AMAP FINANCIAL SERVICES KNOWLEDGE GENERATION PROJECT: FINAL REPORT

CONTRACT NO. GEG-I-01-02-00011

TASK ORDER NO. 01

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This publication was produced for review by the United States Agency for International Development. It was prepared by Lauren Mitten of DAI.

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CONTENTS

I. INTRODUCTION

Rather than present a laundry list of research deliverables completed during the contract period, this final report focuses on some of the key lessons learned resulting from the funded research. This report contains five sections:

1. Background, which includes a description of the contract, its purpose and key components;
2. Overview of the core research topics, including learning objectives as well as key lessons learned;
3. Description of short-term technical services and lessons learned through this component;
4. Knowledge management activities and lessons learned; and
5. General lessons learned through the implementation of a USAID-funded research contract.

II. BACKGROUND

In September 2003, the United Sates Agency for International Development (USAID) awarded one of the Financial Services Knowledge Generation (FSKG) task order contracts under the Accelerated Microfinance Advancement Project (AMAP) Microfinance IQC to Development Alternatives, Inc. (DAI). Under this five-year task order, USAID and DAI generated knowledge products designed to help move the microfinance field forward in its efforts to extend efficient, sustainable and quality financial services to the poor. Furthermore, USAID and DAI expected this new knowledge to increase the capacity of EGAT/MD and its partner USAID missions to design and strengthen the implementation, monitoring, and evaluation of USAID-supported microfinance projects.

The following three components comprise FSKG:

- **Core Knowledge Generation:** Per contract guidelines, DAI spent the greatest amount of human and financial resources on this component. Knowledge generation activities included research, applied research, action research, technical services, conferences, seminars and other activities-- all of which fed into USAID's core long-term microenterprise learning agenda.
- **Short-Term Technical Services:** This component included short-term technical services and training activities specified by technical directions provided to DAI from the Office of Microenterprise Development (OMD). These short-term activities also fed into the core knowledge/learning agenda.
- **Knowledge Management:** This component allows each of the contractors to support knowledge generation, synthesis and cross fertilization within the financial services sector of AMAP as well as across the two other sectors, Enabling Environment and Business Development Services.

DAI'S PARTNERS UNDER FKSG

- ACCION International
- Alternative Credit Technologies
- The SEEP Network
- IMCC
- J.E. Austin
- Ohio State University, Rural Finance Program
- Bannock Consulting
- ECIAfrica
- QED LLC

The total approved budget for these three components was $5,373,991. Of this amount, USAID obligated a total of $3,640,625 over the life of the project.

During the life of the project, Colleen Green and Lauren Mitten served as Project Directors. Catherine Johnston and Ira Singh served as Deputy Project Managers from project inception until May 2008. In July 2008, Lisa Lynn assumed the role of Deputy Project Manager. Over the contract period, Donata Kane, Carmel Pryor and Andrew Iappini served as Project Administrators for FSKG. Tim Sparkman worked with Catherine Johnston as the DAI FSKG Knowledge Managers.

III. OVERVIEW OF CORE RESEARCH TOPICS

For each of the approved core research topics, this final report includes a brief introduction to the topic, the specific learning objectives, examples of the types of research funded, and key lessons learned from the research.

A. CONSTRAINTS AND POTENTIAL OF STATE-OWNED RETAIL BANKS

State-owned retail banks (SORBs) are institutions, either completely or primarily owned by the state, which provide either full or limited financial services, including lending, savings, and/or deposit functions for individuals or businesses. In many countries, SORBs are the only financial institutions in rural areas, and they have a wealth of assets in terms of branch infrastructure and institutional knowledge that-- under the right circumstances, strategies, and leadership--can be leveraged and oriented toward sustainable and inclusive financial services for micro-entrepreneurs and small farmers.

SORBs come in many forms, including agricultural development banks, state-owned commercial banks, and postal banking facilities. They also come in various financial conditions. Although many have become sinkholes for government and donor bailouts, others are merely moribund, uninterested in doing more than taking customer deposits and buying government debt. Only a few SORBs have realized the real ability of the market to reach lower income groups with savings and credit provided on a commercial or sustainable basis.

Learning Objectives

Given this background and the state of SORBs, DAI and USAID investigated the following:

- The factors that lead to successful, sustainable SORBs;
- The rationale for, the prerequisites to, and factors responsible for successful SORB reform, particularly in light of all the criticism of the state’s involvement in direct retail financial services provided after years of failed experiments;
- The diverse strategies for restructuring SORBs and the ability to refocus SORBs’ activities on sustainable micro and rural finance.

Research

To investigate the above, USAID, through DAI’s FSKG contract, supported research to understand 1) the number and statuses of SORBs operating in developing countries, and 2) the critical success factors of specific instances where SORB reform led to increased financial access for poor, rural communities.

A comprehensive census conducted in 2004 of SORBs gathered information on 234 institutions in 68 countries. Analyzing that information, researchers isolated four key operational strategies: closure, continued government involvement, creation of new SORBs, and privatization.

In addition to the census, FSKG published a series of short case studies, including reviews of Banco Agrario del Peru , Khan Bank in Mongolia and Banco do Noreste, and Banrural in Guatemala using secondary sources for the data. From 2004-2006, DAI and its subcontractors developed case studies of three other state banks -- Land Bank of the Philippines, Banque du Caire Egypt, Amhara Credit and Savings Institution (ACSI) in Ethiopia-- based on primary data collected from visits to the banks.

In 2008, DAI reviewed research completed by other donors and looked at the future direction of SORBs.

Key Lessons Learned

The worldwide experience with SORBs has been, in general, negative. The research indicates that SORBs' use of subsidized interest rates limits outreach and discourages private financial intermediaries from entering rural credit markets. In addition, poor collection practices and forgiveness schemes produce a poor credit culture that adversely affects the financial health of the institution. Furthermore, government mandates and political pressures frequently result in fund transfers to government-favored groups and projects. Finally, the failure of institutions to cover operational and program costs from earned income leads to repeated bailouts and recapitalization.

Although there are cases of successful SORBs, a comprehensive or consistent framework for studying these institutions does not exist. The list of possible success factors is relatively long, and includes:

- A clear and achievable policy mandate to provide retail-level financial services without interference from the state in the lending process;
- Where needed, outside technical support to assist with the restructuring process. Third parties can assist in providing a neutral framework to carry out reform while managing internal resistance to change;
- A legal and regulatory environment, under which SORBs are not owned and supervised by a single entity, such as the Ministry of Agriculture;
- Good governance (which may require a change in ownership);
- Strong internal operations, which includes the presence of a transition management team, quality permanent management, performance-based remuneration for branch managers and loan officers, robust internal controls, effective and efficient delivery systems, decentralized decision-making, and the view that borrowers are clients rather than beneficiaries.
- Diversification of client-base and products in order to reduce portfolio risk;
- The elimination of implicit subsidies that artificially lower the interest rate charged on loans, usually to the point that loans become unprofitable to the institution;
- Increased outreach while maintaining efficient operations;
- A vision and strategy to achieve long-term sustainability; and
- A degree of self-financing through savings mobilization.

B. COMMERCIAL BANKS

COMMERCIAL BANKS IN MICROFINANCE

Private commercial banks continue to provide the vast majority of financial services in terms of loan and deposit value in developing countries. Most of their services target the middle market and above, but a few private banks have expanded their market presence and now provide large volumes of financial services to micro-entrepreneurs and other low-income populations. Market forces, regulations, leadership and donor assistance have all helped encourage banks to enter this market. However, many of the commercial bank microfinance programs fail to reach significant scale despite the institutions' existing infrastructure and other resources. The reasons for such disappointing outreach results are many, but three factors stand out:

1. Bankers do not clearly understand or accept, and therefore resist, the operational changes that need to be made to succeed in the microfinance marketplace;
2. Bankers are not convinced of the profitability of the product (in terms of net operating margin); or
3. Bankers are convinced of the margin but become impatient with slow growth in volume (in terms of total portfolio and hence absolute net income) compared to other lines of business and therefore do not make the investments required to scale up.

Commercial banks have tremendous potential to service the microfinance market profitably. Branch networks, access to capital, and qualified human resources all provide banks with the fundamentals to launch and grow successful microfinance operations. Over the past decade, many banks have entered the microfinance market and several banks have recently shown promising results in terms of profitability and growth in this market segment. While their strategy and operations share many elements of traditional, nonbank microfinance operations, innovative practices and models are emerging.

Learning Objectives

Research conducted under this topic aimed to answer the following questions:

- What is the best way to design donor assistance to encourage banks to enter the microfinance market?
- What are the strategic and operational options for commercial banks interested in launching microfinance services?
- What are the most interesting and useful demonstration models of commercial banks expanding to microfinance products?
- How can commercial banks be profitable as direct microfinance retailers?

Research

USAID and DAI prepared guidelines on commercial banks and microfinance for two separate audiences. The first, *Banking at the Base of the Pyramid: A Microfinance Primer for Commercial Banks*, presented a detailed discussion of the decisions banks face in designing and implementing microfinance. The document was prepared to help bankers and those advising banks on microfinance make better-informed decisions about whether to enter microfinance and, if so, how to approach this new business endeavor to ensure success.

