micro credit in Chile, invested somewhere between $200,000 and $300,000 to develop their systems, and broke even within a period of 18 months. How were they able to achieve profitability so quickly? They were the latest entrant in the market in a country where NGOs have been working for ten years and private banks have been involved for about five years. Thus when the State Bank started, they were able to hire the best people available in the market. The bank was essentially able to build on past investments — exceeding several million dollars — by the donor commu-nity in other organizations. The same thing is happening in Bolivia. There is now a proliferation of finance compa-nies in Bolivia involved in microfinance that are building on the R&D investments of previous entrants in the market.

Mr. Christen mentioned that in a country with no previous investments, as was the case for Workers Bank in Jamaica, start-up costs will be significantly higher than they are in Chile or Bolivia today. In the case of Workers Bank, the high costs stemmed from the scarcity of local expertise, the lack of an MIS — which can require an investment as much as $1 million — and the need to overcome an "image" problem from past insolvency.

Many African banks have developed microfinance programs with donor funds. The Co-operative Bank of Uganda representative mentioned that his program was subsidized, and "the subsidy was important to the board's decision to agree to enter into the microfinance market." CBZ also received a subsidy of £1.3 million from DFID for start-up costs, including staff recruitment and training, and — in the pre-implementation phase — research and development. In the R&D phase, CBZ commissioned a microenterprise census of areas where they planned to operate. Subsidies also paid for computers, motor bikes, furniture, and technical assistance. Similarly, the "credit with education" program of Nsoatreman Rural Bank required up-front subsidies for the education program, training, motor bikes, and operational expenses for the program's first nine months. The Rural Banks of Ghana were able to access World Bank and other donor funds.

The story of Nubank and subsidies, however, is somewhat different. Nubank's start-up costs were financed by ABSA, but because ABSA's funds came from shareholder money, expectations regarding Nubank's performance —including time required to break even — were more in line with a business than a subsidized and/or donor-funded venture. Shareholders expected — as in a normal business environment — a break even period within 18 to 24 months, ROE of around 25 percent, and ROA of at least 2 percent. With these expectations, Nubank responded by scaling up consumer loans and de-emphasizing micro-enterprise loans which were much riskier. While the eventual plan is to roll out a larger microenterprise loan program, Nubank will be pressured to generate profits in the very near term, while developing a lending model that works in South Africa for Nubank.

Given this situation, a World Bank representative asked if Nubank would "consider a longer time period to break even and to reach profitability, if you were provided with some subsidies to cover some of your costs while you are learning to approach and get into a market." Nubank's representative responded affirmatively. According to the Nubank representative, the subsidies benefit the program:

> You take the heat off the microenterprise division and give it time to experiment without dipping into the bank and asking them to fund losses for the initial period. One of my discoveries is that when I started looking at the research I found that almost all of the institutions that are now commercialized or are doing microenterprise on a profitable basis . . . had a long gestation period which was funded by donors. I just don't have that luxury.

4. Achieving Profitability in Africa

Given the substantial start-up costs, the time needed for a microfinance program to reach a break-even point was a noteworthy discussion topic. This concern for the time needed to reach profitability was ably expressed by the one conference participant:

> Mine is not a question as to whether microfinance is profitable or not, but when does it become profitable? How long does it take? From the presentations heard today, we find that some of the institutions that provide microfinance services employed technical assistance. Technical assistance is very expensive and, in most cases, it is not factored into the computation of profitability. Should such an expense be capitalized or should it be expensed immediately?

Mr. Christen responded with a brief discussion of business start-up costs:

> In any business up-front costs — like MIS and technical assistance costs — are typically amortized over a five-to-seven year period and across the entire branch network. Whereas banks and NGOs that receive grants for start-up costs may not worry about amortizing up-front costs, commercial banks using their own funds and/or NGOs that are forced to demonstrate financial self-sufficiency may need to worry about how long it takes to pay off the initial costs.

A number of the banks that received grants and/or some other form of donor funding for microfinance activities did not incorporate these sunk funds into their profitability calculation. There were repeated references from some commercial banks about the importance of adding the full costs of initi-ating services into the equation. Mr. Christen then queried the audience about the investment size and time needed before MFIs begin to move out of the red, into the black. He asked, "What is that total investment that a bank needs to make before it really starts recovering that money?"

On several occasions, reference was made to BRI's experience. BRI has invested $15 million to create a microfinance program that today is valued at $3.2 billion. This up-front investment did not look reasonable during the first five years of operation when the bank was generating only a $10 million profit, after a $15 million investment; but almost 15 years later, a $15 million investment for a $3.2 billion liability fund is an attractive ratio.

Ms. Rhyne also referred to BRI in answering a question on the length of time it takes an MFI to reach profitability:

When BRI introduced its new loan system, its lending became profitable within 18 months. That is probably a lower limit of what it would take. On the other hand, Grameen Bank claims a period of about 15 years. I think the number for commercial banks is much more likely to be in the range of two to four or five years.

The length of time it takes to reach profitability in Africa is difficult to gauge given the short duration of many programs that have received donor funding and that-in many instances-have not incorporated this funding into profitability calculations. Nonetheless, the history of the microfinance field in Latin America suggests that the more developed the field in a given country — the more successful the MFIs and the longer their history — the shorter the time required for new MFIs to become profitable.

5. Ultimate Aims: Profits with Poverty Alleviation

Although much of the conference was focused on the technical and financial requirements for building profitable microfinance operations, participants never forgot the underlying goals of microfinance to help the poor. They returned to this theme on several occasions.

The Nubank representative asserted that, although ABSA's microfinance unit was a commercial venture, one "motivation for getting involved in microfinance in South Africa was to help create jobs. At the end of the day, we must not lose sight of the fact that microlending is not an end in itself. We are trying to solve a problem, and that problem is a 32 percent unemployment rate."

To many Africans, reducing the enormous gap between the rich and the poor, addressing social and economic inequities, and making "a difference in people's lives" are the motivating factors for banks to get involved in microfinance. Addressing these social and political problems is not merely a social welfare issue. It is the key to future investments in Africa by wealthy nations, the success of democracy movements, and resolving the huge unemployment problem in many countries.

The question raised by bankers was whether profit maximization needed to be balanced against impact on social welfare and if this was realistic for a bank. In answer to this question, a Central Bank of Uganda representative argued that if banks get involved in social problems such as job creation, they will "compromise the sustainability of the institution."

The Nubank representative added, "The bank is a stakeholder in the society and, as such, cannot stand aside and not get involved in the social problems of the country. As a corporate citizen, we've got to do it (make a contribution through microfinance) responsibly and on a sustainable basis." A Standard Bank representative went further and discussed the role of an ethics code for MFIs and banks:

> I think an interesting point for this conference would be developing a code of ethics for organizations. Certainly in Standard Bank we have realized the need for a code of ethics that involves five stakeholders: shareholders, customers, staff, suppliers, and the larger society. The principle underlying a code of ethics is "no injury to fellow stakeholders." If you are going to injure a fellow stakeholder, then you're basically starting to destroy your organization from within. And even a big powerful organization like Standard Bank or ABSA can actually be destroyed from within, let alone from outside competition if there is no code of ethics. Now if "no injury to stakeholders" is a policy, how do you begin addressing the needs of the shareholders for a 25 percent return on equity against the lending to the poor who need capital? Society is a stakeholder, shareholders are stakeholders. Society wants more jobs. Shareholders want more return on equity. The two have conflicting needs. If you want your organization to survive, you have to find a

solution. And I think that this is what has to be argued in forums such as these and in banking forums. If you are going to survive in the twenty-first century, you have to satisfy all stakeholders. This means some form of compromise between shareholders and society at large.

Beth Rhyne and Bob Christen provided convincing arguments regarding how the market will result in increasingly customer-focused microfinance services as competition increases. Competition will lower prices and improve services to the benefit of the poor. This type of evolution has taken place in Latin America — where MFIs have lowered their interest rates substantially over the years and competition has motivated MFIs to develop new and more convenient products for low-income customers. The concern, however, on the part of Africans was "how long this would take for microfinance to reach the poor and contribute to the economic development that is needed so badly in the African context," especially given that "MFIs have only begun to scratch the surface of the microfinance market."

B. INTEREST RATES

1. Full-Cost Interest Rates: The African Debate

The conference facilitators, Bob Christen and Beth Rhyne, initiated a discussion on interest rates as part of a framework for analyzing profitability. In presenting the framework, Beth Rhyne made the following points about interest rates:

> We have spent a lot of time over the last 15 years agonizing over interest rates but, the fact is that the successful microfinance institutions are able to charge their clients the interest rates that it takes to cover the extremely high administrative costs and the cost of money . . . microfinance portfolios can yield as high as 40 percent on average . . . that is sufficient to cover costs and it is compatible with client demand.

Although the facilitators initially assumed that the debate over interest rates was "put to rest" some time ago, the high-charged discussions in the plenary sessions made clear that this was not the case. In response to this discussion, Mr. Christen opened the session to further debate:

> There is a question about whether, from the institution side, interest rates should be high, or relatively high. There is a whole question about whether clients can pay or should pay high interest rates. There is a series of questions about the developmental impact of high interest rates on clients . . . the sustainability-driving issues of market, scale, and interest rate, and profitability.
>
> Interest rates in the countries which are represented here today are still a very live issues. A significant proportion of the people here today believe that micro clients are capable of paying whatever interest rate it

> takes to pay for microfinance services provided that these services are provided in an efficient and effective manner. But there is also a substantial share of people here who are very uncomfortable with that idea or who cringe a bit when they hear the actual numbers that are involved in full-cost recovery interest rates . . . this is clearly an issue we haven't put totally behind us.

The interest rate debate centered on two issues: the image and/or political problems faced often by for-profit banks in charging high interest rates, and concern over the developmental impacts of full-cost interest rates. These issues were viewed against microfinance's objective of alleviating poverty; they were discussed in the context of widespread poverty in Africa and the recent move by many African governments away from socialism toward a more democratic, free-market economic system to address social inequities.

2. The Image Problem and High Interest Rates

Nowhere was the "image problem" associated with high interest rates greater than in South Africa. Standard Bank of South Africa and Nubank representatives underscored the political sensitivity of interest rates in a country with a Usury Act that effectively caps interest rates with the purported aim of protecting poor consumers.

According to Stuart Grobler, from the Banking Council of South Africa, while the Usury Act has existed in South Africa for 30 years, the Act is not well understood. After nearly a dozen amendments, it remains a very complex, often misinterpreted, and controversial piece of legislation.

> In fact, the Chief Inspector for the department responsible for monitoring the implementation of the Act said to a professor of law, a world-renowned advocate of consumer rights, "You have no understanding of the Usury Act. I, the Inspector, am the only person in the country who understands it."

The Act's claimed objective of consumer protection — to protect the poor from being exploited — affects all credit grantors, including retail credit and certain leasing programs. The Act specifies maximum interest rates, certain maximum administrative fees that may be charged, and technical and service requirements for credit grantors. Over a number of years, politicians and government officials have supported the Usury Act.

The Standard Bank of South Africa representative discussed the consequences of full-cost interest rates on Standard's decision to venture into microfinance:

> We, in Standard, estimated that more or less 85 percent per annum was the interest rate that we would have to charge in order to make our microfinance activity viable — not including a 25 percent return. Our senior general management said, "There is no way that Standard Bank, with a profit level of two billion Rand last year, could go out and charge the poor 82 percent." This was one of the major reasons we withdrew from the market. Not only could we not expect a return of 25 percent, our bank would not be prepared to be seen charging 82 percent or even 50 percent.

The political situation in South Africa makes it impossible for even profit-driven, commercial banks to ignore their "image," as one South African banker explained:

> South Africa has a 32 percent unemployment rate, as you've heard, and obviously anybody with a conscience, including large powerful commercial banks like ABSA and Standard, are not comfortable to sit by and just watch the poverty-stricken communities while they themselves are making substantial profits. I think we

> genuinely wish to try and do something. However, the moment you try and change your suit from a banker to a microenterprise lender you find that the suit, (the small amount of microlending in South Africa) of which probably 90 percent is consumer lending, is an embarrassment to our country. We are not doing what we should be doing. And it's a question, I think, of making sure that we wake up and do it before we face a social revolution.

In summarizing these points, a conference moderator noted that many MFIs — particularly those that are non-governmental organizations (NGOs)— are trying very much to emulate the "hard headedness" of commercial banks, and yet the South African bankers involved in microfinance argue that commercial banks need the "soft heart" of the MFIs to deal with some of these issues.

The problem of "image" was also raised by the NGOs. One conference participant noted that NGOs also have to be politically sensitive. In the society where they operate, NGOs are viewed as "do-gooders" who are supposed to help the poor. They are not supposed to charge high interest rates, and they are not supposed to foreclose on the property of the clients who are in default.

Given the brief discussion time available at the conference, it is difficult to discern if this "image" problem is greater in Africa than in other regions. In Africa, businesses must operate in an environment where popular opinion strongly supports measures that help the poor, and where the formal private sector is often regarded with suspicion. Moreover, in countries such as Zimbabwe and Ghana, structural adjustment programs are seen as having exacerbated income inequities and increased unemployment. As a result, microfinance is welcomed in many countries as a tool for meeting the demand for more jobs and increased incomes. However, the high interest rates generally charged by MFIs to cover their costs runs counter to political sentiments. Political figures prefer to view microfinance as a social welfare program to alleviate poverty, create jobs, or develop new businesses, rather than as a business that aims to achieve profitability.

This dilemma is most evident in South Africa, where the need to address poverty and income gaps is a matter of political urgency for government and survival for big business. Yet there is little growth in microfinance activity because of the image problem associated with charging high interest rates to the poor.

3. The Developmental Impact of High Interest Rates on Poor Clients

3.1 The Concentration of Micro Loans in the Retail Sector

Conference participants also raised the issue of the impact of high interest rates on clients. They questioned whether clients could afford to pay high interest rates and still grow their businesses and/or increase their incomes. Participants also wondered whether there was a trade-off between high interest rates and client demand, and questioned whether high interest rates were a barrier to reaching scale and deepening outreach. A related question was whether high interest rates are compatible with poverty alleviation, the most often cited objective of donors that invest in microfinance.

A central banker questioned how clients could afford the nearly 100 percent interest rate that some MFIs charge in South Africa. "What I would like to know is whether you could give us a picture of the type of economic activities that your clients are engaging in because, with an interest rate of 108 to 110 percent, I can't visualize how they can meet the loan repayment."

The Nubank representative discussed his clientele (while noting that his own bank charges an interest rate of 50 percent per annum):

> My clients are based mostly in retail, and therefore their turnaround time is quite short, and they never use the money for too long of a period. If you speak to most of the microenterprise lenders here, you would discover that the (loan) term is normally three months, maybe six months, except for equipment, for which the interest rate is higher. So I think the rate is immaterial. When you come from the background where access to credit has been a major stumbling block, you begin to understand how it works.

The Nubank representative further explained that when a client has a short-term loan, his or her exposure to interest cost is not as high as the number might suggest.

Further questions were asked about the concentration of microfinance loans in the retail sector, which economic sectors were particularly profitable for the client, and whether MFIs targeted loans to the retail sector because of loan defaults in other sectors. One participant suggested that "90 percent of loans went to the trade sector because retailers can afford to pay high interest rates due to the fast turnover in this sector." He wondered, however, whether lending to retailers contributes to economic development.

This question prompted the representatives from several microfinance programs to note that a large share of their lending reaches other sectors, including manufacturing and agriculture. A Commercial Bank of Zimbabwe representative stated:

> CBZ must be concerned about economic growth since this is fundamental to the bank's growth. There are an estimated 1.5 million people employed in the informal sector. According to a GEMINI study in Zimbabwe, 70 percent of the activity in the informal sector is in manufacturing. Moreover, 70 percent of these informal manufacturing microenterprises are owned by women. CBZ statistics on loans by sector indicate that more CBZ loans have gone to the manufacturing sector than any other.

