Village Banking: A Cross-Country Study of a Community-Based Lending Methodology

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by

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EXECUTIVE SUMMARY

This study is a coordinated effort between the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project of the U.S. Agency for International Development and the World Bank's Women in Development Division. The study was initiated to document and assess village banking projects as they are being implemented by five nongovernmental organizations (NGOs) -- FINCA, CARE, CRS, Save the Children, and Freedom from Hunger -- in Thailand, Costa Rica, Northern Mexico, El Salvador, and Guatemala. The paper has four main objectives:

- Present the village banking model as developed by the Foundation for International Community Assistance and describe its various adaptations;
- Document its achievements to date;
- Point out the problems and prospects village banking programs may face in the future as they develop into larger and more mature programs; and
- Derive conclusions and future policy direction.

THE VILLAGE BANKING MODEL

Village banks (VBs) are community-managed credit and savings associations. They are established to improve poor people's, and especially poor women's, access to financial services, build a community self-help group and financial association, and help members to accumulate savings.

The functioning of a VB as outlined in the model can be demonstrated as follows. Sponsoring agencies provide loans to VB members. These loans are to function as catalysts to generate internal savings (and a community fund) for members. Initial loans from the sponsoring agency, operating through an **external account**, are for $50. While these loans are being repaid at commercial interest rates, members deposit savings into an **internal account**. The model is structured to encourage internal and external accounts to grow simultaneously, because external loan eligibility is determined by the previous loan plus a member's total savings contribution. After three years (nine four-month loans), if a member's savings have grown at the anticipated level of 20 percent per cycle, each member will have accumulated $300 in savings in the internal account. At this point, the model anticipates that both the village bank and its members will "graduate." Also, a viable VB organization, capable of independent operation, should have been established during this period.

Many organizations have taken this basic model and adapted it to local conditions and their own operating procedures. Few changes have been introduced in the model's financial structure. All projects studied have retained the internal/external account format. Financial changes have focused on loan maturities and limits and on interest rates. More substantive changes have involved organizational alterations and different forms of service delivery. The minimalist administrative setup espoused in the model has been abandoned in most projects as sponsoring agencies have built larger staffs and begun to collaborate with other organizations such as local NGOs and commercial banks for assistance in implementation, funding, and training. In addition, two projects (CARE/Guatemala and FFH/Thailand) have expanded the variety of services they deliver to include, for example, nutritional messages and agricultural extension.

DOCUMENTING ACHIEVEMENTS: VILLAGE BANKING IN PRACTICE

After presenting the VB model and its adaptations, actual project experience from the financial, institutional, and social perspective is examined.

Financial Performance

The main lessons learned regarding finance have centered on repayment rates, loan limits, savings levels and behavior, and project cost and income.

i) Repayment Rates: Repayment rates affect a VB's external and internal accounts. All but one project studied have experienced high external account repayments rates (between 92 percent and 100 percent). When external delinquencies have occurred, they have happened when projects have provided limited training to VBs, subsidized interest rates heavily, or been initiated in areas with highly transient populations. Alternatively, a study from Costa Rica demonstrates that external delinquencies are minimized in VBs with formal, written screening mechanisms and high levels of internal savings that can cushion against arrears or default.

By contrast, VB internal accounts have been plagued by arrears and unplanned rescheduling. Evidence shows that incidences of financial mismanagement usually occur in projects where internal accounts are not closely supervised. But in projects with highly supervised accounts, arrears and default have been minuscule because lending has been limited. FINCA/Costa Rica VBs have made inroads into solving this paradox. Flexibility in repayment seems to be acceptable as long as it is well managed. For example, if a member is late in his or her payments, he or she pays a penalty.

ii) Loan Limits and the Significance of $300: Lending limits are integral to the VB methodology. The model justifies a $300 limit by arguing that loans over this amount will not go to the poor and the timetable and structure of village banking is based on the $300 loan and savings level. Loan limits have been important as they keep elites from dominating projects. The $300 loan limit has been abandoned, however, in projects where $300 has proved to be an insufficient sum to meet investment requirements in the local context (CRS/Senegal and FINCA/Costa Rica) and where older VBs have demonstrated their creditworthiness and ability to manage larger loans. Loan limits currently range from $150 at CARE/Guatemala to $2,000 for advanced banks at FINCA/Costa Rica.

iii) Savings: Savings play an integral role in VBs as members are supposed to save 20 percent of every loan. In practice, savings levels have varied substantially across programs (from 5 percent to 48 percent). Savings do not vary positively with interest paid on deposits. Instead, savings levels are high in projects where members have a high demand for liquidity and where they use their savings to leverage larger loans. Further, members seem willing to accept low return on savings or even to pay for these facilities since they have few alternatives for secure money deposits. In addition, an inherent tension exists in the VB model between access to savings and building a viable, manageable internal account fund. In projects where members can withdraw their savings accounts with few restrictions, internal accounts have proved to be too difficult for committees to manage so internal loan funds have not operated. In contrast, in projects where there are significant restrictions on member access to savings, the internal loan fund has been very active. In general, savings have been higher in projects where they are readily accessible.

iv) Program Costs and Income: The project cost and income analysis has been limited by a lack of detailed data, the pilot stage of many of the projects, and inconsistent cost accounting methods used across programs. To compensate for the problems with the data, a portfolio analysis is used on three projects to estimate various break-even points under different economic scenarios. Sensitivity analysis is also done on interest and repayment rates. This financial analysis has indicated that the two pilot projects (CARE/Guatemala and FFH/Thailand) are currently the most subsidized, while the nonpilot project (FINCA/Northern Mexico) is less so. More importantly, the financial analysis suggested that for a program of average size to break even (40 medium-size banks in a portfolio), it must charge 36 to 48 percent in annual interest. Smaller programs with large education components may have to charge more (around 60 percent). The analysis also suggests that all projects studied must increase their interest rates if they are to break even.

Organization and Management Issues

Organization and management are relevant in projects at both the VB and sponsoring-agency levels.

i) Village Banks: For VBs, the issues of membership (especially size and variation) and leadership appeared to be the most pressing. The average VB has about 29 members, although membership ranges substantially among VBs (between 166 and 5). VB size has ramifications for the VB committee managers, sponsoring-agency costs, and the resources available to VBs in their internal accounts. Unfortunately, size has divergent effects on these variables: small banks are easier to manage but more costly to service and more financially vulnerable as they have fewer resources to distribute. To overcome these problems, sponsoring agencies have charged higher interest rates to small banks to cover the higher costs, and established two banks in one village to reduce costs.

Membership variation also affects VB projects. In contrast to what is anticipated in the model, membership has varied substantially between loan cycles. Membership flexibility is seen as advantageous to members who participate and withdraw as their household and work schedules permit. But it can create difficulties for leaders trying to manage fluctuating accounts and for sponsoring agencies attempting to anticipate credit needs.

Village banks are dependent on their leaders for effective operation. Strong VB leaders are able to keep accurate financial accounts, and resolve nonfinancial management issues such as ensuring that members pay fines and determining the way internal accounts should be allocated. This frequently requires training in accounting and management. As VBs mature, they face additional challenges associated with regularizing leadership turnover and compensating leaders for their time and resource commitments to the VB.

ii) Sponsoring Agency: The organization and management issues affecting sponsoring agencies include the effectiveness and efficiency of VB promoters, and the administrative support systems necessary to carry out VB programs. It is sometimes assumed that VB promoters that come from the community can be more effective than professional promoters. Although the community promoters have advantages, particularly in their ability to mobilize communities, they also have unanticipated costs given the expenses that must go into their training. Also, they are not appropriate in all cultural contexts.

Promoters constitute a significant proportion of projects costs (32 to 17 percent). Therefore, projects strive to reduce the number of promoters they require per VB. Promoter-to-VB ratios varied between

1:15-20 and 1:6-8. Ratios decrease substantially over time, but remain fairly high in projects that have substantial technical or education components and in which members are uneducated and have little access to alternative public or private services.

In addition, despite the administrative minimalism espoused in the VB model, in practice VB programs require a more elaborate administrative network to function effectively. In particular, VB programs require auditors, coordinators, management information systems, and other administrative support systems to operate effectively.

The Social Dimension

The three main social issues addressed in the paper include how projects adapt to socioeconomic environments, the socioeconomic status and gender of the clients served, and the role of empowerment in VB projects.

1) Socioeconomic Variations: Although they have commonalities, VB programs vary to fit local environments and clients. Education levels of members and their access to resources and infrastructure affect the services and types of assistance VB projects provide. Projects operating in relatively advanced countries like Costa Rica can have more advanced bookkeeping and rely heavily on other agencies to provide training and other inputs. Also, in highly migratory communities, VBs have greater difficulty imposing sanctions and discipline on their memberships.

ii) Who Is Being Served?: The VB model seeks to serve two overlapping target groups, the poorest of the poor and poor women. Socioeconomic data gathered on three projects suggest that the average VB member is poor, but not extremely poor. Moreover, VBs sometimes include relatively better-off members of a community who can, in some instances, add legitimacy to VBs.

Women are emphasized in the VB model because they are seen to have a greater impact on household and child welfare and because they are viewed as more responsible clients. Women's participation levels vary across programs (from 100 to 27 percent). In the all-women projects, women were identified as the sole target group and men were prohibited from participating. In the remaining projects, women are targeted by proxy. The terms and conditions of the loan and membership determine women's participation levels. Projects with smaller loans and strict terms attract more women. Experience from the VB projects also illustrates that women are not always better financial clients than men and that gender cannot substitute for training and external supervision.

iii) Empowerment and Participation: The VB model emphasizes "empowerment" or providing poor people, and especially poor women, with the tools (social and financial) to move out of poverty. Although it was beyond the scope of this paper to assess whether an individual has become empowered, there is evidence to suggest that VBs provide a forum for community action that could be viewed as a form of empowerment. Through village banks, communities have been better able to express their needs to outside organizations, and service agencies have been better able to deliver their goods to the localities. In addition, communities with VBs have increased their investment in community projects (public goods such as drainage ditches) and bulky investments (such as stores) that are too large for any one member to undertake but have communal benefits.

PROBLEMS AND PROSPECTS

Five main challenges face VB programs as they mature: the prospects for graduation, the potential for financial self-sufficiency, the role of apex institutions, project scale, and interaction between community management and supervision.

i) Graduation: Graduation to formal sector banks could occur at the individual or village bank level. However, experience indicates that individual graduation is unlikely to be a realistic option for the vast majority of VB clients. After two years, only 2 percent of CARE/Guatemala's clients have graduated. Moreover, if other programs such as ACCION International provide any example, individual graduation will occur infrequently. But VBs may be able to graduate as a single unit since both lenders and borrowers can decrease their transaction costs when they operate through group mechanisms. Questions remain, however, as to which agency will have the responsibility of auditing or supervising VB activities and accounts. Moreover, in countries with ill-functioning formal financial sectors, VB graduation may not be desirable.

ii) Financial Self-Sufficiency: If graduation is not an option, VB projects could seek to become financially self-sustaining. Financial self-sufficiency is unlikely to be a viable alternative for individual village banks, however, because they are too small and their portfolios too concentrated for them to overcome covariance problems or to generate sufficient resources to provide their membership with continual services. Therefore, financial self-sufficiency may be a more realistic option at the sponsoring agency level.

A program would be considered financially self-sufficient if it could cover -- through fees and interest charges -- its operating costs, including loan loss reserves, the cost of funds, and inflation to maintain the real value of the loan capital. But to date no VB project has come close to financial self-sufficiency, although some projects have taken preliminary steps (such as establishing relationships with commercial banks) that may aid the process. Factors mitigating against financial self-sufficiency include the pilot stage of many projects; the inadequate financial procedures and interest rate structures adopted (for instance, interest rates are not set to reflect costs); the $300, three-year time frame envisioned in the model; and sponsoring agencies' limited access to commercial funds and ready access to donor grants.

iii) Apex Institutions: If projects are to become financially self-sufficient they must establish supporting financial (or apex) institutions that provide VBs with a source of funds and a secure place for surplus deposits, and offer auditing and general technical services. Two projects studied (CRS/Thailand and FINCA/Costa Rica) have taken steps toward establishing apex institutions. CRS is considering building a confederation of VBs and could benefit from looking at lessons learned from the credit union experience. FINCA/Costa Rica is developing into an intermediary itself. Its four main functions include:

- Helping to establish VBs by identifying communities and training members to manage funds;
- Linking VBs to other private and public agencies for economic, technical, and marketing services;
- Playing a supervisory role, which includes auditing and ensuring local elites do not dominate banks; and

- Providing loans.

iv) Scale: The issue of scale is relevant at the VB and sponsoring-agency levels. As a result of management and covariance problems, it is unlikely that VBs will be able to grow large and continue to function effectively. Consequently, scaling up is more likely to occur at the sponsoring-agency level. To date, however, VB projects have limited outreach. The majority serve under 800 people. FINCA/Costa Rica is by far the largest, reaching over 3,500 clients. The factors constraining VB sponsoring-agency growth are similar to those affecting many NGOs. These include low levels of funding, the sometimes adversarial relationship of NGOs with formal sector institutions, and an emphasis on adaptability and flexibility at the expense of standard procedures, all of which lead to smallness.

If VB programs are to increase in size they will have to decrease their emphasis on specialized local interests and standardize more procedures; negotiate with formal institutions, particularly commercial banks; rationalize their cost and pricing structures; and increase their investment in activities and instruments that will enhance financial and institutional sustainability.

v) Community Management, Supervision, and Risks: The VB model emphasizes participation and is important for VBs as it helps build a sense of ownership that is necessary for successful functioning. All projects studied have achieved fairly high levels of participation and community management. However, many sponsoring agencies (and the VB model) have assumed that participatory local organizations are self-regulating and supervision has been viewed as a threat to VB independence. As a result, in some instances, little attention is paid to supervising VB internal accounts. This strategy has resulted in financial mismanagement (both planned and unplanned) in mixed-gender and all-female banks alike. A lack of supervision and risk management has been especially damaging when it has led to a loss of client savings. Moreover, projects such as FINCA/Costa Rica that have incorporated supervisory services (like semiannual audits) have not jeopardized VB autonomy. Indeed, FINCA/Costa Rica's VBs were probably the most independent banks visited.

Traditional methods of risk management such as deposit insurance and external audits may not be appropriate for village banks. Local solutions may involve the monthly cross-checking of accounts, keeping members' savings secure in a local bank or post office savings box, external audits, establishing reserve funds, and providing more training in risk management.

CONCLUSIONS

In conclusion, village banking projects and the VB model have shown promise particularly in their ability to reach the poor, mobilize local resources (including savings and labor), foster community participation and investment, and achieve high repayment rates at least in the external accounts. But this study has also exposed shortcomings in the model and in project implementation. First, the three-year, $300 time frame does not accurately reflect the financial behavior or needs of clients and VBs. Second, the administrative requirements of sponsoring agencies greatly exceed what is implied in the model. Third, VBs require considerable training (especially financial and management) and supervisory services that are understated or ignored in the model and in many VB projects. Finally, VB projects must put greater effort into working toward financial self-sufficiency, VB graduation, and establishment of apex institutions.

SECTION I

INTRODUCTION

1.01 This study is a preliminary investigation into the village banking methodology as pioneered by the Foundation for International Community Assistance (FINCA). The main objectives of the study are to define this particular community-based saving and loan model, document its achievements to date, and suggest future policy directions with a particular focus on factors that contribute to (or jeopardize) sustainability.

1.02 The assignment is a coordinated effort between the Growth and Equity through Microenterprise Investments and Institutions (GEMINI) Project of the U.S. Agency for International Development and the World Bank's Women in Development Division. The rationale behind focusing on the model is fourfold. First, the FINCA methodology, with its emphasis on the poorest of the poor and women and rapid expansion with low external costs, represents a very appealing model that deserves close examination and documentation. Second, it is a relatively new initiative (the first projects were introduced in the 1980s) that has been widely adopted by nongovernmental organizations (NGOs). By 1990, the methodology was being introduced in more than 14 countries by over eight international assistance agencies and numerous local NGOs.[1] Third, many programs have made significant adaptations of the original FINCA model to fit varying local conditions. These deserve documentation. Finally, to date, few external studies of village banking initiatives exist to document the methodology's successes, lessons learned, and various adaptations.

1.03 The paper is divided into five main parts. First, it describes the research methodology used in the paper. Second, it presents the village banking model and variants that have been adopted. Third, it illustrates village banking in practice by documenting the financial, institutional, and social achievements of selected projects. Fourth, the paper highlights the problems and prospects for the methodology. It concludes with potential policy alternatives and areas for further research.

[1] The countries include Bolivia, Chile, Costa Rica, Dominican Republic, El Salvador, Ghana, Guatemala, Haiti, Mali, Mexico, Peru, Senegal, Thailand, and Togo. Participating agencies include CARE, Catholic Relief Services, Foster Parents Plan, Foundational For International Community Assistance, Freedom From Hunger Foundation, Katalysis, Rotary International, World Share, and others.

SECTION II

METHODOLOGY

2.01 The study is based primarily on field visits that were made to project sites in Thailand, Guatemala, Costa Rica, and Mexico. In Thailand, two different village banking initiatives introduced by the Freedom from Hunger Foundation (FFH) and Catholic Relief Services (CRS) were visited between August and September 1990. In Guatemala, Costa Rica, and Mexico, projects funded by CARE, FINCA/Costa Rica, and FINCA/Northern Mexico, respectively, were visited between October and November 1990. Information from Save the Children/El Salvador, FINCA/El Salvador, and Freedom from Hunger/Ghana is also incorporated into the study. Although field visits were not made to these project sites, efforts were made to collect sufficient data on them to warrant their inclusion in the paper to broaden the study's perspective and database. This information was complemented by discussions with project headquarters staff and a literature review.

2.02 The project visits fulfilled three main functions. First, they facilitated the collection of project data on financial indicators, participating organizations, and the varied social and cultural settings of the different projects. Second, the field visits allowed for discussions with locally based staff regarding project strengths and weaknesses. Third, they permitted interviews with village bank members. These interviews were used to solicit beneficiaries' perceptions of the project to see if they conformed to those of the staff and to gather anecdotal evidence on project impact.

2.03 General information was gathered from each project on, for example, total beneficiaries reached, loans extended, and savings mobilized. In addition, more in-depth information was collected on three village banks within each VB (village bank) program.[2] This information included, for example, more specific financial data on savings and loans trends in the particular banks, membership variation, income status of VB members, and individual member's personal experience with the banks. The in-depth review of particular village banks provided specificity to the general project data, highlighted short-term trends or patterns not detectable through overall data analysis, and improved understanding of social achievements.

2.04 It is important to reiterate that the study is preliminary. The short-term nature of the research limits the conclusions that can be drawn. Issues such as development impact, which require survey analysis, could not be addressed except anecdotally. Moreover, the early stage of implementation of a significant number of the projects has important implications for the study. Many of the projects reviewed

[2] In Guatemala the three banks visited were Santo Domingo Xenacoj in Chimaltenango Department, San Vicente Pacaya in Escuintla Department, and San Mateo Milpas Altas in Sacatepeguey Department. In Northern Mexico, the four banks visited were Banco Futuro in Tijuana, and Banco Superacion de la Mujer, Banco Mujeres Activas, and Banco del Futur la Progressor Mujer in Mexicali, Baja California Norte. The three banks visited at the CRS/Thailand project were Na Poe 1, Na Poe 2, and Nang Sum banks in Surin Province. The two banks visited at the FFH/Thailand project were Na Sri Nuan and Ban Kvaow banks in Chumpang District in Korat (Nakhon Ratchasima) Province. The banks visited in Costa Rica included San Gerardo de Rivas, Juntas de Pucuar and Playa Linda in Perez Zeledon; Fuertz Unitas and Asociacion Agricultures Iztaru in Pococi, Limon; and Playa Hermosa in OSA, Puntarenas.

are pilot initiatives. This status affects their implementation schedules and objectives.[3] Pilot projects, for example, are typically more interested in learning from the process of implementation and monitoring and evaluation than they are in reaching a large number of beneficiaries. Given these limiting factors, the study's objectives are to highlight trends and issues and identify an agenda for additional research rather than come to definitive conclusions about the village banking paradigm.

[3] At the time of the study, the projects of FFH, CRS, and CARE/Guatemala were explicitly stated to be pilot initiatives.

SECTION III

PRESENTING THE VILLAGE BANK MODEL

3.01 VBs are community-managed credit and savings associations that are established to improve members' access to financial services, build a community self-help group, and help members accumulate savings. Together these factors are supposed to help participants -- poor people, and especially poor women -- move out of poverty. Village banking as a methodology has been developing since the mid-1980s through experimentation in varying economic and social settings. It is still evolving to fit local conditions and the operating procedures of the implementing agencies that have adopted the methodology. This section will define village banking in its most basic form as well as describe its various adaptations.

THE BASIC MODEL

3.02 The basic village banking model is presented by John and Marguerite Hatch in the *Village Banking Manual* (1989). This manual, produced by FINCA after several years of experimentation, has acted as a preliminary design document for many of the agencies adopting village banking. Consequently, significant elements of the model as presented in the manual are found in most village banking initiatives. In an effort to clarify presentation, the model is broken down into its financial, institutional, and social components.

Poverty's Roots

3.03 Before going into the central components of the model it is necessary to demonstrate what the methodology identifies as the central causes of poverty. The roots of poverty are seen to be both social/psychological and financial. The manual suggests the social causes, especially for poor women, are low self-esteem and the concomitant effect this has on poor people's perception of their capabilities and opportunities. For Hatch and Hatch, this is expressed through an "I can't" mentality. The financial determinants of poverty include limited access to external resources and low or nonexistent personal savings. Savings play a particularly important role in breaking the "cycle of poverty," which is presented as follows:

> When a family has scarce income, it does not have the resources to save, and with low savings the family is unable to increase its investment. The family that is not achieving new investment cannot increase its productivity. The family with low productivity cannot increase its income, which once again reinforces lack of savings (Hatch and Hatch, 1989:1-3).

Village banks are intended to provide the tools to ameliorate the factors that cause poverty and prevent people from breaking out of it. These tools include:

- Loans to finance income-generating activities;
- A stimulus for voluntary savings; and

- A mutual support group of 30 to 50 members. These tools fall broadly into financial, institutional, and social categories.

Financial Components

3.04 How does a VB operate financially? Sponsoring agencies provide seed capital to the newly established village banks, which then use the money to lend to their membership. Individual members first loans are typically for the local equivalent of $50 dollars. Therefore, the first capitalization of a loan for a bank with 20 members would be $1,000, $1,500 for a bank with 30 members, and so on. The loans require no collateral. Instead, all members sign the loan agreement to offer a collective guarantee.[4] Maturity on loans is typically four months (or 16 weeks) and is repaid in weekly installments (1/16th of the obligation) to the VB. Each member selects his or her own income-generating activity and loans usually finance short-term, working capital investments. Commercial rates of interest are charged -- rates in most programs range from 1 to 3 percent per month although rates vary with the economic conditions of the country. At the end of the 16 weeks, the VB repays the sponsoring agency with interest. The loan money that comes from, and is repaid to, the sponsoring organization makes up what is called the **external account.**

3.05 If members repay their first loan they are entitled to a second loan with the same maturity, but the amount of the second loan for which a member is eligible varies. The amount is determined by how much savings a member has been able to accumulate over the four months. Members' weekly loan installments are accompanied by savings contributions. The methodology anticipates that a minimum of 20 percent of the loan amount will be saved per cycle. Members taking out a first loan of $50 should then save $10 over a period of 16 weeks, and be eligible for a second loan of $60. The previous loan then serves as a base for the following loans, and the savings match is always based on the accumulated savings. Therefore, a person saving $10 on an initial $50 loan and $12 on a second loans for $60 would be eligible for a third loan of $82 ($10 + $12 + $60), and so on.

3.06 Members' savings stay in the village bank and can be used for purposes that members determine, including making loans to members and nonmembers, or financing collective income-generating activities. No interest is paid on savings. Instead, members receive a share of VB profits from the bank's relending activities or other investments. The manual suggests that the distribution of profits be based on the amount of savings each member has accumulated -- for example, a person with 10 percent of total bank savings is entitled to 10 percent of the profit. The VB determines the terms and regulations -- interest rates, maturity, and eligibility -- regarding loans made with member savings. The interest rates charged on these loans almost always exceed the amount charged on the external account. By loaning out members' savings and installment payments, the VBs keep money circulating and generating income.[5]

3.07 These funds, comprised of savings, interest from loans made with member savings, fines charged to members, profits from village bank investments, and installment payments to the external account, make

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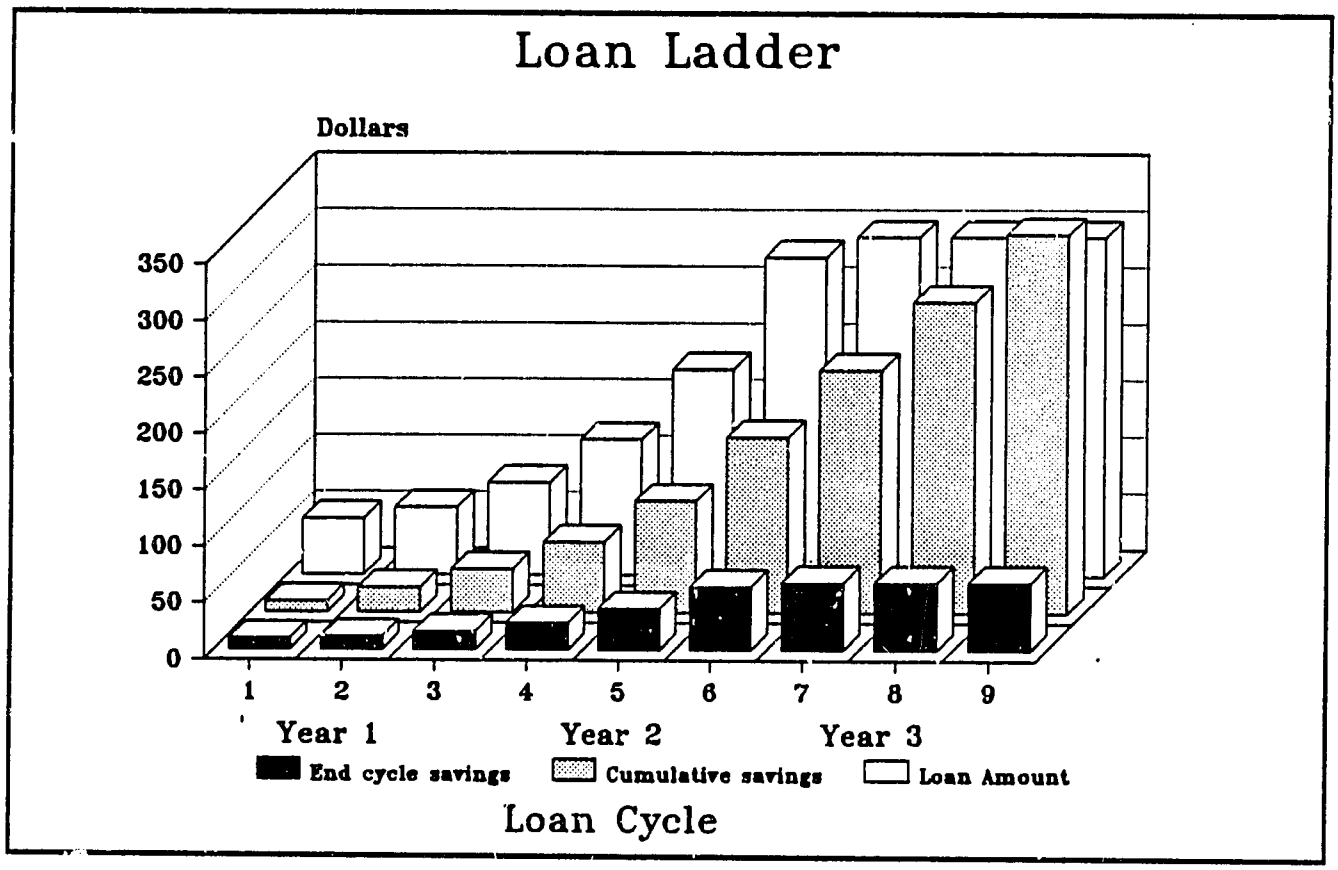
[4] Joint liability is imposed on the loan. The sponsoring agency makes its own loan to the village bank, which then distributes it among its membership according to specific eligibility requirements. The village bank as a whole then is responsible for the repayment of all individual loans.

[5] Installment payments must be repaid to the sponsoring agency at the end of the cycle. But while the money is sitting in the VB, it can be loaned out on the condition that it is repaid in time to meet the external funds deadlines.

up the internal account. This internal account is fully managed by the village bank, and is made up exclusively of local funds. The loans from the sponsoring agency, the external account funds, act as a catalyst to stimulate the development of the internal account and of members' personal savings. Figure 1 illustrates the interaction between the internal and external accounts.

FIGURE 1: THE VILLAGE BANK LOAN LADDER



3.08 Members work toward building sufficient savings to reach the external account maximum loan limit of $300. If a member has been saving at an average rate of 20 percent per cycle, this external account ceiling should be reached in three years. Also over the three-year period, a member's savings level should have grown to $300 dollars. After achieving this level of savings, a member will have "graduated" from the program. Also after three years, the sponsoring agency recovers all of the borrowed capital for the last time and then employs these funds to finance one or more new banks.

3.09 Why the $300 ceiling and graduation level? The $300 loan limit was established on the external account to prevent wealthier members from getting disproportionate access to VB capital. Members can, however, exceed the $300 limit by borrowing from the internal account, but in such cases their internal capital loans must be approved by all bank members. The $300 graduation savings level is less clearly articulated. Implicit in the model is the assumption that savings is integrally linked with poverty. Presumably the assumption is that $300 is a sufficient sum to allow for self-financing of income-generating activities. Also the model anticipates that the bank will continue to function, financing its operations with members' savings after the three-year start-up period.

The Organizational Structure

3.10 The organizational structure that accompanies the village banking model includes the implementing agency and the VB. Instructions for the sponsoring agency emphasize the role of the VB promoter -- the sponsoring agency staff person that organizes the VBs -- and the materials needed to support VBs directly. There is an implicit assumption that village banking requires very limited administrative overhead. Administrative support requirements at the sponsoring-agency level, such as accounting procedures, management information systems, or follow-up monitoring, are not specified. Also, there is no discussion of access to funds. Sponsoring agencies are not necessarily supposed to act as an intermediary between commercial and village banks as they are in other models such as that espoused by Women's World Banking.

3.11 The responsibilities and requirements of the VB promoter are clearly outlined meeting by meeting in the instruction manual. The promotor of the sponsoring agency is responsible for training and organizing VB members and the committee. Much of this training takes place before a VB gets its first loan. During a month-long trial and training period, the manual suggests that the VB have four weekly meetings to organize, elect directors, start the saving process, establish bylaws, and plan for the bank's inauguration.

3.12 After the initial month, the manual foresees a drop in visits by promoters. Although promoters are expected to attend the end-of-the-cycle meetings to collect interest and to disburse the new loans, they are not supposed to attend every weekly meeting. One goal of village banking is to establish self-sustaining community banks, and one way of promoting independence is to have VBs learn to conduct meetings without outside assistance.

3.13 The structure and role of the village banks receives greater attention. A VB consists of its general membership and a committee. Membership is based on self-selection: members are not chosen by promoters. This is crucial since members guarantee each other's loans. Further, a screening process is typically imposed on members, who are required to go through a trial period before getting access to a loan. After the first four start-up meetings, loans are only granted to those who have attended at least three consecutive meetings and have made at least three voluntary savings contributions. The size of a village bank is another important issue. The optimal size of a VB is purported to be between 30 and 50 members. This figure limits the management needs of village banks and increases the potential for group liability to function adequately as a substitute for collateral.

3.14 Village banks are managed by a democratically elected committee. Members elect an administrative committee composed of at least three officers: the president, secretary, and treasurer, whose tenure and responsibilities are described in the bylaws. Committee responsibilities include convening meetings and keeping minutes, approving loans, supervising loan payments, receiving savings deposits, loaning out or investing savings, and keeping up-to-date records of financial transactions. Although the committee does the majority, if not all, of the financial transactions and management tasks, VBs are supposed to be highly participatory. Full attendance at meetings is stressed, as is member input in decision making. According to the manual, participation will reduce the chances that resources will be co-opted by elites and facilitate planning and administration (presumably by pooling resources and knowledge).

Social Components

3.15 Social objectives are frequently the most difficult to describe, let alone assess. The village banking methodology, however, has adopted a clear social goal: reduce poverty in families by increasing the income of women who are typically the ones most responsible for household -- and particularly children's -- welfare.[6] The woman's role in the household is only one reason why they are targeted as beneficiaries. Additional justifications are that women are sometimes seen as more responsible financial services clients (that is, they are less likely to spend their loan or profits from investments on leisure activities or miss a loan repayment), and that village groups, when they include both male and female members, tend to be dominated by men. A related argument is that women tend to have less access to resources than men (which also provides an argument for targeting them) (Berger 1989, Berger and Buvinic 1989, Blumberg 1989, Holt and Ribe 1991, World Bank 1989). Finally, it is also anticipated that female participation in VBs combined with their increased access to financial services and (it is hoped) increased cash earnings will help to enhance the social status of women and their intra-household bargaining power.[7]

3.16 Village banking embraces three strategies to meet social objectives: target poor women, create a support group, and build capacity to manage participatory local organizations. The model does not give guidelines as to how to target poor people directly -- for example, through means testing or by listing specific criteria (such as land holding) for identifying poor people or suitable villages.[8] Instead, targeting is done by proxy. It is assumed that wealthier clients will not be interested in small, short-term loans ($300 or less) that are only available at commercial or above-commercial interest rates and that require frequent attendance at community meetings. Wealthier clients typically have access to cheaper financial alternatives that offer larger loans and do not require as many demands on their time. Further, since many of the implementing organizations are grassroots NGOs, they may already have established contacts in low-income communities.