The second document, *Guidelines for Successful Partnerships*, sought to inform USAID staff and other donors who are considering approaching banks to develop microfinance programs. It is intended to help donors, bank advisors, and other strategic partners make better-informed decisions about approaching a bank to offer support for implementing or expanding a microfinance program, and how to ensure success for such an endeavor.

FSKG also wrote two case studies describing successful models of commercial banks expanding to serve microfinance clients. The first case study, which profiles Hatton National Bank (HNB) in Sri Lanka, examines profitability and lessons learned for a bank with an internal microfinance department. The second case study documents CREDIFE, an Ecuadorian microfinance service company that provides loan origination and credit administration services to its majority owner, the Banco del Pichincha. CREDIFE's rapid growth and contribution to Banco del Pichincha's profitability show how a private commercial bank can become a significant player in the microfinance market in a relatively short amount of time.

Key Lessons Learned

The research conducted for this topic resulted in guidelines for banks, donors and MFIs. We present a summary of key findings below.

- Whatever model is used must establish the autonomy necessary to uniquely service the nontraditional client segment. At the same time, it should leverage the bank's assets in terms of reputation, systems, financing, and human resources.
- Given their business priorities and organizational culture, banks present a unique set of challenges for donors and development professionals. In particular, keeping microfinance a priority and making the organizational and operational changes required for growth and profitability are important areas in which outside support can be critical for banks entering microfinance.
- To ensure bank buy-in to outside assistance, it is important to structure the relationship in such a way that the bank is accountable for performance. It should demonstrate commitment by covering operating expenses (such as branch costs and personnel) and assuming risk by providing loan capital.
- Support for the development of an enabling legal framework and market infrastructure facilitates entrance and expansion of banks in microfinance.
- When creating an internal microfinance unit within a bank, an emphasis on social responsibility and community development can only be sustained with a strong commitment from senior bank management, but is limited as product profitability is an important driving force for continued growth.
- The service company model may facilitate portfolio growth, but the adoption of this model alone does not solve all of the challenges that banks face when developing microfinance portfolios and services. The service company's board, if a separate legal entity, must formally link to the bank's board in order to ensure success.

COMMERCIAL BANK LINKAGES WITH MFIS AND/OR NGOS

For some time donors and practitioners have been interested in effective linkages between microfinance institutions (MFIs) and commercial banks. The majority of MFI-bank linkages are created out of necessity by non-bank MFIs, typically because of the legal restrictions they face or because they lack the capacity to perform a service. This type of linkage often develops as an MFI requires additional services to support growing, day-to-day operations. For example, an MFI may seek to link to a commercial bank in order to provide its clients with access to some bank services it is unable to offer such as regulated savings or because it needs specific back office services such as tellers to collect loan repayments and deposit management. However, it is rare that an MFI's management undertakes an extensive quantitative and qualitative cost/benefit analysis as part of its decision-making process before entering into an agreement with a commercial bank. MFIs often do not take full advantage of their negotiating power – in terms of their ability to generate significant deposits and new customer relationships – to secure better terms and service levels. If MFIs could present a comprehensive analysis of the potential customer relationships they are offering to banks, they could negotiate from a position of greater strength, gaining important benefits both for themselves and its clients.

Learning Objectives

Under this research topic area, DAI and USAID aimed to understand the types of relationships that exist between MFIs and commercial banks. The contract sought answers on the following questions:

- What are examples of models for commercial bank/MFI linkages?
- What are the best structures and arrangements for supporting a broad array of linkages? What will lead MFIs and commercial banks to seek and develop more effective partnerships?
- What tools would be helpful for MFIs for structuring bank relationships and/or assessing the feasibility of developing in-house capacity for developing bank office services?

Research

The starting point of FSKG research in this area was to document a range of bank-MFI linkages, including lending and deposit relationships, loan windows, service company relationships and purchase of operational services such as loan processing and treasury functions. As a result, DAI published a series of papers on Opening Markets through Strategic Partnerships, including:

Alliance between FIE and ProMujer— FIE, a regulated private financial fund, uses the existing branch infrastructure of ProMujer, an unregulated NGO, to open teller windows in peri-urban markets where it has little or no presence. Through these teller windows, ProMujer clients have access to safe and convenient deposit services in the same branch where they receive loans and other services. At the same time, FIE gains access to thousands of new savings clients, adding a steady, low-cost source of funds to capitalize its loan portfolio.

Alliance between ICICI Bank and Cashpor— The chronic lack of funds faced by MFIs in India, coupled with the priority sector lending quota for commercial banks, catalyzed the partnership between the Indian MFI CASHPOR and ICICI, India's largest private bank. CASHPOR needed an unrestricted flow of funds that would enable them to achieve scale of operations, yet comply with regulatory requirements related to capital adequacy, and ICICI needed to meet its priority sector lending requirements. Under the terms of the alliance, CASHPOR acts as a service agent of the bank undertaking loan analysis, processing, and recovery of the loans.

Alliance between AMEEN Sal and three Lebanese Commercial Banks— The Access to Microfinance and Enhance Enterprise Niches (AMEEN) linkage demonstrates how local commercial banks are able to outsource certain aspects of the credit process to a microfinance institution, while generating a portfolio of microenterprise clients. Through this linkage, the MFI is able to expand outreach without infrastructure requirements and secure stable sources of funding for on-lending to microenterprises. Commercial banks, on the other hand, are able to enter a new market without the heavy upfront investment requirements in know-how, staffing, and technologies.

Drawing on the cases documented, DAI created a guide that MFIs can use to form alliances with commercial bank partners. Specifically, the guide includes a generic checklist of common issues (financial, strategic, documentation and other) for MFIs and bank partners, and an annotated agreement template for MFIs entering into strategic alliances. The guide also examines the issue of forming alliances in the context of new, structured forms of financing such as securitization of microfinance portfolios.

Key Lessons Learned

FSKG research on commercial bank linkages concluded that detailed contracts and realistic business plans that outline the roles of both linked parties are essential for fruitful collaborations. At the start of the partnership, there must also be a clear understanding of bank expectations of the product and the sector. In addition, flexibility should be built into the relationship to allow the partnership to adapt to changing circumstances. Finally, the most successful alliances were comprised of partners who were all directly invested and shared responsibility for partnership design, implementation, and risks.

COMMERCIAL BANKS AND SAVINGS FOR THE POOR

The microfinance industry has enjoyed a great deal of success in terms of outreach and sustainability. However, microfinance remains primarily a supply-driven endeavor, with a limited number of methodologies applied to provide mainly working capital loans to poor microentrepreneurs. Over the past few years, industry practitioners and experts have increasingly recognized that the poor require a wider range of financial services to manage risk and improve their welfare.

In practice, everyone saves, even if the amounts are very small. Thus, absence of formal savings services for the poor results in "financial exclusion" of the larger population. The prevalence of thriving informal mechanisms that have evolved to meet the local needs for savings systems reflects the need and demand for savings services. These informal mechanisms also demonstrate the significant savings capabilities of low-income people, and the unmet demand for savings services.

Formal microfinance initiatives started much later in the North East Region of India (NER) than in the rest of the country and still have much to achieve. In particular, savings has not been in the forefront of financial services offered by microfinance service providers. Therefore, FSKG undertook research to understand the diverse savings needs of the poor and to design products and services that would improve the availability of savings services in the NER.

Learning Objectives

This topic examined how formal financial institutions might respond to the demand for savings. The specific objectives of the research were to:

- Understand the saving options and practices of the low-income people in the four states of the North East India
- Examine the options, challenges, and opportunities for financial institutions interested in delivering financial services to the poor in this region; and

- Explore the ways in which donors and other players can ensure sustainable and safe provision of savings services to this market.

Research

USAID and DAI engaged MicroSave India to study the demand for savings in four states in the Northeast Region of India and to explore the options and challenges for formal financial institutions to serve "unbanked" microentrepreneurs and poor households in this region – either on their own or through linkage arrangements.

The FSKG project conducted qualitative research in the four North Eastern states of Assam, Meghalaya, Manipur, and Tripura. The sample of the research was in proportion to the population of the states, with a minimum of 25 focus group discussions in each state. The sample also reflected the ethnic background and geographic location of each state, both of which affect the level of monetization and availability of social capita. The respondents were mostly married women from rural areas.

Key Lessons Learned

How people use available savings options depends on their specific needs. These needs often emerge from the different life cycle events and are determined by the pressure these events create. The needs and uses of savings can be broadly classified into short-term or long-term or into planned (one time or recurring) or emergency. The researchers determined that a single product could not meet the diverse financial needs of the poor people living in the four different states. Instead, four product options emerged from this research, based on the preferences of the poor. These products are:

- General Savings Accounts: Encourage poor people to enter the formal financial system, through simple demand saving accounts.
- Short-term Recurring Deposit Accounts: Help the poor to save up small lump sums to address a variety of small and often recurring clients savings needs.
- Long-term Recurring Deposit Accounts: Help strengthen coping mechanisms by providing the poor with a way to save for planned expenses and to reduce dependence on loans.
- Monthly/Annual Fixed Deposit with Certificate Accounts: Allow the poor to capture seasonal cash surpluses for future uses, through this simple and flexible fixed-deposit product.