A Ghanaian MFI representative who added, "(Our) clients use loans for retailing and some manufacturing, including dressmaking." An Ugandan Centenary Bank representative stated that 23 percent of their loans were for agriculture, and they would like to double that percentage in the next five years. On the other hand, Nsoatreman Rural Bank in Ghana observed that, while their clients are predominately engaged in farming activities, agriculture loans are both riskier and require a longer payback period than microfinance can handle. Nsoatreman invests in microenterprises that have a quick turnaround; this includes retail and some agricultural processing activities.

The Co-operative Bank of Uganda's initial loans, offered to micro borrowers, also must be paid back within a period of 12 weeks. Experienced customers receive longer-term loans. Nonetheless, to meet the repayment schedule, individuals must borrow for activities that have quick returns.

A number of conference participants questioned the extent to which microfinance contributes to economic development, and if it only contributes to the growth of the sectors with the quickest return on investment. They also questioned if it promoted adding value to primary products.

3.2 Full-Cost Interest Rates and Client Demand

Earlier Beth Rhyne stated that full-cost interest rates were "compatible with client demand." She suggested that experiences from around the world demonstrated that MFIs can charge full-cost interest rates while increasing their client base. BRI and Banco Sol, both represented at the conference, were good examples of this strategy.

Yet a PRIDE/Africa representative argued that while there are examples of MFIs in other parts of the world that have "gone to real scope and scale," there are no such examples in Africa. The representative continued:

While the facilitators maintain that the market for microfinance in Africa is enormous, MFIs have only reached a minuscule percentage of this market. Does this lack of market penetration suggest that MFIs in Africa have not found the right product at the right price? Do high interest rates reflect inefficiencies on the part of MFIs? Are these inefficiencies expressed in high interest rates and do these high interest rates translate into products that are not at the "right price?"

In agreeing with the thrust of this question, a Commercial Bank of Uganda representative asked whether there is a mismatch between institutional inefficiencies that require banks to charge high interest rates and the rates that would tap effective client demand.

Most banks represented at the conference were subsidized by donors, and many were still struggling with establishing efficient operating systems, including computerized management information systems Without an efficient MIS, a number of banks were uncertain about fundamental statistics needed to measure operational efficiency.

Mr. Christen asserted that, "Full-cost interest rates are a precondition not only for sustainability but for exponential growth." To illustrate this point, Mr. Christen reviewed microfinance's history in Latin America. His key points are summarized below:

1. Compared to Africa, Latin America has a longer microfinance history and traditionally, very high levels of inflation.

2. Ten years ago, NGOs in Latin America learned from loan sharks that charging high interest rates is possible and will not be an impediment to growth. Today these NGOs constitute the most important MFIs in Latin America.

3. Successful MFIs found microentrepreneurs were willing to pay high interest rates that covered the costs of administering micro credit. Many microenterprises were able to repay high interest loans because they were generating extremely high rates of return from the extra liquidity represented by a loan.

4. NGOs in Latin America initially grew exponentially because of the huge untapped market for microfinance services. In many countries, NGOs had a near monopoly because of the scarce number of MFIs. More recently, however, competition has begun to drive down interest rates.

5. As the market drives interest rates down, the MFIs that survive and grow are the most efficient providers of microfinance services over the long run. In Latin America, the most successful institutions are those that have provided the highest quality services at the lowest price.

6. Are high interest rates anti-developmental? This is not a concern of for-profit banks; it is the concern of donors and investors who subsidize microfinance.

7. Micro credit is a tool for some people who have access to an economic opportunity from which they can generate income. Credit works for many poor women who have access to profitable economic opportunities.

8. If someone is too poor to pay the required interest rate, he or she probably should not get credit, since they will not generate a return that justifies the credit's interest cost. A different program is needed for this group of people.

C. THE ROLE OF MICROFINANCE IN ECONOMIC DEVELOPMENT

The value of financial services to poor people, at a micro level, and the role of microfinance in economic development, at a macro level, were at the heart of the debates over interest rates and profitability.

1. The Impact of Financial Services for the Poor

In Africa, where poverty is a fundamental political and economic issue, many bankers are concerned about social goals. For donors, on the other hand, sustainability has been an important selling point to governments as they budget microfinance funding with the expectation that funding will end once self-sufficiency is reached. This tension between these two perspectives was expressed eloquently by one participant:

> We are talking about microfinance and asking if it is profitable, but another question which is important to me is whether microfinance will do what we intend it to do. Against what parameters will we measure the success of microfinance? Do we go the bank way and measure it against profitability or do we measure it against the objective of poverty alleviation, which in my mind was why we all got into this in the first place.

Ms. Rhyne argued that "the tools do not exist to link financial services directly to specific economic impacts either at the macro level or the micro level. In thinking about the value of providing microfinance services, we have to think in terms of what finance does." Finance facilitates transactions and helps people take advantage of economic opportunities, but does not create these opportunities. As a result, it is not easy to trace impact in a linear way; rather the impact is diffused within the clients' various activities.

Nonetheless, an abundance of research shows that overall microfinance does result in increased incomes for borrowers and savers. As Bob Christen noted, however, "This is only the case when microentrepreneurs have access to an economic opportunity that produces sufficient returns to repay the principal and interest on a loan. Creditworthy microentrepreneurs tend not to be the poorest of the poor and/or those engaged in marginal economic or subsistence activities. For this group, credit can actually be harmful; it can create debt that microentrepreneurs cannot repay given the income they are able to generate." In response to participants' concerns that microfinance was ignoring the needs of the poorest, Mr. Christen countered that "programs other than microfinance are required to meet the needs of more economically-marginalized groups. Microfinance can make a contribution to the lives of a segment of the poor, but it is not a panacea for all the poor."

Ms. Rhyne addressed a question posed by the audience: "Will we lose the kinder, gentler face of microfinance if it is delivered by banks instead of by NGOs?"

> Microfinance services work when they are adapted to the particular needs of the informal sector clientele . . . anyone who is trying to do microfinance with a face that is not friendly to the informal sector will fail. The ones that will succeed are the ones that understand what the clients' needs are, the ones that speak the same language as the clients, and the ones that make it convenient for clients and treat clients with respect. That is true whether you're an NGO or a commercial institution.

Ms. Rhyne further explained the profit-driven and service-oriented nature of commercial businesses. While these motivations are different from the altruistic drive of NGOs, the effects are similar. Competition in Latin America, for example, has motivated commercial banks to go "down market," and in doing so, to serve poorer and poorer clients.

Reaching the bottom end of the spectrum is an objective of both NGOs that are concerned with empowerment and poverty and commercial banks that are concerned with expanding their market share.

2. The Impact of Financial Services on Economic Development

As Ms. Rhyne noted, it is difficult to directly link the impact of financial services to changes in economic development. Researchers have only been able to infer the relationship; they note that in developed countries the financial system tends to be deep and in developing countries the financial system tends to be shallow. Based on this, conclusions are drawn about whether or not financial systems are the cause and/or outcome of the development process.

By intermediating capital between those with surpluses and those with deficits, financial institutions help people take advantage of economic opportunities. By providing microentrepreneurs with capital to increase the size of their business and/or increase income, microfinance contributes to the informal sector's development, which is the most dynamic economic sector in most African countries.

As mentioned above, a participant asked whether the tendency for micro loans to be concentrated in the retail sector contributed to economic development, when — in many instances — other sectors have more potential for economic growth. In response, Ms. Rhyne argued that the retail sector is a sufficiently productive activity to be worthy of support and/or credit. Informal vending is a major source of employment and income for poor people and, as such, contributes to the economy. People use the income earned from informal sector activities in ways that are productive for them. They may invest income earned in their existing enterprise or a new business, to educate their children, or buy commodities from other enterprises. As a result, the informal sector can be a learning ground for entrepreneurs who might eventually transition into more productive activities and/or increase the size of their businesses. Although research indicates that most microenterprises do not grow, it also indicates that about 10 percent of microbusinesses do. This is a substantial number in absolute terms.

In response to microfinance's role in national economic development, a Co-operative Bank of Uganda representative stated that his bank "saw microfinance as a tool for the development of the country." He continued:

> Microfinance achieves three objectives related to national development. First, it attempts to increase levels of national savings. For instance, in Uganda, savings levels have been falling. Ugandans are liquidating their savings and investing them. Microfinance can contribute to increased national savings and the accumulation of equity for investment.
>
> Second, microfinance attempts to reduce the rural-to-urban transfer of financial resources. The Ugandan banking system has been moving the money away from the rural areas into the urban area. Microfinance can play an important role in making financial resources available in rural areas.
>
> Third, microfinance attempts to increase local circulation or multiplication of resources by investing in rural communities, enterprises, and other local non-farm activities. Moreover, people understand that the money they borrow comes from their own communities. This is a motivation for fiscal responsibility.

Conference facilitators argued that microfinance clients are informal sector entrepreneurs, essentially urban and rural household members who are non-salaried. Beth Rhyne argued, "If we look at the countries who are represented here today, I think that in a very real sense, this market (the informal sector) represents a very big part of the future of these countries." Microfinance supports the informal sector by providing the necessary capital to help a segment of microentrepreneurs — those with access to an economic opportunity sufficiently profitable to pay back a loan.

3. Microenterprise vs. Financial Sector Development

Mr. Christen described the evolution of microfinance from a microenterprise development strategy to a financial sector development strategy. Initially, microfinance was viewed as micro credit for microentrepreneurs. It was a strategy for alleviating poverty and a "bottom-up approach" to economic development. In the early years, people interested in micro credit came from a social perspective with a concern for poverty. Over time, those involved in microfinance have increasingly viewed the field from a financial sector perspective with the aim of supporting sustainable financial institutions able to reach "down market" to meet the informal sector's financial needs.

Organizations like K-Rep and PRODEM learned that, not only could they lend money, but they could also get it back and charge an interest rate that covered operational costs. This ability to cover costs was a fundamental transformation in the idea of working with poor people. With cost recovery came the idea that micro credit might not require a continual subsidy, and that microcredit institutions might be able to become self sustaining. Sustainability, in turn, would allow these NGOs to penetrate a market consisting of millions of poor people without access to financial services.

To grow, however, these organizations would need money. They began turning to the national financial sector for funds and developing links with local banking system. Mr. Kiplagat, the K-Rep board chairman, explained that, as his organization began to realize that if it grew, it might be able to do more than implement "little programs;" it might also be able to reach hundreds of thousands or millions of poor people with a range of financial products that poor people could use just as much, if not more, than credit.

This evolution in thinking spawned a new perspective within the field — one that viewed microfinance as part of the financial system and as contributing to "financial sector building." Mr. Christen argued that:

> The future of microfinance needs to include the provision of a whole range of financial services to very poor people on a profitable basis. If we are not profitable with the offering of this full range of microfinance services, then we will not, in fact, reach the millions of people around the world who could very well use financial services.

Microfinance now represents not only those interested in the field from the social perspective, but also from the financial sector perspective — those motivated to increase people's access to basic financial services that undoubtably will improve their lives. These two perspectives both contribute to economic development. And while they may diverge in the origin of their motivation, they converge in the common goals of increasing the poor's access to financial services, and improving the productivity and standard of living of people working in the informal sector.

4. The Democratization of Microfinance

The conference debate continued between those with a social perspective and those with a financial sector perspective. Those concerned with addressing poverty and unemployment spoke of the pressing need to address an essentially political problem in Africa in the short term. Those concerned about building sustainable MFIs argued that their strategy would address poverty eventually, sustainably, and more effectively. By developing the financial sector, they argued, microfinance could impact the lives of millions of poor Africans. This group contended that sustainable MFIs would "democratize" financial services for the masses, and that while this development would take time, it would last.

A participant argued that one quarter of the population in Africa owns three quarters of the resources. These inequities have been in existence for many years. By offering financial services to the majority without resources, microfinance could increase their share of the national "pie." Whether this imbalance in wealth is redressed through "banking with a developmental face" or by banks eager to make profits is immaterial. What matters is those without access to capital will gain access.

According to Mr. Kiplagat, the opening keynote speaker, redressing the inequities in Africa will require bringing this 75 percent into the banking system and equipping the banking system with the tools to provide, not only basic services to the poor, but also a range of products tailored to their needs.

> Between 75 and 80 percent of our population are engaged in commercial economic activities, but are not involved in the formal banking sector. These people need to be brought in. K-Rep's policy is providing financial services to these people involves not just giving them loans. To undertake commercial activities, they require a range of financial services, for example, health insurance. We have established a small think-tank with doctors, economists, and bankers to assess how to create a health insurance scheme that could answer the needs of the informal sector that cannot afford the premium of 6,000 to 8,000 shillings charged by formal institutions.
>
> K-Rep is also concerned about payment of school fees. The months of January and February are the hardest time for parents. K-Rep is exploring how to help families spread the payment of these fees. There is a huge market for school fees; finding the right instrument to tap this market and help the population will be challenging but could have an enormous impact on the lives of poor people in our country.

In answering participants' concerns about social needs, Ms. Rhyne argued — from the financial sector perspective — that the demand for financial services in Africa is "virtually untouched," despite a lot of efforts. She suggested that NGOs — despite their good intentions — will never be able to meet the demand. This daunting task will require the banking system's involvement with its far greater outreach. As background, Ms. Rhyne recounted the history of financial sector development in the United States, and the eventual "democratization" of financial services to meet these needs.

> At the beginning of the century, the financial system served only the elite. Ordinary Americans could not get any type of financial services. Over the course of the century, particularly in the 1930s, 1940s, and 1950s, there was a major transformation in the ability of the financial system to serve ordinary Americans. Today, most Americans have access to a whole range of financial services. They have credit cards, home loans, deposit services, consumer loans-any variety of services. That kind of transformation is the vision that we are looking for. Those of you in this room who are beginning to do this will, I think, look back in 10 or 20 years and find that you were the pioneers in a real transformation of your financial system.

Bob Christen explained that only through the kind of financial sector transformation that Ms. Rhyne referred to "can we ensure that the mass of people have access to basic financial services that will undoubtably improve their lives." He emphasized that donor funding will never be sufficient to reach the millions of poor people who could use credit and deposit services.

Banco Sol's experience supported the facilitators' suggestions. After a presentation on this MFI's profitability, a participant asked about the impact of Banco Sol's success on the banking industry in Bolivia. He asked whether other banks were trying to replicate Banco Sol's achievement. The Banco Sol representative, Hermann Krutzfeldt, explained that private institutions not only in Bolivia but elsewhere in Latin America were attempting to replicate "our" experience. Together, Banco Sol and these replications "have been able to democratize access to credit" in Bolivia.

By investing in microfinance, banks and NGOs can contribute to economic development and improve people's standard of living, these experts argue. Years have already been spent attempting to subsidize financial institutions to help the poor. Yet the evidence has shown repeatedly that this strategy does not help the poor, and it undermines the financial system. In countries where financial liberalization has taken root, profitable institutions — pressed by competition — will serve the needs of the poor.

CHAPTER 3: INSTITUTIONAL PROFILES

AFRICAN BANKS IN MICROFINANCE

- Agricultural Development Bank, Ghana
- Centenary Rural Development Bank, Uganda
- Commercial Bank of Zimbabwe
- Co-operative Bank of Kenya Ltd
- Co-operative Bank of Uganda
- Family Finance Building Society, Kenya
- Kenya Rural Enterprise Programme (K-Rep)
- Kilimanjaro Co-operative Bank, Tanzania
- King Finance Corporation Ltd, South Africa
- National Microfinance Bank, Tanzania
- Nsoatreman Rural Bank, Ghana
- Nubank - ABSA, South Africa
- Standard Bank of South Africa Ltd

AGRICULTURE DEVELOPMENT BANK

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Contact Name:
Mark Owusuansah

Year of Formation:
Institution: 1965
Microfinance Unit: 1965

Background: The Agriculture Development Bank (AgDB) was established in 1965 through an act of Parliament. The bank is public-owned, with the Government of Ghana holding 65 percent of shares and the Bank of Ghana owning the remaining 35 percent.