3.17 Village banks are supposed to act as self-help groups that provide mutual aid to their membership.[9] This is necessary, according to the manual, since poverty stems not only from the lack of money but also from a lack of self-confidence. Low levels of confidence may be especially pronounced among females

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[6] This emphasis on women has also been pursued by other financial services organizations such as the Grameen Bank in Bangladesh, the Working Women's Forum in Madras India, and Production Credit for Rural Women in Nepal. Although there is anecdotal evidence to suggest that income generating programs targeted at women will have greater impact on children's nutritional status, this hypothesis has yet to be rigorously tested or documented systematically across regions or programs. For additional reading see Acharya, M and Bennett, L., 1982, "Women and the Subsistence Sector: Economic Participation and Household Decision-Making in Nepal," World Bank Staff Working Paper No. 526, Washington D.C: The World Bank; and Guyer, Jane, 1980, "Household Budgets and Women's Issues," Working Paper No. 28, Boston: African Studies Center, Boston University.

[7] For further reading on intra-household bargaining see Lynn Bennett, 1990, "An Approach to the Study of Women's Productive Roles as a Determinant of Intra-household Allocation Patterns," in Beatrice Lorge Rogers and Nina P. Schlossman (eds.), *Intra-Household Resource Allocation: Issues and Methods for Development Policy and Planning*, Tokyo: The United Nations University.

[8] This is in contrast to organizations such as the Grameen Bank that follow more standard operating procedures that range from how to identify the target group to accounting procedures and training requirements (Hossain 1988:25-28).

[9] For further reading on self-help groups see Smith and Pillemer 1983, and Kropp, Erhard et al. 1989.

who possess limited capital -- human or otherwise. Village banks are to help change members from a negative mind-set (characterized by an "I can't") to a positive one (characterized by "I can").

3.18 The emphasis on building local capacity to manage village banks in a participatory manner has interrelated social as well as organizational objectives. Building local capacity for community management of locally generated funds can increase the ability of the target group to affect decision making -- or, in other words, empower the poor.[10] Increased participation and group formation, particularly if they are backed up with resources, can improve the ability of poor women to affect household, local, and potentially national decisions. The model, however, is primarily concerned with women's increased ability to affect resource allocation decisions in the household -- and especially investment in children's welfare.

Conclusions

3.19 The model has many attractive attributes both for lenders and for borrowers. From the financial perspective the model satisfies three key tests of financial performance. First, it reduces risks for the implementing organization and the VB itself by imposing joint liability on the members to repay external loans, tying loan levels to savings deposits, and starting with small loans and only gradually increasing loan amounts as a member builds a credit history. (It is important to point out, however, that these risk-reducing mechanisms may have more relevance for the external than the internal accounts that are not subject to the same restrictions.)

3.20 Second, it provides a mechanism for keeping funds circulating and for generating income. Third, by transferring many of the administrative aspects of providing financial services to the VBs, an implementing agency minimizes its own transaction costs -- at least in the longer term. The short-term costs of organizing the VBs and providing the necessary training may actually be considerably higher than lending to individuals (Bratton 1986, and Huppi and Feder 1989). The simplicity of the financial mechanism and the relatively small amount of capital it requires may also be desirable to sponsoring agencies.

3.21 Organizationally it also has appeal. The methodology calls for limited administrative overhead. Moreover, although it demands some training for the set-up of the bank, it does not emphasize business training. In that sense, it is a minimalist financial service model. The combination of these factors also reduces costs for implementing agencies. In addition, the model does not require coordination with many different agencies such as commercial banks, government ministries, or apex institutions, and it allows for direct interaction with communities. Since VBs remain outside of formal regulations and restrictions, bureaucratic red tape can be avoided.

3.22 Socially, village banking is desirable because it targets a difficult-to-reach and disadvantaged population (poor women), builds capacity for community management and local organizations, and

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[10] There is considerable literature on participation and empowerment that encompasses a wide range of experiences and opinions. For some of the more comprehensive works see: (a) Robert Chambers, 1983, *Rural Development; Putting the Last First*. London: Longman; (b) David Korten and Felipe Alfonso (eds), 1983, *Bureacracy and the Poor*, Connecticut: Kumarian Press, Inc.; (c) Albert Hirshman, 1984, *Getting Ahead Collectively -- Grassroots Experiences in Latin America*, New York: Pergamon Press; (d) Michael Cernea (ed), 1985, *Putting People First: Sociological Variables in Rural Development*, New York: Oxford University Press; and (e) John P. Lewis (ed), 1988, *Strengthening the Poor: What Have We Learned?*

mobilizes local resources. All these factors combined are also supposed to promote institutional and financial sustainability.

3.23 The positive attributes described above stress the needs of lenders or donors. Borrowers may also be attracted to the methodology for a number of reasons. First, by setting up community banks with simple financial procedures and loans that are available immediately, VBs reduce member's noninterest costs of borrowing. Research has clearly demonstrated that these noninterest transaction costs impose some of the greatest barriers to formal sector financial services for poor people (Adams and Nehman 1979, Adams and Graham 1984:315, and Christen 1989).

3.24 Second, by establishing joint-liability group lending mechanisms, VBs allow members to overcome collateral requirements. Collateral requirements similarly impede poor people's access to formal credit. This barrier is particularly severe for women because formal land titles (an item commonly used as collateral) are typically registered in men's names. Third, village banking offers both savings and credit services. Finally, it provides a forum for the community to interact for social or productive purposes. Again, these groups can be especially important for women (March and Taqqu 1982, Otero 1989). Groups can help women find work, spread information, offer training, and provides access to resources in societies where women are excluded from more formal networks (Holt and Ribe 1991).

3.25 But in some ways the strength and appeal of the model are also its weaknesses. The risk management schemes intrinsic to the model allow poor people to substitute for traditional types of risk-reducing mechanisms (such as physical collateral for loans) that impede their access to formal financial services. It is unclear, however, whether these alternative forms of risk management would be sufficient to ensure financial viability especially after the implementing agency departs and if loan sizes are increased. Further, the three-year $300 time frame and loan limit, while appealing to donors, has not been rigorously tested.

3.26 From an institutional perspective, the model may also have shortcomings. Its low-cost, highly decentralized institutional structure may suffer from the lack of an intermediate-level institution. Typically, such institutions are necessary to absorb excess savings, provide access to capital when local demand for funds exceeds supply, perform occasional supervisory duties and audits, and undertake responsibilities such as leveraging capital from a bank. Moreover, the manual advocates a minimalist service delivery methodology, yet it also suggests targeting the most disadvantaged and difficult-to-reach group. It is precisely this group that may require both financial and nonfinancial inputs (such as business training) to help develop their businesses beyond mere subsistence levels (Mann, Grindle, and Shipton 1989). Many of the model's adaptations, discussed below, have begun to address these potential problems.

ADAPTATIONS OF THE BASIC MODEL

3.27 The village banking model has been adapted in numerous ways by different organizations to fit varying contexts. Adaptations of the methodology have focused on financial and institutional changes including alterations in the service delivery systems. In addition, more recent programs being introduced at higher funding levels have initiated more substantial changes in the implementing institution that are designed to allow it to reach a greater number of beneficiaries.

Financial Adaptations

3.28 Most sponsoring agencies have held on to the basic financial structure of the model, establishing both internal and external accounts that grow simultaneously with members' savings levels. Financial alterations have focused on loan levels, loan maturity, and to a lesser extent interest rates. A number of programs have departed from the $300 limit and the $50 starting point when these amounts have not been appropriate in the country context. For example, CARE/Guatemala's loans range from $50 to $150, FINCA/Costa Rica's from $64 to $2,000, and CRS/Senegal's from $67 to $500. Raising (or lowering) limits has not necessarily appeared to be associated with reaching a different (poorer or better off) clientele.[11] Rather, it reflects the divergent needs of different countries and growing demand for loans over time as communities develop and individual businesses expand.

3.29 Loan installment payments and maturities vary between programs as do meeting schedules. Some programs require banks to meet once a week to make installment payments, others meet fortnightly, and still others only monthly. The older programs tend to meet less frequently. FINCA/Northern Mexico and CRS/Thailand maintain the four-month cycles. For FINCA/Northern Mexico, this appears to match the market and trading-based income-generating activities of bank members. In most programs, however, members are much more tied to a longer agricultural cycle. At CARE/Guatemala and FFH/Thailand loans are for six months, reflecting the fact that they mostly go for livestock raising -- primarily pigs and poultry -- or textile weaving, activities that turn over less quickly than trading.

3.30 At FINCA/Costa Rica loan maturities are significantly longer and vary between 18 and 60 months. These longer cycles probably reflect several factors:

- VBs started with longer loans cycles (60 months);
- Loans are considerably larger;
- The majority of members are men involved in agricultural activities;
- The program is much older than the others, having started in 1985; and
- Loans are frequently for community investment projects such as building a local store, which requires a longer and more substantial financial investment.

3.31 Some programs have also opted for noncommercial interest rates. Save the Children/El Salvador lends to its banks at a heavily subsidized rate of 3 percent per annum while CRS/Thailand lends at 12 percent, which falls below the government-regulated commercial rate of 17 percent. FINCA/Costa Rica has subsidized loans to new banks at the rate of 18 percent annually, but then increases the rate to between 21 and 30 percent over time as banks develop. These amounts are still below the commercial rate of 36 percent. In contrast, CARE/Guatemala charges 24 percent per annum, which is above the government-regulated commercial rate of 16 to 18 percent. VBs across the programs typically add 1 or 2 points on to the interest rate to generate income for the bank itself. Consequently, at CRS/Thailand, for example, members pay 2 or 3 percent per month -- 1 percent per month goes to the sponsoring agency and the rest stays in the village to capitalize the internal fund.

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[11] An 1988 in-depth study of 36 FINCA/Costa Rica VBs found that the average annual income for members was $987 (Wenner 1989:14), which is under the $1,310 poverty line but above the $637 poverty line, which was the amount associated with households living in extreme poverty in 1986 (World Bank 1990:75:).

Institutional Adaptations

3.32 Most adaptations have emphasized institutional rather than financial changes. These have occurred at both the village and intermediate -- sponsoring agency -- levels. At the VB level, changes have involved innovations in the organizational structure of the VBs, the introduction of a classification system for VBs based on their stage of development, and relaxing restrictions on bank membership to include both genders. Adaptations at the intermediate level have included using local NGOs as implementing agencies, collaborating with commercial banks, and coordinating with private and public agencies for economic, marketing, and technical support purposes.

Village Banks

3.33 Having been strongly influenced by the Grameen Bank, the Freedom from Hunger Foundation (FFH) has adapted the organizational structure of the VBs to include five-member solidarity groups. Freedom from Hunger requires potential borrowers to organize themselves into solidarity groups of four to seven borrowers. These groups then join together to make a VB. Liability for the loan is then transferred to this smaller unit. However, if the solidarity group does not or cannot repay the loan, the entire VB is liable. The committee is comprised of individuals selected from each five-member subgroup rather than being elected from the total membership.

3.34 Older VBs in the Costa Rica program have introduced their own organizational changes. In banks with many participants (one, for example, has 163 members), committee members take on the tasks of bank teller and manager. Financial transactions do not take place at weekly meetings in front of the whole membership. Instead, members go to the treasurer to make transactions on an individual basis. Other programs have also abandoned the 30-50 member restrictions, but this has not resulted in any real changes in the functioning or organization of the banks.

3.35 FINCA/Costa Rica has introduced a VB classification system that does not alter the organizational structure of the banks, but rather the services that FINCA provides. Banks are categorized by their stage of development and more developed banks are eligible for larger loans and receive different types of assistance. There are currently three classifications (A, B, and C). Banks are in Stage A from one to three years during which period members are eligible for loans of between 15,000 colones and 40,000 colones ($150-$400). Banks graduating from Stage A to B possess characteristics such as:

- Demonstrated organizational capacity;
- A system of financial controls (such as requiring collateral for larger individual loans);
- Sophisticated membership selection procedures;
- Demonstrated savings discipline; and
- A favorable credit history.

3.36 Members of banks in Stage B have access to loans ranging from 41,000 colones to 1,400,000 colones ($410-$1,400). Stage B banks are supposed to undertake community investments, have development-oriented interactions with organizations (public and private) other than FINCA, and initiate

subgroup joint ventures. Stage B banks demonstrating this capacity graduate to Stage C. Currently, 12 banks are in Stage C and therefore their members are eligible for loans of up to 2,000,000 colones ($2,000) with five-year terms (and a one-year grace period), at an annual interest rate of 30 percent (subject to yearly review). These loans are mostly for such relatively large-scale community investments as starting a cooperative (cattle and charcoal cooperatives are common), or building a market for members to sell their products.

3.37 Additional alterations in bank membership include changes in the gender composition of the banks. A number of the older programs do not focus on women, because gender was not an emphasis in the early versions of the VB methodology. Therefore, Save the Children/El Salvador (1985) has 57 percent women and FINCA\Costa Rica (1985) has only 27 percent. In addition, the FINCA/El Salvador program is going to reach both men and women, although it plans on giving preference to serving the poorest 20 percent of the population, and particularly poor women.

Intermediate Institutions

3.38 Most institutional changes have come at the level of the sponsoring agency. Two programs, CRS/Thailand and FFH/Mali, have altered their projects to include local NGOs that implement the projects. CRS/Thailand is working with three local NGOs -- the Rural Friends Association (RFA), the Foundation for Integrated Rural Development (FIAM), and the Credit Union League of Thailand (CULT). This additional institutional layer typically requires institution-building efforts that increase costs. CRS project management must monitor not only the VBs but also the NGOs. This strategy may, however, contribute to sustainability.

3.39 FFH's programs and CARE/Guatemala use commercial banks either as sources of funds or places to keep VB accounts or both. Despite the collaboration, neither program has established a formal partner relationship with the commercial banks. At FFH/Thailand, the Bangkok Bank, a local private commercial bank, makes loans directly to each VB at a slightly higher interest rate than it normally charges to more "credible" borrowers. FFH facilitates this process by providing a 25 percent guarantee (which is matched by a 50 percent guarantee by the Friends of Women's World Banking and a 25 percent guarantee by the Bangkok Bank). FFH staff also take VB committee members to the Bangkok Bank and teach them how to establish and operate accounts. The Thailand Design Document expresses the expectation that Bangkok Bank's role in the project will grow (August 1990:15). During the second phase of the program, Bangkok Bank is supposed to begin to assume direct supervision of community promoters and credit associations with its own staff. FFH's staff or a local NGO partner will then emphasize providing technical assistance primarily on hunger-related issues.[12] In Ghana, FFH is working with Kintampo Rural Bank in a similar fashion with similar expectations.

3.40 Commercial banks do not provide funding for CARE/Guatemala's project. Instead the collaborating commercial banks -- Banco del Agro, Banco Industrial, and Banco del Cafe -- offer VBs a place to keep their savings and lending accounts. In contrast to FFH, individual VB members -- not just the committee -- go to the commercial banks to make financial transactions. CARE anticipates that the VBs may be able to graduate to commercial banks as a source of funds after they have established a

[12] FFH/Thailand is also hoping to identify a local NGO partner to become the intermediary between VBs and the Bangkok Bank to provide direct supervision of community promoters and OBs. This scheme may eventually include a tie-in to the CRS/Thailand program with a CRS-created support center providing support to the FFH-identified local NGO, or the creation of a parallel system to that of CRS.

strong financial history and built up savings in the commercial banks. Few incidences of this type of graduation have taken place to date, however.

3.41 Additional institutional adaptations of the model emphasize coordination with other organizations to fulfill advisory, technical assistance, or marketing support functions. Both the FINCA/Costa Rica and FFH's programs have established informal and formal links to other institutions. FFH/Thailand has a National Advisory Committee that has a membership of senior representatives from the Interior and Public Health Ministries, Bangkok Bank, USAID, and Cargill/ Thailand;[13] the committee provides advice, technical assistance (particularly from Cargill) and high-level government and private sector support to the village banking initiative. Also, FFH/Thailand and FFH/Ghana get assistance from government extension workers primarily from the health ministries. These workers typically provide health extension messages and reduce demands on FFH staff who otherwise would have to prepare and offer all messages themselves.

3.42 FINCA/Costa Rica has developed a broad network of collaborating institutions. Like FFH/Thailand, it has a National Advisory Board and contacts with government agencies and private companies, but these relations have been more developed. Thirty-five different private firms give economic, technical, or marketing assistance to specific village banks. For example, Perifericos, a grocery store chain, offers economic, technical, and marketing assistance to several VBs. This assistance focuses on products ranging from poultry raising to charcoal production. The grocery chain tells the farmers which varieties it prefers to buy, tells them the quality control restrictions it imposes, and then sends a truck to collect the products after they have been harvested or processed. In this way, FINCA/Costa Rica provides its clients with nonfinancial assistance without having to pay for it directly.

Broadening the Service Delivery

3.43 The issue of technical assistance deserves further elaboration as it represents an alteration in the VB service delivery methodology. Three sponsoring agencies, Finca/Costa Rica, FFH, and CARE, have purposely altered the model to include a technical assistance or education component. CARE's promoters have had training (formal and informal) in agriculture and deliver extension messages regarding pig and poultry raising in addition to information on financial services. CARE, in collaboration with members, has also developed subgroups of four or five women for joint venture investment in agricultural innovations -- new breeding techniques, varieties, or immunizations -- that are started with the help of the extensionist. These groups then act as demonstration ventures to the rest of the women in the village bank. CARE also helps link the VBs to NGOs or government agencies that provide education on nutrition and other health-related issues. CARE finds this additional assistance necessary to ensure that women entrepreneurs are able to build their business beyond subsistence levels (see Box 1).

3.44 FFH has taken the education component one step farther. FFH's motivation to enter village banking was based on the underlying aim of reducing malnutrition and responding directly to hunger issues. In FFH's program experience, solely providing information regarding appropriate nutritional interventions was not enough to attract regular active participation by poor people. The financial services portion of the program was developed to entice participation and improve poor people's ability to generate income for food. Education can improve the effective use of credit for income generation and food

[13] Cargill is a large, U.S.-based, private grain and milling company.

BOX 1

THE CARE/GUATEMALA VILLAGE BANKS PROGRAM

The Village Banks Program started with $59,000 as a pilot project in April 1988. Funds were generated from the monetization of rice from the P.L. 480 Title II Program. Nine banks with 25 to 75 members each were established in the rural areas of Guatemala's central highlands. A baseline survey revealed that a high percentage of members were single heads of households, had four to five dependents, and had experience operating small-scale productive or commercial ventures. Further, the survey showed that the most frequently mentioned reason for discontinuing or downgrading their enterprises was inadequate working capital and lack of success.

With these resources and background information, CARE initiated the pilot VB project with four main objectives:

- To develop and adapt the VB methodology to local conditions;
- To provide village women with the resources (financial and human capital) that would contribute to their income generating activities;
- To form viable community groups; and
- To establish links between the VBs and commerical banks for sustainable financial services.

The project was adapted to local conditions with feedback from VB leaders, the general membership, and the extensionists. Examples of adaptive modifications that were introduced in the model include changes in loan maturity from four to six months; the introduction of regularized leadership training for committee members; and the initiation of joint production demonstration activities, typically for livestock production.

CARE has attempted to increase village women's income generating potential by improving their access to credit, savings facilities, and agricultural extension. Agricultural extension represents another alteration from the original VB model and is viewed by CARE as necessary for improving the productivity of member enterprises. Seventy percent of the members have been engaged in cash and subsistence crop production and animal husbandry. Program extensionists teach women how, for example, to vaccinate animals and use improved feeds. Messages are relayed using nonformal education techniques that involve short sessions focused on practical topics and locally based technologies and materials.

CARE also seeks to help VBs become viable local institutions. This is done by first selecting villages that appear to have the strongest potential for maintaining effective VBs. Village women demonstrate their interest by performing organizational tasks such as finding places to meet, electing members, and sending letters of invitation to CARE with 20 to 25 member signatures or thumb prints. More direct efforts to build strong local organizations include providing leadership training and ensuring that VBs hold weekly meetings to collect members' savings and undertake financial transactions.

The final objective is to establish links between village and commercial banks. This is done by introducing VB leaders to formal sector bankers, setting up VB accounts at commercial banks, and charging rates of interest slightly above the commercial rate to make VBs appealing to formal sector banks. VBs also receive an orientation to the legalization process, so that they can obtain legal standing, open bank accounts, and negotiate more effectively with formal institutions. After two and a half years with CARE, it is anticipated that most VBs will opt for graduating to the participating banks (Banco del Agro, Banco Industrial, and Banco del Cafe).

With the benefits of lessons learned during the pilot stage, CARE's village bank project has grown rapidly in recent months in the Chiquimula region with financial support from the Government of the Netherlands. In the first three months of 1991, 18 additional banks were added and the project provided 685 low-income rural women with working capital loans amounting to $30,670 (an average of $47 each). In the future, the program hopes to extend to 40 communities and reach 1,600 women. □

BOX 2

NONTRADITIONAL EDUCATION IN AN INNOVATIVE SETTING: FREEDOM FROM HUNGER'S CREDIT-WITH-EDUCATION APPROACH

"I have learned how to analyze my business and give ORT to my child with diarrhea. And I can see now that my porridge makes my baby get bigger."

These words from a Malian woman participating in one of the village banks sponsored by Freedom from Hunger reflect the kind of knowledge and behavior change that is the goal of the program's education component. This component seeks to provide village bank members with information, motivation, and skills to identify and solve problems that cause chronic hunger and malnutrition. Using the appeal of small loans to attract low-income rural borrowers, the credit-with-education projects provide the opportunity for loan transactions and a forum for nonformal, participatory adult education.

Education Techniques and Topics

The education model uses a problem-solving approach to address hunger-related issues. VB members, with assistance from promoters, identify hunger-related problems. Working as facilitators, promoters use role plays, pictures, symbols, and stories to introduce problems and their solutions in a manner that is engaging and appropriate to the local context. They pose questions to stimulate participation, encourage analysis by personalizing the problem, and help members find practical solutions. Once solutions are found, they are reinforced with well-targeted, "homegrown" messages. This process enhances VB clients' decision-making skills and commitment to the program.

VB promoters help participants select hunger-related issues to discuss. Only problems within the power of the members to control or respond to are chosen. Typically, discussion emphasizes:

- Improving techniques for surviving periodic, predictable periods of food shortage;
- Identifying interventions that help meet the nutritional needs of family members, especially infants, children and pregnant and breastfeeding women; and
- Accessing and using community services that provide family planning to better space births and determine family size, oral rehydration therapy for management of diarrhea, and immunization against disease.

Promoters are trained to identify barriers to interventions or adoption of behaviors that lead to the above outcomes.

Integrating Education with Finance

The goal of credit-with-education is to introduce and integrate relevant educational messages without disrupting smooth financial transactions. Financial transactions and training are integrated in VB meetings through the use of learning sessions. Participants are divided into groups to discuss assigned questions. The learning assignment may involve identifying the cause(s) of each problem, the consequences, the benefits of certain solutions, and the actions that individuals or the group can take to ameliorate the problem. Discussion groups and financial transactions take place simultaneously at VB meetings. Loans and deposits are collected from one borrower group while the other groups are engaged in learning discussions. After accounts are paid, each group reports its findings to the entire village bank. In this way, VB meetings process financial transactions, minimize use of time, and maximize educational messages. Smaller, experienced VBs take only 45 to 60 minutes to complete their business.

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Different educational messages are introduced in various stages of VB development. Initially, financial management issues are the main focus of the learning sessions. Problems such as attendance, internal loan management, and arrears are discussed and, when appropriate, policies for dealing with these concerns are adopted. After the basic financial training sessions, learning groups begin focussing on broader issues such as illustrating links between increased income and enhancing the nutrition and health of the members and their families.

Freedom from Hunger's Village Banking Programs

Freedom from Hunger has established five credit-with-education action research programs in Bolivia, Honduras, Ghana, and Mali, in addition to the Thailand program featured in this paper (see table at end of box on Village Bank Portfolio). The VBs are relatively young; the oldest is a little over two years old. Freedom from Hunger projects that its programs will be reaching approximately 2500 members in 100 village banks by the end of 1991, with the cumulative amount loaned approaching $250,000.

The first few years of operation have been devoted primarily to the development of the credit-with-education model, testing the adaptability of the model in diverse economic settings, and examining the impacts of the model on participants. Examples of FFH research and development efforts include a learning game that simulates loan cycles and teaches staff how to organize VBs and do financial accounting and management, and operational tools such as monitoring and reporting systems. These investments help strengthen VBs and partner implementing agencies.

Freedom from Hunger also helps local partner organizations establish links to formal sector banks to finance all or part of the loan funds. Local banks may loan directly to the VBs (for example, Thailand), or loan to the local partner organization, which on-loans to the VB (as is under negotiation in Mali).

Freedom from Hunger believes VBs can act as vehicles for reducing the causes of chronic hunger and malnutrition. VBs can provide poor women with resources -- savings and credit -- to increase production and income, and thus access to food. VBs also offer a forum for building solidarity and provide women with a legitimate social space for their productive and communal ventures. The education provides health and nutrition information using a problem-solving methodology that stimulates behavior change.

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Freedom from Hunger
Village Bank Portfolio - March 1991

	BOLIVIA	GHANA	HONDURAS	MALI	THAILAND	WORLDWIDE
Date of first loan	3/90	4/90	5/90	12/88	7/89	
Length of loan cycle	4 months	6 months	4 months	4 months	6 months	
Annual interest charge	24%	26% plus 5% bank fee/loan	30%	24%	17% plus 3% FWWB fee/loan	
Number of Village Bank members*	230	389	45	860	211	1,735
Number of borrowers	230	389	45	763	191	1,618
Number of women borrowers	200 (86%)	389 (100%)	45 (100%)	630 (82%)	190 (99%)	1,454 (89%)
Number of Village Banks	10	14	3	34	12	73
Number of villages	10	2	3	16	12	43
Cumulative amount lent	$29,716	$66,146	$3,822	$88,274	$28,440	$216,398
Estimated number of individual loans since project start-up	521	572	76	3,838	442	5,449
Average loan size per borrower	$52	$113	$50	$25	$68	$56
Estimated number of VB loans since project start-up	21	20	5	140	29	215
Average loan size per Village Bank	$1,200	$3,169	$754	$563	$1,089	$1,243
Amount of outstanding loans	$12,009	$44,239	$2,261	$19,150	$13,068	$90,727
Repayment rate	100%	100%	100%	100%	100%	100%

* Members are those who attend regular meetings and deposit savings. Some do not take loans every cycle, but they do benefit from the education.

Source: Freedom from Hunger

security, as well as promote nutritionally beneficial expenditure patterns and behavior changes (See Box 2). The hope is that the two components will have reinforcing effects. This focus on hunger-related education makes the objectives of FFH's programs slightly different from that of the others. Not surprisingly this translates into a slightly different program design (and higher costs) with more intensive extensionist interaction with villages to fulfill hunger-related objectives.

Village Banking: Larger Scale and Longer Time Frame

3.45 The newest village banking initiative studied, FINCA/El Salvador, diverges the most from the basic model. The goal of the project is to establish a Salvadorean institution that will provide financial and nonfinancial services to microentrepreneurs. This institution, known as the Microenterprise Support Center, will be a nonprofit organization designed to serve both credit groups (village banks) and individuals in rural and urban areas.[14] The emphasis in the design document, therefore, shifts away from the direct needs of the VBs to the administrative and financial requirements of the supporting financial (or apex) institution. It is important to acknowledge that other projects discuss the issue of an intermediate institution, but it has not been the centerpiece of their projects as it is in El Salvador.

3.46 In addition, the financial services component in the Salvadorean initiative focuses on credit for working and investment capital. Also, the El Salvadorian project appears to be less minimalist. Nonfinancial services, including training and technical assistance, are to be provided both to borrowers and project staff.

3.47 Two factors help explain this considerable departure from the basic methodology. First, the project was designed in response to a rather specific Request For Proposal (RFP) sent out by USAID/El Salvador. Second, the El Salvador project is much larger in terms of funding and expected beneficiaries than the others. It is budgeted at $14.9 million over seven years and anticipates establishing 240 village banks (7,200 women) and reaching 240 individual borrowers in the first year alone.

3.48 The corresponding targets for the other projects illustrate the substantial difference in size and scope. CRS/Thailand budgeted US$1,067,488 to reach 34 banks over three years. CARE/Guatemala operated for its first two-and-one-half years as a pilot project on $64,000 to reach a target of 9 VBs.[15] FFH/Thailand anticipates reaching 17 banks in the first two years. After that, if there is confidence that the design is working, it will decide how much to expand. After two years of operation, FINCA/Northern Mexico has formed 38 banks. Again, these projects are in their initial stages or are pilots, which clearly has an impact on their planning and objectives. When projects are small it is much easier to take the time to focus on village-level concerns. Nevertheless, it is also true that larger projects typically require greater administrative support. Therefore, it is not surprising that the larger projects put more emphasis on designing administrative components than the pilot efforts.

3.49 FINCA/Costa Rica, with 3,825 beneficiaries in 153 banks, lies somewhere between the smaller projects and FINCA/El Salvador. FINCA/Costa Rica acts as an intermediary and maintains a permanent relationship with its VBs. Neither banks nor individuals graduate. Even after three years, FINCA/Costa

[14] Loans made through the village banks will range from $50 to $300 dollars while individual entrepreneurs will be eligible for loans of between $500 and $3,000.

[15] CARE/Guatemala received a grant of $455,000 to expand its operation to 40 communities in the Chiquimula zone beginning in 1991.

Rica continues to play a supervisory role, occasionally auditing the VBs; links VBs to other agencies for economic, technical, and marketing support; and provides technical support in finance and management. In addition, it employs a staff and data management network to support large numbers of VBs.

Summary and Conclusions

3.50 This exercise of defining village banking in its most basic form and documenting its various adaptations has highlighted a number of themes. First, the financial structure of village banking with its interconnected savings and loans and its internal and external accounts has proven to be robust across projects. Second, the financial changes that have been made have emphasized loan maturities, size, and, to a lesser extent, interest rates. Third, changes introduced at the VB level have been relatively minor. They include adding solidarity groups, classifying banks by their stage of development, and broadening the target group to include men.

3.51 Fourth, most institutional changes have focused on the implementing agency and the service delivery methodology. The minimalism espoused in the basic model has been abandoned to some extent for more administratively intensive alternatives. For intermediate-level institutions, this has involved collaborating with other organizations such as local NGOs, commercial banks, or public agencies for assistance in implementation, funding, and extension. It has also meant expanding the service delivery system to include nonfinancial educational messages. Moreover, as programs grow larger there has been a tendency for VBs to maintain longer-term relationships with sponsoring agencies and for the administration and information networks of these agencies to grow.

SECTION IV

DOCUMENTING ACHIEVEMENTS: VILLAGE BANKING IN PRACTICE

4.01 The above section was meant to familiarize the reader with the basic features of the model and illustrate the ways in which it has been adapted by various organizations. In this section the goal is to document the model's achievements in practice. This presentation will mirror the previous one, emphasizing financial, organizational, and social outcomes.

FINANCIAL PERFORMANCE

4.02 The discussion of financial achievements focuses on five main themes: repayment rates, loan sizes, savings levels, program costs, and interest income. When applicable, these issues are discussed from two perspectives, that of the village bank and the implementing organization.

Repayment[16]

4.03 Repayment is a critical issue for financial services programs. If high repayment levels are not achieved, programs have no chance of sustaining themselves. Moreover, repayment can be an indicator of the financial health of a lending institution. In the village banking programs, repayment affects the sponsoring agency -- through the external accounts -- and the VBs themselves -- through the internal accounts.

External Accounts[17]

4.04 For the most part, the repayment rates in village banking programs have been high. Average repayment rates in the external accounts for all programs studied is 90 percent, but this is slightly misleading since all programs except one have repayment rates above 90 percent. Table 1 illustrates that the pilot programs (FFH/Thailand and Ghana, CRS/Thailand, and CARE/Guatemala) have managed to maintain rates of 100 percent. FINCA/Costa Rica and FINCA/Northern Mexico have achieved rates of 98 and approximately 92 percent, respectively. Save the Children/El Salvador has considerably lower repayment rates of 52 percent.

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[16] Repayment can be a difficult indicator to use as many programs have different methods for calculating repayment. Most programs, for example, do not have a system for classifying arrears.

[17] Repayment rates are slightly misleading indicators because they mask arrears that appear to be fairly common in VB programs. For example, FINCA/Costa Rica repayment rates have exceeded 90 percent since it began in 1985, but a 1988 study of 36 village banks demonstrated that 31 percent of the villages had experience with late payments to FINCA (Wenner 1989). Unfortunately, VB programs do not track arrears so they cannot be compared across programs.

TABLE 1: REPAYMENT AND INTEREST RATES IN SEVEN VILLAGE BANKING PROJECTS,1990

NAME OF PROGRAM	Start Date	No. of Banks	Repay Rate (%)	Annual Int. Rate (%) (ext.)	Annual Int. Rate (%) (int.)
FFH/Thailand	7/89	11	100	23	24
FFH/Ghana	4/90	10	100	36	60-120
CRS/Thailand	/89	13	100	12	24-36
CARE/Guatemala	4/88	9	100*	24	24
FINCA/No. Mexico	3/88	38	92	36-48	60
FINCA/Costa Rica	/85	153	98**	18-25	30
SAVE/El Salvador	/85	100	52	3	36
Total	--	333	--	--	--
Average	--	48	90	18-24	35

* Approximate figures.
** Some of these funds may be still be recoverable.