C. HOUSING PRODUCTS

The rapid urbanization of global poverty is contributing significantly to the importance of housing financing on the international development agenda. In response to the market's failure to supply affordable housing, USAID sought to facilitate long-term solutions without distorting markets or displacing the formal financial sector.

Microfinance for housing (MFH) holds promise for alleviating lack of shelter for the poor, as well as for providing a new growth product area for MFIs. MFH is a subset of microfinance, designed to meet the housing needs of those without access to the banking sector or formal mortgage loans. It is designed for low-income households who wish to expand or improve their dwellings or to build a home in incremental steps relying on small sequential loans.

A range of institutions, including MFIs, commercial banks, and NGOs, offer MFH. Innovative delivery models include partnerships between MFIs and housing NGOs, cooperative housing development, loan underwriting using remittances, and MFI/commercial bank partnerships.

Learning Objectives

The learning objectives under this topic sought to understand the strengths and weaknesses of various types of institutions and delivery models, to better define key roles for donors and practitioners, and to identify potentially replicable models. Key research questions included:

- *Access to long-term capital*- To what extent are supply-side bottlenecks preventing the expansion of housing microfinance, and how can these MFIs overcome them?
- *Land tenure security*- What legal structures relating to property rights and land tenure can guarantee microfinance for housing?
- *Infrastructure*- What methodologies and approaches are required for the provision of microfinance for infrastructure?
- *Profitability*- How profitable is housing microfinance, and how does it compare to other products offered by microfinance institutions?
- *Construction technical assistance*- How expensive is the provision of construction technical assistance to clients, and to what extent does it improve the quality of housing and enhance repayment performance? What is the best way to design construction assistance to meet client demand?
- *Partnerships*- What types of partnerships provide synergies that enhance the impact of MFH? What is the best way of scaling up these partnerships?
- *Reaching the very poor*- How can sustainable, scalable MFH be developed that effectively reaches the very poor?
- *Government led efforts*- How can governments develop subsidies that create risk-sharing arrangements aligned with private sector incentives that help increase, rather than replace, private sector participation?
- *Impact*- Do housing loans lead to increased business productivity and enhanced earnings, and what is the true potential impact of housing microfinance of alleviating poverty?

Research

FSKG aimed to contribute to the growing field of housing microfinance, and to the body of research that disseminates lessons learned from the field. The project produced a series of case studies and overview documents that demonstrated the strengths and weaknesses of various types of institutions and delivery models, and defined key roles for donors and practitioners. Research included:

- *Habitat for Humanity Vietnam: Partnering with MFIs to Improve Housing for the Poor*--a study that explores the strategic considerations important for MFIs and housing NGOs creating partnerships to enter the housing finance market.
- *Housing Finance for the Poor in Morocco: Programs, Policies and Institutions*--a report which explores various aspects of MFH, including the use of credit enhancements to create confidence in a

new market and the establishment of retail platforms and provision of product development and staff training to commercial banks serving slum-dwellers.

- *Housing Finance for the Poor: El Salvador*--a paper that demonstrates the growth and success of housing microfinance when the financial sector is well capitalized and competitive, when market infrastructure is established, and when government subsidies assist the poorest to attain adequate housing.

- *Housing for the Poor in Kenya: NACHU's Cooperative Approach*--a paper that examines the importance of advocacy and technical services, in addition to providing lessons learned in balancing low interest rates for clients with the ability to access commercial capital to reach a scale commensurate with the immense scope of the low-income housing problem.

- *Expanding Microfinance for Housing*—a report based on the recently published Housing Microfinance: A Guide to Practice (Kumerian Press, 2004). This document provides a broad overview of the current state of housing microfinance, including recommendations for bringing together urban development strategies, slum upgrading models, assistance to micro lenders, and the greater role that housing microfinance could play in relieving the shelter problems of the poor.

- *Going to Scale with Housing Microfinance: The Role of Commercial Banks*—a paper that examines the current state of commercial bank engagement in the MFH market and analyzes the potential for these institutions to significantly increase the scale of housing microfinance available worldwide.

- *Maximizing Choice: Diverse Approaches to Housing Microfinance*—a document that offers a review of varied delivery models, considers strengths and weaknesses of each, and suggests roles for donors in supporting these innovative approaches to addressing the extensive unmet housing demands of the less-developed world.

Key Lessons Learned

A review of the above-mentioned case studies led to the following findings:

- Institutional capacity and commitment can be a major determinant of the success of a HMF product. Given the extensive costs and organizational changes that can be required to implement a new product such as housing, institutions must be committed and have the necessary institutional capacity to launch the product.

- Land titling is a crucial issue. Although not all micro-lenders require title, studies are now showing that households are reluctant to invest without secure tenure. Major synergies emerge when housing microfinance is combined with secure land title and infrastructure provision to maximize household incentives to save and to borrow.

- Mortgage loans, consumer loans and HMF, which used to be distinct loan products, appear to be converging.

- Construction technical assistance can strengthen the quality of progressive housing, but is not a necessary component to HMF. Models of post-loan disbursement construction assistance by the MFIs have not proven to be cost-effective and are therefore not widely available.

- Strategic use of government subsidies is extremely helpful, but only if provided in a way that does not undermine householders' financial incentives. The most successful government initiatives in low-income housing are those that strategically use subsidies to encourage participation by the private sector—including land developers and financial institutions.

- Profitability of housing microfinance is not yet proven, although MFIs that have been able to reach substantial scale tend to show higher profitability.
- Donor funds are best targeted at technical assistance and policy development that reduce some of the perceived risks in progressive housing finance. For example, funds can be used to build alliances with experienced community-based organizations to diminish the complexity of land tenure issues and housing.
- The more successful MFIs and commercial banks offer a range of HMF products, micro-mortgages and "lease purchase" consumer products that address consumer demand for housing. The asset/liability mismatch issue remains a limitation in issuing longer-term loans.
- Housing NGOs can play a role in the global efforts to improve housing for the poor by educating national governments, local communities and service providers about high quality progressive building techniques, and by facilitating peer-learning networks among institutions engaging in microfinance.

D. HIV/AIDS RESPONSIVE PRODUCTS AND SERVICES AND DISSEMINATING THE DEFINING OPTIONS CURRICULUM

Donors and practitioners increasingly recognize the HIV/AIDS pandemic as more than a health crisis. It is a major economic development challenge, posing serious socio-economic consequences at national, community, and household levels. To what extent households, communities, and nations are capable of coping with the consequences depends on the type and amount of resources at their disposal.

Financial services, including loans, savings, and insurance, can help poor households mitigate the economic consequences of the disease. They can help clients to maintain a consistent income stream, to build a savings base which can be liquidated to cover emergency expenses, and to avoid selling productive assets (such as land and equipment), which may have a devastating effect on the clients' future earning potential and ability to recover from the crisis. Working together, AIDS Support Organizations (ASOs) and MFIs can play an important role in mitigating the devastating effects of HIV/AIDS on poor households and communities.

Learning Objectives

USAID and DAI's main objective under this topic is to help MFIs, ASOs, and donors to think more holistically about the economic ramifications of HIV/AIDS and how they might be able to bridge the gap between prevention, treatment and the economic strengthening of affected households and communities. This research sought to:

- Help MFIs recognize the impact of HIV/AIDS on their clients and how they can respond to the disease;
- Provide ASOs and MFIs with a common understanding of each other's competencies and how they can form strategic partnerships to better address the diverse health and financial services needs of HIV/AIDS affected households and communities; and
- Guide donors and practitioners on developing economic strengthening or health programs that more holistically address the socio-economic challenges present in HIV/AIDS affected communities.

Research

USAID and DAI's focused on disseminating the Defining Options curriculum that was developed under the Microenterprise Best Practices project. The training course was revised and then disseminated to microfinance associations and their members in Ethiopia, South Africa, Kenya, Rwanda, Mozambique and Haiti. In addition, DAI and ECI Africa developed an aftercare guide and an action planning tool for MFIs to think about the impact of AIDS on their institutions and begin planning specific interventions. As a follow on program to this training, DAI, in collaboration with ECI Africa and MEDA (who had funding from the Canadian Internatonal Development Agency), implemented an action research project to support four MFIs operating in an HIV-prevalent area in Mozambique. This action research project provided technical assistance and funding to the MFIs to implement HIV/AIDS mitigation interventions.