Mission Statement: The AgDB's mission is to build a strong customer-oriented bank run by knowledgeable and well-motivated staff, providing profitable, financial intermediation as a foundation for Ghana's overall economic development.

Enabling Environment: There are no specific laws in Ghana on microfinance regulation. While some adjustments were recently made to the laws to account for the differences among the many financial institutions in the country, there is still a need for a more specific framework to regulate micro-finance institutions. Towards this end, a microfinance desk at the Ministry of Finance has been created with the objective of coordinating a microfinance network where information and best practices can be shared. Several strategies to strengthen the microfinance industry were developed from the network meetings and research. These strategies include providing a framework to share information among microfinance practi-tioners; setting standards for the microfinance industry; engaging in dialogue with government and donors on different problems and issues that affect microfinance; and, generally providing advocacy and training in support of microfinance activities. With CGAP's assistance, training is being offered in financial analysis and portfolio management; market services; negotiation skills and customer care; internal control and supervision; strategy planning; product development; and management information systems.

Organization and Structure:

- Marketing - AgDB's target market for microfinance services are small-scale banks and NGOs, such as TechnoServe, that on-lend to groups and individuals. AgDB collaborates with these partners in the provision of microfinance products. In marketing these products, AgDB is very conscious of the needs of everyone along the chain from the end user to the intermediary organization to make money.
- Products and Services - AgDB is a fully-registered bank that provides commercial, corporate, and interna-tional banking services in addition to microfinance products. The bank has developed, piloted, and implemented a number of microfinance schemes, some which were sustainable and others which were not.

Loan Products/Lending Services: Through its partner organizations, AgDB provides production credit to rural producers and processors at an interest rate of 36 percent, plus a 2 percent administrative fee. Currently, there are four wholesale lending microfinance products. The first is a grain inventory credit program implemented with TechnoServe. The second product is aimed at small-holders producing seed-cotton for private companies through an outgrower scheme. These private companies are used as a vehical to lend to microentreprenures. The third product organizes lending from large, private agricultural companies to micro-entrepreneurs who are often outgrowers. The outgrowers' scheme promotes the production of food crops and non-traditional exports.

- AgDB established the grain inventory credit program in 1990 after TechnoServe had designed and success-fully piloted the product in 1989. Under this program, groups place their harvest or produce in storage, waiting to bring the crop to market until members can obtain the maximum price. TechnoServe negotiated with AgDB to provide loans to cover the costs of storage and consumption expenses until the product was marketed. Initially, Rabo Bank provided the loan guarantees until AgDB, convinced of the product's success, withdrew the guarantee. This product has since been expanded to additional crops such as coffee and cashews.
- AgDB has been offered the seed-cotton production product since 1992, when the bank began wholesaling credit through private cotton companies to numerous outgrowers in Ghana's three northern regions. Cotton companies apply to AgDB for credit on behalf of the outgrowers who they are sponsoring. The credit is used to provide agricultural inputs at planting time, and for the purchase and processing of crops at harvest. Loans are paid back when the produce is sold.
- AgDB offers wholesale loans through private plantation companies to outgrowers, consisting of approximately 500 small farmers.
- The newest product, offered by AgDB since 1997, is the nucleus growers' scheme. This is an adaptation between the cotton outgrowers' scheme and the plan-tation scheme, but limited to cash crops. This product offers small farmers an alternative market for their produce, as opposed to the large processing companies.

Outreach: Seventy percent of AgDB's lending portfolio is devoted to agriculture and 30 percent to commercial activities. Seed-cotton loans were extended to 10 private companies in 1997, which lent the funds to 74,000 smallholder cotton growers. The nucleus growers' scheme serves 2,400 growers through 52 private companies.

CENTENARY RURAL DEVELOPMENT BANK

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Adrian Sibo, Chairman
Dirk Van Hook, Chief Executive

Year of Formation:
Licensing (1983)
Start of Operations (1986)

Background/Mission: Centenary Rural Development Bank (CERUDEB) owes its existence to an initiative of the Uganda National Council of Lay Apostolate in the early 1980s, when the Apostolate attempted to find ways to promote the provision of basic financial services to the economically-disadvantaged, rural population. In 1983, the Centenary Rural Development Trust was registered as a non-bank financial institution which could take savings deposits, fixed deposits, and make loans. Operations began in 1986, and the Trust was transformed into a commercial bank in 1993, when current and foreign accounts were added to their list of products.

Enabling Environment/Regulations: Historically, economic and political instability in Uganda made commercial banking a nearly impossible proposition and deterred private investment. In 1993, Uganda underwent a financial reform program, assisted by the World Bank Financial Sector-Credit Project, at which time the existing banking legislation was created. In July 1994, interest rates were fully liberalized, and all limits on interest and administrative charges were removed.

While CERUDEB is a registered financial institution, there are a number of issues facing unregistered, NGO microfinance units, which will eventually have an impact on banks. In 1996, the Central Bank of Uganda halted commercial bank licensing due to the large number of new entrants into the market. The commercial banks were largely targeting the high-end, commercial and corporate customers in Kampala to the exclusion of rural clientele. The government-owned Uganda Commercial Bank, which previously serviced this market, closed down approximately two-thirds of its rural branches before it was privatized in 1998. In response, many NGOs began microfinance projects to provide financial services to the business people in rural communities.

Existing license restrictions, coupled with the lack of provision in the regulations for microfinance institutions, prevented many of these MFIs from being formally recognized or registered. After exerting pressure on the Bank of Uganda for recognition, the BOU entered into a dialogue with these organizations in 1996. All parties agreed that the BOU is the most suitable body to regulate MFIs in Uganda. The existing legal framework will be modified, and MFIs will be given guidelines on accounting standards and capital adequacy requirements. However, the bank does not intend to rush into legislation without proper research.

Area of Operation: CERUDEB's 9 branches are located in Arua, Hoima, Kabale, Kampala, Kyotera, Lira, Masaka, Mbarara, and Mityana. Approximately 71 to 73 percent of the bank's business is up-country (rural). The same services are offered to rural and urban clients. The approximate radius of operations for a branch is 30 kilometers.

Organization and Structure: While most of CERUDEB's business comes from small- and micro entrepreneurs, it is not a specialized bank nor has it formed a specialized microfinance unit. The Catholic Church of Uganda owns 70 percent of the bank, 18 percent is owned by the HIVOS-TRIODOS Fund from Holland, and 12 percent of the shares are held by SIDI, a French social investment company.

CERUDEB has a traditional, commercial bank structure. The board of directors, to which the chief executive reports, represents the bank's owners. Until 1988, the bank's board and management did not stress the importance of repayment and growth. The shareholders then replaced the board and managers with people who would emphasize commercially-viable practices and accountability.

Since microfinance activities are integrated into the general bank structure, special loan officers are not hired specifically for the microfinance program. Typically, newly-hired loan officers will take these accounts, moving to increasingly larger ones as they gain seniority. Loan officers typically manage a portfolio of 150 to 200 clients and US$160,000.

Marketing: CERUDEB has found a profitable market niche in lending to small and micro enterprises and attracts a large savings pool, predominantly from low-income households, to finance the bulk of its lending operations. Very few organizations provide services to this market niche at the rates that Centenary offers, resulting in very little competition. The development of CERUDEB products and services is largely demand-driven. Market research is achieved simply through daily contact with the 2,000 clients who enter CERUDEB branches daily. These clients are vocal about their appreciation for bank services and suggestions for improvement.

Products and Services:

- Lending Services/Loan Products: CERUDEB currently lends only to individual clients who have businesses that have been in operation for over one year. Bank management has been discussing the possible implementation of a group borrowing scheme to improve the outreach of the credit program; however the decision to initiate this scheme will ultimately depend on pricing. At the moment, it appears that individual lending is less expensive in Uganda than group lending. More research into the costing of these two methodologies will determine whether the bank will add group loans to their list of products.

CERUDEB's minimum loan is US$80. The maximum loan, given the core capital available, can be as high as US$250,000, with an average new loan of US$833. Eighty percent of CERUDEB's loans are under $1,700. CERUDEB is flexible in the types of securities it accepts from loan applicants. Land titles, business inventory, equipment, motor vehicles and personal property can all be used as collateral.

Many NGOs and banks in Uganda who are involved in micro credit are currently charging between 80 percent to 100 percent interest per annum, if the price of forced savings is included. CERUDEB's real interest rate for first time borrowers is 48 percent per annum. For repeat borrowers who have paid off 3 loans, this rate is reduced to 29 percent.

- Savings Products/Deposit Services: There are three types of savings accounts - regular, demand, and fixed term. Regular savings accounts provide instant liquidity to the passbook holder, offer a nominal deposit interest rate of 2 percent, and have low minimum and opening balances (US$10 and US$6 respectively). The fastest growing savings instrument is the passbook savings account.

The minimum deposit required to open a new savings account is US$10. The average deposit account is only $150. Most of the large, commercial banks have a minimum balance of US$200 to US$250, excluding many of Centenary's clients.

- Non-Financial Services: Centenary Bank does not provide non-financial services to its clients. There is no effort to organize groups, provide formal business management or production technology training or services. These services are considered to be beyond the scope of CERUDEB's mission as a commercial bank.

Outreach: CERUDEB grants 1,000 loans per month, largely (80 percent) to micro and small entrepreneurs for a total of 7,350 borrowers. Sixty-eight percent of the loan clients are repeat borrowers. The majority (71 percent) of these loans are granted to up-country (rural) clients. Only 27 percent of borrowers are women, despite a clear preference by loan officers to serve women clients.

The loan portfolio is diversified in terms of activities, location, and seasonality. Loans are made to three types of economic activities: (i) commerce (small retail stores), (ii) agriculture, and (iii) small and microenterprises. Agricultural loans — which account for 13 percent of CERUDEB's total portfolio — are primarily for processing and marketing of coffee and other crops.

CERUDEB serves a total of 80,000 savings clients, 73 percent of whom are located up-country (rural). More than 47 percent of these savers are women, representing greater than 32,000 low-income households.

Social Impact: The potential market for financial services, especially among small businesses and microenterprises outside of Kampala, is large. However there are no viable financial institutions prepared to serve this sector, with the exception of Centenary. In addition, Centenary's low savings account minimum and opening and monthly balance requirements brings savings services to the poorest segments of the population.

Investment/Subsidies: CERUDEB's contributors number over 50,000 individuals. When the Trust was formed, investors contributed to fund shares which are held by the Dioceses. CERUDEB has an investment portfolio of US$1,680,000 to insure liquidity and safeguard depositors. At the Bank's 1997 Annual General Meeting (AGM), 100,000 ordinary shares were converted into preference shares to insure that the contributors receive dividends. The AGM also declared that the first dividends will be payed from the profits of 1997.

Since 1993, CERUDEB has received technical assistance from the German consulting firm Internationale Projekt Consult (IPC) in the fields of credit, financial management, auditing and computerization. The bank has received technical and financial support from the Austrian Regional Bureau, The British Council, CGAP, CRS, DANIDA, European Development Fund, FMO a Dutch development agency, German Savings Banks' Foundation and most recently, GTZ. From 1992 to 1997, Centenary received a total of US$1,563,770 in managed and equity funds from donor organizations.

Technology: In order to improve operating efficiency and service, Centenary's board recently approved a plan to computerize the entire bank by October, 1998. Currently, all branches have their loan portfolios computerized, and five out of nine of CERUDEB's branches have their deposit accounts computerized.

Obstacles/Risks:

- CERUDEB has faced a culture of non-payment in their loan customers, largely as a result of the poorly monitored, welfare-oriented loans that had been granted by NGOs and Churches.
- In the past, CERUDEB experienced poor and weak management that did not stress the importance of repayment for the growth of the bank. This jeopardized Centenary's savings program in that customers did not trust the bank to handle their funds. In 1988, the bank's owners addressed these problems by increasing their supervisory role, hiring new, more commercially-oriented management, revising bank operations to be more efficient and cost-effective, and devising new loan monitoring systems.
- Due to the lack of skilled professionals in Uganda, Centenary initially suffered from a high turnover of staff who were recruited by other organizations. Salaries and benefits were substantially increased in 1995 and have since been kept at competitive rates.
- The risk of fraud at the branch level has been lessened through the computerization of records, thorough internal audit procedures, and the formation of an internal credit review committee consisting of the Branch Manager, Loan Officers, and the Loan Recovery Officer.

Innovations and Lessons Learned: In 1993, CERUDEB introduced a new approach to lending. Individual loans are carefully assessed before the loan is granted and performance is carefully tracked with loans classified as problems starting a single day beyond the due date. Defaulters are contacted immediately. This methodology reduced delinquency from 37.5 percent to 10 percent. Human resource development is another one of the strengths of the Centenary Bank. Evidence of this commitment includes a detailed, formal training plan, in-house workshops, competitive salaries, and a performance-oriented staff incentive program.

Plans: In the next five years, CERUDEB plans to triple the size of the bank to over 200,000 savers, 25,000 borrowers and 24 branches/agencies. With minimal staffing and a loan portfolio of US$ 300,000, it is anticipated that these branches will be profitable within 8 to 9 months. New products which will be introduced in the future include agricultural production loans, investment credit and home improvement loans, as well as more attractive deposit instruments.

Commercial Bank of Zimbabwe

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Dyson Mantwega, Senior Manager for Community Banking

Year of Formation:
Institution: 1991
Microfinance Unit: 1996

Background: The Commercial Bank of Zimbabwe Limited (CBZ) was formerly the Bank of Credit and Commerce Zimbabwe, which was a joint venture between the Zimbabwean government and Bank of Credit and Commerce International (BCCI). BCCI collapsed in 1991, at which time the Government of Zimbabwe took it over and renamed the bank the Commercial Bank of Zimbabwe. When the bank once again faced collapse in 1995, a turnaround program was initiated, which has brought CBZ to the position of second in the Zimbabwean financial sector vis-à-vis other international banks, and third in deposit mobilization.

In April 1996, CBZ launched the Community Banking Pilot Scheme with assistance from the British Department of International Development (DFID) and CARE International. This scheme involved the establishment of a microfinance unit within the bank.

Mission Statement of Microfinance Unit: The mission of the Community Banking scheme is to increase employment and income for micro and small enterprises (MSEs) in the informal sector through the extension of credit and savings services in urban and peri-urban areas of Zimbabwe.

Areas of Operation: The CBZ currently has 18 urban and peri-urban branches including: Harare (6), Chitungwiza (2), Bulawayo, Gokwe (2), Gweru, Kwekwe (2), Mutare (2), Chimanimani, and Masvingo. Community Banking units are in the Bulawayo, Chitungwiza, and Highfield (high-density suburb of Harare) branches.

Organization and Structure: In August 1997, CBZ was successfully privatized. Government stockholding was reduced from 100 percent to 20 percent, with 27 percent of the shares going to local institutions, 26 percent to the general public, 25 percent to an international technical partner, and 2 percent to the staff.

Community Banking products are provided through separate specialized units in the bank. These units use a separate methodology and approach and specially assigned staff as compared to the regular banking operation. Credit officers working in Community Banking are remunerated in the same way as other CBZ staff; however, the nature of their job differs in that a larger portion of their time is spent in the field.

Marketing: CBZ has targeted a market located in the most marginalized areas of the city and high-density suburbs. Given the current lack of interest in this market by the other six commercial banks in the country, CBZ has been largely successful in this marketing approach.

Products and Services: Clients are encouraged to grow with the bank and products are offered to accommodate borrowers and savers as they move from micro, to small, to mainstream savings and loans. This graduation process is relatively seamless as clients are still dealing with the same bank in the same branch.