4.05 A number of factors appear to affect repayment and delinquency in the external accounts. First and foremost, the programs that have invested heavily in VB training and the administrative oversight of the banks have been the most successful at maintaining high repayment rates. Initial VB experiments put little emphasis into the administrative set-up, training, or supervision of village banks. The basic assumption was that communities could effectively regulate their own funds with minimal outside assistance and training. For example, in its earlier iterations, VB efforts did not require banks to go through the four-week practice period to mobilize savings and establish bylaws. In addition, promoters had little experience with working with VBs. This approach led to default and arrears in the Save/El Salvador, FINCA/Costa Rica, and FINCA/Northern Mexico programs.

4.06 Save the Children reports that its defaults have been the highest in its older banks where it invested the least in the VB's set-up and training and was working with inexperienced staff. Table 2 shows how the lack of investment in VB training and staff experience has translated into VB inactivity and default. In the first year of funding, when VBs received the least training and supervision, 43 percent of Save/El Salvador's banks failed and became inactive. This figure dropped to 23 percent in 1986/87, to 16 percent in 1987/88 and eventually to zero in 1988-1990 as Save the Children began to put much more emphasis on preparing and supervising VBs and promoters gained experience and skills.

4.07 Similar experiences, albeit less extreme, have occurred at FINCA/Northern Mexico and FINCA/Costa Rica. In Northern Mexico in 1990, two of the program's oldest banks that had the least training and supervision collapsed and defaulted after two years of spotty operation. At FINCA/Costa Rica, an in-depth study of 36 VBs revealed considerable discrepancies between the VBs operating in the Atlantic Zone and those in the Southern Pacific Zone (Wenner 1989, 1990). The 1988 study showed that although the VBs in the Atlantic Zone were poorer and younger than those in the Souther Pacific region, they tended to be much stronger, smaller, more homogeneous, and had fewer incidences of default (Wenner 1990). In contrast to the Southern Pacific banks, the Atlantic Zone VBs had received considerable training and administrative guidance even before the first loan was issued. Since 1988, the Southern VBs have gotten stronger with assistance from FINCA (Wenner 1990). Repayment rates at

FINCA/Costa Rica have increased as the program gained experience, altered its training methodology, and slowed its expansion.[18] Repayment rates have gone from 92 percent in 1986, to 90 percent in 1987, to 98 percent in 1990.

TABLE 2: NUMBER OF INACTIVE VILLAGE BANKS BY YEAR OF FUNDING SAVE THE CHILDREN/EL SALVADOR

Funding Year	Number of VBs Funded	Number of Inactive VBs	Percent of Inactive VBs
1985/86	28	12	43
1986/87	13	3	23
1987/88	32	5	16
1988/89	25	0	0
1989/90	2	0	0
Total	100	20	20

Source: "Evaluacion Estrategia Bancos Communales," Desarrollo Juvenil Communitario El Salvador: Gerencia De Planeacion. October 1990:16.

4.08 The training affects repayment not because promoters are there to enforce loans but because VB members must learn to manage a savings and credit association. The committee members, not the promoters, enforce repayment. VB leaders are the ones to visit members' houses if someone falls into arrears. The role of the promoter is simply to teach the necessary management and accounting skills and ensure that local sanction for repayment is maintained.

4.09 The four pilot projects studied (FFH/Thailand and Ghana, CARE/Guatemala, and CRS/Thailand) gained from the other programs' experiments and started with a different philosophy. They have, for the most part, emphasized training and to a much lesser extent supervision. All programs now incorporate the four-week trial/training period. Moreover, both FFH and CARE have their extensionist attend a significant percentage of VB meetings for the first year of a VB's operation. CARE extensionists have a greater presence because they attend meetings of the joint venture production groups even during the weeks that they do not attend general VB meetings. Whereas the administrative investment clearly has payoffs in terms of repayment, it substantially escalates program costs. Moreover, VB promoters must be careful to teach VBs how to operate independently and avoid creating an unhealthy dependency of the VB or the sponsoring agency.

4.10 Second, highly subsidized interest rates may also influence repayment. Save the Children has had the lowest repayment, only 52 percent. This probably results not only from low administrative input, but also from the low interest rate charged to the community banks, only 3 percent per annum. In the internal accounts the interest rate is considerably higher, 36 percent per year, and repayment is also higher, 72 percent. This is in sharp contrast to the other programs where the incidence of delinquency and nonrepayment in the two accounts is reversed. For example, at FINCA/Costa Rica, 75 percent of the VBs had at least one case of internal delinquency whereas only 31 percent of the VBs had fallen into arrears

[18] Between 1985 and 1988, the number of FINCA/Costa Rica VBs grew by 700 percent.

in the external accounts. Highly subsidized interest rates do not promote the development of well-functioning, self-sustaining financial institutions and can indicate to borrowers that the credit is a gift or welfare transfer that does not have to be repaid. Moreover, they encourage inefficient investment by borrowers.

4.11 Third, the village-level study done on FINCA/Costa Rica banks demonstrates additional factors that affect delinquency from the village perspective (Wenner 1989). The study tested eight variables to see which had the strongest explanatory power on delinquency in the external and internal accounts.[19] The two variables that had the strongest negative association with external delinquency included VBs use of formal, written codes for member participation and a VB's level of savings.[20]

4.12 The study seemed to indicate that VBs that have integrated formal, written membership requirements and screening measures into their bylaws and operations have had greater success in either disciplining their members to repay on time or in keeping less creditworthy individuals from joining the VB or both. Savings also appeared to play an important role in reducing external account delinquency. If a VB has accumulated sufficient savings in its internal accounts it will use these funds to repay FINCA and cover a member's late external payments when necessary (Interview with VB committee members at different VBs in FINCA/Costa Rica). The tardy borrower(s) then must repay the internal account, sometimes with a penalty.

4.13 Fourth, sociocultural factors can also have an impact on repayment as evidenced by FINCA/Northern Mexico and Save/El Salvador. These programs are being introduced in villages or slum areas that have highly transient/migratory populations, in sharp contrast to the other programs. This diminishes the effectiveness of local sanction as an incentive for repayment. Joint liability is more likely to work as an effective substitute for collateral in areas where communities are comprised of families that have lived in the region for some time and know each other. If members can easily relocate to other regions and do not have strong communal ties to fellow members, their incentive to repay loans decreases.

4.14 Experience suggests four main lessons regarding repayment rates in the external accounts. First, it illustrates that the risk-reducing components in the village banking model -- joint liability and linking savings and loan levels -- can be effective insurance against default. It also demonstrates, however, that they must be accompanied by sufficient training and administrative oversight or VBs are likely to slip into financial mismanagement. Implementing agencies then must learn to balance weaning village banks from dependence on promoters and maintaining sufficient administrative oversight to ensure that banks continue to repay and repay on time. Second, it suggests highly subsidized interest rates are as likely to have a deleterious effect on village banking programs as they have had on other credit programs.[21] Third, the sample study of VBs at FINCA/Costa Rica illustrated that VBs with formal, written screening mechanisms for membership and high levels of savings experience fewer incidences of delinquency in the external

[19] The variables included (a) VB use of nonwritten (or informal) screening mechanisms to determine membership; (b) the use of formal, written codes for membership participation; (c) the frequency of promotor visits to VBs; (d) the number of members in the VB; (e) member's agricultural output; (f) the level of infrastructure in the village; (g) the VB's level of organizational effectiveness; and (h) the amount of savings mobilized.

[20] The variables were significant at the 10 percent level.

[21] See Von Pischke, Adams, and Donald (eds.) 1983 for a thorough discussion of the effect of subsidized interest rates on formal credit programs.

accounts. Fourth, it indicates that repayment will be more difficult to maintain in regions where the population is transient.

Internal Accounts

4.15 Unfortunately programs do not keep records of the internal accounts with the same degree of rigor they require for the external financial transactions. Nevertheless, a preliminary review of various banks' internal account records suggests that repayment rates and schedules in these accounts are characterized by a different dynamic. In contrast to the external accounts, internal repayment records of VBs in CRS/Thailand, FINCA/Northern Mexico, and FINCA/Costa Rica appeared to have a number of incidents of arrears and rather ad hoc rescheduling.[22]

4.16 The experience of rescheduling in Na Poe village in CRS/Thailand is illustrative. A $2, four-month loan slowly grew to a $70, one-year loan with no amortization payments. Interest payments on the loan, however, were maintained and the loan was eventually repaid in its entirety. Whereas this particular example probably had little impact on the internal account because the loan size was so small, it is easy to imagine a situation that could have graver repercussions in this 19-member bank. Had the initial loan size been $150, which expanded over two years to $500, the ability of the bank to meet other members' borrowing needs could have been severely constrained.

4.17 At the FINCA/Northern Mexico program, financial delinquencies in the internal accounts have had negative consequences for the external account. FINCA/Northern Mexico had adopted the policy of reloaning external loan installment payments in addition to members' savings in the internal accounts to generate more interest income on loans. In a number of instances, VBs could not meet their external account payments on time because internal loans had fallen into arrears. Although the external account loans were eventually repaid, the "abuse" of the internal accounts led the project manager to discontinue the practice of loaning out installment payments. These experiences strongly suggest that the risk management mechanisms that work in the external accounts are less applicable to a VB's internal financial transactions. The FFH program in Ghana has run into similar delinquencies after its first loan cycle. By contrast, the FFH/Mali program has not encountered problems with the relending of installment payments.

4.18 Other programs have suffered from a completely different set of problems with the internal accounts. At FFH/Thailand and CARE/Guatemala, internal accounts have not (or just barely) begun to operate, making the issue of repayment premature. Table 3 illustrates that after over two years of lending, San Vicente Pacaya bank in Guatemala has lent only $624. This seems to result less from a lack of demand than from an unease or unfamiliarity with the internal accounting mechanisms by members, committee representatives, and probably the staff. In countries with high inflation (Guatemala's reached 85 percent in 1990), not circulating internal account monies will severely decapitalize the loan fund. Moreover, if internal monies do not get relent, members never learn how to manage locally mobilized capital, which threatens project sustainability.

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[22] Save the Children's El Salvador program staff estimate that repayment rates on the internal accounts reach 72 percent, significantly higher than the 50 percent rate achieved by the implementing organization. Without additional information on the program, it is difficult to say what factors may explain this outcome.

TABLE 3: SAVINGS AND EXTERNAL AND INTERNAL LOANS AT SAN VICENTE PACAYA BANK IN CARE/GUATEMALA
(in dollars)

Cycle	Savings	Loans (ext)	Loans (int)	No. Members
1	923.89	2314.81	0.00	53
2	956.22	3361.11	0.00	57
3	821.18	2208.82	0.00	42
4	1093.53	2914.71	0.00	42
5	682.95	2050.00	0.00	35
6*	320.30	2123.40	624.00 **	35
Total	4,798.07	14,972.86	624.00	

* Six cycle includes only nine weeks of savings.
** This figure represents seven loans to individual members.

4.19 Despite the disparate experiences with repayment in the internal accounts, some lessons can be drawn. First, the risk management mechanisms integral to the working of the external accounts appear to be less applicable to the internal accounts. Second, the experience broadly suggests that internal accounts may be more difficult to manage than the external accounts since the funds base and loans sizes are less fixed. Table 4 illustrates the considerable variation in availability of funds in the internal accounts at Banco Futuro in the FINCA/Northern Mexico program. Savings available for on-lending in the internal account after the first cycle were $339. After the second cycle, this figure jumped dramatically to $1,440, and then fell again in the third cycle to $1,370. At Banco Futuro, this substantial fluctuation in funds results from:

- High membership turnover (only four VB members from the first loan cycle were still borrowing participants in the third cycle); and

- The considerable variation in the size of saving contributions ($245 to $5) made by members and the frequency of savings withdrawals.

These factors make it difficult for committee members to manage the internal accounts for lending purposes.

4.20 This instability has had opposite effects in the different programs. In the programs with little external supervision of the internal accounts it has led to financial mismanagement -- arrears and rescheduling. In the FINCA/Northern Mexico and CRS/Thailand programs, the implementing agencies have made a concerted effort to let the VBs manage these accounts independently, with no or relatively little input from outsiders. In the programs with tighter controls, particularly CARE/Guatemala and FFH/Thailand, the lack of stability in the internal accounts has resulted in no or only very few funds being lent.

TABLE 4: SAVINGS AND EXTERNAL LOANS AT BANCO FUTURO FINCA/NORTHERN MEXICO

Member	Cycle 1 External loan	Cycle 1 Savings contr.	Cycle 1 Savings w/drawn	Cycle 2 External loan	Cycle 2 Savings contr.	Cycle 3 (a) Savings w/drawn	Cycle 3 (a) External Loan
Irene Quinchez	50	13	13	0	0	0	0
Martha Hernandez(b)	50	22	22	75	43	0	120
Blanca Leon	50	15	15	0	0	0	0
Ana Talavera	50	35.5	0	90	112	112	0
Reyna Sanchez	50	19	0	70	61	0	50
Ma. Elena Frausto	50	13.25	13.25	0	0	0	0
Martha Relles	50	20	20	0	0	0	0
Santos Gonzales	50	45	0	100	130	130	0
Baudelia Muniga	50	22.5	0	75	61.9	0	140
Andrea Fernandez	50	10	10	0	0	0	0
Julieta Perez	50	100	0	150	245	0	0
Leticia Garcia	50	23	0	75	55	0	130
Rita Raudalez	50	14	14	0	0	0	0
Martha Rodriguez	0	0	0	75	43	0	0
Julieta Martinez	0	0	0	50	26	0	80
Autenicia Vergara	0	0	0	50	202	202	0
Refulio Torres	0	0	0	50	52.31	0	100
Maria Martinez	0	0	0	50	254	0	150
Julieta Bailor	0	0	0	0	0	0	200
Guadalupe Soto	0	0	0	0	58	0	50
Martha Reyes	0	0	0	0	0	0	50
Luiza Rodriguez	0	0	0	0	5	0	50
Everida Baes	0	0	0	0	0	0	50
Maicela Pancheco	0	0	0	0	25	0	50
Gabriela Polanco	0	0	0	0	10	0	50
Rosa Soto	0	0	0	0	5	0	50
Maria Sandoval	0	0	0	0	26	0	50
Paula Ayon	0	0	0	0	5	0	0
Julieta Soto	0	0	0	0	21	0	0
Eurilda Voez	0	0	0	0	5	0	0
Total	650	339.2	94.2	910	1440.21	444	1370

a) Incomplete cycle.

b) Member's financial accounts do not add up correctly. Loan availability in the second cycle should be only $50 and only $92 in the third.

4.21 What is the solution when lack of oversight appears to lead to mismanagement and supervision seems to bring the whole system to a halt? FINCA/Costa Rica's experience offers some insight. The VBs in Costa Rica also engage in rescheduling and use internal account monies to repay FINCA when necessary. But there are important differences between the working of the accounts in FINCA/Costa Rica and FINCA/Northern Mexico and CRS/Thailand. FINCA/Costa Rica's VBs have planned contingencies for problems that may emerge in the internal accounts that are similar to those found in informal financial markets. For example, at San Gerardo de Rivas bank in Pérez Zeledón, borrowers can fall into arrears but they must pay the consequences in terms of high interest rates (5 percent per month) to the account. Harsh penalties, which are understood by all members, tend to limit abuse of the accounts. Exceptions arise in cases of emergency. If, for example, a member or someone in his or her family falls ill, they may not be charged increased interest on arrears.

4.22 The experience of FINCA/Costa Rica suggests flexibility in repayment is tolerable if it is planned and well managed. But this, in turn, requires relatively sophisticated management and members' compliance. These skills and group dynamics must be built up over time with assistance from the promoting agency. Moreover, even after banks have become relatively independent, their accounts should be checked periodically. At FINCA/Costa Rica, accounting controls take two forms. FINCA promoters and government agencies do periodic audits of VBs and the banks keep FINCA updated by sending bimonthly or, at least, biannual reports and internal audits to the headquarters staff. These are done without threatening the independence of the banks. As in the case of the external accounts, supervision (or administration) is crucial and does not necessarily jeopardize autonomy.

Lending Levels and the Significance of $300

4.23 Lending levels are important to village banking for two reasons. First, the methodology justifies the $300 limit by the poverty-lending argument that loans above this amount will not go to poor people. Second, the whole timetable and structure of village banking is based on the $300 loan and savings levels, and consequently, deserves review. The issues that emerge from the loan level analysis are twofold. Is the $300 an appropriate limit across cultural contexts? Is the loan ladder with its $300 limit and three-year time frame an accurate reflection of client and VB needs?

4.24 As mentioned previously, several village banking programs have abandoned the $50 starting point and the $300 limit as being inappropriate for the local context (Table 5). CRS/Senegal's programs starts at $67 and caps off at $500, while FINCA/Costa Rica begins at $140 and increases to $2,000 for the more advanced banks.[23] In these countries, $300 was not a sufficient sum to provide a meaningful input into income-generating activities. In Guatemala, in contrast, loan limits have dropped from $300 to $150 over the last two years as a result of inflationary pressures (Table 5). The variation in loan sizes across projects suggests that loan limits will vary across regions and programs to comply with local needs. The $300 limit has proven appropriate in some regions but not others.

4.25 Loan limits appear important in programs targeted at a low-income clientele, especially when funds are community managed, to prevent elite co-optation of benefits. The objective is to set a level that will dissuade elites from viewing the VB as an attractive source of resources to attempt to control. Project managers argue that loan limits can play an important role in discouraging powerful groups from

[23] The larger loans provided to the Costa Rican banks are funded with monies from the Inter-American Development Bank (IDB).

becoming members. In some programs, for example, project managers claim that men have not been interested in joining the all-women groups because the loans sizes are too small to make it worth their while. Further, other restrictions such as the meeting schedules, small initial loan sizes, and strict installment payment requirements also help to ensure that only the needy participate. As will be discussed in a later part of the paper, no VB visited appeared to be financially dominated by elites, although VBs frequently possess members with a broad range of income levels.

TABLE 5: LOAN SIZE, MATURITIES, AND INVESTMENT PATTERNS
(in dollars)

	FFH Thai	CRS Thai	CRS Sen	CARE Guat	FINCA N.Mex	FINCA CR	SAVE El Sal
Loan Maximum	300	300	500	150*	300	2000	62
Initial Loan	60	60	67	50	50	140	NA
Maturity (mos)	6	4	NA	4-6	4	18-60	24-36
Community Involvement	no	no	NA	some	some	yes	NA
Sub-group Involvement	no	no	NA	yes	some	yes	NA
Agri-based Economy	yes	yes	NA	yes	no	yes	mixed

* The loan limit is 750 quezals which once equaled $300 but dropped to $150 with rising inflation.

4.26 In addition to opening the potential for large disparities in loan sizes among members and probably for elite co-optation of benefits, eliminating loan limits would make financial management more difficult. Larger loans are clearly more risky, especially for new clients without credit histories. To address the problem of risk, large loan sizes may require collateral, for example. They may also necessitate longer maturities. When banks are young and clients inexperienced, it may be necessary to impose limitations on lending levels. This may be true both for the external and internal accounts. Again, the FINCA/Northern Mexico and CRS/Thailand experience with arrears and rescheduling in the internal accounts suggests a need for tighter financial management, at least in the initial stages. Therefore, there is a need for loan limits, but limits will vary to meet the different needs of divergent communities across countries. Hence loans range from $30 to $150 to $2,000. This roughly collaborates Liedholm and Mead's (1987:38) review of available evidence that indicated that the overall initial capital requirements for small businesses range from $49 in Sierre Leone to $1,104 in Jamaica.

4.27 Moreover, loan limits may have to change as projects age. The experience of Asociacion Juntas de Pacuar VB of FINCA/Costa Rica demonstrates what happens to investment patterns in VBs over time. The bank started in 1986, when members were eligible for loans up to $150. As members built up savings and a credit history and the bank developed its capacity to manage funds, loan sizes grew and so did maturities.

4.28 By 1990, the bank had grown to 163 members and had changed to meet the divergent needs of its primarily agriculturally based members. Loans being granted varied in size from about $150 to just over $2,000. They also varied in maturities. Currently, 11 have long-term maturities (3-4 years), 80 are shorter term (approximately one year), and the remaining loans are for less than one year. Not all of these loans are for individual ventures. Three joint ventures were underway in 1990 -- the largest in terms of loan size ($3,250) included three members who had taken out individual loans and jointly invested them in starting a mill. At the same time, the community, with the help of FINCA, had gotten a loan from an

agricultural cooperative bank to fund a community shopping area that had stalls for members to sell their products.

4.29 Juntas de Pacuar is an extraordinary case in that it has such a large membership and is seeking to build a more ambitious project than most other VBs. Nevertheless, its range in investment patterns is replicated in other older VBs and suggests that loan sizes should reflect the financial and organizational management capabilities of VB and the investment needs of the community. In communities where there are increasing economic activities and market opportunities, VB members and the community itself are likely to experience a growing demand for loans. The experience of Costa Rica suggests that the $300 three-year time frame may not conform to local needs and capacities that appear to grow over time. Sponsoring agencies should be prepared to respond to this need while being careful to maintain poor clients.

Saving

4.30 Unlike many other financial services programs targeted at poor people, village banking includes savings as an integral part of its methodology. Members are expected to save a minimum of 20 percent per cycle in addition to meeting their loan installment requirements. Some programs have reached this goal while others have not. This section on savings will examine each project's savings levels, different incentives to save, and the issue of access to savings. As will be illustrated, an inherent tension exists in the methodology between allowing for ready access to member savings and lending savings in the internal accounts.

4.31 Before documenting a VB's experience with savings, it is important to review the role savings plays for individuals. The VB methodology highlights two roles, savings for investment and liquidity. But savings are also used to respond to security and emergency needs. To fulfill all these functions, deposits should be secure and accessible and yield a good return -- relative to other available savings options. Unfortunately, meeting all these demands when there is only a limited capital base has been difficult.

TABLE 6: SAVINGS IN VILLAGE BANKING PROGRAMS, 1990*

	FFH Thai	FFH Ghana	CRS Thai	CARE Guat	FINCA N.Mex	FINCA CR
Start Date	3/89	4/90	/89	4/88	3/88	/85
Total Savings ($000s)	.88	2.7	7.3	24.4	31.8	NA
Savings/Loans (%)	5	15	16	29.1	47.8	11.2
Annual Interest (%)	9	none	NA	11	none	7-15
Profit Sharing	no	yes	NA	no	yes	yes

* Save the Children does not keep information on individual VBs savings.

4.32 Table 6 illustrates the saving levels across the various programs.[24] Saving levels vary from a low of 5 percent in the FFH program in Thailand to a high of almost 48 percent at FINCA/Northern Mexico. The level of savings has important implications for the timetable of the program. In programs with low savings, reaching the $300 loan and saving levels will take years. Figures 2 and 3 illustrate that a program recording savings rates of 5 percent will take 38 four-month cycles (or over nine years) and a program with 10 percent will take 20 four-month cycles (over six years). Alternatively, some members have nearly reached their $300 limit after one cycle (Table 4).

4.33 What factors explain these discrepancies in savings levels? Savings are high in programs where there is considerable demand for liquidity. The VB members in Northern Mexico, for example, demand liquidity to meet their working capital needs, which are primarily for trading and selling (typically clothes, cosmetics, or food) -- activities that turn over quickly and require considerable working capital.

4.34 In contrast, in programs with low levels of savings, members do not have the same liquidity needs since they are not involved in quick turnaround activities. At FFH/Thailand, for example, members use their loans for livestock raising and fertilizer for crop production, activities that turn over about once every five to seven months rather than every day or every week. This decreases the demand for liquidity as investments are tied up in physical assets for longer periods.

4.35 Two additional factors probably also diminished FFH/Thailand members' incentive to save. First, FFH/Thailand's project has gotten off to a relatively slow start, which probably reduced members' confidence in the security of their future loans and, therefore, savings levels. Second, FFH members may not have felt their savings are easily accessible since the internal account has not yet begun to lend. Once the internal accounts begin to operate and members gain confidence in their community bank, savings may grow.

4.36 A review of interest paid on savings across the programs (Table 6) suggests that return on deposits does not have a strong correlation with saving levels. Nominal interest paid on deposits varies from 7-15 percent at FINCA/Costa Rica, 11 percent at CARE/Guatemala, and 9 percent at FFH/Thailand. FFH/Thailand has the highest real deposit rate (around 6 percent), but the lowest level of savings (5 percent). In contrast, CARE/Guatemala has a high level of savings (29 percent), but a highly negative real deposit rate: inflation in 1990 in Guatemala was 85 percent. Similarly, FINCA/Northern Mexico boasts the highest savings level (48 percent), but the project offers no interest on savings. Instead, it has a profit sharing scheme that has not yet become operational.

[24] Savings levels reflect total savings as a percentage of total loans.

FIGURE 2: SAVINGS AT 5 PERCENT

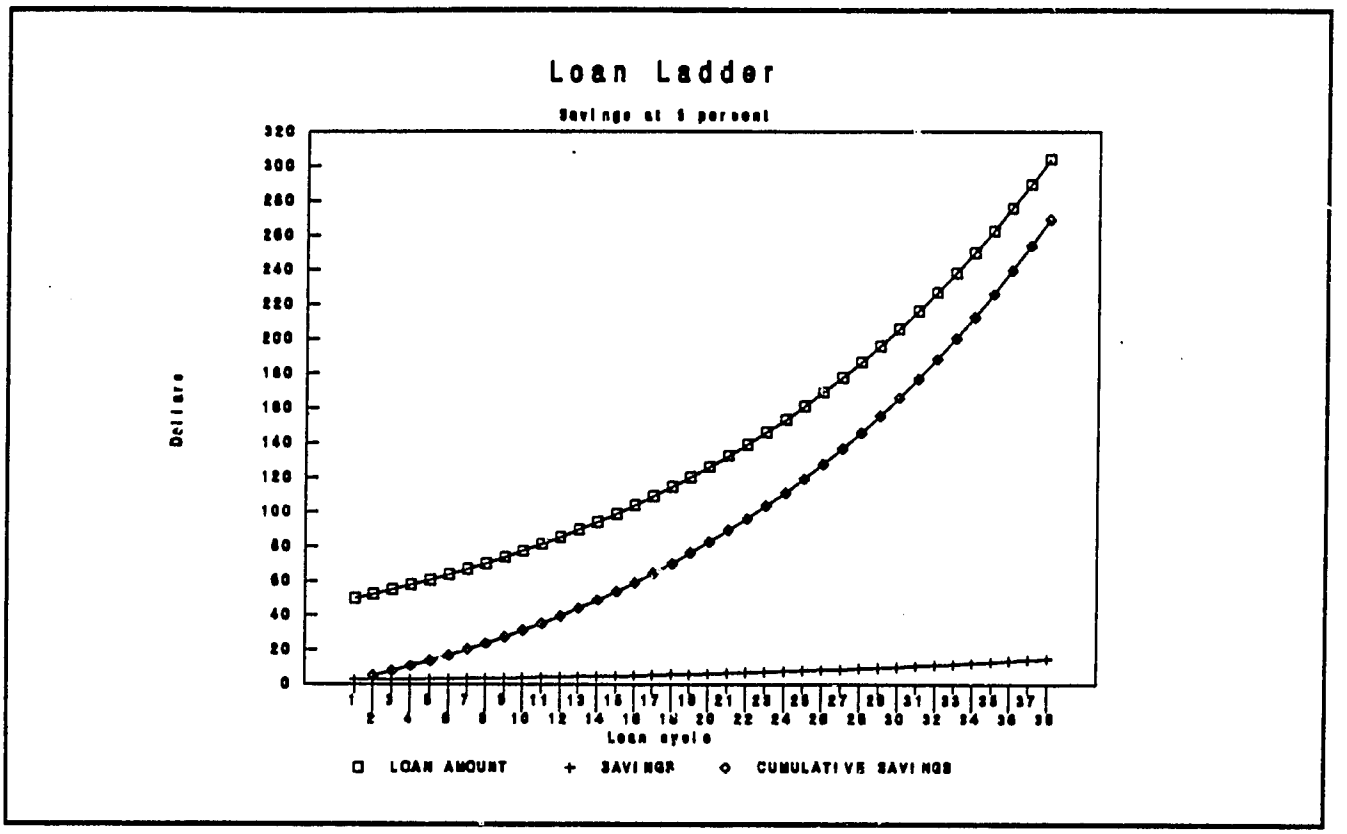
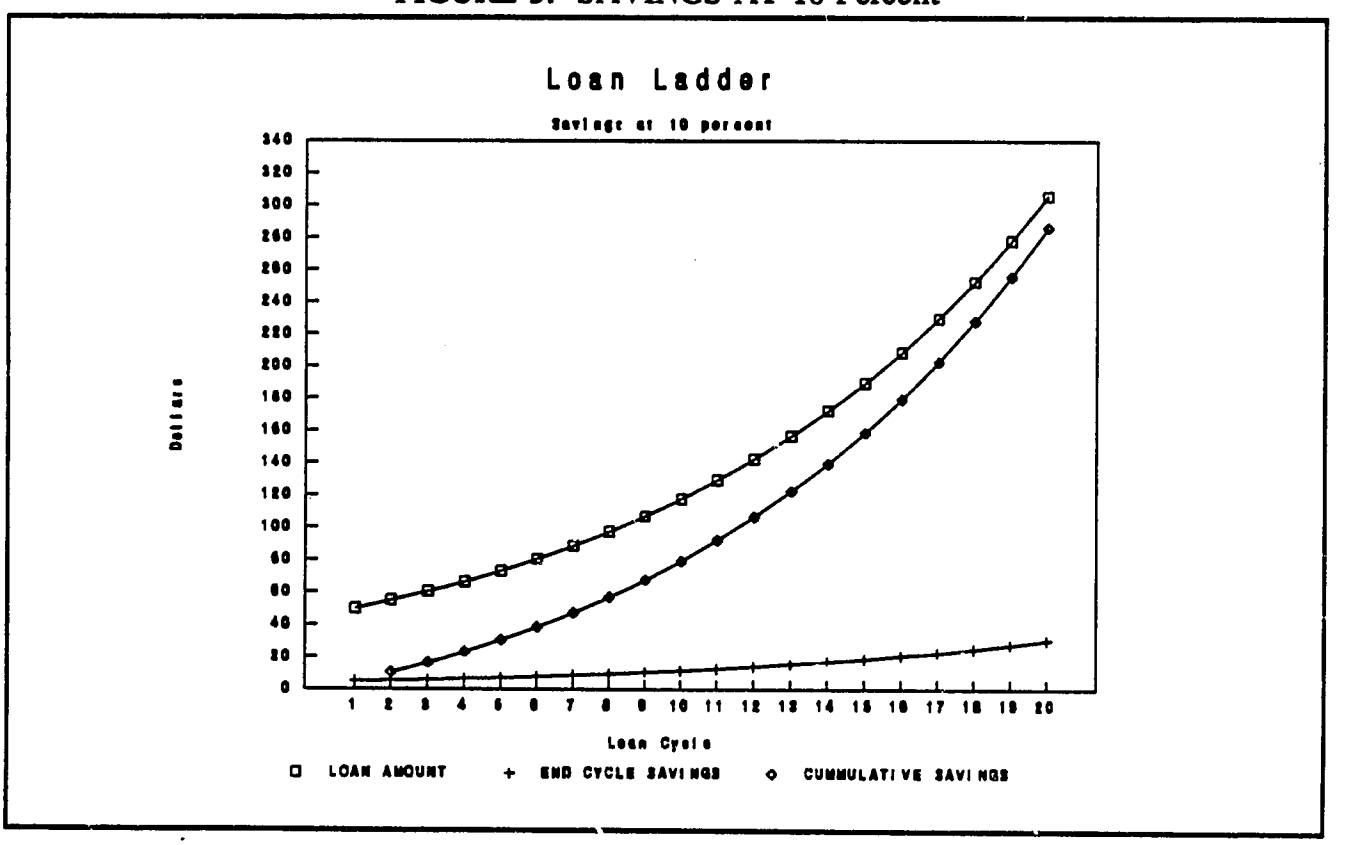


FIGURE 3: SAVINGS AT 10 Percent



4.37 This finding appears to contradict the prevailing belief that savings must yield a good return to attract depositors (Otero 1989, Vogel 1990). Two explanations are possible. First, the fact that VB members probably have few, if any, alternative options for storing their savings in liquid assets may mean that they are willing to pay for a deposit facility. Their other options may be highly risky (money under the mattress) or illiquid (assets such as livestock or jewelry). Illiquid assets are not only risky (the livestock may die) but also potentially expensive to convert into currency or to barter. A second explanation is that VB members are just using their savings as a means of getting access to larger loans. Under this scenario, the low or negative return on savings could be viewed as an additional cost to the loan -- for instance, it translates into a higher effective interest rate.

4.38 The issue of inflation and negative real interest on deposits deserves further elaboration. The effect of high inflation in Guatemala will be particularly pronounced. Since savings sit in an account earning only 7 percent interest and do not circulate, the internal loan fund is decapitalizing rapidly. High inflation is likely to wreak havoc on village banking as it does on all financial programs and sectors. Because village banking mobilizes local savings and targets the lower income groups, inflation in these programs will affect those who are least able to bear its costs.