In the last year of the project, DAI rolled out a microNOTE series that sought to build a common understanding between ASOs and MFIs by improving the information gap between them. We examined the reasons that ASOs and MFIs are concerned about increased household vulnerability due to HIV/AIDS and explained the role that microfinance can play in addressing this vulnerability. In addition, we offered guidance to health and financial service providers on how best to form strategic partnerships to address the socio-economic needs of their target populations, how to develop savings and insurance products that address the needs of the AIDS affected, and how to develop workplace programs that protect staff. Further, we made recommendations to donors and funders on how to improve and support programming in this area. These recommendations were culled from discussions with a wide variety of donors that support both HIV/AIDS initiatives and microfinance.

Finally, in addition to the microNOTE series, FSKG funded the SEEP Network to develop an on-line guide that provides practitioners and donors with guidance, case studies, and consultant contact information on microenterprise development in HIV/AIDS prevalent areas.

Key Lessons Learned

This section presents key lessons learned by research deliverable, given that the type of lessons learned depended upon the nature of the topic.

Dissemination of Defining Options Curriculum and Aftercare Guide

- MFI leaders and managers must be present at the training in order for the training to have any lasting institutional impact.
- Training alone is insufficient to bring about institutional change. MFIs frequently need additional tools, guidance, and funding to implement some of the intervention options outlined in the training curriculum. Moreover, given the size of many MFIs and the limited depth of senior and middle management, the ability to make real strides in addressing HIV/AIDS is limited.

Action Research in Mozambique

- Due to limited capacity, some MFIs need short-term technical assistance and funding in order to implement mitigation strategies. MFIs can accomplish sustainable results with minimal external support when this support is channeled into well-designed activities.
- MFIs should seek to establish partnerships with ASOs, government agencies, and other MFIs with mutually compatible goals and objectives. In so doing, MFIs can focus on their core competencies and share some of the costs with another institution.

- Donor and government funding is primarily funneled through programmatic channels that often focus only on health or social aspects. In order for MFIs to receive the funding and support that they need from donor and government organizations, these organizations need to take on a more holistic approach.

HIV/AIDS MicroNOTE Series

- An MFI's implementation of comprehensive HIV/AIDS programs and written policies can diminish the disease's impact on its staff. In order to be effective, management must commit to consistently upholding the policies.
- Strategic collaboration between AIDS Service Organizations (such as banks, insurance companies, and health organizations) and MFIs -- where partners focus on their own competencies—is the most efficient response to mitigating the socio-economic impact of HIV/AIDS on poor communities. Collaboration is most effective when both the MFI's and ASO's mission, vision and operating style align with each other, when realistic expectations are established, management of both institutions commit to the partnership, and proper training and adequate communication clarify the roles of each organization in the partnership.
- MFIs serving HIV/AIDS-infected populations should develop risk mitigation strategies, including client diversification, planning in advance how to respond to client default due to illness, and monitoring client exit rates and staff absenteeism. MFIs would benefit from improving management information systems to better track the impact of HIV/AIDS on financial performance and from adjusting loan-loss provisioning to reflect an increase in delinquency and default.
- Microinsurance can be an effective risk management strategy to protect poor HIV/AIDS-impacted households from devastating losses.

Lessons Learned on Distributing Information on HIV/AIDS via MicroNOTES

- Short microNOTEs are often more effective at communicating key messages than longer documents and provide MFIs with salient information on key topics.
- In order for these microNOTEs to be effective, they need to be demand-led. DAI selected the topics for the microNOTE series based on requests made by institutions during the learning event following the Mozambique Action Research and by health organizations and MFIs participating in the Haiti dissemination of the Defining Options curriculum.
- In order to encourage and facilitate a common understanding between ASOs and MFIs, HIV/AIDS-related microNOTEs need to be written to for both a health as well as a microfinance audience.

E. RURAL AND AGRICULTURAL FINANCE

Value Chain Finance (VCF) is an approach used by donors and finance providers to analyze at which points in the chain finance is needed and how better access to or understanding of finance could help to improve the competitiveness of the entire chain. This approach implies that, when making finance decisions, a potential lender would consider not only the client's business, but factors and players that affect the movement of product from producer to end consumer (e.g. information, technology, transport etc.). When the entire chain is taken into account, relationships within the chain can be leveraged in order to either decrease risk or decrease financing costs. These decisions could result in a variety of finance models including input financing, out-grower schemes, warehouse receipts financing, or other financial flows.

Learning Objectives

The Microenterprise Development Office sought to answer the following questions:

- What circumstances facilitate various types of direct or indirect VCF?
- What are the terms and conditions of the production and financial contracts involved?
- Does value chain lending play a role in improving MSME creditworthiness, leading to greater access to formal finance?
- What is the best way to incorporate financial considerations into analyzing and upgrading value chains?
- How can VCF increase the competitiveness of value chains?
- How can VCF increase the incomes of poor households active within those value chains?

To answer these questions, USAID, DAI, and other FSKG contractors and contributors undertook research to better understand existing examples of value chain financing, and draw lessons for how USAID missions and other donors could support more effective VCF programming. Using the Value Chain Project Cycle as an organizational framework, USAID, DAI and other FSKG contractors are developing a suggested methodology for integrating VCF into project design and implementation.

Research

Some of the major research undertaken by DAI on rural and agricultural finance included:

- *Hortifruti in Central America* – a report that examines the impact of increasing demand for supermarkets and influence of supermarkets' chains on the pace and style of rural financial deepening. The report also investigated whether increased access to financial intermediation can assist in democratizing the chains by helping small and medium producers overcome finance-related barriers to entry.
- *Value Chain Finance Role Play Training* – a training that explores how and why finance is extended within a value chain (direct value chain finance), and the decision making process of lenders in extending credit to the various value chain actors (indirect value chain finance). It examines why finance may be available to certain agricultural value chain actors, but not to others, and how the local environment impacts the availability of finance to members in the value chain.
- *Uganda Value Chain Finance Governance Study* – a study that explores three value chains in Uganda to understand the relationship between governance and value chain finance. The value chain governance structure influences how easily and successfully a value chain actor can accomplish these tasks, and thus provides insight into the conditions that facilitate VCF.
- *DCA/Loan Guarantees for Rural and Agricultural Finance* – a report that analyzes the DCA Loan Guarantees used to support warehouse receipt lending in Kenya, Uganda and Zambia. The report includes the "ideal case" and the analysis of the actual cases in the context of the ideal conditions necessary for the success of such an activity.

- *Mexico Mango Value Chain Finance Study* – a study which identifies opportunities and constraints of improving competitiveness among small mango producers and also provides information to financial service providers interested in financing investments to help value chain participants upgrade.
- *Albania Apple Value Chain/Kenya Fish Value Chain Finance Studies*- studies which assessed the use of Value Chain Finance Guidelines in the analysis of the upgrading strategy for the value chain and identified the opportunities of value chain actors, constraints to financing, and solutions to address these constraints.

Key Lessons Learned

Lessons emerging from the research conducted by researchers under this topic suggest that:

- Value chain actors are motivated primarily by production and productivity goals, and offer finance in order to ensure the success and profitability of their business activity rather than to earn income from the financial transaction itself. They may accept higher levels of risk and losses in their lending operation than would traditional financial intermediaries, if the profits from the resulting production provide an acceptable overall rate of return.
- The costs of VCF are frequently hidden in the price paid for products or in the cost of inputs provided on credit. They can exceed the typical costs of commercial loans.
- Value chain actors are dependent on each other for producing and marketing products, as well as for lending and repayment. Lenders must decide who to lend to, how to monitor the performance of their clients, and how to successfully collect their loans. Borrowers must evaluate whether lenders will fulfill their part of the contract, such as supplying promised inputs on time, buying the product at harvest, and paying on time and at a competitive price.
- It can be effective to accompany value chain finance with other embedded services, such as training and technical assistance, quality control, or transportation. For stakeholders who lack solid financial literacy and business management skills, capacity building should be provided along with credit solutions for long-term sustainability.
- It is critical to facilitate information flow from agricultural value chains to financial markets to reduce the real and perceived risks of agricultural finance.
- Financial institutions serving value chains must develop products adapted to the cash flow cycles of the value chain, which presents challenges for liquidity management and seasonal operations.
- Partnerships between financial institutions and value chain actors can increase liquidity, lower risk, and lower costs to meet VCF demands.
- The value of adding finance/governance to the VCF analysis provides true insights into (1) the essence of the problems standing in the way of growth at the business/value chain level and (2) into the behavior of stakeholders (their capacities and incentives).
- VCF typically requires a formal or informal contract, some client screening and monitoring, and contract enforcement in order to lower risk and increase value chain lenders' willingness to lend.

F. TECHNOLOGY INNOVATIONS FOR FINANCIAL INCLUSION

In today's rapidly changing and competitive microfinance industry, most institutions are looking hard at the potential benefits of Information and Communications Technology (ICT). This focus has taken on even greater urgency as institutions struggle with the issue of sustainable rural finance and the challenges of outreach and scale. In recent years, institutions and donors have invested a significant amount of resources in overcoming technology and infrastructure barriers. Much has been written about the use of personal digital assistants (PDAs), point of sale (POS)/smart cards, automated teller machines (ATMs), and mobile phones.