- Loan Products/Lending Services: CBZ, through the Community Banking Scheme, offers micro and small loans for businesses and agriculture. Promotion and marketing activities aim to institute repayment disci-pline and a culture of savings to potential borrowers. Loans are disbursed strictly on the basis of the individual and group track record of sound savings, group cohesion, and intended use for viable commercial undertakings. Lending is largely based on the group solidarity methodology, although alternative forms of collateral such as individual savings, moveable assets, and personal guarantees are also accepted. Borrowers are required to have been operating their microenterprises for two to three years, to have a CBZ savings account with a minimum balance of US$25 (Zim$400), to be willing to form a group with other business people in the area, and to attend community bank training sessions.

Community banking loans are offered in the range of US$31 (Zim$490) to US$2,200 (Zim$35,000), with the average of approximately US$130 (Zim$2,100). Repayment periods vary, depending on the customer's requirements, from 3 to 12 months. Payments include interest which, at 38 percent to 40 percent per annum, is slightly below market rates and well below the informal sector rate of 25 percent per month.

- Deposit Services/Savings Products: CBZ has developed special savings products designed to demonstrate to Community Banking clients that they are recognized by the bank as respected clients. Separate Community Banking passbooks are given to clients to distinguish them from the banks other customers. Interest rates of 15 percent are paid on savings and a low minimum balance has been set.
- Nonfinancial Services: CBZ offers training in business management to its Community Banking clients.

Outreach: CBZ has served a total of 1,237 small and micro loan clients as of March 1998, 67 percent of whom were women. Of these clients, 63 percent were in the manufacturing sector, 27 percent in trading, 7 percent in services, and the remaining 3 percent in other types of business. Savings clients numbered 2,297 in March 1998.

Social Impact: The investment that CBZ has made in marginal communities through the extension of credit to small and micro entrepreneurs has resulted in the creation of 1,269 jobs, the expansion and establishment of businesses, and a rise in the standard of living.

Financing: In addition to the US$2,194,140 from DFID for startup and a loan guarantee fund and the technical assistance provided by CARE, CBZ receives World Bank funding for the promotion of small and medium scale enterprises. Approximately US$844,000 of these donor funds was spent in startup costs such as research and development, staff training, recruitment and equipment (computers, motorcycles, etc.).

Technology: In 1997, CBZ began installation and training of a new, on-line, real-time processing system to provide speed and convenience for customers, and enhance internal risk-management systems. It is anticipated that all branches will be on this system by the end of 1998. In May 1997, automatic teller machines were installed nationwide and a wide-area network between branches and the central office was put into place.

Obstacles: Due to a history of soft, unmonitored loans provided by the Zimbabwean government and NGOs, a culture of nonpayment has emerged in the Community Banking target market. To address this problem, the bank has had to pay particular attention to the assessment of loan applications, induction training, and loan monitoring and follow-up.

Innovations and Lessons Learned: The CBZ coupled their strengths as an established institution with existing infrastructure and skills in the provision of financial services, with strategic partners that had experience and technical knowledge in the provision of microfinance. The benefits the bank has derived from the Community Banking scheme include:

i) The mobilization of savings allowing the bank to overcome liquidity constraints
ii) Access to an untapped market niche of over 95 percent
iii) Increases in the number and mix of clientele
iv) Diversified savings instruments
v) An positive increase in the reputation and recognition of CBZ

vi) Additional offers from donors for the provision of funds for on-lending

vii) Human resource development through training and study visits for key staff

Plans for the Future: The Community Banking Scheme has performed beyond the bank's expectations, as the savings deposits mobilized continue to surpass the amount of out-standing loans granted. As a result of these early successes, the program will be expanded this year to other suitable population centers where the bank has branches.

Co-operative Bank of Kenya, Ltd.

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Year of Formation:
Institution: 1991
Microfinance Unit: 1996

Background: The Co-operative Bank of Kenya (CBK) was formed in 1965, when coffee farmers joined together after being marginalized by commercial banks. At the time, the Government of Kenya regulations required that US$ 8,400 (500,000 Kenya shillings (Ksh)) in capital be mobilized. Bank owners were only able to raise half of this amount, but were advanced the additional US$ 4,200 (250,000 KSh) by the government.

Mission Statement: Since the bank's inception in 1965, the main objective has been to provide savings and credit services to small and micro clients.

Enabling Environment: CBK was incorporated as a cooperative society. In 1968, the institution was formally licensed by the Central Bank. CBK's regulation is divided; operations and management fall under Co-operative Society regulations, while financial transactions are monitored by the Central Bank.

Area of Operation: The CBK currently operates two microfinance agencies in Nairobi and two pilot branches in Maro and Karatina.

Market Targeted: CBK's members are micro and small enterprise owners in the areas of industry, agriculture, fishing, housing, and banking.

Products and Services:

- Loan Products/Lending Services: CBK issues loans directly to individuals, and to cooperatives that, in turn, on-lend these funds to individual members. Loans are small and short-term. The base interest rate paid by cooperatives who are shareholders in the bank is 25 percent; all other loans carry an interest rate of 27 percent. Depending on the amount of collateral available, an additional 0 to 6 percent is charged on top of this base rate. For individual loans, an additional 0.2 percent administrative fee is charged.

  An arrangement has been made with the donors of K-Rep, whereby a loan fund guarantee has been deposited at CBK for on-lending to K-Rep at a nominal interest rate of 30 to 35 percent; a portion of this is offset by the interest earned from the loan guarantee.
- Savings Products/Deposit Services: CBK mobilizes deposits from individuals and through cooperatives.

Outreach: Fifty-seven thousand shareholders have invested in the bank through their cooperatives.

Financial Performance: The total value of loans and overdraft disbursed by the bank since 1965 is US$ 114 million. Annual profits are currently US$ 8 million.

The CBK is the third largest bank in Kenya in terms of capitalization, with a total of US$ 30 million. In addition to investment from shareholders, the CBK has received donor funds from USAID, the German Government, and the Danish International Development Agency (DANIDA).

Co-operative Bank of Uganda

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Year of Formation:
Institution: 1960s
Microfinance Unit: April 1997

Background: For years, the Uganda Co-operative Bank (UCB) has struggled to stay alive. Declared insolvent throughout the early 1990s, the Co-operative Bank gradually built up its assets and has had a positive balance sheet for two years running. USAID played a critical supporting role in the development and restructuring of the bank. Currently, the UCB is the second largest commercial bank in Uganda, with a national operational network that extends deep into the rural areas. Since its inception in the 1960s, the bank has served small rural farmers.

During the restructuring process in the 1990s, the UCB hired a number of new senior managers who introduced the idea of microenterprise lending, later called the Agency Program. In July 1997, the UCB opened its first Microfinance Agency outside of Uganda's largest market.

Enabling Environment: see Centenary Rural Development Bank

Area of Operation: The Co-operative Bank's Agency Program was mandated to open six agencies nationwide. As of August 1998, all six agencies had begun operations. Two of these agencies are located in Kampala, one is within an hour's drive from Kampala (peri-urban), and three are in the rural areas of the northern half of the country. With the good performance of the Agency Program, the Board agreed to place microenterprise products in 22 of the UCB's other 24 branches. An expansion proposal has been completed; it includes the establishment of an microfinance center, additional support for the existing six agencies, and the introduction of microfinance banking products into the 22 branches.

Organization and Structure: Originally, the bank's owners were the co-operative unions and building societies it served. High default rates and a dwindling capital base resulted in the restructuring of the bank. Currently, the UCB has a typical bank structure with a board of directors and a managing director. Below them are the senior managers and branch managers.

The Agency (Microfinance) Program is a specialized unit, however, and their functions are joined, or grafted, to the main bank at several key points. Branches act as the Agency's bankers. Agency managers must report to branch managers and all transactions pass through the branch before being reported to the head office. Agency managers were typically second-level UBC managers, such as branch accountants or assistant branch managers. This ensures a commercial orientation to agency operations and that agency managers have sufficient financial and banking experience. Each agency manager is assisted by a credit supervisor and a savings supervisor. Credit officers and other staff in the division receive the same pay as their counterparts within the bank.

The Agency savings division is run and staffed directly through the UCB with approximately three banking assistants per agency working under the savings supervisor.

Marketing: The UCB, through the Agency Program, is targeting the largest market in the Ugandan economy —microenterprises. Customer service is stressed among agency staff as one of the prime marketing tools, especially since these small-scale customers are not accustomed to receiving personalized service from the larger commercial banks. The Agency Program initially marketed its services stressing savings mobilization. The credit products were then introduced as complementary to regular savings.

Products and Services: In addition to the Agency Program products, the UCB offers the standard commercial banking services. The Agency Program's strategy is to commercialize the microfinance products that have been developed by NGOs working in the country and adapt them to the bank's operations.

- Lending Services/Loan Products: The Agency Program offers three credit products:

Credit services are offered to individual members in groups of five. Members often form these groups because they have businesses in common. Ten groups are joined together into an "economic group." This allows agency personnel to meet with loan clients once per week in groups of 50. Several weeks of training are required before a loan is granted. The agency then develops a timetable of hourly meetings and serves a maximum of 40 groups; 8 groups per day for 5 days for per week.

The UCB also offers wholesale loans to existing groups; the product is similar to the standard village bank but without the internal fund. Each group is responsible for retail lending, monitoring, and collecting the loans. Training is also mandatory for group lending through this program.

UCB's third product is credit services to individual entrepreneurs who have successfully paid off a minimum of three loans through either of the group lending programs. The average loan size is US$93. The first loan term is approximately 12 weeks. The add-on interest rate charged by agencies is 10 percent per 3 months, with a 2 percent loan application fee.

- Savings Products/Deposit Services: There are two types of savings products offered in the agencies. The first is a typical passbook savings account. The second is a hypothecated savings account which is the forced savings account required of all borrowers. The hypothecated account has a minimum deposit requirement of US$2 per week. The average balance for both accounts is US$60. Interest is paid on both types of accounts. There are no fees associated with these savings products.

Outreach: Access and Impact: As of August 1998, the Agency Program had formalized 7,672 micro credit clients, 55 percent of whom are women, and issued 10,961 loans valued at $1.7 million. Agency savers totaled 14,361 as of Aug., 1998, with a portfolio of $1.4 million.

Within two months of opening its first agency outside of Owino market, the program had mobilized US$121,800 in small deposits from close to 2,000 savings clients. Within eight months, the agency had to rent additional meeting space to accommodate the large number of solidarity group borrowers.

Social Impact: The UCB has contributed to the achievement of three objectives in terms of national and community development: (I) the provision of financial services to microentrepreneurs increases the level of national savings; (ii) the transfer of financial, and indirectly, human, resources from the rural to urban areas is reduced and local circulation of resources through reinvestment in communities is increased; (iii) customers understand that the money they are borrowing is their own and that they are not receiving charity, but helping themselves.

Financial Returns: The UCB's initial cost estimate for opening an agency was US$300,000. On average, each new agency has only cost US$110,000 because of the UCB's diligent financial management. The UCB requested US$65,000 from USAID for each agency to serve as loan funds, however, when the agencies opened, the bank found that savings were high enough that USAID funds could be reprogrammed for future use when the loan demand is projected to increase dramatically. Within 7 months, the first agency was able to cover their costs, and within 10 months, it had erased its accumulated deficits, 14 months ahead of schedule. This agency was located in a central market in Kampala, therefore this rapid growth pattern may not be replicated completely, but the rural agencies are showing similar, if not as spectacular, trends. For example, the second agency opened in Mukono was able to mobilize US$346,000 from 2,679 savers in its first seven months of operation.

Financing/Subsidies: USAID has played a critical supporting role in the development of the Agency Program. The initial USAID award for restructuring UCB was for US$1 million, which the UCB matched at 42 percent. A subsequent award of US$0.3 million brought the total to US$1.3 million, which was then granted at the same matching rate. The USAID award pays the salary of the microfinance specialist/program manager. This subsidy was required initially to start up the Agency Program. Eighty-three percent of the Microfinance Program's income (apart from donor funds) is earned through interest and fee income.

Technology: Agency savings divisions use the same software as the other savings divisions in the branch offices. Special programs were designed for the credit division to track loan activities and the flow of funds through agencies. These programs have increased the speed and efficiency of agency group transactions to the point where approximately 50 transactions, (i.e. 200 general ledger posting entries), are processed in five minutes. This is especially important when 50 clients are meeting every hour, eight hours a day for five days each week. The bank's profitability is calculated on a branch-by-branch (or agency-by-agency) basis to allow management to effectively track each location's performance.

Obstacles/Risks: The UCB's transition into microfinance activities began in April 1997. There was some resistance from board members and senior managers, who come from a traditional commercial banking background; however, they were eventually convinced of the potential profits to be made in targeting this sector.

The next challenge is to place the products into existing bank branches. As the pilot program for entry into the branches was being implemented, the branch manager attempted to give the microenterprise officer additional duties, not fully understanding the officer's job description. Another problem is that of separating the expenses associated with microfinance provision from branch expenses. Extensive microfinance training and sensitization are underway in the bank and its accounting system is being strengthened to successfully track these costs.

Innovations and Lessons Learned: The relationship between the branches and agencies has been very successful in enhancing the profitability of new agencies. The branch managers act, in a way, as mentors for the new agency managers, providing advice on organizational and financial issues. On several levels, the UCB has used this technique of mixing previous bank staff with financial expertise with staff who are trained in microenterprise provision to ensure that both banking experience and the ability to serve agency customers are present.

The Agency Program is also innovative in its marketing and outreach efforts. Each agency is treated as a separate building block that must focus its efforts to achieve a critical mass of customers. Pro-active marketing, well-developed products, and customer service are the tools used by the agencies to achieve this critical mass. Agencies are placed in locations convenient to a large number of microentrepreneurs, such as in a marketplace. Products were designed using the 20 to 30 years of microenterprise knowledge gained by organizations such as BancoSol and BRI. Research is constantly being done to determine how to improve and adapt these products. Extensive and continuing training prepares front-line staff to deliver microfinance products. Finally, agency efficiency and performance are constantly being monitored to ensure that problems are quickly identified and solutions developed immediately.

FAMILY FINANCE BUILDING SOCIETY

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T.K. Muya, Executive Chairman

Year of Formation:
Registered: 1984
Savings: 1985
Microcredit: 1986

Background: Family Finance Building Society (FFBS) was founded and registered in 1984 and started operations in early 1985. The bank was licensed as a deposit-taking institution, and its initial objectives were to mobilize long- and short-term deposits for on-lending short-term to businesses and long-term for mortgages. On realizing that long-term deposits were not available, FFBS adjusted its objectives and focused its attention on serving and lending to small and micro clients, including small businesses and women's groups. Management also realized that the demand for micro credit in Kenya far exceeded supply, providing a profitable market niche for the institution. FFBS has followed these adjusted objectives since 1986.

Mission Statement: The FFBS founders had a vision for the institution that came mainly from the farming communities where small-scale cash cropping was the main source of income for the local population. Since crop payments are seasonal, a large portion of family funds are tied up at certain times of the year. FFBS' vision is to mobilize these seasonal resources in times of plenty and lend them back to the same community when they are most needed. FFBS' mission is to provide financial services to these families for a better future.

Enabling Environment: Kenya's financial sector faced serious, macroeconomic instability and rampant political corruption in the early 1990s. Rapid inflation, decreasing real interest rates, lowered GDP, and increasing exchange rates all occurred during this period because of poor macroeconomic policies, lack of control and corruption in the Central Bank, and weakness in the National Legislation. Moreover, there was a legal crisis in the financial sector caused by the lack of compliance with banking regulations.

In July 1993, monetary policy was tightened significantly and the economy began to stabilize with the positive implementation of structural reforms. Five years later, the Central Bank is still in the recovery process, largely because of the billions of unrecovered shillings which were borrowed by government banks through political connections. Despite an interest on the part of the Government of Kenya and the Central Bank to adapt to and support the microfinance sector, very little has been achieved to date.

Area of Operation: The first branch was opened on February 1985 at Kiambu township 15 km. from Nairobi. Since then, FFBS has opened four additional branches in the most densely-populated areas of Kenya's Central province, including Githunguri in Kiambu District, Gatundu and Thika in Thika District, and Murang'a in the Murang'a District. A sixth rural branch is currently under construction at Kangare in the new Maragua District.