4.39 Another issue that deserves elaboration, but is not immediately evident from Table 6, is the relationship between access to deposits and the savings that are available for relending in the internal account. In the optimal saving program, clients can withdraw their savings whenever they want, savings earn a meaningful return, and they are secure. But in the village banking programs, savings are frequently inaccessible (at least immediately) because they are tied up in loans. This reduces the incentive for clients to put their emergency savings into such an account. The alternative is to not lend savings and keep them readily accessible. The FINCA/Costa Rica and CARE/Guatemala programs appear to illustrate the two scenarios.

4.40 The VBs in Costa Rica have put restrictions on savings. VBs set the regulations so they vary, but the system established at Playa Linda bank is typical. Members are paid an annual interest of 15 percent on savings and members must contribute $0.25 per month. (The interest rate paid on savings was raised from 7 to 15 percent in 1990 to encourage members to increase their savings.) Savings are then lent at an annual rate of 30 percent and individuals' savings are calculated every month. But members cannot get access to their savings. Rather they are to take out loans (at an annual rate of 30 percent) instead. This helps to work the money and capitalize the fund with interest. If a member quits, they can get 50 percent of their savings immediately and 50 percent after three months. This reduced access to savings appears to be the price paid for maintaining healthy internal accounts. Under this type of scenario, savings play mainly a liquidity or leveraging role in that they allow members to get access to larger loans, but they can also be used for longer-term, planned investments. With this type of saving incentive structure, Costa Rica has achieved about a 11.2 percent savings level.

4.41 In contrast, savings are more readily accessible at the VBs in Guatemala. Members can withdraw their savings at the end of a cycle and members do withdraw their savings with regularity. There is also considerable membership turnover, as there is in other VBs, which has contributed to the instability of funds in the internal accounts. In addition, savings are seen as secure because they are kept in commercial banks. These factors combine to diminish the committee's ability to use the fluctuating internal accounts for loans. It is never clear how much money must be available to meet the needs of departing members or those who are just withdrawing their savings. Under these conditions, savings are used for emergency and longer-term investment needs. With this savings incentive structure, savings as a percentage of loans has reached a level of 29 percent.

4.42 One policy alternative that may make inroads into resolving the tension between lending savings and having sufficient savings to meet emergency needs would be to establish a local reserve fund. A few banks in Costa Rica said they had emergency reserves, but it was unclear how (or if) these actually operated. This may be an area for further research and experimentation.

4.43 The lessons learned from the experience with savings are:

- Savings levels vary across programs and tend to be the highest in programs lending to microentrepreneurs who demand liquidity for quick turnover activities;
- Deposit rates do not necessarily have to be positive to attract savings, although savings should earn a favorable return compared to other alternatives; and
- There is an inherent tension in the model between ensuring immediate access to clients' savings and building a viable, manageable internal account fund.

Program Costs

4.44 One of the central selling points of the village banking methodology is its supposed low cost. Unfortunately, getting at the issues of program costs has proved to be complicated as programs do not keep commensurate records of accounts, some programs include costs that are not incorporated into others, local costs of labor and other inputs vary substantially across regions, and programs are in very different stages of development. The "infant industry" or pilot projects are clearly going to be more costly than older more established initiatives given that considerable funds are invested in start-up costs and monitoring and evaluation. Data limitations have made it impossible to compensate for all these distortions and make reasonable projections. Nevertheless, an attempt is made below to analyze the 1990 costs of four programs -- FFH/Thailand, CARE/Guatemala, FINCA/Northern Mexico, and FINCA/Costa Rica.

4.45 A cursory glance at Tables 7 through 10 identifies a few important patterns. First, the two administratively intensive pilot projects that include education components, FFH/Thailand and CARE/Guatemala, are more costly than their minimalist, nonpilot counterparts, FINCA/Northern Mexico and FINCA/Costa Rica. The three-quarter figures for CARE and FFH are $33,212 and $40,659, respectively, compared to only $26,530 for FINCA/Northern Mexico and $13,074 for one zone (Perez Zeledon) in FINCA/Costa Rica.[25] Further, the smaller pilots are spending more to reach fewer banks. CARE/Guatemala and FFH/Thailand have 9 and 13 banks, respectively, compared to 38 at FINCA/Northern Mexico and 31 for one zone of the FINCA/Costa Rica program.

4.46 But these figures may overstate the differences since many of the costs included in the pilot projects are not included in the others. For example, at FINCA/Northern Mexico the project manager uses his own computer and car for work purposes and, consequently, these costs are not included. Similarly, at FINCA/Costa Rica some of the computer equipment and the program's most expensive employees -- an agricultural specialist and credit officer -- are paid by the Inter-American Development Bank and therefore are not included in the accounts. Even without these discrepancies, however, the pilot projects are probably still significantly more costly than the others.

[25] Data limitations made it impossible to do a cost breakdown of the total Costa Rica program.

4.47 A second trend that becomes apparent from looking at the tables is the high percentage of program costs that go into personnel expenses. Percentages range from a high of over 87 percent at CARE/Guatemala to a low of 46 percent at FINCA/Costa Rica.[26] In the other programs, salaries account for over 50 percent of costs. FINCA/Costa Rica's relatively low percentage can be explained by the fact that one promoter can manage many more banks than a promoter can in other programs -- promoters estimate that they can effectively manage 15-20 VBs depending on a number of variables including the distance of the VB from the zone headquarters and the stage of development of the banks. One promoter could handle, for example, 20 more-advanced Stage B banks, but only 15 Stage A. As will be demonstrated in greater detail in the section on staffing, other programs with less experienced staff and banks cannot achieve the same promoter to VB ratios.

4.48 A third factor is conspicuous by its absence. The programs do not show a cost of funds. Only the FFH program in Thailand must pay commercial interest rates for its funds. The rest are either wholly grant funded (CARE/Guatemala, FINCA/Northern Mexico) or rely on grants and highly concessional loans (FINCA/Costa Rica). The collaborating commercial bank at FFH/Thailand, the Bangkok Bank, makes loans directly to each VB at a rate of 14 percent per annum. Also, Friends of Women's World Banking (FWWB) charges an up-front fee of 3 percent of the loan value per cycle for the 25 percent guarantee it puts on the Bangkok Bank loans. Thus for each six-month period, a VB client must pay 7 percent to Bangkok bank plus a 3 percent FWWB fee plus whatever the VB may add on to generate its own income.

TABLE 7: OPERATING EXPENSES, PEREZ ZELEDON ZONE, FINCA/COSTA RICA, 1990
(in dollars)

	(3/4 year)	(% of Total)
Operating Expenses	13,074	
Salaries	5,995	45.9
promoter (1.5)	4,050	31.0
benefits	1,810	13.8
per diem	135	1.0
Office Expenses	4,959	37.9
Transportation	1,940	14.8
Other Promotion and Misc.	180	1.4

Note: Costs cover the operations for 31 banks.

[26] Again the low figures at the FINCA programs may be nonrepresentative. The director at FINCA/Costa Rica and FINCA/Northern Mexico salaries are exceptionally low even by local standards. For example, FINCA's director makes only half as much as her credit officer who is paid by the IDB. Whereas these low salaries may help to keep costs down, they introduce other distortions since it would be extremely difficult to replace either FINCA program manager at the same salary.

TABLE 8: OPERATING EXPENSES, CARE/GUATEMALA, 1990
(in dollars)

	(1 year)	(3/4 year)	(% of Total)
Operating Expenses	44,282	33,211	
Salaries	29,025	87.4	
proj mgr	7,450	5,588	16.8
promoters	7,855	5,891	17.7
admin & others	12,000	9,000	27.1
consults			
(internal)	750	562	2.3
(external)*	1000	750	2.3
benefits	8,191	6,144	18.5
training	1,454	1,091	3.3
Office Expenses (incl rent)	2,400	1,800	5.4
Transportation	2,182	1,636	4.9
Promotion & Misc.	1,000	7,50	2.3

* External consultant fees were budgeted but never used.
Note: Costs cover operations for nine banks.

TABLE 9: OPERATING EXPENSES, FREEDOM FROM HUNGER/THAILAND, 1990
(in dollars)

	(3/4 year)	(% of Total)
Operating Expenses	40,659	
Salaries/Benefits	20,548	50.5
Offices Expenses	8,235	20.3
Transportation	8,978	22.1
Other Expenses	2,898	7.1

Note: Costs cover operations for 13 banks.

TABLE 10: OPERATING EXPENSES, FINCA/NORTHERN MEXICO, 1990
(in dollars)

	(3/4 year)	(% of Total)
Operating Expenses	26,529	
Salaries	16,377	61.7
director	7,420	28.0
promoters	8,458	31.9
admin and others	499	1.9
Office Expenses	4,171	15.7
Transportation	3,679	13.9
Other Prom and Misc.	2,302	8.7

Note: Costs cover operations for 38 banks.

Program Income

4.49 This section focuses on the income that flows back to implementing agencies from client VBs and the methods for projecting future income streams. It emphasizes, therefore, the income generated in the external accounts. Insufficient data prevents a financial analysis of internal accounts. The emphasis on the external accounts, when combined with the previous section's cost calculations, permits the examination of one of the central tenets of the methodology: that village banking can be financially self-sustaining. The larger question of the social costs and benefits, however, cannot be rigorously assessed because of a lack of data on changes in client income, businesses, and general welfare (nutritional or educational status).[27]

4.50 A number of factors complicate the income calculations and projections for the village banking programs. First, since many of the programs -- FFH/Thailand, CARE/Guatemala, and CRS/Thailand -- were still in their pilot stages at the time of the field visits, their costs are atypically high and their income unusually low as they are focusing on a small number of VBs. Second, even the older programs are still fairly young and have introduced changes that skew annual income flows, which make it difficult to determine average income. Costa Rica's loan maturities, for example, changed from 3 to 5 years in the first two years of the project, to 8 to 18 months in later years with the effect that the project generated more income in the third year of operation ($96,019) than it did in the fourth ($84,870) despite the fact that the program had continued to grow.[28]

4.51 Third, few programs keep detailed, disaggregated data on costs and income and typically their projections are based on highly optimistic or idealized assumptions regarding membership and increases in average loan size. Project projections are usually based on the assumption that bank membership will repay at 100 percent, grow at a steady rate, and that each member's loans will increase at 20 percent per cycle (CARE, and CRS design documents). As will be illustrated in greater detail later, since no bank

[27] Wenner, (1989:17-18) in his study of VBs in Costa Rica, calculated the private and social rates of return on 36 banks. Only 11 banks (30 percent) showed a positive private rate of return, but this figure increased to 18 groups when a social rate of return calculation was used. Wenner's calculations, however, did not assess differences in family welfare such as changes in household nutritional status or investment in children's education.

[28] These calculations are based on FINCA Costa Rica's second quarter financial statements.

studied has achieved this outcome, the projections have tended to depart fairly substantially from reality. Given these limitations, it was impossible to do an appropriate income analysis using exclusively real income data or existing project projections.

4.52 The next logical step is to extrapolate from available data to do a financial analysis at the project level that provides information on the conditions necessary for a project to break even. Break-even points are best calculated by varying the interest rate and the overall performance of the sponsoring agencies' portfolio of clients (that is, the sponsoring agencies' collection of VBs). The lack of detailed data has meant that this analysis could only be calculated for three programs -- CARE/Guatemala, FINCA/Northern Mexico, and FFH/Thailand.

FINANCIAL PROJECTION METHODOLOGY: USING PORTFOLIO ANALYSIS TO IDENTIFY BREAK-EVEN POINTS UNDER DIFFERENT INCOME AND COST SCENARIOS

4.53 The methodology underlying the financial assessment used here attempts to mirror standard portfolio analysis practices.[29] Therefore, the goal is to present different income-generating scenarios that estimate break-even points under varying conditions. The varying conditions that affect a sponsoring agency's income-generating potential include such factors as changes in project size, interest rates, and economic environments that affect a VB's income performance. The data that are used to estimate sponsoring agency (and village bank) income under different scenarios are derived from a combination of project (1) experience (or observation), (2) projection, and (3) estimation. The results, therefore, are hypothetical but realistic estimates that indicate the changes in interest rates (or other variables) required to sustain project activities.

4.54 The first step of portfolio analysis involves identifying a set of representative clients (in this case VBs) and estimating their annual incomes. Identifying representative VB clients requires analyzing the actual external accounts of a sample of VBs. This exercise reveals three main gradations of VBs -- C, B, and A VBs; these ratings are based strictly on financial criteria so that C banks are low performers that generate the least income, B banks are medium performers that generate a moderate level of income, and A banks are high performers that generate the most income.[30]

4.55 The second step of portfolio analysis involves a hypothetical pooling of various sets of representative clients (in this case the A, B, and C banks) into a portfolio to estimate a sponsoring agency's total annual income. Three classifications of portfolios are constructed. Depending on the composition of clients, it may be a poor, average, or strong portfolio. Poor portfolios have a high number of low performing C banks and medium B banks and few high performing A banks and therefore generate relatively little income. Strong portfolios, in contrast, possess no C banks and a larger percentage of high performance A banks so they generate more income.

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[29] The methodology used in the paper is somewhat simplified, however, as it does not include covariance analyses of sponsoring agencies' portfolios. This translates into an underestimation of the risks of a given portfolio of VBs.

[30] This scheme for rating banks should not be confused with the earlier-mentioned FINCA/Costa Rica method for classifying banks for loan eligibility. In that case, C banks are, for example, at a relatively high stage of development and eligible for large loans.

4.56 The third step of portfolio analysis involves doing sensitivity analyses on different variables (such as interest and repayment rates). Sensitivity analyses help sponsoring agencies identify what factors must be altered to reach the break-even point under different scenarios.

4.57 Using portfolio management to estimate income has four main advantages. First, it provides a more accurate estimation of sponsoring-agency income than the income-projection methodology currently used in VB projects. Second, it will help sponsoring agencies see when they will need to either lower their costs or increase their interest rates to break even. Third, it facilitates the preparation of a management plan that incorporates contingency options. For example, no program studied has prepared a management plan that illustrates how a sponsoring agency should respond if a number of its client VBs face a crisis (such as a drought or theft) and fall into arrears or default. Fourth, portfolio analysis also aids the development of strategic plans and clear financial objectives. For example, a project can easily look at its portfolio of clients and see if they have too many low performing C banks and set goals that would allow them to transform these banks into A banks.

Step 1: Identifying Representative Clients

4.58 The first step in portfolio management is to identify and describe the VB characteristics that affect a bank's income-generation potential. Using the rating system outlined above (para. 4.54), model C, B, and A banks were chosen from existing program data of three sponsoring organizations. A preference was given to older banks that had more data to draw from.[31] The data from CARE/Guatemala program (Chart 1: Client Profiles) demonstrate the outcome of this process in practice. In the first column on Chart 1, the banks that were selected and their performance are indicated. Again, using strictly financial criteria, Durazno was selected as the C bank, San Vicente Pacaya as the B bank, and Santo Domingo Xenacoj as the A bank.

4.59 In column two, the characteristics that affect the VBs' income-generating potential are listed. The central characteristics affecting VBs' income generating potential are membership size and growth rate, loan size and growth rate, loan terms, and repayment rates. These characteristics have been formulated on the basis of observation, projection, and estimation. Exactly how all the different calculations and characteristics were derived is described in a technical note in Annex II. But the projections and estimates used to determine the income-generating potential of San Vicente Pacaya, the B bank at CARE/Guatemala, are illustrative. The majority of the characteristics laid out in Chart 1 are derived from six cycles of experience and then projected over nine cycles. For example, six loan cycles at San Vicente Pacaya bank showed that loans, which began at an average size of $46, were increasing at an average of 23 percent per cycle. This observed data has been projected over nine cycles and an average has been calculated.[32]

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[31] Banks selected include Mundial de la Mujer (C), Banco Futuro (B), and Banco La Union (A) for FINCA/Northern Mexico; Durazno (A), San Vicente Pacaya (B), and Santo Domingo Xenacoj (A) for CARE/Guatemala; and Na Sri Nuan (C), Pa Lai (B), and Ban Kvaow (A) for FFH/Thailand.

[32] The VB's stage of development also has implications for a sponsoring agency's income flows. VBs generate less income in the starting cycles, but as banks age and clients' savings accumulate, total loans typically increase and therefore so does interest income. Sponsoring agencies generally have a mixture of older and younger programs. To compensate for these biases, portfolio incomes are estimated for nine cycles and then an average is calculated.

4.60 In contrast, the assumptions regarding membership are not determined with the same projection analysis because the existing data are misleading. Membership at San Vicente Pacaya bank fell from 50 in the first cycle to 35 in the fifth when the VB's committee decided to restrict the number of participants for management reasons (see Table 12 and the section on membership). As the committee gets more comfortable with running the VB, however, it anticipates allowing the membership to increase again, slowly. Yet projecting with the available data would result in further decline in members over nine cycles. To accommodate these management decisions, it is estimated that after the sixth cycle two new members would enter the bank in cycles seven through nine in contrast to what would be projected using strictly numerical data. The result is that the hypothesized fall in membership averages to only 2.61 percent per cycle instead of 5 percent. The combination of observed, projected, and estimated data allows for the calculation of San Vicente Pacaya's loan and membership sizes and growth rates: the VB's membership ranges from 35 to 50 members and the average loan sizes from $46 to $118 (see Chart 1, Column 2).

4.61 The same process is then repeated for the other banks with divergent results and implications for their income generation. For example, five cycles of experience produce different characteristics for Durazno Bank -- CARE's low performance C VB. Loans have been growing at a rate of 16.5 percent per cycle. Membership has grown slowly at 2.5 percent per cycle. Average loans have been relatively small, starting at $46 in the first cycle and increasing to only $99 in the ninth cycle. And with its 25 to 29 members, Durazno is small to medium in size. It is important to point out that some of the characteristics found for CARE's C village bank Durazno are better than its B client San Vicente Pacaya. For example, Durazno's membership grew steadily over nine cycles rather than declined. But this positive characteristic is offset by other less positive features: Durazno possessed a smaller initial membership.

4.62 The other programs' client profiles are set out in Charts 2 (FINCA/Northern Mexico) and 3 (FFH/Thailand). Unfortunately, because such limited data were available on the FFH/Thailand banks, the income characteristics outlined for the A, B, and C banks rely fairly heavily on estimates and less on observation and projection.

4.63 To further distinguish the A, B, and C banks, they are assigned different repayment rate ranges that are purely hypothetical. Two rates are used for each type of VB client: the lower rate is meant to reflect poor general economic conditions and the higher rate a strong economic climate. C banks are estimated to have the lowest repayment rates (65 and 80 percent, respectively), B banks are slightly higher (81 and 90 percent), and A banks have the highest rates (91 and 100 percent). These rates are kept constant across all three programs. The different rates reflect not only repayment, but also act as proxies for other factors (such as arrears) that would reduce the income flow to sponsoring agencies.

4.64 Interest rates are also varied to illustrate how they affect income streams. For CARE/Guatemala and FINCA/Northern Mexico, income estimates are shown at 24, 36, and 48 percent annual interest rates (Charts 1 and 2 listed under **interest rate**). For FFH/Thailand, interest income has been calculated on a slightly higher schedule, at 24, 48, and 60 percent annual interest rates (Chart 3 under **interest rate**). The higher rates were necessary to show the break-even point in the FFH/Thailand program.

4.65 The combination of the assumptions with the different repayment and interest rates allows for the calculation of interest income for the different VBs. Going back to the experience with CARE's Durazno bank, Chart 1 tells us that an average C village bank will generate an average income for the sponsoring agency of $126 per cycle when:

- A 24 percent annual interest rate is charged;

- The VB's repayment rate is only 65 percent; and

- It possesses characteristics similar to those listed under the assumptions category. In contrast, the same bank will generate $308 per cycle in interest if it is paying a 48 percent annual interest rate and repaying at 80 percent per cycle. The annual interest income earned by the different model VBs under varied interest is presented in Charts 1, 2, and 3.

Step 2: Portfolio Analysis

4.66 Implementing agencies will have a portfolio made up of the different types of VBs. This financial analysis identifies three different types of portfolios -- poor, medium, and strong -- depending on the composition of VB clients. In a poor-case scenario, it is assumed that a sponsoring agency would have 30 percent C banks, 40 percent B banks, and 30 percent A banks. With this composition and using a weighted average of the VB repayment rates specified above, the sponsoring agencies' cumulative annual repayment rates would be 79 percent under unfavorable economic conditions and 90 percent under a favorable economic climate.

4.67 In a medium-case scenario, a portfolio is assumed to have a better mix of banks: 10 percent C, 40 percent B, and 50 percent A. This translates in to average repayment rates of 85 percent (unfavorable economic conditions) and 94 percent (favorable economic conditions). In the strong case scenario, a portfolio would have the following distribution and repayment rates: 0 percent C, 30 percent B, and 70 percent A banks and cumulative repayments rates of 88 or 97 percent depending on the economic climate. (These are listed under **Composition of Village Banks** and **Cumulative Annual Repayment** in Portfolio Analysis Charts 4, 5, and 6).

4.68 Calculating a program's total interest income also requires information on the number of VBs in a portfolio. For the CARE/Guatemala and FFH/Thailand programs, interest income is calculated for different sized portfolios: Portfolios of 24, 36, and 48 banks are tested for the CARE/Guatemala project and 21 and 42 bank portfolios are tested for FFH/Thailand.[33] The portfolio at FINCA/Northern Mexico is kept constant at 38 banks. (Listed under **Number of Banks in Portfolio** in Charts 2, 4, and 6). Also included in the Portfolio Analysis Charts are the different estimated annual costs of the programs.

4.69 The rationale behind increasing the portfolio of some of the programs and not others is related to cost. Detailed cost information is available for CARE/Guatemala and FFH/Thailand and these projects are currently investing heavily in start-up costs that would permit project expansion. For these reasons, it is possible to increase the portfolio of the programs and maintain realistic cost estimates. (Charts 4 and 6 describe in greater detail how costs were determined in relation to portfolio size for the two projects.) In contrast, FINCA/Northern Mexico has not made commensurate investments in start-up costs such as basic infrastructure, automation materials, or transport. Before this program grows in scale it will have to make these investments. Since it was not possible to estimate these basic costs, the number of VBs in FINCA/Northern Mexico's portfolio is held constant at 38 banks. Once cost and income information is collected, it is possible to estimate the conditions necessary for a project to break even.

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[33] The different size portfolios were selected based on data that came from the project officer's estimates of their village bank promoter to VB ratios described in later section. For example, CARE/Guatemala promoters estimated that they could service six VBs each. Therefore, if the program were operating with 6 promoters working full time they could cover 36 banks in total.

CHART 1: PROJECTED PROFILES OF CARE/GUATEMALA VILLAGE BANKS

PERFORMANCE	CHARACTERISTICS	VARIABLE FOR SENSITIVITY ANAL. Repay. Rate	Int. Rate	OUTCOMES Est. Income Per Cycle*
"C" (Durazno)	* 16.5% increase in avg. loan size	* 65%	* 24%	* $125.51
		* 80%		* $154.48
	* Small to medium avg. loan size, $46-$99			
	* Small to medium size bank, 25-29 members	* 65%	* 36%	* $188.27
		* 80%		* $231.72
	* Slow (2.5%) growth in membership			
	* Low repayment	* 65%	* 48%	* $251.03
	* Average cycles per year 2.33	* 80%		* $308.96
	* Projected exchange rate of Q5:$1 after cycle 5			
"B" (San Vicente Pacaya)	* 23% increase in avg. loan size	* 81%	* 24%	* $247.18
		* 90%		* $274.65
	* Medium avg. loan size, $46 to $118	* 81%	* 36%	* $370.77
	* Medium size bank 35-50 members	* 90%		* $411.97
	* Est. memb. growth, 2.6%. (projected-5%)	* 81%	* 48%	* $494.36
		* 90%		* $549.29
	* Medium repayment			
	* Average cycle per year, 2.22			
	* Projected exchange of Q5:$1 after cycle 6			
"A" (Santo Domingo Xenacoj)	* 11% increase in avg. loan size	* 91%	* 24%	* $343.74
		* 100%		* $377.73
	* Small avg.. loan size from $46-$76	* 91%	* 36%	* $515.60
	* Large bank with 57-73 members	* 100%		* $566.60
	* Low (.5%) growth in membership	* 91%	* 48%	* $687.47
		* 100%		* $755.47
	* Good repayment			
	* Avg. cycles per yr. 2.33			
	* Projected exchange rate of Q5:$1 after cycle 4			

* Calculated by taking average village bank interest income over a 9 cycle period.

Notes: Exchange rates used (Quezals to the US dollar): Q2.7:$1 in 1988; Q3.4:$1 in 1989: and Q5:$1 in 1990.

CHART 2: PROJECTED PROFILES OF FINCA/NORTHERN MEXICO VILLAGE BANKS

PERFORMANCE	CHARACTERISTICS	VARIABLE FOR SENSITIVITY ANAL. Repay. Rate	Int. Rate	OUTCOMES Est. Income Per Cycle*
"C" (Mundial de la Mujer)	* 22% increase in avg. loan size * Small avg. loan size from $36 to $74 * Small to medium size bank, 13-27 members * Slow (7.6%), sporadic growth in membership * Low repayment (65-80%) * 4 month cycles * Projections begin at cycle 6	* 65% * 80% * 65% * 80% * 65% * 80%	* 24% * 36% * 48%	* $ 79.25 * $ 97.54 * $118.88 * $146.31 * $158.50 * $195.C8
"B" (Mexicali: Banco Futuro)	* 21% increase in avg. loan size * Medium avg. loan size, $50 to $185 * Small to medium size bank, 13-20 members * Slow (6.7%) and steady growth in membership * Medium repayment (81-90%) * 4 month cycles * Projections begin at cycle 4	* 81% * 90% * 81% * 90% * 81% * 90%	* 24% * 36% * 48%	* $ 98.76 * $109.73 * $148.14 * $164.60 * $197.52 * $219.47
"A" (Tijuana: La Union)	* 32% increase in avg. loan size * Medium avg. loan size from $50 to $195 * Medium size banks 17-32 members * Rapid (15.1%), uneven growth in membership * Good repayment (91-100%) * 4 month cycles * Projections begin at cycle 6	* 91% ** 100% * 91% * 100% * 91% * 100%	* 24% * 36% * 48%	* $272.18 * $299.10 * $408.27 * $448.65 * $544.36 * $598.20

* Income estimates equal to the average income per cycle calculated over 9 cycles.

CHART 3: PROFILES OF FREEDOM FROM HUNGER/THAILAND VILLAGE BANKS

PERFORMANCE	CHARACTERISTICS	VARIABLES FOR SENSITIVITY ANAL. Repay Rate	Int. Rate	OUTCOMES Est. Income Per Cycle*
"C" (Na Sri Nuan village)	* 22% increase in avg. loan size * Small avg. loan size from $36 to $74 * Small to medium size bank, 18-23 members * Slow (7.6%), sporadic growth in membership * Low repayment * 6 month cycles * Projections begin at cycle 6	* 65% * 80% * 65% * 80% * 65% * 80%	* 24% * 36% * 48%	* $ 79.25 * $ 97.54 * $118.88 * $146.31 * $158.50 * $195.08
"B" (Pa Lai Village)	* 21% increase in avg. loan size * Medium avg. loan size, $50 to $185 * Small to medium size bank, 13-20 members * Med. (12.3%), steady growth in membership * Medium repayment * 6 month cycles * Projections begin at cycle 4	* 81% * 90% * 81% * 90% * 81% * 90%	* 24% * 36% * 48%	* $ 98.76 * $109.73 * $148.14 * $164.60 * $197.52 * $219.47
"A" (Ban Kvaow Village)	* 32% increase in avg. loan size * Medium avg. loan size from $50 to $195 * Medium size banks 17-28 members * Slow (8.7%), uneven growth in membership * Good repayment * 6 month cycles * Projections begin at cycle 6	* 91% * 100% * 91% * 100% * 91% * 100%	* 24% * 36% * 48%	* $272.18 * $299.10 * $408.27 * $448.65 * $544.36 * $598.20

* Income estimates equal to the average income per cycle calculating over 9 cycles.

PORTFOLIO ANALYSIS OF SPONSORING AGENCY VILLAGE BANKS

CHART 4: CARE/GUATEMALA: THREE PROJECTED PORTFOLIOS UNDER TWO ECONOMIC CONDITIONS

UNFAVORABLE ECONOMIC CONDITIONS

PROJECTED PORTFOLIOS	COMPOSITION OF VILLAGE BANKS	CUMULATIVE ANNUAL REPAYMENT	NO. OF BANKS IN PORTFOLIO	ESTIMATED ANNUAL COSTS*
Poor	30% "C", 40% "B", and 30% "A"	79%	24	$44,282
			36	$48,209
			48	$52,137
Medium	10% "C", 40% "B", and 50% "A"	85%	24	$44,282
			36	$48,209
			48	$52,137
Strong	0% "C", 30% "B", and 70% "A"	88%	24	$44,282
			36	$48,209
			48	$52,137

FAVORABLE ECONOMIC CONDITIONS

PROJECTED PORTFOLIOS	COMPOSITION OF VILLAGE BANKS	CUMULATIVE ANNUAL REPAYMENT	NO. OF BANKS IN PORTFOLIO	ESTIMATED ANNUAL COSTS
Poor	30% "C", 40% "B", and 30% "A"	90%	24	$44,282
			36	$48,209
			48	$52,137
Medium	10% "C", 40% "B", and 50% "A"	94%	24	$44,282
			36	$48,209
			48	$52,137
Strong	0% "C", 30% "B", and 70% "A"	97%	24	$44,282
			36	$48,209
			48	$52,137

Note: Increases in costs represent increases in the number of promoters needed to serve additional banks. In accordance with CARE staff projections, costs are calculated based on a ratio of one promoter per six VBs. The costs figures do not include cost increases in other areas such as management information systems, transportation nonpromoter staff.

CHART 5: FINCA/NORTHERN MEXICO: THREE PROJECTED PORTFOLIOS UNDER TWO ECONOMIC CONDITIONS

UNFAVORABLE ECONOMIC CONDITIONS

PROJECTED PORTFOLIOS	COMPOSITION OF VILLAGE BANKS	CUMM. ANNUAL REPAY.	NO. OF BANKS IN PORTFOLIO	ESTIMATED ANNUAL COSTS
Poor	30% "C", 40% "B", and 30% good	79%	38	$33,161
Medium	10% "C", 40% "B", and 50% "A"	85%	38	$33,161
Strong	0% "C", 30% "B", and 70% "A"	88%	38	$33,161

FAVORABLE ECONOMIC CONDITIONS

PROJECTED PORTFOLIOS	COMPOSITION OF VILLAGE BANKS	CUMM. ANNUAL REPAY.	NO. OF BANKS IN PORTFOLIO	ESTIMATED ANNUAL COSTS
Poor	30% "C", 40% "B", and 30% "A"	90%	38	$33,161
Medium	10% "C", 40% "B", and 50% "A"	94%	38	$33,161
Strong	0% "C", 30% "B", and 70% "A"	97%	38	$33,161

CHART 6: FREEDOM FROM HUNGER: THREE PROJECTED PORTFOLIOS UNDER TWO ECONOMIC CONDITIONS

UNFAVORABLE ECONOMIC CONDITIONS

PROJECTED PORTFOLIOS	COMPOSITION OF VILLAGE BANKS	CUMM. ANNUAL REPAYMENT	NO. OF BANKS IN PORTFOLIO	ESTIMATED ANNUAL COSTS
Poor	* 30% "C", 40% "B", and 30% "A"	* 79%	* 21	$50,824
			* 42	$50,824
Medium	* 10% "C", 40% "B", and 50% "A"	* 85%	* 21	$50,824
			* 42	$50,824
Strong	* 0% "C", 30% "B", and 70% "A"	* 88%	* 21	$50,824
			* 42	$50,824

FAVORABLE ECONOMIC CONDITIONS

PROJECTED PORTFOLIOS	COMPOSITION OF VILLAGE BANKS	CUMM. ANNUAL REPAYMENT	NO. OF BANKS IN PORTFOLIO	ESTIMATED ANNUAL COSTS
Poor	* 30% "C", 40% "B", and 30% "A"	* 90%	* 21	$50,824
			* 42	$50,824
Medium	* 10% "C", 40% "B", and 50% "A"	* 94%	* 21	$50,824
			* 42	$50,824
Strong	* 0% "C", 30% "B", and 70% "A"	* 97%	* 21	$50,824
			* 42	$50,824

Note: Costs are kept constant for the 21- and the 42-bank portfolio. Since Freedom from Hunger is currently investing heavily in one-time start-up costs such as developing program materials, monitoring, and training, it is assumed that increases in staffing that would accompany a growing portfolio of VBs will be off-set by substantial decreases in total costs.

Step 3: Using Sensitivity Analysis to Estimate Break-Even Points

4.70 From the VB client and portfolio-level analyses, it is possible to make estimates regarding annual income at varying repayment and interest rate levels and for different portfolio sizes (at least for the CARE/Guatemala and FFH/Thailand projects). This data can then be compared with annual costs that are based on the nine months of available data (presented in the previous section) projected over one year. The results of these analyses (shown in Figures 2 through 18) indicate the different outcomes for the three projects.

4.71 The **CARE/Guatemala** income analysis shows that at a 24 percent interest rate even under the strong bank scenario (cumulative average repayment 97 percent) and a 48-bank portfolio, the project could not break even. The project would cost $52,137 per annum but would only generate $38,287 in revenue (Figure 4), which would leave a 27 percent subsidy. Under the poor projected portfolio scenario with unfavorable economic conditions and a 24 percent interest rate, these subsidies would be 49 percent of program costs.