To date, the results of technology investments in the microfinance industry are mixed. Full understanding of the problems in implementing ICT requires examination of the environment and institutions themselves, as well as the technology. With so much money spent on ICT for microfinance, why has the industry been largely unable to demonstrate significant results? The reasons include:

- Common problems that affect the ability of microfinance institutions (MFIs) to deploy and manage advanced technology;
- The reality of cost versus impact of ICT investments;
- The theory vs. practice of the solutions (i.e. are they really appropriate?); and
- The infrastructure limitations present in country environments that create a real barrier to effectively deploying ICT.

MFIs are facing increasing competitive pressures from other MFIs and larger entrants such as traditional commercial banks, and seek to use technology innovations to improve their competitive advantage. Practitioners and donors, as they consider large investments in ICT, need clarity and guidance regarding the true impact of these technologies.

Learning Objectives

To date, the evidence of the benefits of ICTs for microfinance is more anecdotal than quantifiable. Under FSKG, USAID and DAI sought to separate the ICT hype from the reality with more hard evidence. The research has focused on:

- *Core banking systems.* The lack of robust management information systems (MIS) has been and continues to be one of the most significant constraints to MFI growth. The cost of implementing and maintaining an MIS can be as daunting as the task of selecting an appropriate MIS. With the increasing availability of open source software, ASP/middleware, and outsourcing options in the market, we explored the business case for each of these models for MFIs.
- *Client-focused technologies.* Technologies such as PDAs, ATMs, POS, and mobile phones have the potential to improve the efficiency and lower transaction costs of MFIs as well as provide more convenience to the customer**.** However, more quantitative data was needed to understand the level of usage of ICTs among MFIs, the challenges MFIs face in implementing these technologies, and whether IT investments produce real business benefits for MFIs. In addition, the DAI aimed to determine the factors critical to successful implementation, high adoption rates, and high levels of usage.

- *Strategic alliances for improved delivery*. MFIs seeking to expand and deepen their outreach to rural and more remote areas need to develop different delivery channels to reduce transaction costs as well as increase security and convenience for their clients.

Research

FSKG conducted a survey of 54 microfinance providers (MFIs, non-governmental organizations, credit unions, and banks) regarding their current use of technologies, and found that half of the responding institutions are using one or more client-focused technologies. A number of the respondents, however, appear to be unable to measure the benefits they are receiving.

The surveyed institutions had high expectations that many of the new technologies would substantially benefit their bottom lines, but the results were mixed. ATMs appear to be the best performers in delivering benefits. Point of sale devices, one of the least used technologies, nevertheless seems to be the most interesting of these technologies in terms of increasing productivity and revenue. Contrary to what one might believe from the literature, PDAs appear to be less successful at delivering business benefits. Mobile phones also showed mixed results, though they are the least mature of the four studied and should continue to be monitored and evaluated.

In a more in-depth follow-up study of eight financial institutions, research showed that ICT implementation has had measurable positive impact on client outreach and efficiency. Factors such as institutional buy-in, the choice of technology provider, the state of local infrastructure, and regulations play a key role in the success of these technology projects. More due diligence on the technology and the vendor is a key to success.

Furthermore, FSKG examined the possibility of outsourcing core banking IT systems as a potentially viable option for MFIs in developing countries. By studying the experiences and lessons of US small banks, as well as interviewing core banking system vendors and implementation consultants, FSKG hoped to build a business case for applying this outsourcing model in the developing world.

Key Lessons Learned

Research on this topic has highlighted the following key lessons learned:

- Outsourcing information and communication technology systems can solve MFIs' IT capacity, IT staffing, and infrastructure challenges. Despite outsourcing, reliable power and network connectivity continue to provide challenges for many MFIS. These challenges can be mitigated through additional power sources and network points.
- If an institution is very small (fewer than 1000-2000 loans) with a slow growth rate, a simple in-house solution may be less expensive than outsourcing, given the low IT staffing and infrastructure required. Rapidly growing or more complex MFIs that offer a wider variety of products and services should consider a more robust core banking MIS, at which point outsourcing could be the quickest and least expensive way to "go to market".
- Potential drawbacks to outsourcing include the MFI's need to learn to manage the vendor, their need to adapt some of their business processes in order to work with the vendors product rather than customizing the product to work with existing internal processes, dependency on the vendor's product release schedule, and the ability of existing vendors to supply state-of-the art technology.

- Biases are very strong regarding outsourcing, and those MFIs that outsource their IT systems or IT support do so because a compelling business case unseats their biases.
- The maturity of outsourcing service providers is likely a major factor that allows US small banks to outsource, as opposed to the options available to MFIs. In the US, the full complement of functionality is available or can be integrated with third parties, the systems are highly configurable or customizable, and there is a track record of satisfied customers.
- Customers in the US view the leading outsourced core banking vendors as partners, not just as vendors. This should be a criterion used by MFIs when selecting an outsourced core banking MIS.

G. THE MISSING MIDDLE: MIDDLE MANAGEMENT TRAINING FOR MFIS

The strong and sustained growth of the microfinance sector in recent years has led to a sharp increase in the demand for qualified middle managers with diverse skill sets. Due to the increased complexity that growth brings to their job descriptions, middle managers must know how to:

- Recruit and retain clients in an increasingly competitive environment;
- Understand new markets and adapt products and services appropriately;
- Increase operational efficiency;
- Monitor and communicate performance effectively using new technologies; and
- Manage institutional changes to meet regulatory requirements or to diversify funding sources.

In most countries, a readily available labor supply from which to recruit qualified middle managers does not exist. Institutions must either train new managers themselves or “steal” managers trained by other MFIs, a growing phenomenon that does not increase the aggregate supply of qualified managers.

Few MFIs offer management training programs that help front-line workers quickly and successfully transition to a management role. Middle managers have more complex training needs than field staff. They tend to be less educated than senior managers, and there are more of them to be trained, with limited time and funding available.

Learning Objectives

Under the FSKG project, DAI sought to:

- Understand better the needs of middle management in terms of knowledge, skills, and assets;
- Develop a comprehensive inventory of current training opportunities for middle management in order to identify gaps in the supply of training;
- Increase the pool of qualified local trainers through the replication of the International Labour Organization’s (ILO) Middle Management for MFIs curriculum; and
- Explore whether the use of a learning network for certified ILO master trainers and those participating in the Training of Trainer (ToT) programs could enhance the effectiveness of classroom-based training.
- Determine factors leading to the long-term sustainability of middle management training.

Research

FSKG funded the roll-out of the ILO's Middle Management ToT program in Senegal, Pakistan, and Bolivia and the establishment of a web-based learning network for master trainers and the trainers participating in the ToT. To do the latter, the ILO worked with a knowledge management team at the QED Group. Finally, USAID and DAI published a number of microNOTEs on the lessons learned by the ILO in the creation and maintenance of their Middle Management training program.

Key Lessons Learned

Research on this topic identified eight gaps between the type of training needed to build a strong cadre of middle managers and the training currently offered. These include:

- Limited or absent exposure to "the big picture." There are few opportunities to interconnect the content of short-term, independent management courses to obtain a holistic overview;
- The failure of most management training packages to address the development of soft skills such as analysis and communication;
- The unavailability of quality training materials in languages other than English;
- The timing of training offerings lags behind the demand. Furthermore, training programs are often marketed with little notice and/or are held at times when it is difficult for middle managers to attend;
- Affordable training opportunities for middle managers are not widely available, limiting the number of middle managers that can benefit from training.
- The number of high-quality trainers and technical assistance providers that are locally accessible to MFIs is very small in most countries.
- Pre-training planning and preparation should be conducted to identify the course participants' needs, tailor course materials to address issues in participants' institutions, and demonstrate how the knowledge and skills acquired during the course can be applied to the identified issues.
- Accountability for productive change should be better reinforced. Too many learning opportunities end when the classroom-based course ends and this prevents them from having their desired impact.

Lessons learned from the implementation of the ILO Community of Practice (CoP) suggest that:

- It is important to set realistic expectations over a longer timeframe. A more realistic timeframe would require low levels of activity across a longer timeframe to accommodate individual schedules and priorities and engagement by all key stakeholders.
- It is necessary to establish roles and expectation from the beginning, sanctioned by all core team members in order for the community to progress—and just as importantly for all actors to recognize inherent limitations in roles according to their respective roles in the community for which the CoP is to serve.
- A CoP requires an internal champion throughout the planning and implementation process. Without such a committed and consistent champion, the community building and initiation of a pilot discussion using the CoP platform will not take place in an organized and timely fashion.

- Donor expectations must reflect (not exceed) community expectations for the donor investment to be viable and productive.

Key factors influencing sustainability of middle management trainings include the maintenance of course materials, central control over course content and delivery, the ability to price the course in a way that is profitable to suppliers yet affordable to clients, and the provision of incentives to keep partners and trainers interested in offering the training over a period of time.