Organization and Structure: FFBS is governed by a board of directors, which formulates policies and defines objectives. These objectives are implemented by the Executive Chairman with the assistance of the Operations Manager, the Internal Auditor, the Marketing Manager and the six Branch Managers. FFBS has a total staff of 50, including 8 managers, 10 supervisors, clerks, and junior staff. Each of the six branches has an average of 7 employees and is headed by a

Branch Manager. FFBS management is from the same farming communities as the bank's clients, and thus is aware of client needs and problems.

Many functions occur at the branch level. The branches are semi-autonomous from the head office in that branch managers are empowered to make decisions such as the terms of interest rates on deposits. Loan approvals are also decided at the branch level, with the head office advising the market rate. Branches are regularly audited by the Internal Audit Division of the head office to ensure that they conform to bank regulations.

Marketing: Most of FFBS marketing efforts are targeted towards potential savings customers, largely small-scale coffee and tea growers. This market of small and micro-savers form a natural niche for the bank. In addition, the prices for coffee and tea are relatively stable compared to other crops. Tea growers are paid monthly, while in the case of coffee, payments are irregular, and the price fluctuates. This makes it more difficult for FFBS to assess potential loan customers. As a result, the bank increasingly targeted more tea growers for their credit program.

One of the bank's major marketing advantages is that it is small and community-based. Service is personalized and clients are familiar with the staff. If decisions need to be made, they can be done immediately by the Branch Manager. Customers therefore feel loyal to the bank even after they have graduated to commercial-bank status.

Products and Services:

- Lending Services/Loan Products: FFBS offers short-term (unsecured) loans and longer-term (secured) loans. Over the past 12 years, short-term lending to agriculture and microentrepreneurs has formed the core of the bank's lending business. This matches the pattern of deposits, which are largely short term and small. The short-term loans offered by FFBS to their clients are recycled each year by placing community pressure on the lender to repay on time. In addition, borrowers do not want to risk being rejected for new loans due to late or non-payment. All loans are unsub-sidized; interest rates charged are set at market rates. Interest rates are slightly higher for unsecured loans.
- Loans for Women's Groups: FFBS offers a special loan product to women's groups in conjunction with the Kenya Entrepreneurship Promotion Program (KEPP) through a program called Credit Link. KEPP identifies women entrepreneurs who are doing business in the open markets or who have ideas for an enterprise, but lack financing. These women are organized into groups of five and trained in bookkeeping and business operations by KEPP, and in financial management by FFBS.
- Loans for Microentrepreneurs- Individuals and Groups: Loans are offered to microentrepreneurs individually, or in groups that are coordinated through KEPP. The maximum first loan is US$360 for individ-uals and US$1,800 for groups. Loans made to women's groups do not require collateral. Other loans do; however, FFBS is flexible on the issue of collateral, which can include vehicles, machin-ery, savings, salaries, household goods, etc.
- Agricultural Loans: Agricultural loans, particularly to small-scale tea and coffee growers, use the crop and land as security. Questions regarding production over the past few years and in the coming season are included on the loan application.
- Savings Products/Deposit Services: Passbook savings accounts are FFBS' main savings product. These accounts range from ordinary to current savings accounts for business clients and children. Through these accounts, clients receive their salaries or crop sales proceeds as well as voluntary savings. FFBS also offers fixed deposit accounts. Interest rates on savings are generally 4 percentage points above commercial bank rates. FFBS offers savings and deposit accounts with lower minimum balances, greater liquidity flexibility and more attractive interest rates than their competitors.

- Nonfinancial Services: FFBS offers free business advisory and counseling services to their customers. For women's groups, these services are offered with the assistance of KEPP.

Outreach, Access and Impact:

- Loan Clients: FFBS has lent billions of shillings to micro borrowers. Some of these borrowers, especially women, have gone on to become successful business people who have graduated out of being micro clients.
- Savings Clients: FFBS serves over 30,000 savers, most of whom live in rural areas.

Social Impact: The introduction of FFBS' unsecured loans to tea farmers and women's groups has had a far reaching effect. The social impact of these financial services are especially evident in the rural tea and coffee growing zones, where improvements have been made in the production of tea and other goods and services, contributing to increases in GDP and reduced poverty.

Financial Performance: The growth of FFBS has been slow, but steady. In 1995, the institution reported its first profit of Kshs 2.4 million (before-taxes). By 1997, profits had grown to Kshs 11.7 (before taxes). Costs are kept low through cost sharing and low staff levels pr branch. Furthermore, FFBS has adopted a conservative dividend policy and, as a result, reserves and liquidity have continued to grow.

Technology: All FFBS branches are computerized. However, due to limited resources, FFBS has not been able to network branches or introduce more modern banking software. There are plans for these improvements in the future.

Obstacles: FFBS' obstacles to profitability include: (i) competition with large commercial banks; (ii) the high costs of government regulation; (iii) high costs associated with maintaining a MIS and capacity-building; (iv) the costs of training of borrowers; (v) the political obstacles faced by the bank include payment delays to coffee or tea growers as a result of political disturbances; and (vi) corruption within regulatory authorities.

Innovations and Lessons Learned: FFBS has been innovative in selecting a target market in an area they know well: specialized commodities. When the bank decided to increase its customer base to microentrepreneurs and women's groups, they approached a local NGO that understood the market well, forming a profitable partnership that greatly expanded the bank's outreach. FFBS has also recognized the need to be customer oriented and has trained all staff in customer service. Its low cost structure enables the institution to return a profit where many are unable to.

Plans for the Future: FFBS aims to increase its assets from Kshs 300 million to Kshs 600 million by the end of the year 2000, and to Kshs 1 billion by 2002, an average growth of 20% per annum. This is an ambitious plan compared to past average growth rate of 4% but can be achieved through more aggressive marketing and opening additional branches.

Kenya Rural Enterprise Programme

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Kimanthi Mutua, Managing Director

Year of Formation:
Institution: 1984
Microfinance Unit: 1990

Background: K-Rep Holdings Limited (K-Rep) is a microfinance development organization established in 1984 with USAID funding as a project of Boston-based World Education Inc. The project was incorporated as a Kenyan NGO in 1987 and in 1993 received a certificate of registration as an NGO. Initially, K-Rep operated its program activities through partner institutions, which implemented microenterprise promotion projects. This strategy proved unsatisfactory on virtually all programmatic and financial parameters, (i.e., impact, efficiency and sustainability). K-Rep therefore changed its strategy in 1989 to include direct lending activities and adopted the minimalist approach through which it launched two experimental micro credit delivery systems code-named 'Juhudi' and 'Chikola.' Both systems deliver credit through groups. But while Juhudis are formed by K-Rep, Chikolas are pre-existing savings and credit associations whose members have some experience in managing members' savings and credit activities.

Mission Statement: From its inception in 1984, K-Rep's mission has been to empower low-income people, promote their participation in the development process, and enhance the quality of their lives. The strategy used to achieve this mission has included the provision of loans, training, and technical assistance. K-Rep also seeks to assist the microfinance industry in general by testing innovative methods of providing banking products for the poor and conducting operational research in this field.

Enabling Environment: see Family Finance Building Society

Areas of Operation: K-Rep operates in five areas of the country including west and east Nairobi, Eldoret, and west and east Mt. Kenya. The organization has 6 branches (including the Nairobi head office) and 21 field offices. A branch office serves clients within a radius of approximately 15 km., depending on the communication network.

Organization and Structure: K-Rep is led by a board of directors which is responsible for maintaining the vision of the organization. The board's composition is diverse and there are no representatives of any specific interest group or organization.

K-Rep has two major divisions: financial services and non-financial services. Each division (financial and non-financial services) is headed by a deputy managing director who is assisted by various departmental managers. K-Rep's branches act as separate cost centers with a manager, accountant, and credit officers.

K-Rep has growing rapidly with the introduction of direct lending services. In 1995, K-Rep had 112 employees (58 women, 54 men), compared with 93 in 1994, and 24 in 1991. Approximately 66 percent of these employees work in the Financial Services Division with 37 percent located in the head office.

Marketing: In Kenya, at least 80 percent of the population are involved in informal economic activities that are not served by the formal banking sector. This population is thus an extremely large potential customer base.

Products and Services:

- Lending Services/Loan Products: K-Rep is currently implementing three credit schemes, directly through group lending and indirectly through other NGOs.
- Under the Juhudi scheme, K-Rep helps establish groups and provides loans to individual members. Loan repayment is the joint responsibility of the entire group. The Juhudi scheme is a 1987 adaptation of the group-lending methodology developed by the Grameen Bank in Bangladesh.
- The Chikola scheme provides credit to individual entrepreneurs through existing rotating savings and credit associations (RoSCAs). Under the Chikola scheme, K-Rep identifies an existing group to whom it provides a single loan that is then retailed by the group to its individual members. After a Juhudi group has been in existence for some time, it may transform, with the approval of K-Rep, into a Chikola group.
- K-Rep also maintains a wholesale credit facility for selected NGOs that on-lend to their clients using the Juhudi credit methodology.
- Savings Products/Deposit Services: K-Rep is not authorized to mobilize deposits from the public. Group savings are held at nearby commercial banks in accounts to which K-Rep is a signatory. Individual savings by a member are recorded in a passbook pro-vided by K-Rep. Where a group has saved more than the required amount, it may withdraw the excess for group use. The interest earned on savings belongs to the group. Deposit interest rates became significantly positive in 1995. The real rate earned on one-year deposits in 1995 was 10.7 percent. The minimum deposit varies as per the commercial bank. K-Rep negotiates with these banks on behalf of the groups.
- Other Financial Services: K-Rep manages an insurance fund equal to 0.5 percent of loan amounts borrowed by various members. The insurance fund is used to cover loan balances in the event of the death, incapacitation or prolonged illness of a borrower. The fund is operated at a regional level and decisions affecting the fund's use are made by a committee comprising the area manager, the credit officer, and Kiwa representatives.
- Non-financial Services: The functions of the Non-Financial Services division include research, training, technical assistance, information dissemination, NGO loan portfolio evaluation, and consultancies. By providing these non-financial services, K-Rep aims to assist other MFIs in Kenya, and other countries in the region, to improve their products and services, and ensure that a larger number of clients are reached.

Outreach: As of May 1998, K-Rep has served approximately 15,000 clients, 12,000 of whom were servicing loans. This is a 102 percent increase since 1991, the first full year of the direct lending program. On average, K-Rep's customer base has been growing at a rate of 13 percent per year. In 1995, thirty-five percent of K-Rep's borrowers were women. Today, women represent the majority of K-Rep clients. Loans granted for the purpose of commerce and trade amounted to 77 percent, 14 percent went towards manufacturing enterprises, and 9 percent towards services.

Social Impact: K-Rep clients have not only been empowered through the microlending scheme, they have been given the opportunity to participate in the development process. With loans from K-Rep, microentrepreneur clients have expanded their businesses, increased the number of employees hired, and enjoyed an enhanced quality of life. By accessing commercial banks for savings, K-Rep clients have been introduced to the banking system, which has reduced their fear of banks and integrated them into the formal financial system.

Financing: K-Rep has funded its loan programs and institutional investment activities through two primary means: internally-generated funds in the form of loan program "reflows" from loan repayments and operating profits; and externally-derived ones through donor grants and loans.

K-Rep was dependent on donor funding for on-lending and institutional support in the early years of the microfinance program. Between 1991 and 1995, the organization received

US$ 5.8 million (Ksh 352 million) in donor grants, with the majority coming from USAID and the Ford Foundation. During 1991-1994, grants accounted for between 69 to 87 percent of consolidated total income. In 1995, grant funding as a proportion of total income was at approximately 87 percent. In the past few years, K-Rep has changed the nature of its relationship with donors in an attempt to take a step towards sustainability. Through an agreement with the Co-operative Bank, donor funds are held in a K-Rep account which is used for loan collateral. These loans are granted to K-Rep at a nominal interest rate of 35 percent.

Technology: In 1995, K-Rep adopted the computer software, Micro-Banker, to meet its information management needs.

Obstacles and Risks: A major obstacle setback for K-Rep with respect to financing and capital availability is its inability, as an NGO, to collect savings from clients. This situation has served to increase K-Rep's dependence on donor funding. When registered as a fully commercial bank, the organization will be able to begin collecting deposits to address this problem, however, K-Rep will also be subject to increased regulation and liquidity requirements.

Innovations and Lessons Learned: A study of the underlying cause of loan defaults (related to both borrower and lender action) produced the following observations:

- Commercial not subsidized interest rates should be charged
- The borrower should be treated as a client, not a beneficiary
- Full responsibility for credit assessment should not be given to groups alone (often they are not objective enough with colleagues)
- Thorough loan screening and appraisal is needed.
- Incentives for early repayment improve the repayment rate

Other lessons learned include:

- The Chikola scheme has the advantage of using existing groups of entrepreneurs who run small-scale and microenterprises but who may need additional access to credit. Since such groups and businesses already exist, the initial costs of group formation are not borne by K-Rep.
- K-Rep has learned the importance of decreasing dependence on grants and subsidized loans over time.
- The realization that client input is valuable. For example, allowing more flexible loan sizes and frequent group meetings are two primary examples of innovations through interaction with Juhudi borrowers. These resulted in greater potential outreach to clients, reduced costs of intermediation, and improved K-Rep's financial sustainabilty.

Future Plans: The K-Rep Board of Directors has adopted a new strategy to separate the sustainable (microenterprise lending) activities from the unsustainable (non-financial) ones. The separation strategy involves establishing a bank, thus enabling the organization to mobilize savings to support its lending functions, and providing additional financial products such as venture capital, mortgages, and health insurance. The NGO portion of K-Rep will act as a microfinance research organization, which will continue to develop and test new products for the poor. K-Rep, the NGO will hold 25 percent of the shares of the new bank, while the remaining 75 percent will be sold to investors such as the IFC, FMO, the African Development Bank, Triados Bank and ShoreBank of Chicago, and the K-Rep board and staff.

Kilimanjaro Co-operative Bank

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Year of Formation:
Institution: 1996
Microfinance Unit: 1997

Background: The Kilimanjaro Co-operative Bank (KCB) is a new model for a bank in Tanzania. Established in 1996, the bank's founding members were 168 primary marketing cooperative societies in the Kilimanjaro area. Initially, a trust fund was formed with the objective of creating an alternative to the exorbitant lending rates charged by commercial banks. The trust fund was later registered as a full-fledged banking institution.

Enabling Environment: There is no special mention or consideration of MFIs or microfinance units in commercial banks in the existing banking legislation of Tanzania. The need for such legislation is recognized within the Central Bank for the protection of depositors, to avoid systematic risk to the stability of the financial sector, and foster public confidence in the growing number of MFIs, however, regulators are still largely unfamiliar with this sector. Progress to date includes a nationwide study, initiated by the Bank of Tanzania and the World Bank, and conducted by K-Rep, to research the capacity of existing MFIs and review the regulatory and supervisory laws affecting MFIs. On the basis of this study, the government, together with donor organizations, made recommendations and drew up preliminary guidelines and principles for a revised regulatory and supervisory framework. Efforts were made to involve all stakeholders in this initiative including donors and MFIs.

Area of Operation: KCB operations are focused specifically in the Kilimanjaro region. The bank aims to maintain this rural focus by restricting shareholding to primary rural cooperative societies, and savings and credit cooperative societies. No individual shareholders are accepted. While much of the bank's business consists of urban groups, the intention is to recycle these funds to the rural areas.

Organization and Structure: Chairpersons of shareholding cooperatives participate in one general meeting held each year, and six chairpersons are elected to the bank's board management committee. Election of these members is conducted democratically, with one representative from each district. Given the large representation of customers within ownership of the bank, leadership and decision-making are very much client-driven. The KCB operates out of a main office, without supplementary branches.