4.72 At a 36 percent interest rate, the project does break even and even generates a profit under certain scenarios. If the project had 48 VB clients, and had a strong portfolio with 97 percent repayment (good economic conditions), it would generate $57,431 in gross income, which would slightly exceed annual costs of $52,137 and result in a profit of $5,294 (Figure 6). If CARE charged 36 percent in interest and maintained a medium composition of VBs in its 48-bank portfolio (the equivalent to cumulative repayment rate of 94 percent under good economic conditions), it would come close to breaking even -- earning $52,027 in annual income leaving a subsidy of less than 1 percent (Figure 6).

4.73 Only if CARE charged a 48 percent interest rate could it sustain a smaller portfolio. Even if it only had 36 client VBs and a medium portfolio (cumulative repayment of 94 percent under good economic conditions), the sponsoring agency would earn $3,817 in annual profits (Figure 8).

4.74 The financial methodology used here indicates that the CARE/Guatemala program could break even if it charged a 36 percent interest rate and had a portfolio of at least 48 banks as long as it maintained repayment rates above 94 percent. Alternatively, if it charged a 48 percent annual interest rate, the program could maintain a smaller portfolio of 36 banks also with a 94 percent repayment rate. At the time of the study, the project was far from achieving these goals as it had only nine VBs and only charged 24 percent in annual interest. Therefore, like most pilot initiatives, it has been highly subsidized. But recently the CARE program has been expanding its portfolio, although it has not increased its interest rates: by the end of the first quarter of 1991 the project had 28 banks and maintained very high repayment rates. The above analysis strongly suggests that in addition to increasing its client base, the CARE program should also consider raising its interest rates to a minimum of 36 percent to cover costs.[34]

4.75 The **FINCA/Northern Mexico** program similarly could only make a profit if it charged a 48 percent annual interest rate. With a portfolio of 38 banks and a cumulative annual repayment of 94

[34] An additional problem facing the CARE program is inflation. Guatemala's inflation rate in 1990 was 85 percent meaning that real interest rates were negative, although inflation has dropped substantially in the first quarter of 1991. Clearly, the program cannot become sustainable with a negative rate of interest. But indexing or similar methods of overcoming high inflation may not be realistic solutions for village banking programs because they would be too complicated for committee members to manage, especially in changing economic environments.

percent (a medium portfolio operating in a favorable economic climate), it could generate $35,519 in interest income and earn a $2,357 profit (Figure 12). If the program charged less than 48 percent interest or if its repayment fell below 94 percent, it would have to be subsidized. At a 24 percent interest rate these subsidies would range from 62 percent of total expenses under the poor projected portfolio scenario to 36 percent under the strong scenario (Figure 10). At a 36 percent interest rate, subsidies would vary between 43 percent with a poor portfolio (79 percent cumulative annual repayment) and 4 percent with a strong portfolio (97 percent cumulative repayment rate) (Figure 11).

4.76 Currently FINCA/Northern Mexico charges 36 percent annual interest for its larger banks (above 15 members) and 48 percent for smaller banks (below 15 members). Therefore, it is probably the closest of all the programs analyzed to approaching financial self-sufficiency, although it should also be reiterated that its costs appear to be unrealistically low as the project manager, for example, uses his own car and his own computer to run the VB project (see paragraph 4.41).

4.77 The **FFH/Thailand** program is the most costly, and represents that higher end of the cost scale even among Freedom from Hunger's worldwide VB portfolio. Even if the program had 42 banks and a strong portfolio (97 percent repayment) and charged 48 percent in annual interest, it would still require a subsidy of about 3 percent of total expenses (Figure 16). Only if the program charged 60 percent in annual interest could it break even and make a profit (see Figure 18). At a 24 percent interest rate and with 42 banks in its portfolio, subsidies range from 76 percent of program expenses under a poor scenario (79 percent cumulative repayment) to a 52 percent subsidy under the strong case. At a 48 percent interest rate, commensurate subsidies are 52 percent and 3 percent.

4.78 At the time of the study, the program was charging 24 percent in annual interest to 11 VBs, although FFH/Thailand anticipated a considerable expansion in its portfolio. But even with this expansion, the financial methodology adopted here suggests that if the program is to approach financial self-sufficiency it will have to increase its interest rates considerably or, alternatively, lower its costs.

4.79 It is not surprising, however, that the FFH/Thailand program -- with its considerable investment in hunger-related educational messages -- must charge the highest interest rate to break even. Unfortunately, FFH/Thailand's cost structure is not broken down sufficiently to see whether the additional costs of the program result from the investment in educational services or whether it also has higher costs for its financial services.

Summary and Conclusions

4.80 The financial analysis below reveals important conclusions regarding financial sustainability. Not surprisingly, the two pilots (CARE/Guatemala and FFH/Thailand) are currently highly subsidized. If they are to break even, both will have to more than triple their portfolios, reduce their costs per beneficiary, and raise their interest rates substantially -- from a current level of around 23 percent to between 36 and 60 percent. By charging between 36 and 48 percent in annual interest, having 48 banks in its portfolio, and keeping its cost low (probably unrealistically so), FINCA/Northern Mexico has come the closest to breaking even.

FIGURE 4
FINANCIAL ANALYSIS OF VILLAGE BANK COSTS AND INCOME

CARE/GUATEMALA

24% INTEREST/24 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	70%
	high	66%
Medium	low	65%
	high	61%
Strong	low	61%
	high	57%

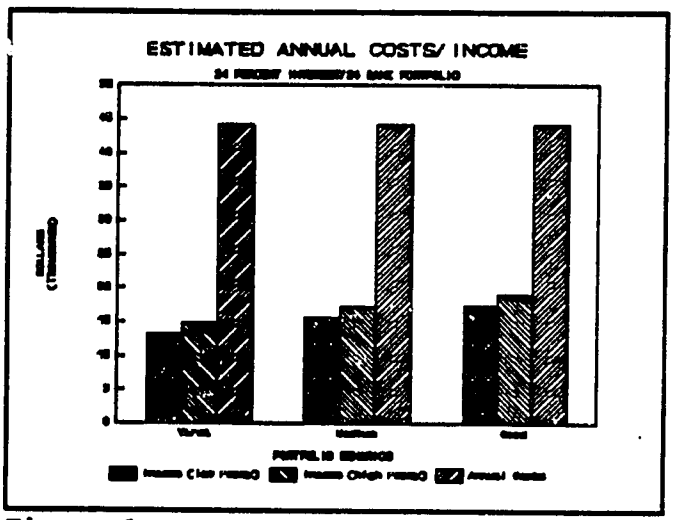

Figure 1

24% INTEREST/36 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	59%
	high	54%
Medium	low	51%
	high	46%
Strong	low	46%
	high	40%

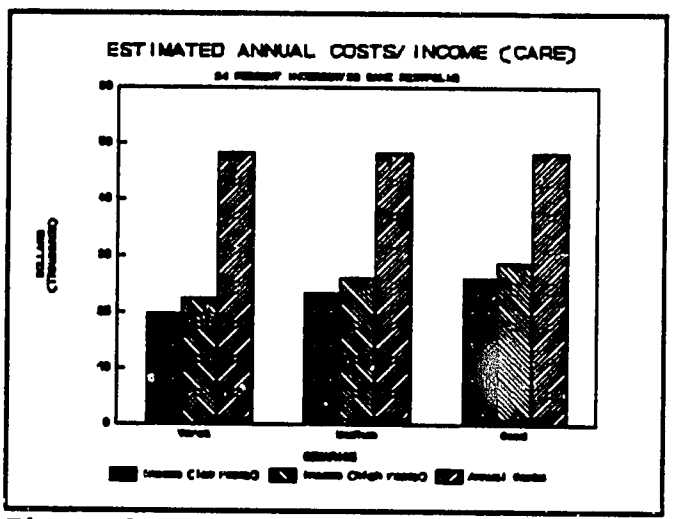

Figure 2

24% INTEREST/48 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	49%
	high	43%
Medium	low	40%
	high	33%
Strong	low	33%
	high	27%

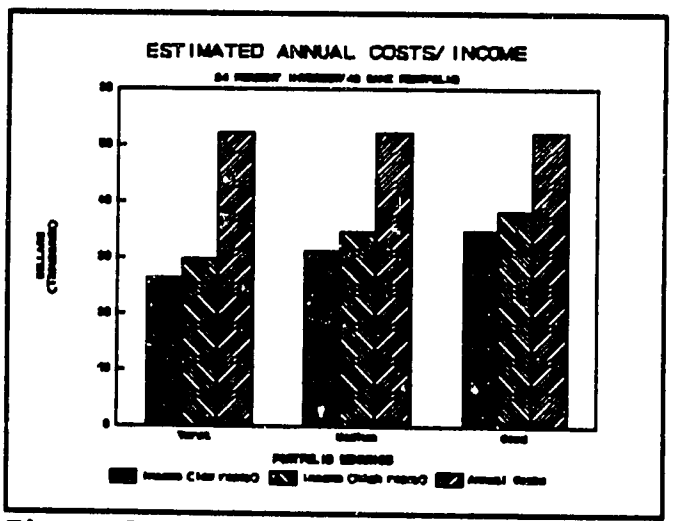

Figure 3

36% INTEREST/24 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	55%
	high	50%
Medium	low	47%
	high	41%
Strong	low	41%
	high	35%

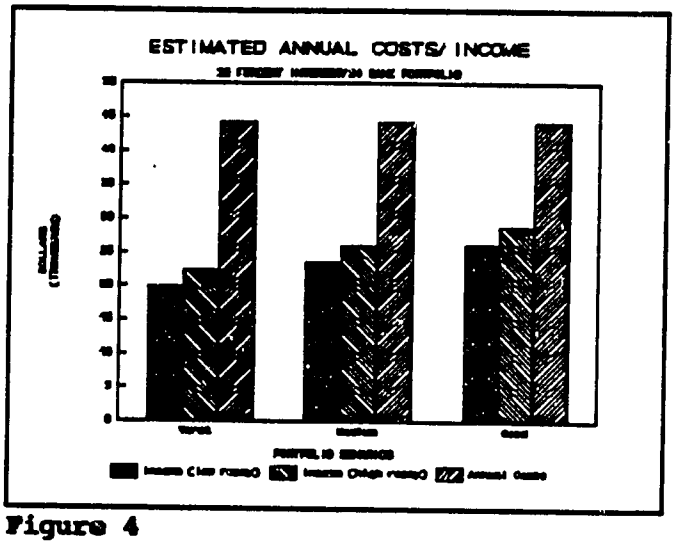

Figure 4

36% INTEREST/36 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	38%
	high	31%
Medium	low	27%
	high	19%
Strong	low	19%
	high	11%

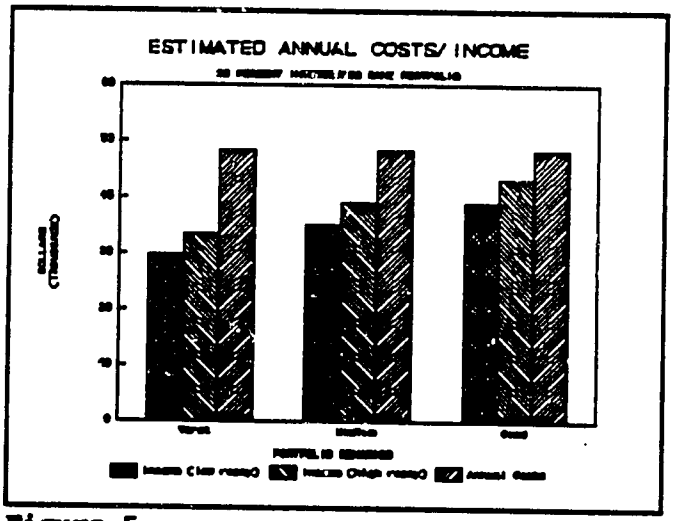

Figure 5

36% INTEREST/48 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	24%
	high	14%
Medium	low	10%
	high	.2%
Strong	low	.02%
	high	(10%)

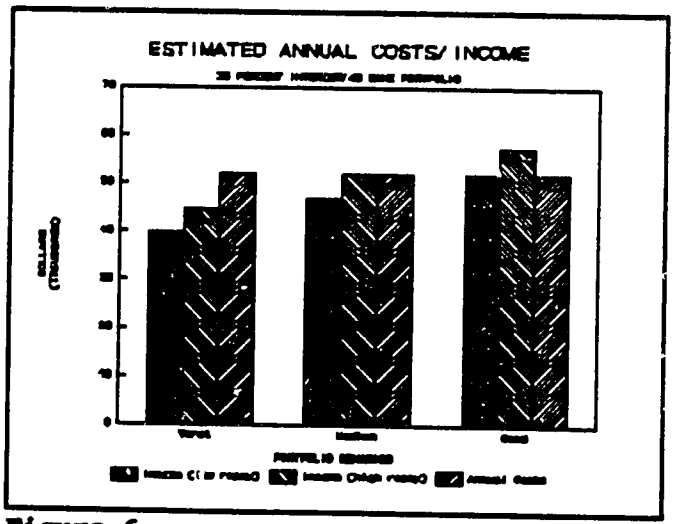

Figure 6

48% INTEREST/24 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	40%
	high	33%
Medium	low	29%
	high	22%
Strong	low	22%
	high	14%

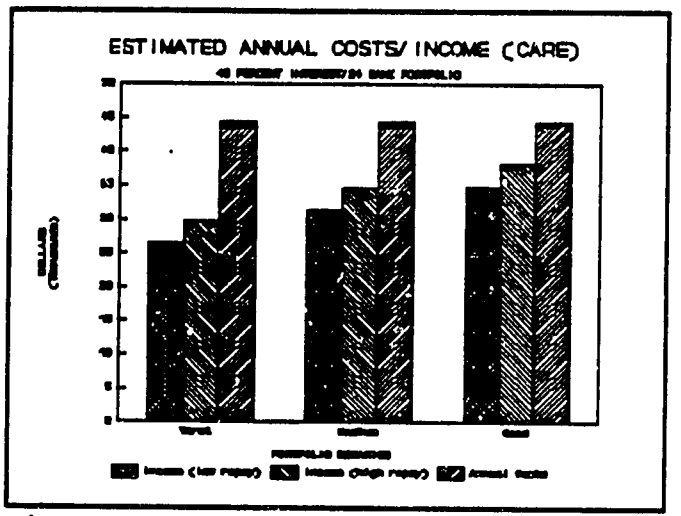

Figure 7

48% INTEREST/36 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	38%
	high	7%
Medium	low	28%
	high	(8%)
Strong	low	21%
	high	(20%)

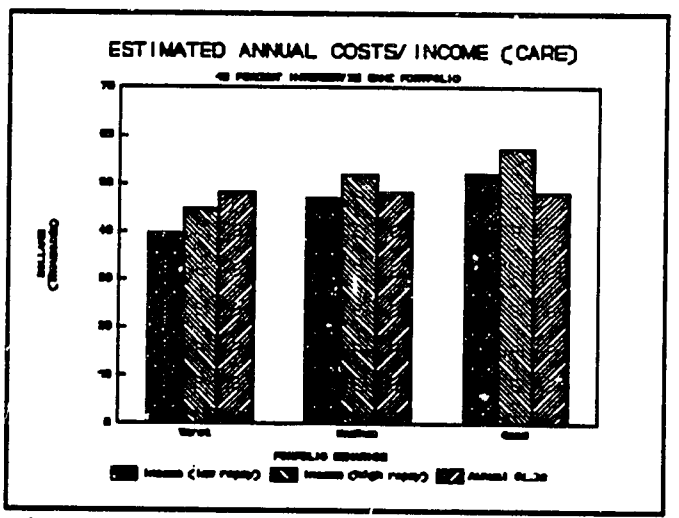

Figure 8

48% INTEREST/48 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	(1%)
	high	(14%)
Medium	low	(20%)
	high	(33%)
Strong	low	(33%)
	high	(47%)

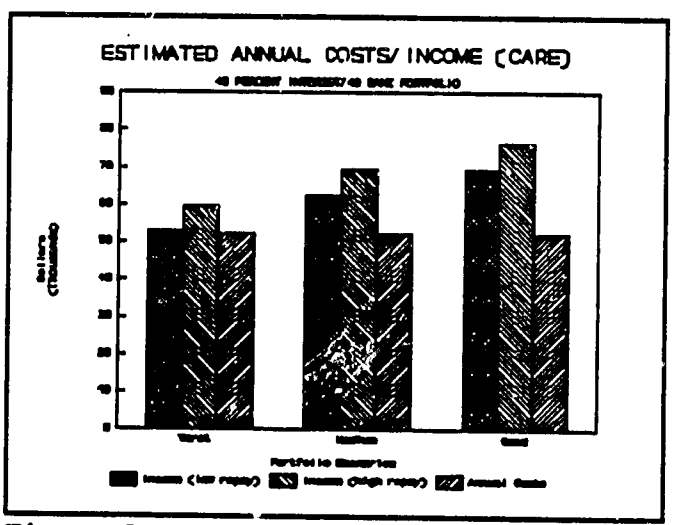

Figure 9

24% INTEREST/38 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	61%
	high	57%
Medium	low	52%
	high	46%
Strong	low	41%
	high	36%

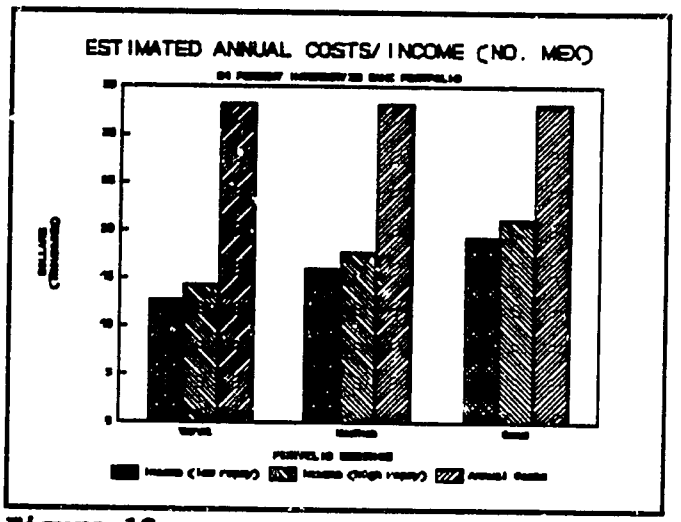

Figure 10

36% INTEREST/38 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	43%
	high	36%
Medium	low	27%
	high	20%
Strong	low	13%
	high	4%

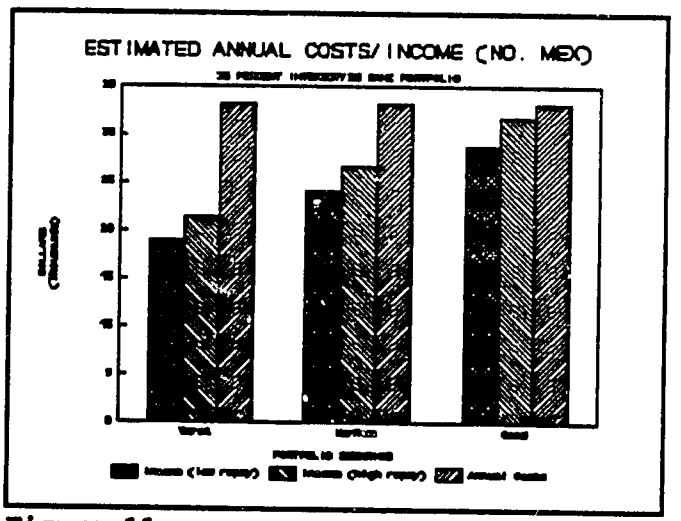

Figure 11

48% INTEREST/38 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	23%
	high	14%
Medium	low	3%
	high	(7%)
Strong	low	(16%)
	high	(28%)

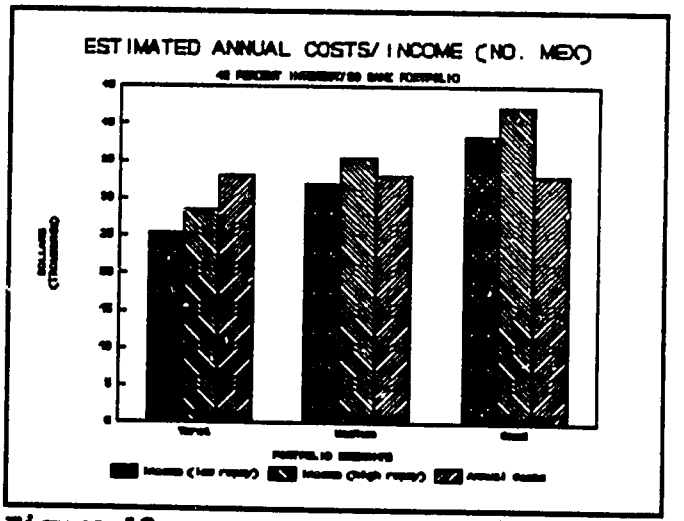

Figure 12

24% INTEREST/21 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	88%
	high	87%
Medium	low	82%
	high	80%
Strong	low	78%
	high	76%

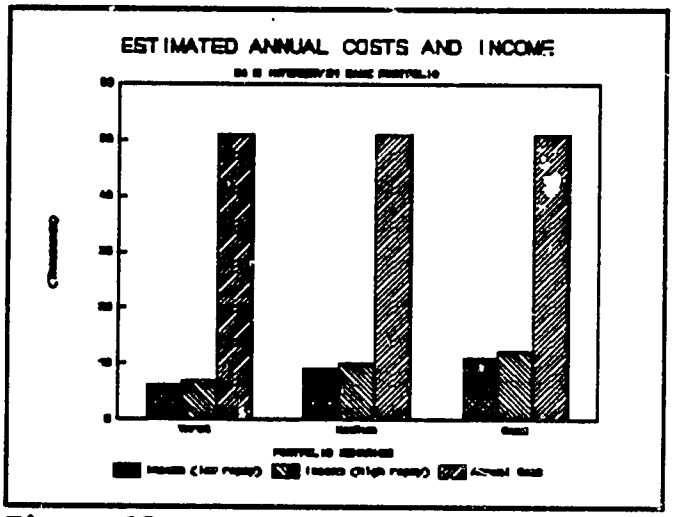

Figure 13

24% INTEREST/42 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	76%
	high	73%
Medium	low	64%
	high	60%
Strong	low	56%
	high	52%

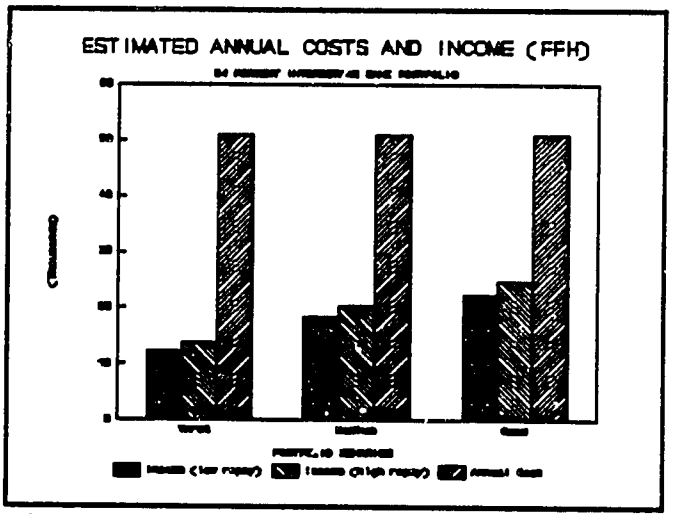

Figure 14

48% INTEREST/21 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	76%
	high	73%
Medium	low	64%
	high	60%
Strong	low	56%
	high	52%

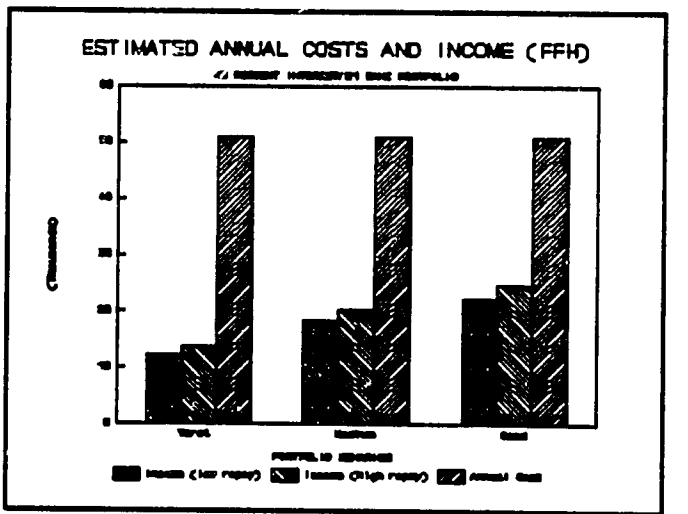

Figure 15

48% INTEREST/42 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	52%
	high	46%
Medium	low	28%
	high	20%
Strong	low	12%
	high	3%

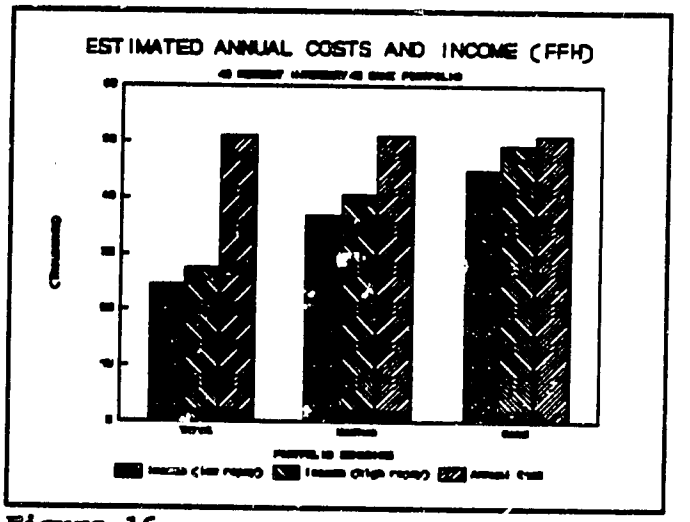

Figure 16

60% INTEREST/21 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	69%
	high	66%
Medium	low	55%
	high	50%
Strong	low	44%
	high	39%

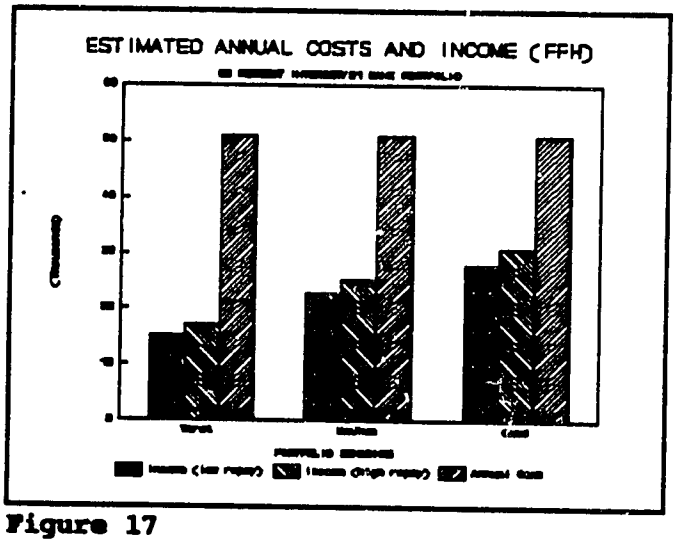

Figure 17

60% INTEREST/42 BANK PORTFOLIO

CASE	REPAY	SUBSIDY
Poor	low	66%
	high	33%
Medium	low	50%
	high	.4%
Strong	low	39%
	high	(21%)

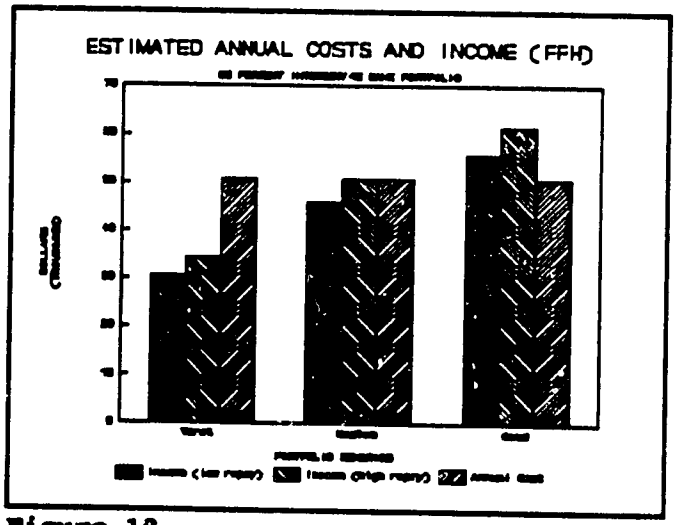

Figure 18

4.81 Clearly, financially sustainable interest rates will vary across programs and regions. For smaller programs or programs with large educational investments, the interest rate may have to be higher (perhaps 60 percent) to achieve full cost recovery. Larger programs will probably be able to cover their costs at lower interest rates if they are operating in areas where VBs have big memberships and literate clients and are close together. Nevertheless, broadly speaking, this limited cross-program study indicates that average programs will have to charge around 36 to 48 percent in annual interest and have a portfolio of about 40 banks to break even. Although these interest rates may seem high, they most likely fall far below prevailing informal interest rates, which are probably the only other source of credit available to VB clients. For programs that are providing educational messages and technical assistance in addition to credit, full cost recovery may not be an operational goal. Nevertheless, even these programs should work toward keeping their financial operations sustainable.

4.82 Programs need to adopt more accurate and precise financial accounting and projection methodologies. This will require improved tracking of their own costs and income, and better records of the income-generating history and potential of their different VB clients. Also programs should begin to collect better data on VBs' internal accounts so that a financial analysis can be done on their operation.

ORGANIZATION AND MANAGEMENT ISSUES

4.83 So far the discussion has emphasized financial performance in village banking. Of no less importance are the organization and management issues. These can be divided into two main topics, VBs and the sponsoring agencies.

Village Bank Organization and Management

4.84 Not surprisingly, the community-level banks play the most critical role in the village banking projects. If promoters have not facilitated the development of effective village-level organizations, the project cannot sustain itself financially or institutionally. It will remain heavily dependent on outside support. Two factors seem to contribute to the development of a strong local organization -- bank membership and leadership.

Membership

4.85 The category of membership can be divided into two subthemes: size and variation. VBs vary in size -- the largest VB studied had 163 members while the smallest had only 5. But most banks have 20-40 members. The average across banks is about 29 (see Table 11). The size of the VB is important as it affects management, the financial resources of the local organization, and implementing agency costs. Unfortunately, however, size has divergent impacts on these three variables. Smaller banks are easier to operate from a management perspective. But small banks are more financially vulnerable and more expensive for the implementing organization. The differing effects of size on VBs can be illustrated in the following manner.

4.86 In small banks, accounts are less complex and decisions easier to reach. But in small banks -- 15 members or less -- local resources are highly constrained so there is greater potential for competition for funds and the financial portfolio is more concentrated and, therefore, more vulnerable. Further, implementing agencies have stronger incentives to work with a smaller number of large banks than the

TABLE 11: SIZE OF VILLAGE BANK MEMBERSHIP

Name of Program	Total No. Members	Percent Women	Total No. VBs	Ave No. Memb.perVB
FFH/Ghana	293	100	10	29
FFH/Thailand	220	99.5	11	20
CRS/Thailand	719	100	13	55
CARE/Guatemala	334	100	9	37
FINCA/N.Mexico	680	100	38	19
FINCA/Costa Rica	3825	27	153	25
Save/El Salvador	1528	57	100 *	15-25
Total	5778	--	323	--
Ave. Total	1156	62.7	53.8	29

* Of a total of 100 VBs, 20 VBs have been inactive for over one year.

reverse situation. It is much easier and cheaper to service one 100-person bank than ten 10-person banks. In addition, larger banks generate more income.

4.87 In the VB profiles, presented previously, the difference in income generated in a large bank compared to a small one was demonstrated to be considerable. Despite the fact that the largest income earner (the "A" bank) in the Guatemalan program Santo Domingo Xenacoj, has significantly lower average loan sizes and slower growth in loan sizes than the lower performing "C" and "B" banks (11 percent compared to 23 percent and 16.5 percent, respectively), it generates more income. Even if Santo Domingo Xenacoj only had an 81 percent repayment rate, it would still generate more income than the medium bank, San Vicente Pacaya, repaying at 91 percent: Santo Domingo Xenacoj would generate $612 in annual interest income compared to only $549 generated by San Vicente Pacaya. The VB financial analysis also demonstrates that strong financial and organizational performance are not always commensurate. Santo Domingo Xenacoj has not been seen by CARE staff as their strongest bank as it has suffered from management problems (including high leadership turnover). Clearly, poor management of banks could adversely affect income if it led to low repayment or a bank collapse.

4.88 All things considered, the ability of the bank to manage itself takes precedent over all else. If effective management requires smaller banks, then smaller banks are necessary. For if a bank is unable to resolve conflicts or manage its accounts, it does not matter how many local resources it has mobilized or how inexpensive it is to service, the bank cannot sustain its operations. Recognizing these limitations, San Vicente Pacaya Bank in Guatemala has limited its membership to 35 women. FFH has found that the optimal number for its VB programs is approximately 30 to permit the development of group solidarity and good management practices.

4.89 Moreover, VBs and implementing agencies can take steps to ameliorate the problems of small banks. To compensate for the higher expense of small banks, for example, FINCA/Northern Mexico has adopted a policy of charging higher interest rates to banks with less than 15 members. Banks with less than 15 members pay 4 percent per month in interest compared to only 3 percent charged to larger banks. In addition, some villages have established two village banks. This decreases costs to the sponsoring agency and management pressures on VB leaders. At CRS/Thailand's Na Poe village, there are two village banks: one with 50 members and the other with 19. The banks meet simultaneously, but keep separate accounts and have different leadership.