H. MONEY TRANSFERS AND REMITTANCES

Given the strong relationship between migration, remittances, development, and access to financial services, migrant remittances are gaining increasing policy relevance in development economics. Remittance research has tackled measurement of remittance flows, methods of analysis, policy instruments that can enhance the impact of remittances on development, and the impact of these person-to-person transfers on poverty alleviation, finances, and macroeconomic variables.

Policy issues include reducing the barriers to entry for effective competition among money transfer operators and payers that can mitigate transaction costs and financial access, understanding the implications of the links between finance and remittances (including solutions to the lack of remittance senders' and recipients' access to financial institutions), and assessing the long-term sustainability of flows.

Learning Objectives

Under this FSKG topic, DAI and USAID strived to:

- Share the latest trends and development in the area of remittances and development to a wide audience of USID staff, other donors, banks, and MFIs, and money transfer operators;
- Document and analyze the competitive landscape of the remittance market in specific corridors that are of interest to USAID missions;
- Develop practical tools to help USAID missions better understand the role and importance of remittance flows in their countries and to identify potential policy and programmatic actions that reinforce ongoing economic growth and poverty reduction strategies;
- Support pilot activities for "productizing" remittances and expanding financial access by banking the unbanked; and
- Share the latest worldwide information—debates, developments, initiatives, data, case studies, events, and publications-on migrant remittances.

Research

Research under this topic sought to illustrate the interplay between research findings and policy instruments on how best to leverage these foreign savings into wealth generating activities:

- *Remittance Transfers to Armenia: Preliminary Survey Data Analysis*-- This briefing offers a preliminary data analysis of remittance flows and migration trends in Armenia, interpreted from the Central Bank of Armenia's household survey. It analyzes typical behaviors among recipients and senders, the marketplace for money transfers, the impact of migration, and explores some patterns that may shed light on the continuity of flows.

- *Remittances, Competition, and Fair Financial Access in Nigeria*—This case study examines the policy and development implications on transfers of remittances to Nigeria. The near-monopolistic hold on the market by one money transfer operator (MTO) and the fact that banks are the only entities legally authorized to perform international payments encourage informal transfers of money. Other findings in this report show that there is willingness among most banks and other financial institutions to entertain alternative strategies, including partnerships with alternative MTOs or innovative technologies for money transfers.

- *Remittances and Microfinance in Latin America and the Caribbean: Steps Forward on a Long Road Ahead*--This report examines the relationship between international remittances and microfinance, and presents the findings from a study on 166 microfinance and credit union institutions and an in-depth case study analysis of six of them. The report seeks to learn whether MFIs are paying remittances and if so, whether they are linking remittance transfers to other financial products.

- *Design of Good Guidelines on Remittance-related Household Survey Analysis*--This briefing offers practical guidelines and observations about how survey data collection on remittances informs thinking on migration and development policy making. Obtaining accurate data on the volume of migrant remittances flows is notoriously difficult, as many remittances transfers still occur informally and even when funds are transferred through official channels—such as bank accounts, the internet, paid cards or phones—the mechanisms for measuring these flows are weak. However, the volume of remittances transfers and awareness of the importance of remittances to poverty reduction have grown over the last decade and donors and organizations specializing in migration-related issues have increasingly supported efforts to improve remittances-related information.

- *Migrant Remittances Newsletters* – These quarterly publications highlight trends in migrant remittances, regulatory issues, cooperation and new projects, and the intersection of remittances and financial intermediation. The FSKG project published fourteen issues, each with an update of remittance-related news from around the world, a research note, a guest profile, an extended country profile, and listings of topical events and publications.

Key Lessons Learned

A review of the above-mentioned case studies led to the following findings:

- Those who receive remittances have an increased likelihood of having savings; research also indicates that those who receive larger amounts are more likely to have bank accounts, savings, and investments. The demand for financial services, however, has yet to be met by an adequate supply of appropriate products from banking institutions, thus posing a development policy problem.

- The Nigeria and Armenia projects (remittance destinations with different patterns of migration) show the continued prevalence of informal flows, underscoring the importance of finding alternative methods to accurately measure the volume of remittances and improve access to formal sending mechanisms.

- Unemployment is an important predictor of amounts received, the intention to migrate, and the expectation of future flows.

- In Nigeria, findings show that policies must address regulatory challenges that constrain the marketplace of remittance transfers. Furthermore, significant opportunities exist in developing innovative financial products.
- Common patterns exist in Latin American MFIs, regardless of the institution's performance. These include a lack of adequate competitive capacity, sufficient data collection and mining for financial analysis and forecasting, and adequate financial product design. Policy solutions address technical assistance on financial literacy, product design, and data management.
- International migration and increases in remittances show no signs of slowing in the coming years. Indeed, remittance income provides an incentive to migrate in countries suffering from high unemployment and limited prospects for growth, as seen in Armenia. Understanding the mechanisms and the human and financial dynamics of migrant money transfers can help shape policies that target remittance income as a key source of asset accumulation.

I. CREDIT SCORING FOR MICROFINANCE

Formal financial institutions worldwide use credit scoring to make decisions about and process small and medium-value loan applications. These institutions use it most widely and successfully for personal credit cards and consumer and mortgage loans. Repayment risk for these products is tied to verifiable factors such as income, credit bureau information, and demographic factors, including age, education and homeowner status. Increasingly, financial institutions are using credit scoring to evaluate loans to small and micro businesses, often in conjunction with a judgmental process rather than as an independent decision-making tool.

Learning Objectives

The key learning objective was to provide banks and MFIs with a framework and tools for designing and implementing custom credit scorecards.

Research

Under FSKG, DAI/USAID developed a guide, *"A Handbook for Developing Credit Scoring Systems in a Microfinance Context,"* to guide banks, MFIs, and donors interested in applying credit scoring as part of their business models. The research team drew upon the experience of microlenders from three continents to illustrate a four-step framework for designing and implementing custom credit scorecards. The framework is flexible, does not advocate any one rigid methodology or technology, and is thus appropriate for any organization with a clear strategy and some experience lending to its target market.

Key Lessons Learned

These lessons learned can be found in *"A Handbook for Development Credit Scoring Systems in a Microfinance Context,"* written by Dean Caire, et al, under DAI's FSKG contract. The lessons learned suggest that:

- Credit scoring is a strategy that the entire organization needs to understand and buy in to, in order for this strategy to receive the investment required and for it to be integrated into all the necessary functions of the institution. It is important to note that scoring not only impacts the credit risk management function, but also the finance, marketing, information technology, and operations functions as well.

- The benefits of using scoring as part of an organization's approach to risk management can only be realized if the entire organization understands the fundamental principles of credit scoring.
- An application scorecard has some benefits in terms of rank ordering risk among first-time applicants, but the real benefits of scoring show up more powerfully in a behavioral scorecard. Behavioral scorecards lead to increased efficiency (faster loan applications for repeat borrowers), loyalty programs, pre-approved loans, more targeted marketing due to the ability to segment the portfolio, more accurate provisioning, and competitive pricing according to risk.
- The key challenges to implementing credit storing are collecting, storing and maintaining data, changing the mindset of the organization to accept credit scoring, and having IT systems that are mature but flexible enough to enable complete integration of the scorecard into the application interface.

J. PROMOTION OF FINANCIAL STANDARDS

As the microfinance industry matures, the importance of common standards by which MFIs can be measured increases. Recognizing the importance of having MFIs follow these accepted common standards, a group of donors, rating agencies, and The SEEP Network worked together to produce Microfinance Consensus Guidelines: Definitions for Selected Financial Terms, Ratios, and Adjustments for Microfinance. Under FSKG, this group took the development of standardized financial performance indictors one step further: they created a framework to provide MFIs with a means to develop financial statements and reports so that those statements and reports can be used for meaningful analysis and monitoring and are in accordance with International Financial Reporting Standards.

Learning Objectives

Under DAI's FSKG contract, USAID funded The SEEP Network and Alternative Credit Technologies (ACT), LLC to develop a framework for MFIs for reporting, analysis and monitoring. The primary objective was to improve standardized reporting and evaluation of MFIs.

Research and Key Lessons Learned

The SEEP Network and ACT created deliverables, including:

- *Measuring Performance of Microfinance Institutions: A Framework for Reporting, Analysis, and Monitoring,* which is based upon the earlier microfinance consensus guidelines; and
- A trainer's guide for *Measuring Performance of Microfinance Institutions: A Framework for Reporting, Analysis, and Monitoring.*

The SEEP Network, ACT, DAI, and USAID learned that the only way that MFIs would adopt the framework would be if they understood the importance and relevance of the guide; it was not sufficient to provide only the tools presented in the guide. For this reason, the team did not stop at developing just the guide, but rather created "promotional" and learning materials, such as the PowerPoint presentation and the presentation handouts, to be used at conferences, seminars, and training sessions to encourage MFIs and MFI networks to adapt the financial reporting and analysis tools contained in the guide.

K. DEVELOPMENT CREDIT AUTHORITY AND OTHER GUARANTEES

Despite advances within the industry, MFIs have had difficulty attracting commercial capital necessary to become self-sufficient. Credit enhancements from USAID's Development Credit Authority (DCA) and other sources offer one way to expand access to capital by MFIs and to catalyze sustainable MFI relationships with formal financial sector actors, thereby increasing the availability of credit to micro and small enterprises.