Products and Services: KCB products include savings and checking accounts, time deposits, overdrafts, guarantes for customers, assistance to other cooperative organizations to open banks, and training for the general public in cooperative banking. In the future, KCB plans to collect deposits from and grant loans to shareholding organizations — the primary cooperative societies, and savings and credit co-operative organiza-tions (SACCOs); they, in turn, will collect savings and on-lend funds to their membership. These loans will be used primarily for school fees, microenterprises, and agricultural inputs, while savings are primarily from crop sales. KCB has not yet begun to on-lend to its member primary societies and SACCOs because they are not performing well. KCB first intends to provide training to its members so as to be able to use them as agents. Fourteen SACCOs have already been trained.

Financial Performance: KCB's 168 founding organizations contributed equity capital of US$480,000 from coffee sales. Additional shares cost US$7.50 and the entrance fee charged is US$15.00. By September 1998, KCB had 170 primary cooperative society members and share capital of US$720,000 from coffee sales. By 2001, the bank aims to reach the Bank of Tanzania requirement for a commercial bank of Tsh 500 million or US$741,000. The bank received technical assistance and funding for a General Manager for the first four years of operation from the Rabobank Foundation, located in the Netherlands.

Technology: Bank operations are very streamlined and efficient. Branches are computerized and clients are served in less than five minutes.

Obstacles: KCB's main weaknesses are as follows:

- KCB has a weak internal capacity to handle microfinance but has good banking practices. The bank has hired new staff — avoiding employing former NBC and CRDB employees. New employees need training in good practices and rural and microfinance.
- KCB is vulnerable to the failures of its major shareholders and key depositors: the primary cooperative societies and savings and credit co-operative organizations (SACCOs).Most of these organizations have poor record and reporting systems.
- Loan applicant assessment and selection within member organizations is often not based on the microenterprise and the borrower's ability to repay, but rather on the tendency of cooperative management to want to use all the loan funds earned through deposits.

Innovations and Lessons Learned: KCB's major strength is that the bank is rooted in, and owned by, primary cooperative societies. This provides KCB with the following advantages: (i) access to a large savings base through SACCOs such that KCB does not have to deal directly with thousands of individ-uals, thus providing a cost-effective outreach strategy; (ii) increased outreach for the provision of credit products by employing SACCOs as conduits; and (iii) the guarantees provided by SACCOs for loans to individuals enhances KCB's repayment enforcement mechanism.

Plans for the Future: KCB has identified the need to expand their presence to accommodate customers who have to travel a long way to obtain banking services. This will be done by using the SACCOs as agents — when their capacity is strengthened — and by organizing mobile banking services to serve SACCOs.

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Year of Formation:
Institution: January 1993
Microfinance Unit: November 1993

Background: King Finance Corporation Limited (KFC) is a retail lender of small loans that are mainly used for housing and educational purposes. Its target market encompasses lower-end income earners that traditionally have fallen outside of the formal banking network. To gain the additional funding needed for growth, KFC has recently broadened its shareholder base to include institutional investors, and management and staff.

Mission Statement: In its mission to provide credit facilities to previously unserved communities, KFC aims to create wealth for its clients, as opposed to alleviate poverty.

Enabling Environment: As a non-traditional, retail lending institution, KFC activities are exempt from the Usury Act restrictions on lending rates; therefore, considerable flexibility exists to generate wide interest margins on collateral. The bank is, however, restricted from mobilizing savings from its customers.

As with other corporations in South Africa, KFC must be sensitive in business and hiring practices with respect to gender issues and serving disadvantaged communities. The corporation is very careful not to give the impression of a large, commercial bank taking advantage of the poorer segments of the population.

Area of Operation: Initially, the company operated in the Free State and Northern Cape. Since 1994, it has broadened its geographic scope to encompass Gauteng, Kwa-Zulu Natal, and the Western Cape and expanded its branch network in large towns outside the major metropolitan and industrial areas. At present, KFC has branches in 44 major cities and towns across the country.

Organization and Structure: A privately-owned company, 56 percent of its shares are held by Baobab Solid Growth, an investment trust company listed on the Johannesburg Stock Exchange. Management, staff, and black economic empowerment groups also hold shares in the company thus reducing the stake initially held by KFC's investor, the IDT Finance Corporation. Bank operations are kept lean and decisions are made quickly without a lot of red tape. The corporation is run by a board of directors and a chief executive officer.

KFC has a total of 155 staff. This includes 5 regional managers, 85 loan officers (including branch managers who also act as loan officers), and 60 administrative staff.

Market Targeted: KFC is working in a market niche that was previously unserved by commercial banks. The bank's target market encompasses lower-end income earners who traditionally have fallen outside of the formal banking network. Both branch site and client selection take into account previous credit performance, when this information is available.

Products and Services:

- Lending Services/Loan Products: KFC provides small to medium-sized unsecured personal loans from US$80 (R500) to US$960 (R6,000) to qualifying borrowers, mainly for housing and educational purposes. All applicants are screened against a checklist of pre-qualification criteria; these include stable employment and strict enforcement of conservative repayment to earning limits. Repayments are made through paycheck deductions that are arranged through employers. A few exceptions to these criteria have been made for microentrepreneurs who own their own business.

The maximum period negotiated for loans is 16 months; this limit restricts KFC's exposure to defaults by borrowers. Though all loans are unsecured, credit risk is reduced through a security deposit of between 6 to 12 percent of the loan's gross value; this is repaid with interest after the final installment is made. Credit life insurance, which covers outstanding capital balances in the event of the borrower's death, is obligatory and charged up-front by way of a deduction from the loan funds advanced.

Incentives are provided for payments made early or on time. Customers who have successfully paid back three installments are entitled to a credit line with the bank.

Outreach: KFC's client base is approximately 110,000 customers, over 99 % of whom are employed workers, mostly with the civil service, with the remaining 1 % made up of microentrepreneurs who own their own business.

Financial Performance: KFC has enjoyed a fairly consistent monthly 10 % growth as seen in its expansion from 17 to 44 branches since 1994. Loan repayments have been in the order of 99.7 %, and non-interest income has closely matched operating expenses after incentives have been paid. Margins are supplemented by income earned on administration costs charged over the period of the loan, interest income on security, and funds on deposit.

The initial capital for KFC's lending operations was raised from founding shareholders's startup and bridging loans, as well as from the IDT Finance Corporation, for which a minimum capital adequacy of 10 percent was warranted. These loans have been repaid; however, KFC's sustained growth necessitated additional funding from a number of sources including increases in shareholder equity and the accumulation of retained income. Therefore, while the bank is not subject to external regulations, KFC is well capitalized with shareholder's funds of approximately US$9.6 million (60 million Rand).

Technology: The corporation makes use of an internally-developed loan monitoring system that enables early detection of arrear accounts. Computers are not networked, therefore, couriers are used to maintain documentation flow between the branches and the head office. Data backup is maintained on a daily basis and adequate disaster recovery facilities are in place. Growth of the bank or additional sophistication of loan products could necessitate significant IT investment.

Obstacles: Potential risks for KFC include competition, changes in the regulatory environment that remove the exemption to the Usury Act, a breakdown in the control environment, or an increased incidence of large-scale retrenchments or unemployment of borrowers.

Innovations and Lessons Learned: KFC has a number of systems in place to reduce credit risk including small loans, short repayment periods, payroll deductions, retention of a security deposit, mandatory creditor insurance, thorough loan assessment and monitoring, and commercially viable interest rates.

National Microfinance Bank

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James Karashani, Managing Director

Year of Formation:
Institution: October 1997 (NMB split from NBC)
Microfinance Unit: October 1997

Background: The government-owned National Bank of Commerce (NBC) was, for many years, the only bank operating in Tanzania. In 1992, the government relaxed regulations to allow private and foreign banks to enter the country. Initially, NBC was able to maintain a commanding 80 percent of the market share, however, operational inefficiencies and financial losses prompted the decision to privatize the bank.

The wide branch network throughout the country made it difficult for the bank to find investors, particularly in those western areas where infrastructure was poor. In 1997, the decision was made to divide the bank into a number of different organizations including the National Bank of Commerce, Limited; the NBC Holding Corporation; and the National Microfinance Bank of Tanzania (NMB).

Mission Statement: NMB was established due to the government's concern over the lack of financial services in the rural areas and the potential loss of what services did exist as a result of the privatization of NBC. The NMB was given the task of fostering microfinance businesses in Tanzania. An international consulting firm is being hired to facilitate the assessment of procedures and the introduction of new and cost-effective ways of handling products.

Enabling Environment: see Kilimanjaro Co-operative Bank

Area of Operation: NMB inherited 95 branches in all 81 districts of the country from the National Bank of Commerce in 1997, the majority of which are in the rural areas. Several branches were originally scheduled to be closed down due to poor infrastructure and the government assessment that rural commercial banking was not profitable. Nonetheless, in an effort to preserve the only existing rural finance network, the government initiated the NMB as an alternative and based on an assessment that microfinance could be profitable in rural areas.

Organization and Structure: The NMB is a government-owned institution, however, a private investor is being sought to take over 70 percent of the bank's shares. The Government of Tanzania will retain the remaining 30 percent until the bank is viable, at which point these shares will be sold to small, private Tanzanian investors through the stock exchange. The present board of directors is government-appointed. The CEO supervises three managing directors, who are in charge of mobilizing savings. The bank currently does not offer credit services to clients, but plans are being made for a credit division to be developed and lending staff hired. The 950 employees that moved from the NBC to NMB have had virtually no training in the provision of microfinance services. The bank is currently seeking funding and technical assistance for this training.

Marketing: The National Microfinance Bank has the advantage of an existing customer base on which to build the new bank. Of the 25 percent of Tanzanians who save in formal financial institutions, 75 percent are NBC customers.

Products and Services: The savings products offered by the National Bank of Commerce before the transition were fairly easily adapted to microfinance, as was the system of government payments and other fund transfers. However, the NBC had very few loan products readily available for the microenterprise market. As a result, the NMB is predominantly involved in deposit services. Full credit services and other financial products will be made available to clients in the future.

- Loan Products/Lending Services: The NMB intends to move into credit services through a pilot project geared to microentrepreneurs and small farmers. NMB's plan calls for a 12-to-18 month program to design and implement a micro-loan product and basic administrative procedures in three test markets. This initial phase will be followed by an equally long second phase to bring this product to 6 additional branches and a final phase that extends credit services to all 95 branches.
- Savings Products/Deposit Services: Approximately 500,000 savings accounts were transferred from NBC to NMB with an average balance of US$ 333 and a total of about US$ 200 million.
- Other Financial Services: Several other products offered by the NBC were transferred along with the branches to the NMB including government salary payment systems, and bank- to-bank transfers.

Social Impact: The network of rural banking branches established by NBC throughout Tanzania is, in many areas, the only formal banking institution available. Without NMB, many customers would have to travel over 50 miles to access banking services and collect their salaries.

Technology: Of the 95 NMB branches, 15 are individually computerized with no network in place. The remaining branches operate manually, in some cases without even electricity or telephones. The staffing of these branches is therefore very important in terms of banking skills and accountability.

Obstacles: In addition to the assets inherited by the NMB, such as the large customer base, the bank has taken on a number of liabilities that will be very expensive to address. First, the 95 branches are widely distributed around the country with very little infrastructure or technology in place for effective communication. In forming the NMB, the government has made a commitment to keep all branches open and to offer a complete range of microfinance services. This is a big challenge for a bank whose board, management, and staff have no training in the provision of microfinance services and no viable credit product developed. Secondly, the government has created expectations on the part of Tanzanians that will be challenging to meet especially considering the resources and time frame available.

With financing, research, and training, the NMB will hopefully be able to successfully undergo the transition, from a commercial bank to a microfinance institution and from a government institution to an efficiently-operated private company.

Nsoatreman Rural Bank

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Year of Formation:
Institution: 1984
Microfinance Unit: 1996

Background: The Nsoatreman Rural Bank (NRB) was founded in 1984 by a group of people from the Nsoatre community in central Ghana in the Brong Ahafo region with the objective of offering financial services to support productive activities in the local area and enhance the rural community's income. Nsoatreman is currently one of Ghana's top five rural banks. In 1996 Nsoatreman formed a partnership with Freedom from Hunger, which helped the rural bank develop a microfinance product called Credit with Education (CWE).

Mission Statement: NRB's mission is to improve the standard of living in the communities it serves by mobilizing rural savings for credit. The objective of the Credit with Education Program is to alleviate poverty, chronic hunger and malnutrition; ensure household food security; empower women; inculcate clients in savings and credit awareness; and disseminate quality information on health and nutrition.

Enabling Environment: The Bank of Ghana (BoG) initiated a special community banks scheme specifically to provide microfinance to rural communities. Due to the low requirements needed to start a community bank under this scheme, problems were encountered with the institutions' management, staff quality, and capital. To address these problems, the government formed the Rural Finance Inspection Department, which specializes in the provision of technical support to the rural banks, and raised the liquidity level to 62 percent to address the lack of capital. While rural banks generally welcome regulatory measures that ensure sustainability and legitimacy, the successful banks that are performing well believe that, had they been consulted, better measures could have been devised. As a result of this raise in the liquidity level, many rural banks now resort to borrowing from commercial banks at high interest rates to lend to customers.

There are no specific laws in Ghana to deal with microfinance regulation. Some adjustments were recently made to these laws to account for the differences among the many financial institutions in the country. For instance, the BoG has agreed to allow rural banks that have consistently performed well, including Nsoatreman, to graduate to "community banks." This change in licensing will allow banks, like Nsoatreman, to expand their geographic scope beyond the current 50 km. limit.

Area of Operation: NRB works in small rural communities ranging from 100,000 to 200,000 in the Brong Ahafo region. The head office is located in Sunyani, and five additional branches are located in neighbouring Chiran, Yamfo, Jinijini, Tochiman, and Nsoatre. The branch and head offices each serve between 1,200 and 2,500 clients depending on their location.

Organization and Structure: NRB is owned by 7,600 shareholders from the community in and around the Nsoatre. Employees also own shares. Day-to-day banking operations are overseen by a team of managers with a general manager as the head, supported by two assistant managers, two project officers, an accountant, and an internal auditor. There are 45 supporting staff (excluding credit agents). Of the 69 credit agents working for NRB in March 1998, nine are working in the microfinance (Credit with Education-CWE) program; six of these are women. A program coordinator oversees CWE staff.

Marketing: Nsoatreman's CWE program targets a market of low-income, rural women between the ages of 18 and 65 years who reside in the local community. These women have limited knowledge of banking, no collateral, an average annual income of less than US$200 and access to less than 4 acres of land.

Products and Services:

- Lending Services/Loan Products: NRB has 4 major loan products:
- Small Holder Credit, Input Supply and Marketing Project loans represented 44 percent of the banks's outstanding loan portfolio in December 1997. SCIMP loans are International Fund for Agricultural Development (IFAD)-financed and concessional loans to NRB to lend to groups of smallholder farmers for processing, production, and marketing their crops.
- Individual loans — with an average loan size of US $331 — represented roughly 30 percent of NRB's loan portfolio as of December 1997. Individual loans are usually made to traders and other service providers in the local area.
- Overdraft facilities are available for those customers who receive their salary payments through the bank. Over-drafts usually carry a one-to-six month term and represent about 13 percent of the bank's portfolio.
- CWE — the microfinance component of NRB's portfolio — represented 9 percent of the banks total loan portfolio in December 1997. The CWE methodology involves organizing clients (all women) into groups of five or six individuals and making loans to two group members at a time, on a staggered basis, with all group members jointly liable for repayment. First-time borrowers are eligible for US$45 and each subsequent loan can be 50 percent larger. The largest loans offered are for US$300; after which borrowers are referred to the main NRB loan products.