4.90 The optimum, or course, is to have a well-managed larger bank. But this option is not always possible. Larger membership banks (50-100 members) are viable alternatives only where there exists a high degree of stability and solidarity in the community accompanied by strong leadership and bookkeeping skills. Also the larger the membership, the greater the demands on the committee and VB meetings. It takes hours for a bank to register and calculate accounts for 100 members, let alone attempt to plan events or resolve conflicts. To compensate for these factors, larger banks sometimes change their management structures. For example, Juntas de Pascuar bank in Costa Rica is training one of its members to become the full-time treasurer and manager for this 166-member local organization. Financial transactions do not take place at meetings: members visit the treasurer for deposits and loans during her business hours.

4.91 A second issue affecting VBs is the variation in VB membership. Tables 12 and 13 illustrate how membership varies over time and even cycle to cycle at VBs in Costa Rica and Guatemala. Turnover in bank membership at FINCA/Costa Rica in a two-to-four year period varied from a high of 1,277 percent at Juntas De Pacuar to a low of 6 percent at San Gerardo de Rivas (Table 12. At banks in Guatemala membership varied from cycle to cycle, with membership turnover between cycles ranging from highs of 28 percent and 26 percent in cycle two at Durazno Chinaulta Bank and San Vicente Pacaya respectively, to a low of zero in cycle four at San Vicente Pacaya.

TABLE 12: MEMBERSHIP VARIATION AT SELECTED FINCA/COSTA RICA BANKS

Bank Name	Start Date	Initial			Current			% Change in Total Members
		Women	Men	Total	Women	Men	Total	
Juntas de Pacuar	8/86	4	9	13	44	122	166	1277
Playa Hermosa	6/88	6	20	26	11	18	29	12
San Gerardo de Riva	8/86	0	16	16	1	16	17	6
Asoc. Agricultures Iztam	7/88	10	21	31	5	16	21	-32

4.92 Although they are not immediately evident from the tables, there are patterns to the membership fluctuations that follow production cycles. In the Durazno bank, the most "urban" of all the Guatemalan banks, some of the women are seasonal traders who commute to Guatemala City markets. They use VB credit in December (Christmas) and January (schools open) to complement other sources of working capital. Then they drop out since the VB's bylaws do not permit them to miss meetings regularly. At San Vicente, the seasonality is agriculturally based. Coffee is the main crop in this volcanic region, and women change meeting schedules to enable them to go to the fields and harvest. In addition, as stated above, the leaders have set a 35-member limit on membership in the bank, which explains why membership is constant at 35 in the fifth and sixth cycles.

TABLE 13: MEMBERSHIP VARIATION PER CYCLE AT SELECTED GUATEMALAN BANKS

Bank Name	Cycle	Members with loans	Members leaving at end of cycle	New Mem at start of cycle	Total No. of Members	% Change in total Members
Durazno						
Chinaulta Bank	1	25	8	--	25	--
	2	29	7	15	32	28
	3	28	4	4	29	-9
	4	32	6	8	33	14
	5	28	--	1	28	15
San Vicente Pacaya	1	50	7	53	53	--
	2	53	19	11	57	8
	3	39	8	4	42	-26
	4	42	10	8	42	0
	5	35	2	3	35	-17
	6	35	--	0	35	0

Note: To calculate this table, subtract the members leaving at the end of the cycle from new members starting at the beginning of the next cycle plus the total number of members from the previous cycle (e.g., 25 + 15 - 8 = 32).

4.93 Additional factors have also contributed to membership fluctuation at the all-female banks in Guatemala. Women have left to marry, or to have and take care of children, or if their husbands have expressed strong opposition to their participation. More generally, they typically leave when they see the time demands of bank membership overtaking the benefits of being a member. Many members will participate in the bank for a few cycles, then withdraw, and then return again as their work and household schedules permit. This flexibility is undoubtedly viewed as a positive attribute from the perspective of the members and probably represents one of the unanticipated benefits of the model. But this flexibility may concomitantly introduce difficulties both for VB leaders who have to manage the highly variable accounts that accompany membership fluctuations and for the sponsoring agencies trying to anticipate project income and credit needs.

4.94 Variation in membership can also be a reflection of a lack of bank unity or solidarity or an absence of effective membership-selection criteria. This, in turn, can adversely affect bank institutional and financial management. Banco Futuro (Table 4) in Mexicali, Northern Mexico, illustrates what happens when VBs have difficulty building solidarity and have loose criteria for membership. In the first cycle, members -- who lived in the same slum area but did not necessarily know each other -- got their $50 loan. In the following weeks, some members did not return to make installment payments and fell into arrears. Remaining bank members had to go to the women's houses to reclaim the loan, but the money had been invested for home improvements and could not be immediately recovered. These loans are still in the process of being repaid.

4.95 In contrast, banks such as Banco Superacion de la Mujer, also in Mexicali, with a more stable and committed membership, have experienced no arrears. Banco Superacion de la Mujer puts more stringent restrictions on membership. A person can only qualify as a member if she has lived in the community for more than two years. The importance of membership selection has also been highlighted in the Costa Rica program. Promoters identify mature banks, in part, by their ability to establish effective membership selection criteria.

4.96 The lessons of the older VB programs suggest VBs are likely to experience considerable variation in membership. This fluctuation, in turn, has divergent implications for VB members compared to leaders and sponsoring agencies. The flexibility has advantages for members who prefer to participate and withdraw as their work and household schedules permit. But VB leaders have problems managing internal accounts when membership (and hence savings, loan levels, and inflows of repayments) are highly variable. As demonstrated previously, VB leaders at CARE/Guatemala banks have responded by essentially not lending internal monies, while FINCA/Northern Mexico and CRS/Thailand banks lend but make numerous financial errors, which result in arrears and rescheduling. Membership fluctuation similarly introduces a new level of complexity to the financial timetables and accounts of the implementing organizations. In contrast to what is anticipated in the model, VB projects are unlikely to have banks with a stable membership of 50 over three years with each member steadily increasing his or her loan size with each cycle. Sponsoring agencies should anticipate such fluctuations and adjust their financial projections accordingly.

Village Bank Leadership

4.97 To operate effectively, VBs depend on strong leaders, especially during their first few cycles. Moreover, a strong leader can help overcome many of the problems VBs tend to run into, such as those related to membership fluctuation. Typically VB leaders are respected members of the community. In Thailand, for example, the village headman's wife is commonly selected as president and in Guatemala it is typically a prominent woman from a local church. Respected members of the community may or may not have strong management skills. For the all-women groups particularly, committee members may have no or little experience with such formal group management activities such as running meetings and setting agendas.

4.98 Strong VB leaders possess the following characteristics. First, VB committees must be able to fulfil the mechanical functions of the banks such as keeping accurate accounts and minutes. These functions can be difficult, especially in areas where literacy and numeracy rates are low. In Guatemala, for example, even after two years of operation some banks could not calculate interest without the assistance of the promoter. While this is clearly a threat to institutional and financial viability, in many ways the mechanics of bank operation are the most clear cut management issues to address and overcome through, for example, simplification of financial tables, additional training for the committee in accounting procedures, and improved risk management procedures.[35] As VBs financial resources increase, there will be increased pressure on VB leaders to keep accurate and transparent accounts to reduce risks.

4.99 Second, bank leaders stated that the more pressing management problems involved nonfinancial issues such as dealing with community rumors (such as that bank management is siphoning off funds or lending savings to themselves), ensuring that members pay their fines for nonattendance or late payments,

[35] Although financial procedures may be the most clear cut management issues to address, no VB visited had a satisfactory financial accounting system. For the most part, they are too complicated, do not provide for sufficient separation of external and internal accounts, and do not allow for the counting of arrears.

resolving conflicts between members, setting agendas, and determining how to allocate internal account resources.[36] Given these types of problems, strong leaders have demonstrated the capacity to dispel rumors, resolve conflicts without alienating members, keep members prompt in their payments (fines, loan installments, or otherwise), and essentially manage all the different personalities and problems that arise in any group setting. Most programs have worked to build management capacity with training sessions. These initiatives appear to be especially important for women's programs because women have typically had less experience with group management. The training builds confidence in addition to skills and an understanding of the leadership's responsibilities and limits.

4.100 Other issues related to leadership include preventing domination by an elite, salaries for committee members, and leadership turnover and routinization. The only place there appeared to be some variety of domination was in FINCA/Costa Rica, where male members controlled most places on the committee. In two of the banks visited, women had positions on the committees, but they never constituted a majority or held the role of president. Yet gender discrimination appeared to be decreasing as VB promoters began to push for women's inclusion in banks, both as regular and committee members. This suggests that the presence of the sponsoring agency may have an important impact in countering domination by any one group and is one argument for VBs maintaining a continuing relationship with an outside organization.

4.101 On the subject of salaries, only two banks visited, one bank in CRS/Thailand and one in FINCA/Costa Rica, gave pecuniary rewards to committee members for their services. The Costa Rica experience coincided with the professionalization of the staff. One member from the VB was selected to receive training to become the bank's professional, salaried treasurer and manager. And in Na Poe Village in Thailand, the "salary" took the form of an end-of-the-year honorarium. Most leaders appeared to be against payment as it would introduce the potential for abuse. At the same time, however, VB leaders take on an extraordinary amount of the burden of management, which takes up their time and sometimes even their resources.

4.102 Finally, many banks have faced difficulties with leadership turnover. Only a few banks at FINCA/Costa Rica have set bylaws regarding leadership change. At Playa Hermosa, for example, leadership changed every two years, and there was a brief transitional period when old leaders trained the new leaders. In Guatemala, some leaders have not stayed in their post, either because the responsibility and time commitment were too great or they were asked to resign by the membership. As programs mature, this issue of regularized changes in leadership will become increasingly important. Over time as bylaws are more clearly written and patterns are established, there is typically less pressure on the leadership. If these patterns are not institutionalized, banks may become too dependent on one charismatic leader, which simultaneously increases the potential for elite co-optation of benefits and decreases the local organizations chances for sustainability.

Sponsoring Agency Organization and Management

4.103 The village banking manual puts very little emphasis on the support required from the sponsoring agency beyond discussing the role of the promoter vis-a-vis the VB. In practice, however, the sponsoring agencies are providing fairly extensive support for the village banking programs. A VB program's sponsoring agency personnel includes not only promoters but also coordinators, accountants, managers,

[36] Guatemalan banks have been particularly plagued by rumors. Since most members are illiterate they must rely on the committee to keep accounts, and the committee rarely presents the financial status of the VB. This lack of transparency can create difficulties.

and support staff. In addition, they require data management systems for tracking the progress of their VB clients. Moreover, although the model puts minimal emphasis on the training of staff, VB leaders, and members, these activities have also proven to be important components of successful projects.

4.104 The position that gets the most attention in the village banking manual and that has the most interaction with the VBs is that of the promoter. The central issues regarding the promoters are whether promoters should be professional staff or come from VBs (in other words, community promoters), and how many VBs one promoter can manage effectively. In most programs, promoters are professional and have some postsecondary training. In the programs with education components (FFH/Thailand and CARE/Guatemala), the promoters typically have some expertise in either agriculture (CARE) or public health (FFH). The only exception is FINCA/Northern Mexico, which has a mixed staff of community and professional promoters.

4.105 Community workers have both advantages and disadvantages. Although the basic assumption is that community workers will be both less expensive and more effective than their professional counterparts, in reality the picture is less clear. Community workers undoubtedly have advantages in working with and identifying potential VB communities and members. Also, in some ways, use of community workers fulfills the goal of having a true "community bank." But they also have drawbacks. First, they require considerable training that includes not only financial accounting and management training, but also information on how to interact with banks, transfer money, and conduct many of the basic tasks associated with moving money safely from one region to another. FINCA/Northern Mexico has had to invest in such things as teaching community promoters how to use telephone answering machines and using money orders.

4.106 Second, community promoters do not always have the clout to pressure communities to comply with regulations and repayment schedules. Therefore, when FINCA/Northern Mexico ran into repayment difficulties with its banks in Agua Prieta, the project manager had to step in to resolve the issue. In addition, they may have a complex, and not necessarily positive, relationship with the community. Third, community promoters are not a viable alternative in all regions. In Guatemala, for example, where village women do not (or only rarely) travel alone, employing village women as promoters may be inappropriate. Fourth, community promoters may not have the expertise to provide extension messages. These drawbacks do not suggest that community promoters cannot make important contributions to VB initiatives. Rather, they indicate simply that community promoters have advantages and disadvantages and that their viability will vary with the sociocultural context.

4.107 Promoters constitute a significant proportion of program costs: 31 percent at FINCA/Costa Rica, 32 percent at FINCA/Northern Mexico, and 27 percent at CARE/Guatemala. Consequently, programs strive to achieve a low promoter-to-village bank ratio. The current ratios are slightly misleading since some programs (CRS/Thailand and FINCA/Northern Mexico) use part-time promoters, others (FINCA/Costa Rica) are currently understaffed, and others (CARE/Guatemala) are currently over-staffed since they are now training new promoters to expand the program. Therefore, the more realistic ratios are denoted in Table 14 as the optimum promoter-to-bank ratio. These figures represent the number of banks one promoter from each program felt he or she could realistically handle.

4.108 These figures vary from a 1:15-20 at FINCA/Costa Rica to 1:10-12 at CRS/Thailand, followed closely by 1:8-10 at FINCA/Northern Mexico. The two programs with the highest ratios include the programs with the education or technical assistance components. A FFH/Thailand promoter said she could handle seven banks, while CARE promoters felt six was more realistic. Other factors affecting these ratios include the maturity of the loans, the distance that must be traveled between banks, and the education and experience of the VBs. Costa Rica has highly sophisticated older banks that do not require the same level

of attention as VBs in other areas. Table 14 shows that in contrast to the other programs, the vast majority of banks in Costa Rica are over two years old. Therefore, it is not surprising that they require less promotor attention and have a much lower VB/promoter ratio. As other programs mature, their ratios will probably also decrease. It is doubtful, however, that they will fall as low as that of Costa Rica's. The unusually high education levels of VB members combined with the considerable assistance VBs get from public and private agencies in addition to FINCA suggests the low ratios achieved by FINCA/Costa Rica will be difficult to replicate.

4.109 Village banking programs require more than just promoters to sustain themselves. In addition to promoters, the village banking programs also require promoter coordinators, accountants, administrative assistance, and managers. Even the most streamlined program, FINCA/Costa Rica, has a sizable staff with 10 people in the field and seven headquarters staff, and it is hoping to expand to include a director of operations. At the other end of the staffing continuum, CARE/Guatemala has eight staff working on nine VBs, although the project manager only spent half his time on village banking.[37]

TABLE 14: PROMOTERS AND VILLAGE BANKS

	FFH Thai	CRS Thai	CARE Guat	FINCA N. Mex	FINCA CR
No. of Promoters	3	3	4	11	6
Full Time	yes	no	yes	no	yes
Uses Community Promoters	no	no	no	yes	no
Total No. of Banks	11	13	9	38	153
No. of Banks less than 1 year old	11 *	11	2	24	3
No. of Bank between 1 and 2 years old	0	3	2	11	16
No. of Banks between 2 and 3 years old	0	0	5	4	134
Banks/No. Promoters	3.7	4.3	2.3	3.5	25.5
Optimum Promoter/Bank Ratios**	1:7	1:1:10-12	1:6	1:8-10	1:15-20

* Although some FFH banks started in 1989, the membership of the banks and the implementation procedures of the banks changed so dramatically in 1990 that all banks are considered under one year old.

** These ratios reflect the promoters' estimates of how many banks they could handle.

4.110 CARE's relatively large staff can be explained by several factors. First, programs like CARE that provide extension messages in agriculture and health along with instruction on finance require more staff to prepare materials and extension. At FINCA/Costa Rica, similar services are provided by other agencies such as the Ministry of Agriculture. Second, the CARE project has been, up to now, a pilot initiative, which has meant it has put more resources into administratively intensive and costly activities such as monitoring and evaluation. Third, there is some evidence to suggest that VB programs have

[37] By 1991, CARE's staffing ratio had changed to 10 staff for 29 banks.

increasing returns to scale, at the pilot level anyway. To keep track of nine banks effectively, data management systems are required and so is the staff to run them. As a program expands to 50 banks, more promoters would be needed but the relative increase in administrative and information support would probably be less. In addition, as staff and banks mature, banks require less oversight and staff less training.

4.111 There is some divergence among programs in regard to VB member training and, more specifically, the committee's training in accounting and general financial management. Not surprisingly, FINCA/Costa Rica provides the most training, and they also have the most sophisticated bookkeeping procedures. The other programs have put relatively less emphasis on financial management training, although some have provided considerable technical assistance in other areas. As discussed previously, staff from the FINCA/Northern Mexico and El Salvador programs maintain that the banks in their programs that have received the least training have also been the ones to fall into arrears or default.

4.112 The lessons learned from experience with sponsoring agencies are fourfold. First, although community promoters have definite advantages, they may also have unanticipated costs and may not be appropriate for all cultural contexts. Second, promoter-to-VB ratios will be lowest in older programs that do not include education or technical assistance components. But the low ratios experienced by FINCA/Costa Rica may be difficult to replicate in other regions with a less-educated population and limited infrastructure. Third, sponsoring agencies undertaking VB initiatives require considerable supporting administrative and information systems to carry out village banking in contrast to what is set out in the basic FINCA manual. Fourth, VBs, even when they have relatively sophisticated members, require considerable training to be able to function effectively.

THE SOCIAL DIMENSIONS

The Socioeconomic Setting

4.113 Although there are many similarities, village banking programs vary to fit the local context. The adaptations introduced by the different programs have focused on financial transactions, services provided, and methods for building community banks. Financial transactions, expressed in terms of loan sizes, maturities, and installment payments, are frequently altered to match the local needs. Table 5 illustrates how loan maturities vary across programs. Programs serving primarily rural-agricultural clients -- such as FINCA/Costa Rica, FFH/Thailand, and CARE/Guatemala -- have longer loan maturities to reflect the longer agricultural production cycle. Shorter four-month maturities are typically found in programs that are lending to urban microentrepreneurs for working capital needs such as FINCA/Northern Mexico.

4.114 Installment payment schedules must also conform to members' needs. At FFH/Thailand, the project had a very difficult time recruiting members in its first year of operation because the sponsoring agency demanded clients make weekly installment payments and adhere to strict criteria regarding poverty levels. As a result, the program ended up with zero to only five or 10 members signing up to be participants. After installment payments were rescheduled to come at the end of the loan cycle, VBs grew substantially from 50 members in 1989 to 220 members in 1990.

4.115 Additional country-specific factors affecting VBs include the education levels of the communities and communities' access to basic infrastructure and services. These factors, in turn, can influence the services and training VB sponsoring agencies provide. In Costa Rica, VB members are the most numerous and literate. Illiteracy rates in Costa Rica are only 7 percent for adult women and 6 percent for adult

males (World Development Report 1990). This is reflected not only in their bookkeeping, but also in their ability to send fairly sophisticated financial reports to headquarters. Similarly, Costa Rica has a comparatively well-developed infrastructure and government service network. FINCA/Costa Rica relies heavily on government and private agencies for support in providing agricultural, marketing, and financial and technical assistance to its banks. To the extent that FINCA can get government and private assistance for services, it can reduce its own costs.

4.116 This is not a viable alternative is all countries. In Guatemala, for example, comparative illiteracy rates are 43 percent for women and 45 percent for men (World Development Report 1990). Also, the government does not offer the same types of services. Consequently, if a sponsoring agency wanted to provide a similar level of assistance to its community banks, the agency would have to take on many of the tasks itself. CARE/Guatemala has essentially taken this option. As a result, it has significantly increased its costs.

4.117 A final socioeconomic factor influencing village banking relates to the types of communities VBs are operating in. Where communities are relatively stable and cohesive such as in rural Guatemala and Costa Rica, VBs are relatively easy to establish. At FINCA/Northern Mexico, which focuses on establishing banks in the slums of Tijuana and Mexicali, establishing and maintaining banks is much more difficult. In these areas, much of the population comes from other regions in Mexico. People move north to find work in the Maquiladoras (the foreign company assembly plants) or the United States. Many of the El Salvador banks operate in similar conditions as families move to seek refuge from the war or find work. In these social contexts, communities do not have the same ties and solidarity can be more difficult to build. This can jeopardize the effectiveness of local sanction as an incentive for repayment and lead to extreme fluctuations in bank membership. To compensate for these factors, banks in regions with highly migratory populations may have to spend more time building up relations between members before they begin to lend large amounts of money in either the internal or external accounts.

4.118 In sum, the socioeconomic context can have strong influences on VB initiatives. The type of activities clients are involved in, and especially rural-urban differences, are likely to affect loan maturities, sizes, and installment payment schedules. Also, the education levels of members and their access to resources and infrastructure will have an impact on the services and types of assistance VB projects provide. Lastly, migration patterns of communities will influence a VB's ability to impose sanctions and discipline on its membership.

Who Is Being Served?

4.119 The village banking model expressly seeks to serve two overlapping target groups, the poorest of the poor, and especially poor women. It also expresses a preference for microentrepreneurs over agricultural workers.

4.120 It is difficult to rigorously test whether the poorest of the poor are actually being reached across programs. Only FINCA/Costa Rica, CRS/Thailand and FFH/Thailand have attempted to document the income and asset status of their clients. The sample study of 36 FINCA/Costa Rica VBs found that the average member was male and had an annual income of $987 in 1987, a small farm (20 hectares), and about a fifth-grade education (Wenner 1989:14). The 1986 poverty line for Costa Rica was estimated to be about $1,310 annually, which suggests that the average VB member is poor. But on average they are not extremely poor. The poverty line for extremely poor was estimated to be $637 in 1986 (World Bank 1990:75).

4.121 Table 15 documents similar information for the CRS/Thailand and FFH/Thailand projects and suggests the following. First, a review of the land holding of VB members suggest that VB membership embraces a wide range of landowners. At the CRS village Na Poe in Surin Province, land holding varied from .5 rai to 50 rai compared to 7 to 60 at the FFH village, Na Sri Nuan, in Nakhon Ratchasima (Korat) Province. Most members were concentrated in the range of 8 to 13 rai at Na Poe, and 15 to 20 rai at Na Sri Nuan.[37] A study of rural poverty in Thailand found that poor households in the Northeast (where both the CRS and FFH projects are located) own about 18 rai compared to 23 owned by the nonpoor (World Bank).

TABLE 15: BASIC INDICATORS OF VB MEMBERS IN TWO THAI PROGRAMS

	CRS Na.Poe Village	FFH Na Sri Nuan Village
Average Age	44.4	31
Range	(68-21)	(22-55)
Occupation		
Farmers	17	15 *
Laborers/traders	2	2
Household members (avg. for NE. Thailand 6)	5.2	5
Average Land Holding (Rai)	13	24
Range	.5-50	7-60
Concentrated	8-13	15-20
Economic Activity		
Pig raising	13	9
Poultry raising	2	3
Silk production	21	1
Trader	8	1
Vegetable garden	1	2

* FFH farmer figure includes members who stated rice production and pig raising as their main occupations.

4.122 This data suggest that the majority of VB members in these two VBs are poor. But they are not all poor. Those with 50 or 60 rai are probably even well-off by local standards. In contrast to being a liability, the experience of VBs in Thailand suggests the broader membership may make them stronger. Conversations with village headman and other important members of the community showed that well-respected, better-off women were asked to join by promoters and others not because their capital was needed, but rather to add legitimacy to the VBs. Moreover, it is unclear whether a bank with a membership comprised exclusively of very poor people from a community could be viable. Banks require a minimum membership for adequate resource mobilization and a leadership with literacy and numeracy skills. If these skills are not available, the banks must hire someone to fulfil the bookkeeping and secretarial functions.

4.123 The other important target group for village banking is women. The main justification for targeting women is that increasing women's income can improve the welfare of an entire family,

[37] Korat is a wealthier province than Surin, which explains why the average landholding in Na Sri Nuan is higher than in Na Poe (Siamwalla 1990).

particularly children. Unfortunately, given the short-term nature of the study, these important questions regarding income and welfare changes could not be assessed. Nevertheless, a few insights were gained on women's role in village banking.

4.124 It was possible to assess women's participation level in the various programs. Table 15 illustrates that women constitute the totality of members in the CRS/Thailand, FFH/ Ghana and Thailand, FINCA/Northern Mexico, and CARE/Guatemala projects and 82 percent at FFH/Mali, 57 percent in Save the Children/El Salvador, but only 27 percent in FINCA/Costa Rica.

TABLE 16: WOMEN IN VILLAGE BANKING

	FFH Thai	CARE Guat	FFH Ghana	CRS Thai	FINCA N. Mex	FINCA CR	SAVE El Sal	FFH Mali
Percent Women	100	100	100	100	100	27	57	82

4.125 The reasons behind the variation in female participation rates require examination. In the programs with 100 percent female participation (FFH/Thailand and Ghana, CARE/Guatemala, CRS/Thailand, and FINCA/Northern Mexico), women were explicitly identified as the target group and men are typically prohibited from participating. Project officers have pursued this approach because they are concerned that if men were allowed to join they would dominate the group and reduce the potential for building solidarity among women (interviews with CARE/Guatemala and FINCA/Northern Mexico staff).

4.126 In contrast, in the other projects (FINCA/Costa Rica, Save/El Salvador, and FFH/Mali) women have not been explicitly identified as the sole beneficiaries. Instead, promoters have encouraged members of the community (male and female), who are interested and willing to comply with the fairly strict conditions of VB loans, to join. In these projects, the targeting of women is done by proxy with the terms and conditions of loans and membership determining women's participation levels.

4.127 The FINCA/Costa Rica and FFH/Mali projects illustrate how varying loan levels and criteria for membership influence women's participation. FINCA/Costa Rica goes into a village offering loans of between $64 and $150 to VBs with annual maturities. Further, promoters encourage VBs to meet fortnightly or monthly to mobilize savings, discuss relevant VB and community issues, and, when appropriate, to disburse loans or collect payments. With these requirements and loan terms, FINCA/Costa Rica has achieved a 27 percent female participation rate. Stricter terms and smaller loans have led to a different composition of clients by gender at FFH/Mali. Recipients of FFH/Mali loans must accept $50 loans in the first cycle, and these loans must be repaid with installment payments in four months. Similarly, participants must be willing to meet weekly to discuss issues related to VB operation and hunger. Under these criteria, FFH/Mali has attracted mostly women (82 percent).

4.128 The varying experiences of FINCA/Costa Rica and FFH/Mali suggests that loan terms and sizes and eligibility requirements have a strong effect on the proportion of women participants. Women are more likely to participate when loans start small (around $50), maturities are relatively short (four-six months), and meeting schedules are relatively demanding (weekly or biweekly). The effectiveness of this type of targeting may result from several factors. First, women may be attracted to the small loan and short terms because they match their business needs. For example, women may be concentrated in

productive activities that only require small amounts of working capital and turn over quickly to conform to short-term maturities. Second, women may be so desperate for funds that they are the only ones willing to comply with these restrictions. On the other hand, the relatively low participation of women in the programs with larger loans and longer maturities may result from men's unwillingness to allow women to participate, because larger loans with longer maturities do not appeal to women, or because promoters did not sufficiently encourage women's participation.

4.129 Women's participation levels have also had an effect on the VB supervision strategies adopted by some sponsoring agencies. The high percentage of women in the VB projects has, in some cases, justified limited supervision of VBs because of the common assumption that women are more responsible financial clients than men. In practice, this assumption has turned out to be slightly misleading. When provided with the proper training and incentives, women can be strong financial clients as illustrated by the experience in CRS/Thailand and FFH/Thailand where repayment rates have remained 100 percent. But women are not necessarily better clients. The experience in FINCA/Northern Mexico shows that they are capable of slipping into arrears and the experience with FINCA/Costa Rica shows that programs with a majority of male clients can achieve high repayment rates. The main characteristics distinguishing strong VBs from weak ones include strong VB solidarity, leadership, and financial management. Consequently, to the degree that gender influenced these variables (and it probably does) it has proven important. Also, since women may have fewer alternatives to get financial services, they may have greater incentive to be strong financial clients so they can stay in the VBs.

4.130 There is evidence to suggest that in some instances the all-women's groups have been more effective at bolstering solidarity. Surveyed participants from the all-women's groups in CRS/Thailand, FFH/Thailand, CARE/Guatemala and FINCA/Northern Mexico said they were glad men were not allowed to join. Two justifications for preferring all-women groups were the wider agenda of topics that could be discussed at meetings (such as family planning, cooking, child bearing, and domestic violence), and greater freedom for interaction among members. At the same time, however, women from mixed-gender banks said they were content to have men as fellow members. They viewed the VB as a community activity and they saw men as integral members of the community. Preference, therefore, may be tied to members' experience. Also, which scenario is preferable probably varies from one culture to the next.

4.131 Effective leadership and financial management also contribute to healthy VB development and operation. Women (and men) members may require training, beyond what is implied in the model, to acquire these skills. Although there is considerable regional variation, women typically have less access to resources than men. As a result, women typically are less educated than men and have less experience with management in formal groups (World Bank 1989), which suggests that contrary to what is implied in the model, they may need more, not less, training.

4.132 There is also the basic assumption in the model that microentrepreneurs will be the main beneficiaries of VB projects, which helps explain why the financial structure was designed on a four-month cycle. In practice, VB members are more diverse. In the Thailand example, Table 14 clearly illustrates that the majority of participants are farmers who use their loans for secondary activities such as livestock raising or silk production. Only eight members in one village and one in the other cited trading as their economic activity. Similar rural activities were cited by women in the Guatemala program. The only program that serves primarily traders and more traditional types of business microentrepreneurs is FINCA/Northern Mexico, which focuses on lending in urban areas in a trade-centered economy. In this region, members cited selling food, clothes, and raffle tickets as their main economic activities.

Empowerment and Participation

4.133 The VB methodology emphasizes providing individual members with the tools (social/psychological and financial) to move out of poverty. In other words, it seeks to "empower" them. Determining whether or not one is empowered or has become empowered would be difficult under the best of circumstances. But without survey data to illustrate changes in objective indicators like increases in income or use of family planning, it is impossible and beyond the scope of this paper.

4.134 The methodology focuses much less on the potential for empowering a community. Yet it became evident throughout the study that fostering the development of participatory local organizations did improve a community's ability to get access to resources and affect decision making at the local level. Generally, as VBs develop they put an increasing amount of their resources -- time and financial -- into community projects. This has been true for both male- and female-dominated banks.

4.135 Typically, these investments start small. For example, Banco Superacion de la Mujer in Northern Mexico, which started in April 1990, has made its first community investments in raffles, a small food stand, and children's uniforms. After two years of operation, San Vicente Pacaya Bank in Guatemala with assistance from CARE is attempting to get a loan from Canadian International Development Assistance (CIDA) to undertake a village-wide drainage system. At FINCA/Costa Rica, countless banks have started cooperative local stores, hotels or restaurant, or other forms of cooperative ventures. By organizing into groups, communities become better able to get resources from other agencies. Also, local groups make it easier for outside organizations to work with communities.

4.136 The lessons learned regarding empowerment center on the role of the VB as a local organization. Once a local organization is established it can serve three important functions. First, it allows community groups to express their common needs better to outside agencies as evidenced by the experience of San Vicente Pacaya bank in Guatemala. Second, local groups also provide a conduit for other service agencies to interact with communities. Third, once a local organization is formed, it increases the community's ability to invest in community projects (for example, public goods such as roads or drainage ditches) and in goods that require relatively bulky investments such as a stove.

SECTION V

PROBLEMS AND PROSPECTS

5.01 The previous section has attempted to document what village banking programs look like in practice. In this context, it has concentrated primarily on operational and implementation issues. In this section, the emphasis shifts to the problems and prospects that these and other village banking efforts may face as they move from their pilot or initial experience to become more mature programs. Consequently, the focus here is on overarching, superstructure concerns. These include:

- The prospects for client or VB graduation;
- The potential for financial sustainability;
- The role of apex institutions;
- Project scale; and
- The interaction of community management, supervision, and risk. Many of these issues are interrelated. For example, projects may have to develop apex structures or grow in size to become financially sustainable. Nevertheless, they are discussed separately for clarity.

THE PROSPECTS FOR GRADUATION

5.02 Most development programs seek to build systems or institutions that will allow target populations to get project services beyond the life of a project. One way to achieve this objective is to provide target populations with sufficient skills or resources so that they can graduate to more established formal institutions such as commercial banks. Some of the VB project design documents assume that VBs will graduate to more formal financial institutions after participating in village banking. Graduation could involve individual clients or a VB may graduate to a formal bank as one unit.

Graduating Individual Village Bank Members

5.03 Although the potential for client graduation is often stressed in village banking, few programs studied have had individual clients graduate to formal commercial banks. For example, after two years of operation, only eight women from one bank (or 2 percent of the total participants) in the CARE/Guatemala project graduated. Moreover, if other programs can offer examples, client graduation may be an unlikely outcome. A study of 10 microenterprise programs in Latin America found that less than 2 percent of their clients graduated to commercial banks, although all 10 identified graduation as a program objective (Steams 1989:22). Further, many of these graduated clients continued to take loans from the microenterprise lending institution. The study provides many reasons for the low level of graduation. The increased time commitment that is associated with commercial borrowing appeared to be the most important factor. Borrowers had to invest considerable time in loan-processing requirements, meeting with bank staff, and transportation. Additional constraints included client familiarity and comfort

with program personnel compared to commercial bank staff and commercial bank guarantee requirements (Stearns 1989).