DCA is a risk-sharing mechanism that encourages commercial banks, other lenders, and creditors to expand credit to sectors and industries they currently do not serve. It also allows them to lend with less collateral than was previously required. The expectation is that during the guarantee period, the lender will get to know the industries and their associated risks so that in the future, the lender will have the confidence to issue comparable credit without enhancements.

Learning Objectives

For fast-growing MFIs that are not licensed to take deposits, a major limitation to growth is the need to source funds for on-lending. FSKG's main research objective under this topic was to review the role that DCA has played in increasing access to lendable funds from bank loans and other sources.

Research

The Microenterprise Development Office, jointly with the Office of Development Credit, commissioned studies of six microfinance DCA or pre-DCA guarantee facilities to determine whether the credit enhancements had the effect of increasing sustainable access to credit and to assess the environmental and structural considerations that should be in place for the guarantee to achieve the desired effect.

The guarantee facilities reflected a wide range of deal structures in a wide range of countries. In Morocco, DCA provided two large MFIs portable guarantees so they could shop for their own loans. A commercial bank was also given a loan portfolio guarantee for loans to MFIs, and the mission worked with the bank to identify appropriate MFI borrowers. In Uganda, DCA gave several commercial banks dual-purpose loan portfolio guarantees for lending both to small and medium enterprises and to MFIs. In Mexico, an MFI received a portable guarantee to source its own loan. In Peru, the DCA enhancement re-guaranteed enhancements issued by a private guarantee facility, FOGAPI, to encourage lending to non-governmental organizations and other microlenders. A partial guarantee was issued for one of the debt tranches of the Global Commercial Microfinance Consortium, a microfinance investment fund sponsored by Deutsche Bank, to encourage purchase of notes issued by the fund. In Colombia, two loan guarantees were issued for loans for an MFI that did not want to take the route of seeking a deposit-taking license.

Key Lessons Learned

All of these facilities were associated with increased levels of lending, and most of these have encouraged lending beyond the period of the guarantee. Guarantees had a catalytic effect in increasing lending to MFIs when macroeconomic conditions were right, including dropping interest rates, decreasing inflation, market demand for microfinance, and licensing MFIs as deposit-taking institutions. While some banks perceived MFIs as a threat because the banks were going downmarket themselves, in most cases participating banks saw this as an opportunity to indirectly reach a new market by developing a niche lending specialty.

Another important lesson is that the guarantee is more effective as a part of a stream of technical support to MFIs, rather than as a stand-alone activity. Evaluations of several deals concluded that USAID support was critical in bringing credibility to the borrower institution. Banks were more interested in lending to MFIs if USAID was encouraging the loan, and Deutsche Bank found that the USAID role encouraged many first-time entrants to make microfinance investments. USAID does need to guard against its “endorsement” being used incorrectly, as one MFI implied that the guarantee was a substitute for deposit insurance.

Other findings included concerns about overlapping guarantees that distort the learning goal for the lenders, because of a perception of a full guarantee. In addition, guarantees offered through funds have leverage potential for USAID because structuring and monitoring services are incurred only once.

L. NETWORK RESEARCH

Microfinance networks play an important role in building inclusive financial sectors in developing countries. Their role is to support retail MFIs with services that improve MFI institutional performance, as well as to advocate an enabling environment for self-sustaining MFIs.

Learning Objectives

The research undertaken on this topic sought to provide microfinance networks with tools to strengthen their institutions and to provide donors with strategies on how to best support the institutional sustainability of microfinance associations or networks.

Research

To complete the research under this topic, DAI contracted The SEEP Network to compile two technical reports—“Building Strong Networks: An Institutional Strengthening Guide” and “Effective Donor Strategies to Support Microfinance Associations.” Both of these publications are available on MicroLINKS.

Key Lessons Learned

Many MFIs struggle to achieve profitability, and as a result, have few resources to support microfinance associations. Often, associations look to donors to provide this financial support needed to cover services, including advocacy, awareness-building, and information dissemination, as well as to develop sustainable demand-driven fee-based services.

Donors should support the development of a microfinance association’s external credibility and its internal capacity. Associations gain credibility when their members and a wide range of stakeholders, including policy makers, donors, and the financial services industry, recognize their importance.

To gain credibility, microfinance associations must possess the internal organizational capacity to deliver services. This capacity is measured in terms of governance, operations, financial viability, human resources, and service delivery.

Donors can best help associations by supporting the development, implementation, and sustainability of key services outlined in the associations’ business plans, rather than funding individual one-off projects. Business plan funding entails a more thorough understanding of, and support for, microfinance associations’ long-term institutional sustainability.

M. PROVING MICROFINANCE MATTERS

Due to a shift in USAID priorities, the Microenteprise Development Office of USAID decided to discontinue work under this topic. The USAID CTO reallocated funding from this topic to other research topics.

III. SHORT-TERM TECHNICAL SERVICES

USAID commissioned four key pieces of work under this component—The Microinsurance Notes Series; dissemination of Defining Options in Haiti; direct assistance to USAID/Mexico Mission on value chain finance action research programming; and direct assistance to USAID/Mexico mission on remittances programming. This report includes a discussion of the Microinsurance Notes Series in this section, because there was no specific microinsurance core research topic outlined in the original FSKG contract. The research and lessons learned pertaining to the other three pieces of research are contained under the appropriate core research topic.

MICROINSURANCE OVERVIEW

Poor people often improve their financial positions with microcredit, but easily fall back into poverty as soon as they face a financial crisis such as the death of a breadwinner, payment of essential health care costs, or the loss of livestock or other productive assets. Microinsurance is a key development tool in terms of helping low-income households better manage their risks and protect the gains they have made. Unlike microcredit's origins, where donors had to bring significant pools of funds to develop, maintain and expand MFIs, microinsurance is in many ways being pushed by the commercial insurance industry and has been expanding and evolving rapidly.

The donors' role in microinsurance is significantly different from that in microfinance, calling for a broad focus on the creation of enabling macro-, meso-, and micro-level environments for microinsurance. This, in turn, will make it possible for more products to reach low-income markets, improving the risk management capabilities of the poor and decreasing their vulnerability.

Learning Objectives

USAID and DAI aimed to provide information that helps explain the opportunities presented by microinsurance, the international lessons learned, and practical means for implementing microinsurance projects.

Research

To this end, FSKG developed a Microinsurance Note Series to provide an introduction and overview of key topics in microinsurance with links to resources that allow for greater exploration. This series can be a "crash course" for donors, practitioners, or project staff interested in microinsurance.

The first three microNOTES develop a general understanding of microinsurance, reviewing the importance of microinsurance in alleviating poverty, describing the fundamentals of microinsurance products, and introducing the array of delivery channels, including partnerships between MFIs and commercial insurers.

The next four microNOTES present a more detailed review of specific microinsurance products. These notes are devoted to successful product development in microinsurance, life insurance, health insurance, and index-based insurance.

The series concludes with two Notes addressing macro-level issues. "*Facilitating an Appropriate Regulatory and Supervisory Environment for Microinsurance*" evaluates the role of regulation in microinsurance, stressing the need for developing country regulators to manage increasing access, innovation and technological change while ensuring financial sector stability and consumer protection.

The final Microinsurance Note, "V*isions of the Future of Microinsurance and Some Thoughts on Getting There*," considers the evolution of the industry and the potential for pushing microinsurance out to the masses. The note summarizes the responses of a broad and diverse group of microinsurance experts about how they see microinsurance growing to cover over a billion people with products that the low-income market will value.

In addition to the Microinsurance Note series, FSKG in collaboration with the CGAP Working Group on Microinsurance produced a Lessons and Recommendations for Donors Note. Using the CGAP Working Group's Preliminary Donor Guidelines as a foundation document, and incorporating interviews with donor staff, consultants, and practitioners, the Note provides a summary and analysis of current donor approaches to supporting microinsurance, implementation issues and challenges, funding mechanisms, and performance and impact monitoring systems.

Key Lessons Learned

During the period in which the Microinsurance Notes were produced there was a dramatic advancement in the understanding of microinsurance, strong progress in the development of new products, and a sustained expansion of markets. The contribution of these Notes to the general pool of knowledge has been important in expanding microinsurance. Using authors at the top of the industry, and focusing on synthesizing lessons and knowledge, has made this series an effective tool for people to quickly understand the issues, trends, and lessons of microinsurance as a central tool to achieving a more permanent solution to poverty.

IV. KNOWLEDGE MANAGEMENT

Knowledge management plays a key role in increasing the development impact of research in the different FSKG topics, by publicizing and disseminating research results so that learning improves practice. DAI carried out a wide range of knowledge management activities that increased awareness of the research products, created venues for public discussion and knowledge sharing on many topics, and created more accessible versions of work done under the major FSKG research topics. A listing of the different types of knowledge management activities undertaken is listed below.