All borrowers must contribute 1 % of the loan amount into a group fund to be used by the association to cover defaults, buy supplies, and make internal loans to the members. Loans are repaid in 16 weekly install-ments of principal and interest. The interest rate is 17 percent (including the 1 percent contribution used for CSA operational expenses), and the annual interest rate of CWE loans is 48 percent, excluding the 1 percent administration fee.

- Deposit Services/Savings Products: Savings services consist of voluntary demand deposits, savings deposits, and time deposits. For CWE clients, mandatory groups savings are held by the bank for the members. Group savings are used as a guarantee against members who default on their loans. NRB pays its demand deposit and savings deposit customers a 25 % interest rate, and its time deposit customers a 35 % interest rate. The minimum deposit is pegged as low as US$1.50. The minimum balance required for demand deposits and savings accounts is cedis 3,000 (US $1.35).
- Non-financial Services: Non-financial services include the supply of agricultural inputs to farmers, farm extension services, consumer credit services and training. CWE customers are trained in basic bookkeeping, record keeping, and business/financial management techniques at the time of group formation. CWE group members also receive health and nutrition information and training.

Outreach: In December 1997, NRB had 13,710 active loan clients. Of these, 1,179 were CWE group members, the majority of whom were rural women. As of March 1998, NRB had served 18,678 savings clients, 74 percent of whom were rural women.

Social Impact: The CWE program has improved clients' knowledge of primary healthcare and nutritional status of families, increased awareness of savings and credit, and enhanced bookkeeping and business management skills. Additionally, group formation is as a product in itself that builds community leadership and leaves behind a cohesive organization that can independently continue providing credit or other services to its members.

In a broader sense, NRB has helped to alleviate poverty and hunger, and ensure food security in its areas of operation.

Technology: The bank's operations are only partly computerized. However, plans are in place to develop and install a fully-computerized MIS with the assistance of CGAP. The bank has recently established an internal audit unit to strengthen its internal controls, accuracy, and accountability.

Obstacles/Risks:

- The lack of an effective MIS is a weakness that has made effective supervision difficult, especially given the bank's rapid growth. New systems need to be in place in the near future to avoid uninformed management decisions. Such systems will require intensive staff training and financial costs that will initially increase the bank's costs.
- The micro lending program has tended to attract more borrowers than savers, which has created a obstacle for the bank in raising capital for lending. Given that the Central Bank requires 52 percent in secondary reserve and 10 percent in primary reserve, the NRB has had difficulties in meeting the demand for credit. This, combined with the initial high costs associated with CWE program implementation, has made an initial subsidy necessary for reaching break even within a short period of time.
- Ghana has been plagued by high inflation and high interest rates; in August 1997 the inflation rate was pegged at 26 percent.

Innovations and Lessons Learned: The extension system and group lending methodology have allowed the bank to bring financial services to greater numbers of people, while saving clients the expense of traveling to larger towns to do their banking and the risk of carrying money over long distances. Group lending also saves the bank money through group administration and a higher possible case load for credit agents. Customers in the microfinance program, who are largely unfamiliar with banking procedures, are more likely to access banking services through this kind of group lending thus increasing NRB's business. Finally, the recovery rate for group loans has proven to be higher due to peer pressure and group monitoring.

The education process for CWE clients is very important in raising client's confidence and success. Clients will continue to grow and increase their savings and loans therefore allowing the bank to expand operations.

Future Plans: To facilitate the bank's growth and raise its efficiency, NRB plans to invest in staff training and to develop a computerized MIS.

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Year of Formation:
Institution: 1992 (ABSA)
Microfinance Unit: February, 1996 (Nubank)

Background: Nubank is a division of the Amalgamated Bank of South Africa. The ABSA group was formed in 1991 through the merger of two building societies in South Africa. Later, two additional banks joined the ABSA group creating one of the largest banking institutions in Africa. With the merger, ABSA began assessing the various market segments to determine which products the bank could continue to offer profitably given the existing infrastructure. Nubank is a special microfinance division that was created out of this process in 1996. The formation of Nubank was timely in a political context when all large South African corporations were striving to create the image of sharing resources with the poorer segments of society.

Mission Statement: The mission of Nubank is not just short-term profitability; Nubank is determined to take on the social responsibility for creating jobs, providing banking services to the poorer segments of the population, supplying microfinance services, and raising the standard of living of their clients. Improvements in the lives and businesses of Nubank clients will, in turn, promote the growth of the bank.

Enabling Environment: See King Finance Corporation, Ltd.

Area of Operation: The first Nubank branch was opened in a town 170 kilometers west of Johannesburg on February 15, 1996. Since then, three additional branches have opened: one in the Orange Free State, a second in the Northwest Province, and a third in Johannesburg. The bank is now planning to open an additional 8 outlets.

Organization and Structure: While Nubank is a division of ABSA, it had to design its operations from scratch, including new methodologies, policies, and procedures geared to the provision of microfinance. A staff of 40 were hired for the microfinance division. Despite its seperate operations, Nubank does have to comply with ABSA Group's standards regarding equipment procurement, remuneration scales, and outfitting branches.

Market Targeted: There are approximately 12 million economically active individuals in South Africa, 3 million of whom are in the microbusiness sector. Of these 3 million microentrepreneurs, only 30,000, or 1 % are currently accessing credit. Commercial banks provide only 0.3 % of these loans, and the remaining 99.97 % are provided by NGOs.

Products and Services:

- Loan Products/Lending Services: Research missions to Southeast Asia, South America, and other parts of Africa in 1994 yielded an initial micro loan methodology which was a distillation of the models seen in other countries. Unfortunately, when tested in the South African environ-ment, it became evident that this method-ology would need to be modified. The bank is currently in the process of redesigning their micro loan products.

At the moment, Nubank only offers a single microenterprise product which accounts for 10 % of the bank's loans. The remaining 90 % are consumer loans, which are being offered as an interim measure until the micro loan product is fully developed and widely offered. The interest rate charged is 50 % per annum, as opposed to the current industry rates of from 80 to 110 % compounded, and loan shark rates of up to 30 % per day. Given the political climate, Nubank decision-makers choose rates that balance profitability and political image. Loan periods depend on the needs of the client. Most loans are from 3 to 6 months, however, equipment loans tend to have a longer term.

- Savings Products/Deposit Services: The average Nubank savings account is US$100, on which a 6 % interest rate is paid. There is no direct relationship between credit and savings customers. Only three of the existing branches offer savings.

Outreach: The vast majority (99 percent) of all Nubank's loans are granted to black South Africans living in townships. The average annual income of the bank's 7,500 micro-enterprise customers is approximately US$3,000.

Social Impact: With only 10 % of South Africa's microentrepreneurs gaining access to credit, Nubank is poised to provide a large service to this sector. As a commercial bank making a profit through the provision of microfinance, Nubank might also serve to attract other institutions to this market.

Financing: Nubank has not received any donor funding.

Technology: All Nubank branches are fully computerized with a comprehensive accounting system that tracks performance on a branch-by-branch basis.

Obstacles:

- When Nubank began offering its micro loan product, the bank discovered that it did not have the capacity to emulate models like BRI, Banco Sol and K-Rep given the funds available and costs associated with the South African context. This resulted in poor loan-assessment monitoring and caused arrears and defaults.
- Low population densities in South Africa decrease the loan officer-to-client ratio and increase transportation costs making it difficult to reach a critical mass in any one area.
- Nubank's costs are five to eight times what they might be because, as a division of the ABSA Group, Nubank is required to install systems which meet with ABSA standards (this includes more expensive computers and accounting systems).
- Because its financing comes from private shareholders, Nubank is expected — like any business venture — to break even within 18 to 36 months with an ROI of at least 25 %. Nubank has been unable to achieve the volume necessary to produce these numbers with microenterprise loans and thus has been offering consumer loans.
- Increased savings would assist the bank in dealing with expectations regarding profitability, however, there is a prohibitive US$10 million Central Bank capital liquidity requirement which comes as a result of Nubank's affiliation with ABSA.

Innovations and Lessons Learned: Nubank has learned of the importance of keeping costs as low as possible, site branches in the heart of the communities served, processes and documentation simple, and loan sizes small and for short periods of time.

Future Plans: For Nubank to succeed in the future, the bank will need to define and focus on its market more clearly, continue to reduce costs, design appropriate and effective microfinance products, and ensure that the Board understands and supports this strategy.

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Year of Formation:
Institution: 1862
Microfinance Unit: 1994

Background: Standard Bank was established in South Africa more than 136 years ago. In the past, the bank developed its standard products to accommodate the needs of larger clients who generated the most profits. As a result, low-income clients who patronized the bank to access salaries and wages had no option but to use these standardized services, that were inappropriate for their needs. This resulted in poor returns for the bank and dissatisfied cus-tomers. To expand its customer base, Standard developed an initiative 4 years ago called "E-Bank," to provide simpler, more appropriate products for low-income clients. E-Bank uses modern technology to provide financial services for the masses. Started in 1994, E-Bank has since been renamed AutoBank E, and is an alternative elec-tronic delivery channel within the Standard Bank network. Standard has also launched a new service called E-Plan, a two-in-one account that offers access to both income and savings.

Mission Statement: The mission of Standard Bank is to be the best financial services group based in South Africa, with the most satisfied customers.

Enabling Environment: See Nubank

Area of Operation: Standard has opened 64 AutoBank E centers delivering the E-Plan product. E-Plan currently handles in excess of 2 million transactions per month.

Organization and Structure: Standard Bank has a staff of 26,750. The bank has hired trained managers experienced in the provision of microfinance to support the needs of E-Plan customers and staff who speak the local language.

Marketing: E-Plan is geared towards formal and informal sector low-income earners, who are largely employees of a corporation or the government, and small and medium sized entrepreneurs. Market research indicated that E-Plan micro-savings customers were looking for easy access to their funds at nearby locations with safety protection. These characteristics are the basis for the design and marketing of the E-Plan savings product. E-Plan also uses promotional incentives that include monthly prize draws and free life insurance.

Products and Services: The products offered to clients through E-Plan include savings, transactions, and electronic banking facilities for micro, small, and medium-sized customers.

The microfinance products offered to clients are predominantly electronic deposit facilities with current and savings account options. Clients are able to access their accounts, receive paychecks, and make deposits through automatic teller machines (ATMs). The wage-payment service is organized so that employers pay the bank a fee to allow employees a certain number of free withdrawals per month. A fee is charged to the client for additional transactions. Transaction fees are designed to encourage the use of E-Plan whereby clients are charged US$1.66 (R10) for branch transactions versus US$0.45 (R2.70) for using ATMs. Interest rates are paid on a tiered basis that depends on the client's account balance. On an average account balance of US$62.50 (R375), 3 percent per annum is paid.

To overcome the problem of customer illiteracy, trainers are available at the electronic banking sites to instruct customers and assist them with transactions. In addition, ATMs have been modified to have pictorial instructions and biometric recognition (fingerprints). Biometric recognition also ensures safety and security for customers.

Outreach: Standard Bank serves a total of 5 million customers. A total of 2,286,002 E-Plan savings accounts have been opened to date, with an average 55,100 new accounts each month.

Social Impact: Through E-Plan, Standard is not only serving customers who were previously unserved by banks, they are also accommodating those who were being pushed out by exclusionary policies designed to keep the masses out of commercial banks for the sake of image and better service to more profitable customers.

Technology: By automating their micro savings product, Standard has taken advantage of the network of 2,158 automatic teller machines and the many thousands more of other banks in South Africa.

Obstacles/Risks: Initially, Standard offered micro loan services to its clients. After three years, this facility was closed down for the following reasons: 1) Standard Bank, like other corporations in South Africa, is very sensitive to the image it portrays with respect to servicing the poorer segments of the population. To make its micro lending scheme profitable, the bank needed to charge interest rates in the order of 50 to 60 percent, which reflected poorly on the bank's corporate image; 2) The integration of micro lending services into such a large bank presented operational difficulties; and 3) The lack of collateral available to micro loan customers did not fit well into the standard assessment procedures of the bank, thus creating problems with the more conventional management and decision-making staff.

Future Plans: Given that the bank is mobilizing such a large amount of savings from their micro clients, Standard plans to re-initiate the micro loan program to return some of these funds back to this market segment.

ANNEXES

- Agenda for the Commercialization of Microfinance
- Participants List
- Keynote Address: Bethuel Kiplagat
  Is Microfinance a Good Business Opportunity in Africa?
- Evaluation of Conference

AGENDA

DAY ONE, MAY 12, 1998

THE PROFITABILITY OF MICROFINANCE IN AFRICA

8:30-8:45

Welcoming from Conference Sponsors

8:45-9:15

Keynote Speech:

"Is Microfinance a Good Business Opportunity in Africa?"

Speaker: Bethuel Kiplagat, Chairman of K-Rep

9:15-9:45

Purpose, Agenda and Introductions

9:45-10:15

What Do We Know about the Profitability of Microfinance?

10:30-12:30

Successful Commercial Experiences in Microfinance

12:45-2:15 Lunch

2:15-3:30

Can Microfinance be Profitable in Africa?

3:45-5:00 cont'd:

Can Microfinance be Profitable in Africa?

5:00-5:30

Synthesis of Panels: What Have We Learned?

5:30-6:00

Open Discussion with the Audience on the Issue of Profitability

7:00 Reception and Dinner

DAY TWO, MAY 13, 1998

INNOVATIONS REQUIRED TO MAKE MICROFINANCE SUCCESSFUL

8:30-8:45 Welcome and Agenda for Day Two

8:45-9:00
The Commercialization of Microfinance,
Robin Bell, USAID MBP Project

9:00-11:00
Lending Methodologies & Products
This panel will explore lending methodologies -- from group lending to individual lending -- that have been successful in banks in reaching microentrepreneurs.

11:00-11:15 Coffee Break

11:15-12:30
Savings Methodologies & Products
Panel Focus: What savings methodologies/products in banks have been successful in reaching microentrepreneurs?

12:30-2:00 Lunch

2:00-3:15
Organizational Innovations for Banks in Microfinance
What are the best ways for banks to incorporate microfinance into bank operations? This topic will be discussed in three concurrent panels.

3:15-3:30 Coffee Break

3:30-4:30
Innovative Strategies for Delivering Microfinance Products
What are the best ways that banks can increase their outreach and deliver their microfinance products to large numbers of microentrepreneurs?

4:30-5:45
Open Discussion with the Audience and Synthesis of Panels

5:45 Close of day. No dinner engagement is planned for this evening.

Day Three, May 14, 1998

Policies and Regulations Affecting Microfinance

9:00-9:30

Welcome to Central Bankers and Day Three Agenda

Bob Christen

9:30-10:00

Keynote Address

Kanga, Chief Economist, Bank of Kenya

10:00-10:20

Central Banks and Microfinance

Grace Rubambey, Bank of Tanzania

10:20-10:45 Coffee Break

10:45-12:00

Creating an Enabling Environment for Microfinance

This panel will discuss the importance of interest rate policies to microfinance profitability.

12:00-2:00

Lunch Banquet and Presentation

by Peter Harris, Citibank

2:00-3:30

Regulating and Supervising Commercial Banks in Microfinance

Central bankers from three countries-Ghana, Tanzania, and Uganda-will explore effective ways of regulating microfinance.

3:30-3:45 Coffee Break

3:45-5:00

The Case of Ghana: Creating a National Strategy to Support Microfinance

Panel Focus: This panel will explore the development of a national strategy for microfinance in Ghana.

5:00-5:30

Closing Remarks and Discussion

Wrap Up by Bob Christen and Beth Rhyne

5:30 Close of the Conference - Closing by the Sponsors

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Keynote Address: Is Microfinance a Good Business Opportunity in Africa

by Bethuel Kiplagat

Chairman. Ladies and Gentlemen. Kallibooney as we say in Kenya, Welcomes. And I say that this morning, Mount Kenya welcomed you. It unveiled itself. I don't know whether you are able to see, but as I was driving here, there it was in all its glory and all its splendor.