5.04 These issues were identified as critical constraints in the sample of ACCION International's programs that have loans ranging from $120 to $3,500 and are located in urban or semi-urban centers. It is likely to be an even greater problem for the typically rural-based village banking clients seeking loans of $50 to $400, particularly when these clients are women who are more likely to be illiterate, have nonregistered informal businesses and no formal land titles to use as collateral, and face difficulties traveling to cities where commercial banks are located. Therefore, client graduation may be even less realistic for village banking initiatives -- especially in rural projects that target women -- than it has been for other microenterprise programs.

Graduating Village Banks

5.05 Another possibility would involve graduating VBs (not just individual customers) to commercial banks. Both CARE/Guatemala and FFH/Thailand VBs have established relationships with local commercial banks. Currently, VBs place their savings in accounts at the Bangkok Bank in Thailand and Banco del Agro, Banco del Cafe, and Banco Industrial in Guatemala. The Bangkok bank also provides loans (which have been guaranteed by donors) to the VBs. Both programs anticipate that VBs will graduate to these commercial banks as a source of loan capital after they have gone through about six cycles of operation. They expect that the banks will accept the VB's credit history and savings accounts as sufficient evidence of the VB's creditworthiness.

5.06 Although to date there is no history of a VB graduating to a commercial bank, there is reason to believe that VBs may face a better chance of graduating than individual entrepreneurs do. Lending to groups decreases transaction costs for both borrowers and lenders. Lenders have a greater incentive to make larger, and therefore cheaper, group loans, and in the aggregate borrowers will spend less time fulfilling loan-processing requirements. Only committee members will have to make the heavy time commitments associated with transportation and loan processing and they could potentially be compensated for their efforts by their VBs.

5.07 But even group lending may have difficulty overcoming all the constraints. For example, collateral requirements and interest rate ceilings may discourage commercial banks from lending to VBs.[39] VBs may be able to overcome the collateral constraint by maintaining a high savings-to-loan ratio in the participating commercial bank as a hedge against default.[40] Even if these constraints were overcome, however, questions remain regarding which agency would be responsible for periodically auditing VBs and whether it is even desirable to link community groups to formal systems in countries where the formal financial sector is not functioning well. On the other hand, if sponsoring agencies do not find some way to help VBs find access to funds, VB clients may have strong incentives to default on their last loan since one of their major incentives to repay -- access to future credit -- is no longer valid.

[39] Typically, interest rate ceilings reduce commercial banks' incentives to make nontraditional loans or, worse, create ill-functioning financial institutions.

[40] This alternative will be more persuasive where the banks want to mobilize savings. But it is not uncommon that government banks have no incentive to collect savings since they have no effective mechanisms to relend them.

FINANCIAL SELF-SUFFICIENCY

5.08 If graduation does not turn out to be a viable option, projects could work to establish sustainable institutions that would continue to offer VB clients financial services outside of the formal financial system. The village banking methodology assumes that the community-managed VBs themselves will be sufficiently strong financially to continue to operate as local savings and loan associations beyond the life of the project. In addition, it assumes that the interest earned by the sponsoring agency will be sufficient to cover the costs of starting up new banks. For a financial institution to be sustainable over the long term and reach more than just a small number of clients, it should become financially self-sufficient (Rhyne and Otero 1991). The issue of financial self-sufficiency is discussed at both the sponsoring agency and VB levels.

Financial Self-Sufficiency at the Village Bank Level

5.09 No village banking program has had experience with a single VB becoming financially self-sufficient. This is not especially surprising, for it is unlikely that a VB can by itself become self-sufficient and provide continual savings and credit services to all of its clients. Financial intermediation requires a certain scale of operation and dispersion of loans and savings to function effectively (Huppi and Feder 1990 and Magill 1991).[41] This scale and dispersion is unlikely to be achieved in one village bank.

5.10 Village banks operate in communities in which the majority of the participants are involved in similar productive activities. In rural areas, these activities are primarily agriculturally based and in urban areas they are typically trading or small-scale production. The result is that at the beginning of the agricultural production cycle, for example, there is excess demand for loans, and at the end there is a surplus of savings. This synchronization (or co-variance) is further aggravated by the related concentration of risks. If drought or flood affects the village, all clients will face similar pressures to go into arrears or default. One village-level institution would have difficulty responding to the synchronization of demand or risks (Binswanger and Rosenzweig 1986).

5.11 Currently, the sponsoring agency's provision of external loans alleviates these bottlenecks. Without access to outside funding, VBs may have difficulty offering the same level of services to their memberships. If they continue to operate after the sponsoring agency withdraws, they will probably look more like traditional rotating savings and loan associations or some type of periodic, small-scale credit union.[42] If the legacies of village banking projects are traditional rotating credit associations or a similar organization, the pertinent question that arises is whether or not the considerable investment involved with setting up a VB is a cost-effective way to achieve this outcome.

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[41] In his study of the credit union movement, Magill (1991:21) finds that small institutions with small client bases can have only a minimal impact on their clients because they are unable to generate sufficient resources to provide meaningful levels of credit to significant numbers of people.

[42] This is not to say that outside funds must constitute the majority of village banking lending to ensure that they meet creditworthy participants' demand for financial services. On the contrary, large amounts of external funds are likely to overwhelm VB management capacity and individual member ability to absorb funds (Huppi and Feder 1990). Experience with a similar financial scheme in India, operated by Myrada, suggests that a group's savings-to-external funds ratio should not exceed 1:3 and that rates of 1:1 are preferable.

Financial Self-Sufficiency at the Sponsoring Agency Level[43]

5.12 Financial self-sufficiency is more likely to be achieved at a sponsoring agency level. As defined here, a program would be considered financially self-sufficient if it could cover -- through fees and interest charges -- its operating costs, including loan loss reserves, the cost of funds, [44] and inflation, to maintain the real value of the loan capital (Rhyne and Otero 1991:11).[45] Using this definition, no program studied has become financially self-sufficient. But financial self-sufficiency should be viewed as a process whereby programs move through stages of increasing cost recovery. Further, programs should be assessed on their efforts to move toward financial self-sufficiency, and not by their current level of achievement (Rhyne and Otero 1991:11).

5.13 In their study of microenterprise programs, Rhyne and Otero (1991:11-12) identify four levels of financial self-sufficiency. At level one, programs are highly subsidized as grants or soft loans cover operating expenses and a revolving loan fund is established from which loans are disbursed and into which principal repayment and interest payments are placed. Unfortunately, these funds are typically quickly eroded by inflation or delinquency. At level two, programs begin to raise funds by borrowing on terms closer to market rates. Interest income covers the costs of funds, as well as a portion of the operating expenses, but grants are still necessary to finance some aspects of operations. At level three, most of the subsidy is eliminated, and at level four programs reach self-sufficiency.

5.14 All of the village banking programs studied are in either stage one (CARE/Guatemala, CRS/Thailand), or stage two (FINCA/Northern Mexico, FFH/Thailand, FINCA/Costa Rica). The preliminary project investments in financial self-sufficiency have involved working toward developing links between village and commercial banks or other funding sources such as government agencies or private investors (FINCA/Costa Rica, CARE/Guatemala and FFH/Thailand); or establishing a confederation of VBs that would raise funds from its membership for operational costs and a central fund, which would alleviate excess demand and supply constraints (CRS/Thailand). Despite these efforts, even FINCA/Costa Rica -- which has been operating since 1985 -- relies on concessional and grant funds to finance staff positions, equipment, and some of its capital lending base.

5.15 Four main factors appear to mitigate against financial self-sufficiency in village banking programs at the sponsoring-agency level:

- The pilot stage of many of the projects;
- The inadequate financial procedures and interest rate structures adopted;
- The $300, three-year time frame envisioned in the VB methodology; and

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[43] This section is narrowly focused on the financial services delivered in VB programs. The agricultural extension and nutritional messages provided are excluded from this financial review since they are more effectively assessed by different evaluation methodologies, such as cost-benefit analyses, which are beyond the scope of this paper.

[44] Even programs operating on grants should factor in the cost of funds since, in the longer term, a program will only become financially viable if it can borrow and pay back capital in commercial markets.

[45] Start-up costs and the cost of providing non-financial training, technical assistance, or educational messages to clients should be factored into a cost stream, but these can be more easily justified with concessional or grant funds (based on, for example, infant industry arguments or social cost-benefit analyses).

- Sponsoring agencies' limited access to savings and commercial sources of funds, and their ready access to grants.

5.16 First, as has been acknowledged previously, three of the projects studied remained in their initial stage (CRS/Thailand, FFH/Thailand, and CARE/Guatemala). Therefore, they have focused on research and innovation and in start-up investments that are not expected to fully recuperate costs. As stated above, some of this research has gone into questions of financial sustainability. But as will be demonstrated below, much remains to be done in laying the groundwork for becoming financially sustainable.

5.17 Second, although projects acknowledge financial sustainability as an objective, those studied have yet to introduce many of the mechanisms that will allow them to meet this goal. Interest rates are rarely associated with costs and programs do not keep sufficiently detailed accounts of their financial operations. With the possible exception of FINCA/Northern Mexico, programs do not set interest rate levels on cost-recovery principles.

5.18 SAVE/El Salvador uses a highly subsidized interest of 3 percent. The rest set their interest rates closer to commercial or government bank rates. FINCA/Costa Rica charges 18 to 24 percent, which is about 10 percent below the commercial rate of 35 percent. CRS/Thailand's on-lending rate of 12 percent equals the subsidized rate charged by the government agricultural bank, the Bank for Agriculture and Agricultural Cooperatives (BAAC).[46] CARE/Guatemala's 24 percent interest was set slightly above the commercial rate of 18 percent because it could more easily be divided into a monthly fee (2 percent per month) and CARE staff have hoped the higher figure will provide a positive incentive for a future VB-commercial bank link. FFH/Thailand's interest rate has some relationship to the cost of funds, although not to operating costs. The interest paid to the sponsoring agency is equal to the interest charged to FFH by the collaborating commercial bank (17 percent) plus an up-front fee of 3 percent of the loan value per cycle (which Friends of Women's World Banking charges for the 50 percent guarantee it places on the Bangkok Bank Loans).[47]

5.19 To set interest rates at a cost recovery level, programs would have to keep detailed records of their operating and technical assistance costs and the cost of funds. Currently, only FFH/Thailand keeps detailed accounts of the cost of its programs (including cost of funds), although it does not separate out the educational components of its programs. The rest of the programs omit cost categories from their accounts (FINCA/Costa Rica and FINCA/Northern Mexico), or do not keep detailed records of their accounts (CRS/Thailand, FINCA/Costa Rica). Clearly, if programs do not set their prices (interest rates) according to their costs or keep accurate accounts, they will have great difficulty achieving financial self-sufficiency.[48]

5.20 This inadequate record keeping is further exacerbated by the fact that financial projections of programs are based on unrealistic assumptions about VB membership and growth in loan sizes. Also, many of the project officers are reluctant to charge higher rates for fear of being exploitative or equated

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[46] This is below the 17 percent rate charged by Thai commercial banks.

[47] In all the programs except for CARE, the VBs typically add additional points on to the interest rate to capitalize their own internal accounts.

[48] Village banking projects commonly lack technical expertise, especially in accounting. This low level of technical competence is not uncommon among NGOs, which tend to put greater emphasis on the social aspect of grassroots development (Brown and Korten 1989).

with loan sharks. This reluctance, however, does not reflect the typical view of the VB membership, who see the interest rate as cheap compared to the prevailing informal rates (interviews with members 1990).

5.21 Third, projects have put limited investment into becoming financially sustainable, in part because the concept is not well incorporated into the VB methodology, which conceives of the sponsoring agency as initiating VBs but not becoming a permanent partner. The VB manual anticipates that clients will graduate after three years or that the VB will continue to operate without assistance (financial or administrative) from the sponsoring agency beyond the life of the project. Therefore, sponsoring agencies have not focused on planning for the establishment of permanent intermediate-level institutions. If, indeed, VBs or VB clients did graduate after three years or VBs became sustainable independent entities, projects could justify long-term subsidies based on infant industry arguments. But, as was discussed above, no VB and few VB clients have graduated to commercial lending institutions and no VB has become financially self-sufficient.

5.22 The final factor that may inhibit financial self-sufficiency is the limited access of sponsoring agencies to funds for a capital lending base. They do not mobilize savings because these local monies stay in the VBs for re-lending in the internal accounts. And only one project (FFH/Thailand) has access to nondonor money for lending. Clearly, this approach is not commensurate with self-sustainability as implementing agencies must rely on donors for most if not all of their loan funds and operating costs. If projects do not find some way to borrow from commercial institutions or mobilize savings, they will continue to be vulnerable to the vicissitudes of donor funding for operation and expansion.

APEX INSTITUTIONS

5.23 If projects are to become financially self-sufficient, they must establish intermediate, or apex, institutions that provide client VBs with a source of funds and a secure place for surplus deposits, and offer auditing and general technical services. Two of the projects studied, CRS/Thailand and FINCA/Costa Rica, have taken steps toward establishing apex institutions. At the time of the study, CRS/Thailand was still in the design stage in regard to apex institutions and its exact organizational makeup had yet to be determined. The project has considered establishing an intermediary structure that would consist of representatives from the local implementing NGOs and the client VBs -- for example, a confederation of VBs and implementing institutions. Four percent of the interest earned from the VBs is currently going into a reserve fund that will be kept at this intermediate institution.

5.24 Since the apex institution has yet to be fully conceptualized, let alone implemented, it is difficult to assess or describe in detail. The international credit union network, which has many years of experience with confederate systems, could potentially provide CRS/Thailand (and others) with models and important lessons learned.[49] Alternatively, CRS/Thailand could pursue a strategy of trying to link its VBs to Thailand's existing credit union network or, potentially, to the Thai Bank for Agriculture and Agricultural Cooperatives, which is the main source of funds for Thai farmers.

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[49] See (a) Huppi and Feder, 1990, "The Role of Groups and Credit Cooperatives in Rural Lending," Washington D.C.: World Bank; (b) Magill, John, 1991, "Credit Unions: A Formal Sector Alternative for Financing Microenterprise," Development Alternatives, Inc.: Bethesda Maryland. Second Draft; and (c) J. Peter Marion, Gloria Almeyda de Stemper, and Dale Magers, 1990, "Credit Unions as Cooperatives: Achievements and Potential," World Council of Credit Unions (WOCCU): Madison, WI. Prepared for USAID-sponsored GEMINI Conference, October 1990.

5.25 FINCA/Costa Rica offers an alternative apex model. Instead of forming a confederation of representatives, FINCA/Costa Rica has assumed the role of a permanent financial intermediary. Clients do not graduate. Rather, they continue to interact with FINCA/Costa Rica, but as banks mature they demand less direct supervision and training and larger loans.

5.26 As an intermediary, FINCA/Costa Rica has four main functions. First, it helps establish VBs, which involves identifying communities, training VB members to manage funds and save, and providing VBs with seed capital. Second, FINCA/Costa Rica links VBs to other private and public agencies for economic, technical, and marketing services. For example, San Gerardo de Rivas VB in Costa Rica's Perez Zeledon zone works with two agencies (the Tropical Foundation and an artisan training group) as a result of FINCA's coordinating efforts. The Tropical Foundation provides technical assistance in environmental protection practices while the artisan organization helps this mountain community to develop handicrafts to sell to the growing tourist industry.

5.27 Third, FINCA/Costa Rica plays a supervisory role, auditing the VBs once or twice a year -- sometimes in collaboration with government agencies -- and ensuring that local elites do not capture a disproportionate share of the funds. Fourth, it provides loans to VBs from its interest income and the soft loans and grants it receives from donor agencies such as the Interamerican Development Bank (IDB), USAID through ACORDE, [50] and the Interamerican Foundation. FINCA/Costa Rica has not had to take in excess deposits from VBs, in large part, because savings have not constituted a large proportion of its client VB's portfolios. Savings were only 11 percent of external loans as of the fourth quarter of 1990.

5.28 FINCA/Costa Rica has been successful at serving its 153 banks as an intermediary. The central challenge it faces involves moving away from donor funds to more stable commercial sources of funds.

SCALE

5.29 The issue of scale is relevant at both the VB and sponsoring agency level, although it has dissimilar implications for the different organizations.

Village Banks and Problems of Scale

5.30 The difficulties and advantages of small VBs have been discussed throughout the paper, but deserve review here. Average membership of village banks is 29 (see Table 11). VBs are small -- particularly initially -- because they are easier to manage. Whereas the small size has benefits for VB management, it has adverse consequences for VB internal resources and sponsoring agency delivery costs.

5.31 Despite the advantages of large village banks, scaling up at this level is unlikely to be a viable option in many places. If sponsoring agencies push banks into growing too large, the pressures on the committee will probably result in mismanaged funds.[51] Moreover, the membership must not only be

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[50] ACORDE is an apex organization that provides economic and technical support to Costa Rican NGOs.

[51] One alternative option would be for VBs to hire professional accountants to manage their books as is common with the credit union movement. Difficulties can also arise with this approach, however. Because management skills are concentrated in one person, embezzlement or fraud becomes fairly easy, particularly if the professional is from outside the community and therefore is subject to less local sanction or peer pressure (that is, it enhances the

large but also diverse in terms of their income-generating activities. Even a large VB may by itself have difficulty providing a significant level of benefits to its members on a continual basis because of covariance problems. Since VB sponsoring agencies tend to target low-income villages and poor clients, these constraints are likely to be especially pronounced. For these reasons, scaling up may be a more realistic option at the sponsoring-agency level.

Scaling Up Village Banking Projects

5.32 To date, village banking projects have reached only a small number of clients -- the majority of programs serve under 200 people (Table 11). FINCA/Costa Rica is by far the largest program, reaching just over 3,500 people. These findings should be unsettling for agencies seeking to have a significant impact on poverty.

5.33 The factors constraining NGO growth identified by Judith Tendler in her study of the Ford Foundation's Livelihood and Employment Generation programs are also applicable to village banking. Her reasons include low levels of funding, the sometimes adversarial relationship between NGOs and government or more formal institutions, the high costs of programs per beneficiary, a tendency not to see large projects as a priority goal, and the smallness and homogeneity of NGOs that can give them a qualitative advantage in responding to local needs (Tender 1989). For example, in an effort to ensure that all systems are adapted to local needs, the CRS/Thailand project originally allowed for the development of different accounting procedures in each village bank. Whereas this approach may benefit individual banks, it militates against achieving any scale since accounting procedures cannot be standardized.

5.34 If village banking programs do not overcome the constraints that are keeping them small, they will be unable to play a significant role in poverty reduction. Yet scaling up will not be a painless process as it will require tradeoffs. Areas where sponsoring agencies are likely to have to compromise include:

- Decreasing the specialized attention they currently give to their VBs, which will include, for example, standardizing some procedures;
- Negotiating with formal lending institutions so sponsoring agencies can begin to intermediate funds between VBs and commercial banks;
- Rationalizing their pricing, cost, and accounting structure -- they may have to put less investment in technical assistance while raising their interest rates; and
- Making greater investments in financial and institutional self-sufficiency.

5.35 In addition, large projects are likely to become subject to government financial regulations. More specifically, three common examples of financial sector regulations that may not be commensurate with village banking practices are:

- Legal restrictions or heavy reserve requirements on institutions that collect deposits (although as long as savings stay in the community, governments may not be concerned);
- Interest rate ceilings on lending; and

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possibility for moral hazard).

- The formal registration of member village banks.

The last policy may or may not create problems for VB projects depending on the political climate of the country. Some governments may not look kindly on local-level organizations because they could provide a forum for antigovernment activity. By contrast, in countries such as Thailand, Guatemala, or Costa Rica, legalization of VBs is likely to help legitimate them and provide an option of legal recourse for VBs that run into problems with their members or other organizations (discussion with project staff). In Guatemala and Costa Rica, VBs have already become legalized with encouraging results.

COMMUNITY MANAGEMENT, SUPERVISION, AND RISK

5.36 The village banking methodology puts considerable emphasis on community management and participation. Village bank members determine their own bylaws, manage their accounts and meetings, and so forth. The central objective of the VB promoter is to train the VB members to run the community savings and loan association autonomously. The manual does not mention the need for auditing or outside supervision beyond the training role of the promoter and does not discuss risk. This section reviews the interaction among these factors and discusses their implication for VB operation.

Community Participation and Management

5.37 Participation is essential to the proper functioning of financial services cooperatives. For cooperatives to be successful, members must feel that they have a stake or sense of ownership in the organization (Huppi and Feder 1990). This sense of ownership is created and sustained by member participation. If members do not feel they are part of the cooperative, the incentives for members to contribute to the association's operations, repay loans, or contribute to savings are significantly reduced. The vast experience with failed nonparticipatory, top-down credit cooperatives testifies to the need to foster participation in community savings and loan associations (Huppi and Feder 1990). The village banking programs have been very successful at promoting participation and building sense of ownership by members in the VBs. Some of the factors that have contributed to this success include the VB's self-selection of its membership, the community-managed and participatory nature of sponsoring agency management training to the VB, and resource contributions by members to the organization.

5.38 Participatory financial services groups can have additional important benefits. First, groups can reduce the transaction costs of reaching dispersed individuals (Bratton 1986, Huppi and Feder 1990). Although the initial costs of establishing the groups may be high, group lending can reduce costs for lenders since many of the transaction costs are transferred from the lender to the borrower. Second, village banking's joint liability arrangements -- one person's default jeopardizes all members' access to future funds -- can decrease a lender's risks and substitute as collateral requirement for borrowers. Third, groups can decrease costs for borrowers as clients save on fees for collateral registration, loan processing, and transportation costs (Adam and others 1981). Fourth, when community-managed credit groups are composed of individuals who know one another, and when they operate in communities where social bonds and peer pressure are strong, they can overcome the problems of inadequate information and moral hazard that have plagued traditional formal lending institutions.[52] Finally, the village groups can provide

[52] Problems of insufficient information arise because commercial lenders have difficulty gathering information on borrowers with no formal credit history and moral hazard becomes a risk for formal lenders because communities frequently have less incentive to repay distant institutions to which they have no ties.

women with a legitimate social space outside of the home and a sense of solidarity that allows them to deal more freely with unfamiliar formal institutions and processes (Interviews with borrowers 1990 and PHRWD Initiating Memorandum 1991).

Supervision and Risk Management

5.39 VB staff frequently view membership participation and community management as adequate substitutes for outside auditing and other forms of risk management. There is the basic assumption that participatory activities have low risks and that communities will be almost self-regulating. This is especially true in the all-female programs since women are seen as being more responsible than men (Hatch and Project Staff 1990). Consequently, while there is some variation in the supervision and risk management strategies adopted by the different projects, the tendency has been to give these issues little priority. At the extreme, outside supervision (for example, auditing) is seen by some project staff as a threat to community authority and participation and risk management is seen as unnecessary (interviews with CRS staff 1990). This philosophy has translated into a policy of minimal supervision of the internal accounts since these accounts are interpreted as belonging to the communities to do with as they see fit.

5.40 The result of this lack of attention to risk is that projects have begun to experience theft and financial mismanagement. In FINCA/Northern Mexico, for example, one bank disbanded when the loan funds and savings were stolen and in other banks, treasurers have unlawfully borrowed from group funds for personal expenses. In another program, a treasurer stole the entire VB savings by falsifying bank documents. On top of these cases of outright theft, there are numerous examples of mismanaged accounts across projects. Some have resulted in arrears and rescheduling, as was discussed earlier, while others have led to inaccurate calculations, for example, of the interest on savings (discussions with treasurers at FINCA/Costa Rica Banks). These incidences have occurred at both mixed-gender and all-female banks, which suggests gender cannot substitute for oversight or risk management.

5.41 The experience with theft and unplanned financial mismanagement raises two concerns. One is the need for improved oversight and risk-reducing strategies and the other is the adequacy of management skills in the community.

5.42 Although risk can never be eliminated, it can be significantly reduced. Since VBs are dealing primarily with poor people's savings, the need for risk management is especially pronounced. The traditional methods of risk management or more accurately depositor protection involve:

- The full disclosure of relevant information about the solvency and liquidity of the deposit-taking institution, typically by licensed external auditors; or
- The provision of deposit insurance -- usually by the government (Vogel 1990).

In projects in which the majority of participants are illiterate, disclosure of information is difficult. Similarly, formal deposit insurance may not be available to village banks.

5.43 If none of the traditional forms of risk management is available, VBs should pursue alternative methods. Examples of more simplified risk management procedures include:

- The monthly cross-checking of accounts by different VB members;

- Keeping savings in safes or at commercial banks where they require at least three signatures to be withdrawn;

- Having external auditors come to audit VB books once or twice a year; and

- Establishing some kind of reserve fund or insurance program for members' savings.

5.44 Of the VB programs studied, FINCA/Costa Rica possesses the most advanced risk management. VBs send their own internal audits and records to the central office once or twice a year. In addition, government agencies or FINCA staff conduct an annual external audit of VB internal and external accounts. These procedures have significantly reduced incidences of mismanaged funds. FINCA/Costa Rica banks have not mobilized many savings to date, so issues regarding deposit insurance have not arisen. Programs that have high saving rates may have to take additional steps, beyond audits, to ensure that VB members' savings are safe. Further, these risk-reducing strategies that involve oversight and supervision have not jeopardized local participation or autonomy. Indeed, FINCA/Costa Rica's VBs were by far the most independent banks visited. Therefore, the participation/supervision dichotomy posited by some project managers appears to be false.

5.45 The second issue that arises in association with mismanaged funds is local ability to keep accurate accounts. As discussed previously, training has proved to be more important than was originally thought by VB designers. If VBs are to remain (or become) effective local savings and loan cooperatives, they must have treasurers (and others) who can keep accurate accounts. Financial management in VBs will not be limited to the standard internal and external accounting mechanisms outlined in the Village Bank Manual. Village bank treasurers may also have to learn additional tasks, such as learning when to change a VB's pricing structure in the face of changing costs or inflation (that is, increase or decrease interest rates on loans or deposit); conducting loan assessments on larger loans to see if collateral is necessary; and learning to do internal audits. Teaching these skills to illiterate or semiliterate people is possible, but it will require creative approaches and a larger time commitment than is currently envisioned by VB project staff.

SECTION VI

CONCLUSIONS

6.01 This examination of village banking in theory and in practice has revealed some encouraging conclusions. First, the review of five VB projects has demonstrated that the model shows promise in its ability to reach poor people, and particularly poor women, who are traditionally excluded from more formal financial services projects. Second, although there is some variation, VB projects have been fairly successful at mobilizing local resources including members' savings and human resources (labor). Third, many of the older VBs, especially, have lived up to expectations regarding community participation and management and have begun to benefit from investments they have made in public goods, such as roads, and in cooperative ventures. Finally, for the most part, VBs have maintained high repayment rates (typically above 90 percent) in their external (sponsoring agency) accounts.

6.02 But this preliminary study has also exposed some substantial shortcomings and divergences between what is prescribed in the model and what actually happens in the field. These inconsistences pervade project operation and implementation and they have important strategic implications.

6.03 From the operational and implementation perspective, these problems affect primarily the financial operation and management of VB projects. The projects appear to be meeting many of the social objectives set out in the methodology -- to the extent that they could be analyzed in this study. This suggests that sponsoring agencies should put greater emphasis on the technical and management aspects of finance.

6.04 Village bank operation has been much more erratic and complex than the VB model or the projects' financial projections imply. Members are not on a three-year path to financial independence, and financial self-sustainability has not been achieved at the community level. In contrast to what is anticipated in the model, members are not steady financial participants in the VBs (membership turnover is common) and their track records on savings and loans do not reflect even or constant growth. This variation has made VB accounts difficult to manage and, in some instances, even led to financial mismanagement, both planned and unplanned. Moreover, there is little evidence to suggest that clients' financial needs stop after they have saved up $300 or that this sum will allow them to graduate to commercial banks. These findings indicate that the three-year, $300 timetable does not accurately describe VB clients' financial behavior or needs.

6.05 Similarly, the scanty administrative setup and financial procedures advocated or implied by the VB model for sponsoring organizations have not matched what is required for successful field operation. In reality, VBs need considerable training, supervision, and monitoring from sponsoring agencies, especially in the initial stages. Although the demand by VBs for these inputs has declined substantially over time, evidence from the older programs indicates that it does not stop after three years. Moreover, if sponsoring agencies are interested in establishing sustainable financial institutions and tracking VBs' progress, they must greatly improve their accounting and management information systems.

6.06 These findings have serious implications for the design, implementation, and sustainability strategies of village banking projects. From an operational and implementation perspective, sponsoring agencies and VBs must gain a more realistic picture of what is required from them in regard to financial and risk management, training, and supervision to effectively sponsor village banking programs. These

requirements, in turn, have implications for project financing. More training, management, and supervision and a more complex administrative structure mean higher costs.

6.07 Moreover, projects interested in fostering sustainable financial systems for their clients must put greater emphasis on issues related to sustainability. These include:

- When appropriate, initiating measures that will allow for VBs to graduate to more formal institutions;
- Introducing procedures that will allow for project financial self-sustainability (such as, increasing interest rates, improving cost accounting, and finding nondonor sources of funds); and
- Establishing apex institutions that can provide funds to VBs or absorb their excess savings when necessary and offer supervisory/training services.

In addition, meeting these objectives will probably require that projects grow substantially and introduce more stringent and standard operating and financial procedures, particularly as they apply to security concerns. The Village Banking Manual, which is given to sponsoring agencies wishing to introduce a VB program, should be updated to reflect these lessons.

6.08 The village banking projects have taken different steps to resolve their problems. FINCA/Costa Rica has continued to provide services to its VBs even after three years; introduced supervisory schemes, such as periodic audits; and provided extensive training to its VBs with the help of private and public agencies, which helps to reduce FINCA's costs. FFH/Thailand and CARE/Guatemala have made VB training a priority and have taken important steps toward graduating their VBs to commercial institutions and building-up adequate administrative structures within the sponsoring agencies to effectively manage VBs. Third, CRS/Thailand has introduced a management information system to track its VBs and has begun to investigate options for establishing an apex institution. Finally, FINCA/Northern Mexico has begun to put more stringent financial controls on its VBs and improve its reporting system. Although these efforts are encouraging, much remains to be done before village banking programs can reach large numbers of clients or begin to approach financial self-sustainability.

6.09 In addition to following and testing the policy guidelines suggested in this paper, VB sponsoring agencies could benefit from continued periodic discussions and information exchanges between each other,[53] and from further research. Additional operational research topics should include:

- Savings, including the interaction between savings and loans in relatively small-scale savings and credit associations, experimentation with reserve funds, and analyses of the optimal savings-to-loan ratios;
- The role of business training in village banking projects (minimalist credit versus credit plus);
- Practical risk management strategies for community banks;
- The potential and the desirability of VB graduation to commercial banks or national credit union networks;

[53] The five NGOs participating in this study have a formalized system for exchanging experience and ideas under the SEEP network.

- The role of apex institutions in VB projects; and

- The potential for project self-sustainability.

6.10 But village banking research should not be limited to operational issues. This study has not delved into impact issues, such as the effect of village banking on household income or the productivity of clients' businesses. This will be another important area of research. Programs could greatly assist this research by collecting baseline data on the income and asset status of their VB members.[54] In addition, projects that include substantial technical assistance or educational components (FFH/Thailand and CARE/Guatemala) should examine these aspects of the projects to see if their benefits outweigh their costs.

6.11 In conclusion, the VB projects studied have shown promise, particularly in their ability to reach the poor. But much remains to be done, especially in financial management and institutional development, before village banking programs will be able to reach significant numbers of clients or begin to approach financial sustainability.

[54] FFH is working on developing a strategy to determine the effects of its credit-with-education programs on client income, health, and nutrition.

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ANNEX I

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* Lawrence Yanovitch (CRS, SED Technical Unit Coordinator), and Didier Thys (SEDTU Program Officer) at Headquarters Office in Baltimore, Maryland. August 1990.

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* Actas de Instalacion, Por la Superacion de la Mujer, and Mujeres Activas, Mexicali, Baja California Norte, and Actas de Instalacion, Banco Futuro, Tijuana, Baja California Norte.

* Northern Mexico: Loan Summary as of July and August 1990

* Northern Mexico: Status of Village Banking Program as of March 3, 1989, June 1, 1989, August 1, 1989, December 1, 1989, May 1990, June 1990, July 1990, August 1, 1990, September 1, 1990.

* FINCA Northern Mexico: Operating Expenses July - September 1990 and future estimates

* Resumen de Bancos, (Monthly Report) August 1990.

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2. Interviews:

* Philip Decker (FINCA Northern Mexico Project Director), Julia Collins (Desarrollo de Programas World Share - Mexico), Project Staff and Village Bank Members in Tijuana and Mexicali, Baja California Norte in Mexico.

* John Hatch Headquarters in Washington D.C. in August 1990.

Save the Children

Save the Children (Desarrollo Juvenil Comunitario)/El Salvador. 1990. "Evaluation Estrategia Bancos Comunales," Gerencia de Planeacion. October.

1. Interviews:

* Betsy Cambell, Program Manager at Headquarter in West, Port Connecticut, November and December 1990.