Dissemination of research products: Under the FSKG contract, DAI contributed to USAID's management of the microLINKS website by providing all research materials, appropriately formatted and branded, along with abstracts and searchable key words. DAI also maintained an updated Publications List, which was provided regularly to USAID and made available to other donors and practitioners. In addition, DAI maintained an up to date list of industry conferences and events that presented good opportunities for the distribution of DAI FSKG research to targeted audiences, provided hard copies and electronic copies of the research products, and selected several university graduate programs to receive promotional materials on FSKG research.

After Hours Seminar Series: DAI assisted USAID in sponsoring a seminar series to facilitate learning and knowledge sharing on key microenterprise topics. DAI presented the results of a number of FSKG research topics, such as HIV/AIDs and microenterprise development, savings mobilization, linking remittances and access to finance, housing finance, credit information markets, agricultural value chain finance, microfinance technologies, transition to capital, and helping clients understand insurance.

MicroNOTE Series: DAI and USAID published a number of microNOTES that synthesized key learnings under the major FKSG research topics. MicroNOTEs funded under the knowledge management component of the contract included:

- State-owned retail banks (SORBs)- the relevance of SORBs in USAID development finance
- Emerging trends in SORBs – which summarizes information presented in the census and includes a text box on three SORB cases
- The SORB, the Amhara Credit and Savings Institution
- The SORB, Land Bank of the Philippines
- A comparison of the Hatton National Bank and Credife case profitability case studies
- Highlights of Banking at the Base of the Pyramid

Illustrative Listing of Organizations, Universities and Conferences That Have Received FSKG Research

- SEEP Annual Conferences
- 2006 USAID Learning Conference
- Boulder Microfinance Trainings in Turin, Italy and Santiago, Chile
- Columbia University – School for International and Public Affairs
- Harvard University – Kennedy School of Government
- Georgetown University – School of Foreign Service
- Tufts University – The Fletcher School
- Johns Hopkins University – School for Advanced International Studies
- UC San Diego – School of International Relations and Pacific Studies
- New York University – Robert F. Wagner Graduate School of Public Service

- The strategic alliance between FIE and Promujer
- The strategic alliance between Cashpor and ICICI bank
- The strategic alliance between AMEEN and three Lebanese commercial banks
- The Hortifruiti finance case
- The Uganda value chain research
- The *Defining Options* curriculum and related tools

Speakers' Corners: DAI sponsored several online discussion forums through the microLINKS website. Topics presented and discussed include IT outsourcing options for microfinance institutions, innovations in outreach to the very poor, savings options for low-income populations and those in difficult to reach areas, and microinsurance.

USAID Learning Conference: DAI assisted USAID in presenting the results of FSKG research at the June 2006 Learning Conference. DAI was selected to present findings on financial services technology for the poor, HIV/AIDS and MSEs, commercial banking for the poor, value chain finance in rural and agricultural markets, and how MFI linkages with commercial banks can successfully expand access to financial services.

Key Lessons Learned

FSKG's efforts to market and disseminate project research illuminated the following lessons:

- Summarizing long reports into microNOTES was successful; the project received feedback that having a succinct overview and being able to access detailed information is useful.
- Using microLINKS, After Hours Events, and Speaker's Corners is an effective way of sharing and disseminating information.
- Outreach to universities with international development or international business programs broadens the impact of the research and can provide formative information for the next generation of development professionals.

A number of overarching project suggestions for knowledge management are included in the final section of the report.

V. LESSONS LEARNED DURING FSKG IMPLEMENTATION AND KEY RECOMMENDATIONS FOR FUTURE RESEARCH ACTIVITIES

ALLOWING FUNDING FLEXIBILITY SUPPORTS DEMAND-LED RESEARCH.

Under the core research component of this contract, USAID allowed DAI to move funds relatively easily from one research topic to another. By allowing this, DAI and USAID were able to spend more money on those activities for which there existed a greater research interest and less on others, which ensured that FSKG focused on researching relevant topics. At the time when contractors and USAID selected the topics and allocated the corresponding funding, there was no way of knowing where the industry would be in the final years of the contract.

While the flexibility to move funding from one established research topic to another existed, the contract provided limited flexibility to pursue new topics and areas of interest as the industry evolved, which prevented the project from tackling some emerging subjects later in the project period.

LINKING FSKG-FUNDED ACTIVITIES WITH USAID MISSION-SUPPORTED ACTIVITIES IS A COST-EFFECTIVE WAY OF ACHIEVING USAID RESULTS.

In cases where FSKG worked with other USAID projects, as in Nigeria with remittances work, Haiti with the Defining Options training, Kenya with analysis of fishery value chains, and Mexico with the mango value chain finance study, USAID has been able to combine theory and practice and disseminate the learning to a broader audience. Other topics and deliverables would have greatly benefited from a more linked approach to missions, mission activities and their interests. This would have allowed FSKG to be significantly more demand driven.

COMMITMENT TO ESTABLISHED RESEARCH AGENDAS ENABLES BETTER RESEARCH.

Flexibility was important for maintaining the relevance of FSKG research. However, once it was determined that a research topic was strategic and important, the development of a research agenda to explore the topic in a holistic and in-depth way was important to generating learning rather than just documenting or reporting on activities. When research topic agendas were not firmly committed to and approved early in the project, an opportunity was lost to maximize the results and impact of the work over the project duration. Good examples of topics that benefited from clear agendas include the Commercial Banks, Microfinance for Housing, HIV/AIDS, and Rural Finance. Each of these supported a series of case studies on specific activities, and a synthesis paper that drew from each of the individual case studies to develop more in-depth analysis and more broadly applicable lessons learned.

RECEIVING USAID SUPPORT FOR A KNOWLEDGE DISSEMINATION STRATEGY EARLY ON WOULD HAVE INCREASED THE OUTREACH AND IMPACT OF THE FSKG RESEARCH.

Although FSKG contractors worked in conjunction with USAID to develop and present a comprehensive knowledge management strategy to USAID early in the project, USAID did not approve the knowledge management plan until project year four. Having a clear knowledge management strategy in place from the start of the project would have made it easier to collaborate information dissemination across multiple contractors.

KNOWLEDGE MANAGEMENT DISSEMINATION STRATEGIES SHOULD BE LINKED TO MISSION ACTIVITIES AND INTERESTS FROM PROJECT INCEPTION.

As with knowledge creation, the dissemination rarely linked to mission activities and interests, and thus became very Washington D.C.-focused. Tying a strategy more strongly to the missions will result in a greater impact on USAID-funded development projects. Also additional strategies need to be developed to reach a wider audience, particularly those in developing countries where internet band width is still not that wide. Future research endeavors should consider broader outreach to universities including those with international development programs, a focus on international business or major universities in the developing world.

USING MICROLINKS, AFTER HOURS EVENTS, AND SPEAKER'S CORNERS IS AN EFFECTIVE WAY OF SHARING AND DISSEMINATING INFORMATION.

Throughout the contract period, DAI referred interested parties (especially those not familiar with USAID's FSKG contract) to the microLINKS website and events for more information on specific topics and on the research contract as a whole. It is important to note, however, that not all practitioners and donors are familiar with USAID's research efforts and the microLINKS site. For this reason, DAI explored disseminating FSKG deliverables through other channels, such as sending CDs containing selected documents to educational institutions overseas. Ideally, FSKG documents should also have been cross-referenced other websites such as the Microfinance Gateway.

THE FSKG PROJECT DEMONSTRATED THAT COLLABORATION BETWEEN DIFFERENT INTERNATIONAL DEVELOPMENT CONTRACTORS IS EFFECTIVE.

FSKG was very successful in getting a broad group of contractors and, to a lesser extent, NGO practitioners to work together.

FUTURE RESEARCH PROJECTS MAY BENEFIT FROM HAVING AN OUTSIDE PEER REVIEW PROCESS BUILT INTO THE CONTRACTING MECHANISM.

For particular topics in which USAID staff do not have in-depth expertise, peer review by a knowledgeable outside expert could ensure that relevant issues under the topic are being addressed, research quality is high, and that the recommendations and tools produced are relevant. This would also spur more fruitful collaboration across the industry and among donors.

THE CREATION OF FEEDBACK MECHANISMS WOULD HELP USAID AND THE CONTRACTOR UNDERSTAND THEIR AUDIENCE, THE RELEVANCE OF TOPICS PURSUED, AND THE IMPACT OF RESEARCH PRODUCED.

Information on who is accessing published research, which research is being accessed, and to what extent (in an indicator such as number of downloads for a particular report) would give USAID and the contractor better insight into the demographics of their audience and provide feedback on the relevance of particular topics. Information on who is accessing the research (be they missions, students, development practitioners, microfinance institutions,) would enable the project to tailor research towards their audience or inform strategies to market research. Data on how frequently (and which) reports are accessed could inform decisions to shift resources to more relevant topics and increase the impact of research efforts. Finally, the absence of a specific feedback mechanism from USAID missions makes it difficult to determine whether the project is pursuing topics that align with mission needs and interests.