One day, there was somebody riding a horse along a footpath. And, as the horse was galloping along, the rider saw a small bird lying on its back with its feet pointing to the skies. The horse stopped. The man stopped and talked to the bird saying, " What on earth are you doing? This is rather strange." The bird replied back and said, " Are you the only one in all this area that doesn't know that the sky is going to fall?" So he said, " How are you. What can you do with your legs up? And in any case, they are very thin legs. They will be crushed." He said, " If only you can get down and put your hands and your feet up and the horse can do the same, and, if everybody else does the same, we will be able to hold the sky from falling."

That is, for me, the story about microenterprise. That small little loans that we may give or small deposits that are given can grow into something much, much bigger and could even help. Those of you who have been in Kenya, with all the debate about the deficit, if we are able to contribute a little each perhaps the governor of the Central Bank will smile and reduce the interest rates. But my story with microfinance goes all the way back to the 1970s, early in the 1970s. I would like to share with you that journey because it is for me, a tremendous honor and real privilege to be here with all of you here and particularly, those of you coming from the commercial banking sector. We have always looked at you up there, and thought you are not at all interested in us working in the fields and also in the slums of our cities trying to access credit to feed our small businesses.

When I was with the National Council of Churches, I was appointed to be a member of the board of what I might consider to be the first microfinance institution in the country, called Partnership for Productivity in Western Kenya. I sat on that board for two or three years. We were giving out loans to business communities. With a lot of frustration, after three, four, five years, we didn't really see our way forward at all and I wondered whether it was worthwhile continuing with that exercise. That institution limped along for many years is still here, and is a very important pioneer in this field of microenterprise.

The second impact, again when I was with the National Council of Churches, in the position where I was, staff used to come to me after the tenth, fifteenth of the month, when we see the month is bending and it is difficult to make ends meet. In fact we do have a very nice dish called, " making the end meet.," so you can continue to push the week. When you are on the twentieth or twenty-first of the month, when there isn't much money around, we have to use vegetables rather than meat and we have a vegetable called "soukamiki" which is for the popular people.

The staff used to come, and sit there almost humiliated in asking for an advance. I always found it extremely difficult in that relationship, when I had to say no. I wondered what I could do to change these relationships. I heard about the credit union system and called a Catholic nun to come and talk to our staff, which she did. Then we established the first credit union at the Council which is going strong up to this day.

The great joy is sometimes when I am walking through the streets of Nairobi, somebody stops me and I don't know his name , " But sir, you remember?" and I say, " But, I really can't remember all those things." " But, you know that credit union which you helped us to start has helped me, and I bought a piece of land at home. I have built a house and I have educated my children."

It is tremendous joy when one hears all those kinds of things. Also, when I was Prime Minister Secretary and Minister of Foreign Affairs, I was very much concerned about the plight of the junior staff, clerks, drivers, problems of housing, school fees, funerals. I called them together to say, " What can we do? We cannot advance money which is government money because the Auditor General will put you on his list and then you will be squeezed by the Public Accounts Committee."

So, as a result of all of that, we were able to form again another cooperative, a credit union within the Ministry, for housing. We collected quite substantial sums of money and bought a piece of land just outside the outskirts of this city.

Then I started knocking at doors, in fact, I came to USAID, " Please, can you give us a loan to build houses for our staff?" They said, " Well, that is not so easy. We cannot agree."

Then I went to 237 Celta Fricke, which is supposed to be actually dealing with housing for very poor houses. Again, the door was shut in front of me. I went to a commercial bank and again, they turned away. The land is still there. Today worth than fifteen, twenty or thirty times. I hope, at tea time, as I see some commercial bankers here, we can discuss that proposal, and please don't charge me 28 percent interest rate.

We then started on K-Rep. Really, we learned a lot as we went along. To begin with, our intention was to support rural enterprises mainly for people to uplift the enterprises and industrialization, if you wish, through agriculture in the rural areas. We went out loaning money to groups of people together for communal projects.

We loaned money to farmers working together to produce vegetables. We loaned money to groups of pasturalists selling their animals and it was groups we failed at that we needed to deal with the groups as such. Believe me, we failed miserably. We never got back any of the money that we lent out. But, we didn't give up. We went back to the drawing board and said, " What went wrong?" We debated and we said, " No, I think we better do the normal development work by investing money like everybody else." But, the board and the staff, in particular, thought, but how helpful is this going to be? This is how our micro credit scheme started, by the courage of the staff who went and did a survey in one of the slum areas in Nairobi called, Kiberra. They came back to the board and they showed us, all in detail, how in five years we would be able to be self-sufficient if we loaned out money and charged interest.

It wasn't easy for us on the board. We debated at three, four or five meetings. In the end, we took a risk and we said, " Go ahead, but please be careful." We were really becoming normal bankers you see, " Be very, very careful."

And that is how, the whole activity in Kiberra started. We went ahead. Within a year, we could show that, yes this is a real possibility. The first product we launched out there was called " Jahouty." My greatest joy was when the staff called me in 1995, to present a check - not a microcheck this time, but a macro check- of 200,000 shillings to a nurse in Kiberra who had started a small clinic and was turning that clinic into a maternity. Her name, and if you have the opportunity you may go there if you have a cold she will treat you at a much reduced price than the clinics at the center of town, Oraro Ogoro. Today, that lady has got that clinic going, serving that community in Kiberra,which is one of the largest slum areas with close to 400,000- 500,000 people. She is employing two full-time doctors. I think that is a beautiful story.

We had wondered wether we should even go on increasing or if we should remain at the micro level. But we couldn't get away from her and now, she got a loan of 1.3 million servicing it very regularly. This is our sixth loan and she started it with 10, 000 shillings but she has grown with us. This is what we hope the commercial banks can take over from us because we would like to concentrate at the micro level.

I could give you stories also university students who had no employment who came to us and started with loans of 10,000 shillings. They put together a group of five to six of themselves, and now are serving the communities around here in Nairobi. And now, this is their state loan which we have given to them.

K-Rep is therefore operating throughout Kenya giving these very small loans which are paid back. Our policy is to give the loan to the individual, not to the group, but through the group, that is one of our very important policies. We have found that when an individual gets that loan, he or she owns that loan but is able to get the support of the community. We do also do some studies and research to find out how the people themselves are loaning money. I think it is important when you are involved in this field, to keep your eyes and ears open to the ground to see how, in our own system-- in the system the people have developed- how the people are loaning money to one anther. And, of course, there are cases which the rotating savings scheme are part of this and we also got involved with them and we meet with them and talk with them and give them money as it were wholesale and again, it has been a real success.

So, today, what results, and I think the bankers will be interested in the bottom line, can you really bank on the poor? Can you rely on this small enterprise? And so, in Kenya, we can say with a resounding yes, you can bank on the poor. Our figures from 1995 we were able to loan out 376 million Kenyan shillings and with a bit of small profit of 2.something million shillings — it wasn't much. But 1996 was a very good year when we lent out 315 million and made a profit of 31.3 million Kenyan shillings.

In 1997, we had some problems in one of our branches and we did not do so well and it dropped to close to 2 to 3 million. It is the fluctuation that we are looking at. So, on average, we have been loaning out on the past four or five years, around 300 million shillings. The studies that have been done show that the demand is so much, that total demand in Kenya according to the studies that have been done is between 4.5 and 5. 0 billion shillings for this sector. I think this is what the ears of the commercial bankers would like to hear. It is between 4.5 and 5.0 billion.

At the present time, the major five micro-institutions are lending out approximately 700 million shillings. These are the figures which I think you may have in your books, but if you don't, I am just sharing them with you. That is the situation here in Kenya.

The market is a very big market. There are over 2.6 million enterprises countrywide according to the studies that have been done. At the present time, most of them do not have access to credit. So, what we are saying to you, is come along, let's join hands together. There is a big market out there.

Also, in the continent of Africa, we must say starting that long journey, things have developed throughout. Just recently, we carried out a major consultancy work for Tanzania and they are launching out on micro credit services. This was by the government of Tanzania and I hope, if there are Tanzanians here, that they are going to share with us. Zimbabweans have also done the same and then in South Africa. Ghana has been way ahead with a lot of countries in the actual loaning of money.

Here in Kenya, we have not just depended on ourselves, we have tried to get ideas from elsewhere and we are indebted to countries like Bangladesh, Indonesia and Peru. There is a synergy, a cooperation, a networking amongst us and I always tell my staff, ideas are ideas. If there are good ideas, and they are for free, grab them. Don't call them foreign ideas or they strange ideas, or they are ideas from the Western world or ideas from the Third World. Good ideas are good ideas. This is what I hope will come out of this conference because we have found when you take those ideas and translate it into your own context it can, in fact, make tremendous impact.

But, worldwide, we are glad that the world has finally, after many years, has taken micro credit seriously and you are all aware of the summit which took place in 1996. Mr. Mutua, he is a member and an advisor of one of the committees. So K-Rep is very proud to be there. But according to the World Bank, there are over one thousand institutions that had reached at least one thousand customers each, that was in 1996. According to this inventory, only 206 of the 1,000 or so institutions that reported an outstanding loan, had loan assets worth seven billion but we'll be getting a lot of that information as we go along during the morning.

So, all I really wanted to share with you is the future is out there. There are many, at least in Kenya 80 percent - between 75 and 80 percent- of our population that are doing a lot of economic activities, commercial activities, are not involved int the banking- formal banking- sector. All we are saying is that these people need to be brought in. For us in K-Rep, at the beginning, we were interested in loaning money to these communities and maybe even taking a small deposit. But, we have changed our mission, our policy is service, financial services to this sector. It is not just only giving them loans, to undertake commercial activities but they do require financial services like anybody else. So, through that process, we are concerned, for example, with the insurance schemes, health insurance scheme, and now we have established a small think-tank with pharmacy to pharmacy sitting with us. A doctor, an economist and bankers to look to see how we could in fact create a health insurance scheme that could answer the needs of this sector that cannot afford the premium of 6,000 to 8,000 shillings charged by the formal institutions that are there. They do require some of these services just like anybody else. We've also been concerned payment of school fees. At the beginning in this country, January and February, is the hardest time for parents when they have to go around looking for money. K-Rep is trying to look at it to see how they can enable the family to spread the payment of these fees.

Let me tell you, as bankers here, I think the Co-operative Bank may be making an attempt but it is a huge market out there for school fees. When you total up the amount of money that has been paid, it is enormous. Finding the right instrument to tap it and to help the population will be very, very helpful. In fact, I should charge AAR some fees because I gave them an idea. I am a member of AAR. This is an insurance health scheme. They used to come to me at the end of the year and say, " Now, Mr. Kiplagat, your premium is due. The total amount for the family is huge." And I would say, " Why don't we spread it out throughout the year? Instead of finding that huge sum at once - it is so hard- can't you discuss with your board? I am prepared to pay the first lump sum and then pay you regularly for the rest of the year, and then continue."

But when he went to the board, the board said no. The Central Bank does not allow us to take money in advance so we cannot do that. But I'm glad that particular young entrepreneur established an institution now in which he pays in advance, and I'm paying mine regularly, but of course at a premium. He charges a very high interest rate. Why can't the banks also think of similar institutions?

So really, in conclusion, let me say this. There is a crying need out there. We do need one which is involved in microenterprise but also, at the same time, in macro enterprise as you are told that I am on the board of the stock exchange. I see there is need of synergy. There is need of cooperation and of helping one another to meet those basic needs out there of our population. We cannot afford to have a nation divided of the rich and the poor or those excluded and if we exclude the majority on the services of this kind, we will be developing very unstable countries as they are. As you are told, I am involved in some of this conflict resolution and always is as a result of political exclusion. Let me warn you, that, if we are going to develop economic exclusion, we will also have explosion.

So, let us work together. That means regulators, the government side, the commercial and formal banks, and the micro credit banks. Let us work together and I believe, if we do this, it's incredible the kind of achievement we can make.

I forgot one partner in this, and of course, these are the donors who have been really at the forefront pushing us hard. It is not easy usually for regulators in Africa. They are very tight and we can understand because of regulations, but we are asking them to be innovative. I'm glad to say that here in Kenya when we approach the Central Bank, they want to be hesitant but through ODA- I'm still used to that name- we were able to take two of the Central Bank staff with us to Bolivia to see how this thing is working practically on the ground. I think these are the kinds of things you have to be diplomatic in pushing ideas. Those who are involved in the microenterprise.

So, as we say here in Kenya, with those few remarks - but they are not really few very often- I would like to again welcome you and to wish you all the very, very best. We shall be studying the findings of this conference. Believe me at AMREF and K-Rep we will study them, and as I say, as ideas we will try and use them.

Thank you very much.

EVALUATION: THE COMMERCIALIZATION OF MICROFINANCE

Aspects of the Conference Most Liked

On day one, conference participants most liked the case studies and panel discussions (22% of responses), particularly the presentation by the Workers Savings and Loans Bank during the panel on Successful Commercial Enterprises in Microfinance. The second aspect most liked by participants was the diversity of presenters and participants (10% of responses), followed by the open discussions (8% of responses), the keynote speech (8% of responses), and the overall conference organization (8% of responses). In general, participants commented most favorably on the presentation of information during day one (39% of responses).

Day two responses primarily praised the topics discussed (55% of responses) including organizational innovations (16% of responses), innovative strategies for delivering microfinance (11% of responses), and savings methodologies and products (11% of responses).

Participants most liked the wrap-up discussion by Bob Christen on day three (15% of responses), followed by the presentations on Central Bank regulations (13% of responses).

For the entire conference, participants indicated that they most liked the presentation of information (32% of responses) which included the case studies and panel discussions (14% of responses) and the open plenary discussions (7% of responses). The diversity of presenters and participants (5% of responses) was also considered one of the best aspects of the conference.

Aspects of the Conference Least Liked

Conference participants least liked the loss of electricity on day one (17% of responses). The second highest response to this questions was "no complaints" (16%). Overall, issues surrounding the location/facilities of the conference were most often mentioned (30% of responses).

Day two comments on the aspects of the conference least liked included the sales pitch for the smart card (11% of responses), and the lack of time for discussion of strategies for delivering micro loans and savings products (8% of responses each). Eight percent of responses to this question stated that participants had no complaints.

Day three responses to this question focused on the lack of time for questions and discussion (17% of responses), followed by the length of the day, and the lack of time management of speakers/discussions (13% of responses each). Overall, 48% of responses commented on the general timing of day three.

Participants generally had no complaints (12% of responses) about the conference as a whole. This was followed by comments on the lack of time for questions and discussion (8% of responses). In general, 34% of responses commented on the content and presentations of the conference, especially the smart card presentation which was said to be inappropriate for a conference of this nature.

Issues Participants Will Take Home to Discuss/Implement in Their Bank

Participants responding to this question on day one stressed their plans to create new microfinance programs (25% of responses), including the creation of a new microfinance unit (11% of responses), after undertaking intensive research and pilot studies (8% of responses). Participants also plan to implement measures to increase profitability in their institutions (16% of responses).

Day two responses also focused on the creation of new microfinance programs (27% of responses) including the implementation of micro-savings products (12% of responses). Participants also plan to focus on organizational issues (21% of responses) when they return to their organizations.

On day three, participants responded most often that they plan to form strategic partnerships (32% of responses) upon returning to their organizations. Improvements in legal and regulatory frameworks for microfinance institutions (23% of responses) was the second most stressed issue for future action.

For the conference as a whole, respondents commented most frequently that they plan to create new microfinance programs (22% of responses), as well as undertaking measures to increase profitability and sustainability (10% of responses).

Recommendations for Future Conferences of a Similar Nature

Participants most often responded that they would like to have more conferences of this kind in the future. In addition, respondents would like to attend conferences which are more region specific, and which cover regulatory issues, commercial banks in microfinance, and methodologies for the delivery of credit. Some respondents would like to put together an informal African microfinance network that meets on a regular basis.

With respect to the organization of the conference, participants suggested that there be increased time for discussion and questions, smaller groups to facilitate discussion, more diverse case studies, more panel discussions, and the provision of handouts/documentation prior to the conference.