* Trish Caffery, Project Manager in Guatemala City, Guatemala, December 1990

ANNEX II
FINANCIAL PROJECT CALCULATIONS

BEST CASE "A" **CARE/Guatemala**

Santo Domingo Xenacoj

	Membs	Est. Mem Change	Loan Amt. Q	Avg Loan Q	Avg Loan Est'd Growt	TOTAL Q/ Interest	Interest $ External Lns	Gd Repay Factor	Adjust Int. Stream (Gd)	Good bank Portfolio	Poor Repay Factor	Adjust Income Stream (Bad)	bad banks Portfolio
Cycle 1	57		7125.00	125.00		570.00	211.11	1.00	211.11	5066.67	0.91	192.11	4610.67
Cycle 2	73		10225.00	140.07	12.05	818.00	302.93	1.00	302.96	7271.11	0.91	275.70	6616.71
Cycle 3	73		11505.00	157.60	12.52	920.40	270.71	1.00	270.71	6496.94	0.91	246.34	5912.22
Cycle 4	71		12910.00	181.83	15.37	1549.20	455.65	1.00	455.65	10935.53	0.91	414.64	9951.33
5	59		11335.00	192.12	5.66	1360.20	400.06	1.00	400.06	9601.41	0.91	364.05	8737.28
6	67		15300.00	228.36	18.86	1836.00	367.20	1.00	367.20	8812.80	0.91	334.15	8019.65
7	69		20375.80	266.04	10.74	2445.10	489.02	1.00	489.02	11736.46	0.91	445.01	10680.18
8	71		25855.77	328.08	10.74	3102.69	620.54	1.00	620.54	14892.92	0.91	564.69	13552.56
9	73		30970.47	382.21	10.74	3716.46	743.29	1.00	743.29	17838.99	0.91	676.40	16233.48
TOTAL			145602.04	2001.30	96.70	16318.04	3399.59	1.00	3399.59	81590.22	0.91	3093.63	74247.10
AVERAGE			16178.00	222.37	10.74	1813.12	377.73	1.00	377.73	9065.58	0.91	343.74	8249.68

0.11 Average Loan Size Increase

0.91 Repayment rate (Bad)

1.00 Repayment rate (Good)

Assumptions:

1. Est. avg. Loan growth of 10.7%
2. Estimated low membership growth (0.5%)
3. Projections begin after cycle 4
4. Projections of exchange rate after cycle 4 (Quetzal 5.0 == $1.00)
5. Ave loan $46.00 $76.00
6. Cycles 1 and 2 (four months) Subsequent cycles (six months)
7. Large bank, 57-73 members
8. Estimated repayment rates, 91 and 100 percent
9. Estimated slow Projected membership (5.5%)

CARE/Guatemala

IEDIUM CASE "B"
an Vicente Pacaya

	Membs	Est. Mem Change	Loan Amt. Q	Avg Loan Q	Avg Loan Est'd Growt	TOTAL Q/ Interest	Interest $ External Lns	Gd Repay Factor	Adjust Int. Stream (Gd)	Good bank Portfolio	Poor Repay Factor	Adjust Income Stream (Bad)	bad banks Portfolio
ycle 1	50		6250.00	125.00		500.00	185.19	0.90	166.67	4000.00	0.81	150.00	3600.00
ycle 2	53	6.00	9075.00	171.23		726.00	268.89	0.90	242.00	5808.00	0.81	217.80	5227.20
ycle 3	39	-26.42	7510.00	192.56		901.20	265.06	0.90	238.55	5725.27	0.81	214.70	5152.74
ycle 4	42	7.69	9910.00	235.95		1189.20	349.76	0.90	314.79	7554.92	0.81	283.31	6799.43
ycle 5	35	-16.67	10250.00	292.66		1230.00	246.00	0.90	221.40	5313.60	0.81	199.26	4782.24
ycle 6	35	0.00	10617.00	352.92		1274.04	254.81	0.90	229.33	5503.85	0.81	206.39	4953.47
7	37.00	5.71	16061.49	411.15	23.32	1927.38	385.48	0.90	346.93	8326.27	0.81	312.24	7493.65
8	39.00	5.41	19723.07	507.04	23.32	2366.77	473.35	0.90	426.02	10224.44	0.81	383.42	9202.00
9	41.00	5.13	25569.80	590.70	23.32	3068.38	613.68	0.90	552.31	13255.38	0.81	497.08	11929.85
OTAL	371.00	-13.14	114966.36	2879.41	69.96	13182.96	2746.45	0.90	2471.81	59323.33	0.81	2224.62	53391.00
VERA	41.22	-1.46	12774.04	319.93	7.77	1464.77	305.16	0.90	274.65	6591.48	0.81	247.18	5932.33
v mem change		-0.06											

rojected mem change (no increase after cyc 6)

0.23 Average Loan Size Increase
0.9 Repayment rate (Good)
0.81 Repayment rate (Bad)

Ave cycle per year 2.22

ssumptions:
Avg. Loan growth of 23.3%
Estimated uneven growth in membership, add 2/cycle
Projections begin after Cycle 6
Projections of exchange rate after cycle 5
(Quetzal 5.0 == $1.00)
Avg. loan $46.00 $118.00
Cycles 1 and 2 (four months)
Subsequent cycles (six months)
Medium bank, 35-50 members
Estimated repayment rates, 81 and 90 percent
Actual neg. projected membership (-5% growth) not used in calculations

CARE/GUATEMALA

	Case 1	Case 2	Case 3
Interest Rate Assumptions	0.24	0.36	0.48
No. Banks in Portfolio	24	36	48

WORST CASE "C"
Durazno Ch./G

	Memb	Est. Mem Change	Loan Amt. Q	Avg Loan Q	Avg Loan Est'd Growt	TOTAL Q/ Interest	Interest $ External Lns	Gd Repay Factor	Adjust Int. Stream (Gd)	Good bank Portfolio	Poor Repay Factor	Adjust Income Stream (Bad)	bad banks Portfolio
Cycle 1	25		3125.00	125.00		250.00	73.53	0.80	58.82	1411.76	0.65	47.79	1147.06
Cycle 2	29	16.00	4305.00	148.45	18.76	344.40	101.29	0.80	81.04	1944.85	0.65	65.84	1580.19
Cycle 3	28	-3.45	5490.00	196.07	32.08	439.20	87.84	0.80	70.27	1686.53	0.65	57.10	1370.30
Cycle 4	32	14.29	7150.00	223.44	13.96	858.00	171.60	0.80	137.28	3294.72	0.65	111.54	2676.96
Cycle 5	28	-12.50	7335.00	261.96	17.24	880.20	176.04	0.80	140.83	3379.97	0.65	114.43	2746.22
6	29	3.57	8850.46	315.69	16.50	1062.06	312.37	0.80	249.90	5997.49	0.65	203.04	4872.96
7	29	0.00	10665.69	367.78	16.50	1279.38	376.44	0.80	301.15	7227.58	0.65	244.68	5872.41
8	29	0.00	12425.53	428.47	16.50	1491.06	438.55	0.80	350.84	8420.13	0.65	285.06	6841.35
9	29	0.00	14475.75	499.16	16.50	1737.09	510.91	0.80	408.73	9809.45	0.65	332.09	7970.18
TOTAL		17.9	73822.44	2566.03	148.04	8341.89	1737.89	0.80	1390.32	33367.57	0.65	1129.63	27111.15
AVERAGE		1.99	8202.49	285.11	16.45	926.88	193.10	0.80	154.48	3707.51	0.65	125.51	3012.35
		0.04											
0.165	Avg. Loan Growth Rate				16.65								
0.8	Repaymt rate (Good)							Ave. Per Yr	2.33				
0.65	Repaymt rate (Bad)												

Assumptions:

1. Projected avg. Loan growth of 16.5%
2. Projected stable membership at 29 after cycle 5
3. Projections begin cycle 6
4. Projections of exchange rate after cycle 5
   (Quetzal 5.0 == $1.00)
5. Ave loan $46.00 $99.80
6. Cycles 1 to 3 (four months)
   Subsequent cycles (six months)
7. Small to medium bank, 25-29 members
8. Estimated low repayment, 65 and 80 percent
9. Projected stable membership (0% growth)

Portfolio Analysis
Worst Case: 30% "C" banks 40% "B" banks and 30% "A" banks
Medium Case: 10% "C" banks 40% "B" and 50% "A" banks
Best Case: 0% "C" banks 30% "B" banks and 70% "A" banks

Assumptions:
Annual Cost 44282.00
Lower Repayment Averages
Interest rate at 24 percent
Number of Banks, 24

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	13228.55	44282.00	-31053.45	70.13
Medium	0.84	15637.72	44282.00	-28644.28	64.69
Strong	0.88	17375.29	44282.00	-26906.71	60.76

Number of Banks, 36.00

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	19842.82	48209.50	-28366.68	58.84
Medium	0.84	23456.58	48209.50	-24752.92	51.34
Strong	0.88	26062.94	48209.50	-22146.56	45.94

Number of Banks 48.00

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	26457.09	52137.00	-25679.91	49.25
Medium	0.84	31275.43	52137.00	-20861.57	40.01
Strong	0.88	34750.58	52137.00	-17386.42	33.35

At 36 percent interest
Number of Banks, 24

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	19842.82	44282.00	-24439.18	55.19
Medium	0.84	23456.58	44282.00	-20825.42	47.03
Strong	0.88	26062.94	44282.00	-18219.06	41.14

Number of Banks, 36

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	29764.23	48209.50	-18445.27	38.26
Medium	0.84	35184.86	48209.50	-13024.64	27.02
Strong	0.88	39094.41	48209.50	-9115.09	18.91

Number of Bank, 48

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	39685.64	52137.00	-12451.36	23.88
Medium	0.84	46913.15	52137.00	-5223.85	10.02
Strong	0.88	52125.87	52137.00	-11.13	0.02

Interest rate at 48 percent
Number of Banks, 24

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	26457.09	44282.00	-17824.91	40.25
Medium	0.84	31275.43	44282.00	-13006.57	29.37
Strong	0.88	34750.58	44282.00	-9531.42	21.52

Number of Banks, 36

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	39685.64	48209.50	-18454.31	38.28
Medium	0.84	46913.15	48209.50	-13524.89	28.05
Strong	0.88	52125.87	48209.50	-9922.09	20.58

Number of Bank, 48

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	52914.18	52137.00	777.18	-1.49
Medium	0.84	62550.87	52137.00	10413.87	-19.97

Portfolio Analysis
Worst Case: 30% "C" banks 40% "B" banks and 30% "A" banks
Medium Case: 10% "C" banks 40% "B" and 50% "A" banks
Best Case: 0% "C" banks 30% "B" banks and 70% "A" banks

Assumptions:
Annual Cost 44282.00
Higher Repayment Averages
Interest rate at 24 percent
Number of Banks, 24

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	14877.59	44282.00	-29404.41	66.40
0.94	17342.31	44282.00	-26939.69	60.84
0.97	19143.71	44282.00	-25138.29	56.77

Number of Banks, 36

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	22316.39	48209.50	-25893.11	53.71
0.94	26013.46	48209.50	-22196.04	46.04
0.97	28715.56	48209.50	-19493.94	40.44

Number of Banks, 48

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	29755.19	52137.00	-22381.81	42.93
0.94	34684.61	52137.00	-17452.39	33.47
0.97	38287.41	52137.00	-13849.59	26.56

Interest rate at 36 percent
Number of Banks, 24

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	22316.39	44282.00	-21965.61	49.60
0.94	26013.46	44282.00	-18268.54	41.26
0.97	28715.56	44282.00	-15566.44	35.15

Number of Banks, 36

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	33474.59	48209.50	-14734.91	30.56
0.94	39020.19	48209.50	-9189.31	19.06
0.97	43073.34	48209.50	-5136.16	10.65

Number of Banks, 48

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	44632.78	52137.00	-7504.22	14.39
0.94	52026.92	52137.00	-110.08	0.21
0.97	57431.12	52137.00	5294.12	-10.15

Interest rate at 48 percent
Number of Banks, 24

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	29755.19	44282.00	-14526.81	32.81
0.94	34684.61	44282.00	-9597.39	21.67
0.97	38287.41	44282.00	-5994.59	13.54

Number of Banks, 36

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	44632.78	48209.50	-3576.72	7.42
0.94	52026.92	48209.50	3817.42	-7.92
0.97	57431.12	48209.50	9221.62	-19.13

Number of Banks, 48

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	59510.37	52137.00	7373.37	-14.14
0.94	69369.23	52137.00	17232.23	-33.05
0.97	76574.83	52137.00	24437.83	-46.87

FINCA NORTHERN MEXICO

GOOD CASE "A"
Tijuana: La Union

	Membs	Loan Amt $	Avg. Loan $	Avg Loan Est'd Growth	TOTAL $ Interest	Interest $ External Lns	Good Repay Factor	Adjust Int. Stream (Good)	Good bank Portfolio	Poor Repay Factor	Adjust Income Stream (Bad)	Bad Bank Portfolio
Cycle 1	17	850.00	50.00		68.00	68.00	1.00	68.00	2584.00	0.91	61.88	2351.44
Cycle 2	16	1351.00	84.44	68.88	108.08	108.08	1.00	108.08	4107.04	0.91	98.35	3737.41
Cycle 3	15	1775.00	118.33	40.14	142.00	142.00	1.00	142.00	5396.00	0.91	129.22	4910.36
Cycle 4	22	2275.00	103.41	-12.61	182.00	182.00	1.00	182.00	6916.00	0.91	165.62	6293.56
Cycle 5	35	4650.00	132.86	32.14	372.00	372.00	1.00	372.00	14136.00	0.91	338.52	12863.76
6	20	3507.43	160.11	32.14	280.59	280.59	1.00	280.59	10662.58	0.91	255.34	9702.95
7	24	5072.16	160.11	32.14	405.77	405.77	1.00	405.77	15419.37	0.91	369.25	14031.63
8	28	5917.52	195.33	32.14	473.40	473.40	1.00	473.40	17989.27	0.91	430.80	16370.24
9	32	8250.72	195.33	32.14	660.06	660.06	1.00	660.06	25082.18	0.91	600.65	22824.79
TOTAL		33648.83	1199.91	257.08	2691.91	2691.91	1.00	2691.91	102292.45	0.91	2449.63	93086.13
AVERAGE		3738.76	133.32	28.56	299.10	299.10	1.00	299.10	11365.83	0.91	272.18	10342.90

0.32 Average growth rate (left cut cycle 5 — 32.14
0.91 Repaymt Rate (Bad)
1 Repaymt Rate (Good)

Assumptions:
1. Projected avg. Loan growth of 32% (compounded)
2. Estimated membership increase, 4 per cycle
3. Projections begin cycle 6
4. No exchange rate assumption ($ figures)
5. Avg. loan $50.00 195.33
6. 4 month cycles (Observed)
7. Medium bank, 17-32 members
8. Medium membership growth (15.1%)

FINCA NORTHERN MEXICO

MEDIUM CASE "B"
Mexicali Banco Futuro

	Membs	Loan Amt $	Avg. Loan $	Avg Loan Est'd Growth	TOTAL $ Interest	Interest $ External Lns	Good Repay Factor	Adjust Int. Stream (Good)	Good bank Portfolio	Poor Repay Factor	Adjust Income Stream (Bad)	Bad Bank Portfolio
Cycle 1	13	650.00	50.00		52.00	52.00	0.90	46.80	1778.40	0.81	42.12	1600.56
Cycle 2	12	910.00	75.83	51.67	72.80	72.80	0.90	61.78	2347.49	0.81	55.60	2112.74
Cycle 3	16	1370.00	85.63	12.91	109.60	109.60	0.90	129.60	4924.80	0.81	116.64	4432.32
4	15	1554.09	103.61	21.00	124.33	124.33	0.90	220.68	8385.84	0.81	198.61	7547.26
5	16	2005.82	125.36	21.00	160.47	160.47	0.90	64.80	2462.40	0.81	58.32	2216.16
6	17	2578.73	151.69	21.00	206.30	206.30	0.90	87.84	3337.92	0.81	79.06	3004.13
7	18	3303.81	151.69	0.00	264.30	264.30	0.90	111.15	4223.65	0.81	100.03	3801.29
8	19	3487.35	185.06	0.00	278.99	278.99	0.90	116.44	4424.78	0.81	104.80	3982.30
9	20	4478.49	185.06	0.00	358.28	358.28	0.90	148.52	5643.61	0.81	133.66	5079.25
TOTAL		20338.29	1113.93	127.58	1627.06	1627.06	0.90	987.60	37528.89	0.81	888.84	33776.00
AVERAGE		2259.81	123.77	14.18	180.78	180.78	0.90	109.73	4169.88	0.81	98.76	3752.89

0.21	Ave increase in loan size	32.29
0.9	Repaymt Rate Good	
0.81	Repaymt Rate Bad	

Assumptions:
1. Projected avg. Loan growth of 21% (compounded)
2. Estimated membership increase, 1 per cycle
3. Slow membership growth (5.5%)
4. Projections begin cycle 4
5. No exchange rate assumption ($ figures)
6. Avg. loan $50.00 $185.06
7. 4 month cycles (Observed)
8. Small bank, 13-20 members

	Case 1	Case 2	Case 3
Interest Rate Assumption	0.24	0.36	0.48
No. Banks in Portfolio	38	38	38

WORST CASE "C"
Mundial de la Mujer

	Membs	Loan Amt $	Avg. Loan $	Avg Loan Est'd Growth	TOTAL $ Interest	Interest $ External Lns	Good Repay Factor	Adjust Int. Stream (Good)	Good bank Portfolio	Poor Repay Factor	Adjust Income Stream (Bad)	Bad Bank Portfolio
Cycle 1	13	650.00	36.11		52.00	52.00	0.80	41.60	1580.80	0.65	33.80	1284.40
Cycle 2	13	858.00	66.00	82.77	68.64	68.64	0.80	54.91	2086.66	0.65	44.62	1695.41
Cycle 3	20	1800.00	90.00	36.36	144.00	144.00	0.80	115.20	4377.60	0.65	93.60	3556.80
Cycle 4	27	3065.00	113.52	26.13	245.20	245.20	0.80	196.16	7454.08	0.65	159.38	6056.44
Cycle 5	18	900.00	50.00	-55.95	72.00	72.00	0.80	57.60	2188.80	0.65	46.80	1778.40
6	20	1220.00	60.26	20.51	97.60	97.60	0.80	78.08	2967.04	0.65	63.44	2410.72
7	21	1543.73	60.26	22.00	123.50	123.50	0.80	98.80	3754.36	0.65	80.27	3050.42
8	22	1617.24	73.51	22.00	129.38	129.38	0.80	103.50	3933.14	0.65	84.10	3195.67
9	23	2062.72	73.51	22.00	165.02	165.02	0.80	132.01	5016.54	0.65	107.26	4075.94
TOTAL		13716.70	623.16	175.82	1097.34	1097.34	0.80	877.67	33359.01	0.65	713.27	27104.20
AVERAGE		1524.08	69.24	19.54	121.93	121.93	0.80	97.54	3706.56	0.65	79.25	3011.58
				22.33								

0.22 Average Loan Size Increase

Average Cycles Per Year 3.00

0.8 Repaymt rate (Good)
0.65 Repaymt rate (Bad)

Assumptions:
. Projected avg. Loan growth of 22% (compounded)
. Estimated membership increase, 1 per cycle
. Slow membership growth (6.7%)
. Projections begin cycle 6
. No exchange rate assumption ($ figures)
. Avg. loans $36.11 $73.51
. 4 month cycles (Observed)
. Small bank, 13-27 members

FINCA/NORTHERN MEXICO

Portfolio Analysis
Poor Case: 30% "C" banks 40% "B" banks and 30% "A" banks
Medium Case: 10% "C" banks 40% "B" and 50% "A" banks
Strong Case: 0% "C" banks 30% "B" banks and 70% "A" banks

Lower Repayment Averages

Interest rate at 24 percent

Case	Repayment	An Income	Annual Cost	% Subsidy
Poor	0.79	12667.25	33161.25	61.80
Medium	0.84	16039.66	33161.25	51.63
Strong	0.88	19241.57	33161.25	41.98

At 36 percent interest

Case	Repayment	An Income	Annual Cost	% Subsidy
Poor	0.79	19000.87	33161.25	42.70
Medium	0.84	24059.49	33161.25	27.45
Strong	0.88	28862.35	33161.25	12.96

At 48 percent interest

Case	Repayment	An Income	Annual Cost	% Subsidy
Poor	0.79	25334.50	33161.25	23.60
Medium	0.84	32079.32	33161.25	3.26
Strong	0.88	38483.13	33161.25	-16.05

Higher Repayment Averages

Interest rate at 24 percent

Case	Repayment	An Income	Annual Cost	% Subsidy
Poor	0.90	14236.23	33161.25	42.70
Medium	0.94	17759.50	33161.25	27.45
Strong	0.97	21176.20	33161.25	12.96

At 36 percent i best bank #2

Case	Repayment	An Income	Annual Cost	% Subsidy
Poor	0.90	19242.55	33161.25	22.10
Medium	0.94	26102.53	33161.25	-6.90
Strong	0.97	32856.45	33161.25	-35.12

At 48 percent interest

Case	Repayment	An Income	Annual Cost	% Subsidy
Poor	0.90	21354.35	33161.25	-16.05
Medium	0.94	26639.24	33161.25	-57.43
Strong	0.97	31764.30	33161.25	-98.16

FREEDOM FROM HUNGER/THAILAND

STRONG CASE "A"
Ban Kvaow

	Memb	Loan Amou	Avg. Loan	Avg Loan Est'd Growt	TOTAL B Interest	Interest $ External Lns	Repayment Factor (Good	Adjusted Int. Income Strea	Good bank Portfolio	Poor Repay Factor	Adjusted Incom Stream (Bad)	bad banks Portfolio
Cycle 1	5.00	7500.00	1500.00		900.00	36.00	1.00	36.00	756.00	0.91	32.76	687.96
Cycle 2	20.00	30000.00	1500.00	0.00	3600.00	144.00	1.00	144.00	3024.00	0.91	131.04	2751.84
Cycle 3	17.00	34400.00	2023.53	34.90	4128.00	165.12	1.00	165.12	3467.52	0.91	150.26	3155.44
4	18.00	42797.65	2377.65	17.50	5135.72	205.43	1.00	205.43	4314.00	0.91	186.94	3925.74
5	20.00	55874.71	2793.74	17.50	6704.96	268.20	1.00	268.20	5632.17	0.91	244.06	5125.28
6	22.00	72218.06	3282.64	17.50	8666.17	346.65	1.00	346.65	7279.58	0.91	315.45	6624.42
7	24.00	92570.42	3857.10	17.50	11108.45	444.34	1.00	444.34	9331.10	0.91	404.35	8491.30
8	26.00	117834.43	4532.09	17.50	14140.13	565.61	1.00	565.61	11877.71	0.91	514.70	10808.72
9	28.00	149105.87	5325.21	17.50	17892.70	715.71	1.00	715.71	15029.87	0.91	651.29	13677.18
TOTAL		602301.13	27191.95	139.90	72276.14	2891.05	1.00	2891.05	60711.95	0.91	2630.85	55247.88
AVERAGE		66922.35	3021.33	15.54	8030.68	321.23	1.00	321.23	6745.77	0.91	292.32	6138.65

8.7%	Membership growth rate	
17.45	Average growth in loan size	17.45
0.91	Repay (Bad)	
1.00	Repay (Good)	0.0869

Assumptions:
1. Projected avg. Loan growth of 17.5 percent per cycle
2. Uneven growth in actual membership, add 2 new per cycle
3. Projections begin cycle 4
4. Exchange rate 25 baht to the dollar
5. Avg. loan sizes $60.00 $213.01
6. 6 month cycles (Observed)
7. Small to medium bank, 5-28 members
8. Est. good repayment, 91 and 100 percent
9. Est. slow membership growth (8.7%)

Note: Existing data is erratic and scanty which makes it difficult to project realistic averages

FREEDOM FROM HUNGER/THAILAND

MEDIUM CASE "B"
Pa Lai

	Memb	Loan Amt B	Avg. Loan	Avg Loan Est'd Growt	TOTAL B Interest	Interest $ External Lns	Good Repay Factor	Adjusted Int. Income Strea	Good bank Portfolio	Poor Repay Factor	Adjusted Incom Stream (Bad)	bad banks Portfolio
Cycle 1	5.00	7389.00	1477.80		886.68	35.47	0.90	63.84	1340.66	0.81	57.46	1206.59
Cycle 2	13.00	19000.00	1461.54	-1.10	2280.00	91.20	0.90	133.92	2812.32	0.81	120.53	2531.09
Cycle 3	12.00	20200.00	1683.33	15.18	2424.00	96.96	0.90	99.79	2095.63	0.81	89.81	1886.07
4	14.00	25923.33	1851.67	10.00	3110.80	124.43	0.90	117.57	2469.04	0.81	105.82	2222.13
5	16.00	32589.33	2036.83	10.00	3910.72	156.43	0.90	137.56	2888.77	0.81	123.80	2599.89
6	18.00	40329.30	2240.52	10.00	4839.52	193.58	0.90	159.99	3359.86	0.81	143.99	3023.88
7	20.00	49291.37	2464.57	10.00	5914.96	236.60	0.90	185.14	3887.84	0.81	166.62	3499.06
8	22.00	59642.55	2711.03	10.00	7157.11	286.28	0.90	213.28	4478.79	0.81	191.95	4030.91
9	24.00	71571.06	2982.13	10.00	8588.53	343.54	0.90	244.73	5139.42	0.81	220.26	4625.47
TOTAL		325935.95	18909.41	74.08	39112.31	1564.49	0.90	903.88	18981.56	0.81	813.50	17083.40
AVERAGE		36215.11	2101.05	8.23	4345.81	173.83	0.90	100.43	2109.06	0.81	90.39	1898.16

12.3% Growth in membership
10.00 Ave increase in loan size
0.90 Repayment Rate Good
0.81 Repayment Rate Bad

0.1228

Assumptions:
1. Estimated avg. loan growth of 10 percent per cycle
2. Estimated medium growth (12.3%) in membership, 2 new per cycle after cycle 3
3. Projections begin cycle 4
4. Exchange rate 25 baht to the dollar
5. Avg. loan size $59.11 $119.29
6. 6 month cycles (Observed)
7. Small to medium bank, 5-24 members
8. Estimated medium repayment, 81 and 90 percent

Note: Existing data is erratic and scanty which makes it difficult to project realistic averages

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FREEDOM FROM HUNGER/THAILAND

	Case 1	Case 2	Case 3	Case 4
Int. Rate Assumptions	0.24	0.48	0.60	0.60
No. Banks in Portfolio	21.00	42.00	--	

WORST CASE "C"
Na Sri Nuan Village

	Membs	Loan Amt B	Avg. Loan B	Avg Loan t'd Growth	TOTAL Interest	Interest $ External Lns	Good Repay Factor	Adjusted Int. Stream (Gd)	Good bank Portfolio	oor Repay Factor	Adjust Income Stream (Bad)	bad banks Portfolio
Cycle 1	10.00	14778.00	1477.80		1773.36	70.93	0.80	56.75	1191.70	0.65	46.11	968.25
Cycle 2	17.00	31000.00	1823.53	23.39	3720.00	148.80	0.80	119.04	2499.84	0.65	96.72	2031.12
Cycle 3	11.00	23100.00	2100.00	15.16	2772.00	110.88	0.80	88.70	1862.78	0.65	72.07	1513.51
4	12.00	27216.00	2268.00	8.00	3265.92	130.64	0.80	104.51	2194.70	0.65	84.91	1783.19
5	13.00	31842.72	2449.44	8.00	3821.13	152.85	0.80	122.28	2567.80	0.65	99.35	2086.34
6	14.00	37035.53	2645.40	8.00	4444.26	177.77	0.80	142.22	2986.55	0.65	115.55	2426.57
7	15.00	42855.40	2857.03	8.00	5142.65	205.71	0.80	164.56	3455.86	0.65	133.71	2807.89
8	16.00	49369.42	3085.59	8.00	5924.33	236.97	0.80	189.58	3981.15	0.65	154.03	3234.68
9	17.00	56651.41	3332.44	8.00	6798.17	271.93	0.80	217.54	4568.37	0.65	176.75	3711.80
TOTAL		313948.49	22039.22	86.56	25107.88	1004.32	0.80	803.45	16872.49	0.65	652.80	13708.90
AVERAGE		34872.05	2448.80	9.62	2789.76	111.59	0.80	89.27	1874.72	0.65	72.53	1523.21

7.6%	Growth in membership	19.28
0.08	Average Loan Size Increase	
0.80	Repay rate (Good)	
0.65	Repay rate (Bad)	

Assumptions:
1. Projected avg. loan growth of 8 percent per cycle
2. Estimated slow growth in membership, 1 new per cycle after cycle 3
3. Projections begin cycle 4
4. Exchange rate 25 baht to the dollar
5. Avg loan size $59.11 $133.30
6. 6 month cycles
7. Small bank, 10-17 members
8. Estimated repayment rates, 65 and 80 percent
9. Estimated slow membership growth (7.6%)

FREEDOM FROM HUNGER

Portfolio Analysis
Poor Case: 30% "C" banks 40% "B" banks and 30% "A" banks
Medium Case: 10% "C" banks 40% "B" and 50% "A" banks
Strong Case: 0% "C" banks 30% "B" banks and 70% "A" banks

Assumptions:
Annual Cost 50823.75
Interest rate at 24 percent
Lower Repayment Averages
Number of Banks, 21

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	6115.64	50823.75	-44708.11	87.97
Medium	0.84	9156.09	50823.75	-41667.66	81.98
Strong	0.88	11192.96	50823.75	-39630.79	77.98

Number of Banks, 42.00

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	12231.00	50823.75	-38592.75	75.93
Medium	0.84	18312.19	50823.75	-32511.56	63.97
Strong	0.88	22385.92	50823.75	-28437.83	55.95

At 48 percent interest
Lower Repayment Averages
Number of Banks, 21

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	12231.29	50823.75	-38592.46	75.93
Medium	0.84	18312.19	50823.75	-32511.56	63.97
Strong	0.88	22385.92	50823.75	-28437.83	55.95

Number of Banks, 42

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	24462.57	50823.75	-26361.18	51.87
Medium	0.84	36624.37	50823.75	-14199.38	27.94
Strong	0.88	44771.84	50823.75	-6051.91	11.91

Interest rate at 60 percent
Lower Repayment Averages
Number of Banks, 21

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	15289.11	50823.75	-35534.64	69.92
Medium	0.84	22890.23	50823.75	-27933.52	54.96
Strong	0.88	27982.40	50823.75	-22841.35	44.94

Number of Banks, 42

Case	Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
Poor	0.79	30578.22	50823.75	-33674.88	66.26
Medium	0.84	45780.46	50823.75	-25500.85	50.18
Strong	0.88	55964.79	50823.75	-20033.88	39.42

FREEDOM FROM HUNGER

Portfolio Analysis
Poor Case: 30% "C" banks 40% "B" banks and 30% "A" banks
Medium Case: 10% "C" banks 40% "B" and 50% "A" banks
Strong Case: 0% "C" banks 30% "B" banks and 70% "A" banks

Assumptions:
Annual Cost 50823.75
Interest rate at 24 percent
Higher Repayment Averages
Number of Banks, 21

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	6859.55	50823.75	-43964.20	86.50
0.94	10129.16	50823.75	-40694.59	80.07
0.97	12315.95	50823.75	-38507.80	75.77

Number of Banks, 36

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	13719.09	50823.75	-37104.66	73.01
0.94	20258.32	50823.75	-30565.43	60.14
0.97	24631.89	50823.75	-26191.86	51.53

Interest rate at 48 percent
Higher Repayment Averages
Number of Banks, 21

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	13719.09	50823.75	-37104.66	73.01
0.94	20258.32	50823.75	-30565.43	60.14
0.97	24631.89	50823.75	-26191.86	51.53

Number of Banks, 42

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	27438.18	50823.75	-23385.57	46.01
0.94	40516.65	50823.75	-10307.10	20.28
0.97	49263.79	50823.75	-1559.96	3.07

Interest rate at 60 percent
Higher Repayment Averages
Number of Banks, 21

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	17148.87	50823.75	-33674.88	66.26
0.94	25322.90	50823.75	-25500.85	50.18
0.97	30789.87	50823.75	-20033.88	39.42

Number of Banks, 42

Repayment	Annual Income	Annual Cost	Deficit	% Subsidy
0.90	34297.73	50823.75	-16526.02	32.52
0.94	50645.81	50823.75	-177.94	0.35
0.97	61579.73	50823.75	10755.98	-21.16

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*35. "A Pre-Project Identification Document Analysis of the Lesotho Agricultural Enterprise Initiatives Project." Mike Bess, Don Henry, Donald Mead, and Eugene Miller. GEMINI Technical Report No. 35. April 1992. $20.00.

36. "Apex Study of the Small Enteprprise Development Program of Catholic Relief Services, Senegal." Arelis Gomez Alfonso. GEMINI Technical Report No. 36. May 1992. $3.00.

37. "The Private Operators' Perspective on an Agenda for Action," Dakar, Senegal, November 22-25, 1991. A Seminar on the Private Sector in West Africa. Organized by the Senegalese National Employers' Union (CNP), the Club du Sahel, CILSS and USAID. GEMINI Technical Report No. 37. May 1992. $7.00.

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*3. "Financial Services for Women." C. Jean Weidemann. March 1992.

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*1. "A Field Manual for Subsector Practitioners." Steven S. Haggblade and Matthew Gamser. $4.65. Also available in French.

Special Publications:

*1. "Training Resources for Small Enterprise Development." Small Enterprise Education and Promotion Network. Special Publication No. 1. 1990. $9.00

*2. *Financial Management of Micro-Credit Programs: A Guidebook for NGOs.* Robert Peck Christen. ACCION International. Special Publication No. 2. 1990. $19.00

*3. *The ADEMI Approach to Microenterprise Credit.* A. Christopher Lewin. Special Publication No. 3. 1991. $15.00

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