Principled Practices in Microfinance

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Catholic Relief Services

MICROFINANCE

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Catholic Relief Services (CRS,) founded in 1943, assists the poor and disadvantaged outside the United States. CRS works to alleviate human suffering, promote the development of people, and foster charity and justice in the world. CRS assists the poor solely on the basis of need, not creed, race or nationality, and maintains strict standards of efficiency and accountability. CRS currently operates in over 88 countries and supports microfinance activities in 33 countries.

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Foreward

What are we doing?

We go through big pieces of our day with incremental progress on our minds. We are intent on the details and getting them right; we can lose sight, from time to time, of why we do what we do. This guide was written to remind us of the bigger "why." It has two purposes for two audiences:

First, it is an attempt to get those who are in the thick of the here and now to glance up and remember why we are in this business of microfinance. Second, it spells out to newcomers – whether they be new Microfinance Fellows or Country Representatives, or even seasoned practitioners new to Catholic Relief Services – those principles that guide us.

It draws on the work of our partners, on CRS management staff and CRS technical staff. It also draws heavily on documents[1] in Catholic Social Teaching and the CRS Justice Lens.

Kim Wilson
Senior Advisor
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September 2001

1 *The CRS Summary of Catholic Social Teaching* (Baltimore:CRS, August 1997); *The CRS Justice Lens* (Baltimore:CRS, November 1999); and Larissa Fast, Janis Lindsteadt, and Andrea Scharf (ed.), *Applying the Justice Lens to Programming* (Baltimore:CRS, July 1998).

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Cover Photograph: Kim Wilson

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The Purpose of Our Work

Mission and Principles

Mission

Our mission in microfinance comes from our Catholic social mission: to serve our poorest clients, to honor the dignity of their work, to advance their work in relation to their community, and to strengthen our partners who work with them.

Reflecting our agency's commitment to social justice, our goal in microfinance is to enable the self-employed poor, especially women, to access reliable financial services. To further this goal, we have focused on transforming viable microfinance activities into permanent institutions. In doing so, we connect those who operate at the farther reaches of the economy to the enduring services of the financial mainstream.

STELLAR EXAMPLE

The Client

Terecia fries dough and vegetables and other delicacies on her stove on a sidewalk near BMMS, a rural bank in Java. Throughout times of political unrest, the fall of the currency, and scarcity of resources, Terecia has continued this humble economic activity. Over the years, she has managed to save $2,000, or about five times her annual income. She deposits her savings in BMMS, now owned by Ukabima, a CRS investment company in Indonesia. Terecia is now part of the financial mainstream. She can access loans and continues to save in the rural bank.

Guiding Principles

As part of an agency-wide program quality agenda in 1997, CRS microfinance practitioners came together to agree on six guiding principles. These principles describe the common values underlying our current programming and provide the foundation for future programming. In 1999, we updated these principles to reflect new lessons from our expanding microfinance sector. The six principles are:

Serve the poorest clients. To forward the CRS goal of advancing social and economic justice, we shape our services to serve the poorest communities. Women make up the majority of our clients, as they generally have the least means to support themselves and the least access to credit.

Link loans to savings. Credit and savings are both important means to finance the growth of economic activities. We connect the amount lent to the amount saved to help clients build wealth as they borrow.

Use solidarity guarantees. Group guarantees replace collateral as a means to secure loan repayment. Solidarity guarantees link new loans to the repayment of old loans. A group of clients guarantees the loans of fellow group members with the understanding that no one in the group will receive a new loan until all loans are repaid. This strategy keeps repayment high.

Practice participatory management. Democratic processes are key to empowering the poorest in a community. Clients are directly involved in the design, management and administration of the services they receive, from creating by-laws to voting on loan applications to choosing repayment schedules. In this way, CRS includes those most affected by decisions in the decision-making process.

Invest in scale and self-sufficiency. The investment that a program makes in research, design, staffing and training is crucial to its success. Achieving scale (reaching at least 5,000 clients per partner) advances our mission to serve the poor. We achieve self-sufficiency through efficient operations and by charging market rates of interest.

Plan for permanence. Prior to launching a new program, CRS plans how the program will evolve into a sustainable resource for the poor. Permanence may include creating a formal financial institution, helping our partners transform programs into specialized microfinance organizations, or consolidating pilot activities and integrating them into larger local entities.

Catholic Social Teaching

CRS asks all practitioners to assess excellence in our work in relation to the broad themes of justice and Catholic Social Teaching (CST). Below are highlights of key CST principles – Option for the Poor, Human Dignity, Community, Rights and Responsibilities, the Common Good, Subsidiarity, Solidarity, and Stewardship – and the ways in which the CRS community of microfinance practitioners has agreed to honor them.

Option for the Poor

This principle argues "that those members of society with the greatest needs require the greatest response and attention." Moreover, this principle "applies to women as a whole, since they are the victims of a long history of being treated as second-class humans, and even yet suffer discrimination as women."[2]

CRS microfinance responds by focusing services on women. Three reasons compel us to do so. First, women are the principal victims of poverty. Of the 1.3 billion people living on less than $1 per day, 900 million are female.[3] Second, women increasingly head up poor households and are often the sole source of support. Third, studies[4] have demonstrated that women are far more likely than men to channel increased

STELLAR EXAMPLE

The Family

In Ethopia, a borrower who lost her husband, her three sons and three sons-in-law in the war with Eritrea inherited a family of 18 dependents. Because of war and massive famine, she had few remaining means of survival. Yet, through perseverance, she was able to create a web of entrepreneurial activities – from trading in baskets and grain alcohol to animal raising and managing her own kiosk – that allowed her to send all the children to school and to clothe and feed them. How did she do this? Through microloans from the diocese of Wenji, through steady savings, even in times when saving was difficult, and by buying her way, with her microloan, into various local rotating savings groups.

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2 Judith A. Dwyer, *The New Dictionary of Catholic Social Thought* (Collegeville MN:The Liturgical Press, 1994), 757.

3 Microcredit Summit, *Meeting the Challenge of Reaching the Poorest: One Year of the Microcredit Summit Campaign*, June 1998.

4 See, for example: *Report of the UN Expert Group on Women and Finance: Transforming Financial Systems* (1994). <http://womensworldbanking.org/english.4000/4300.htm>

income from their business activities into essential benefits for their spouses and children, including improved health care, housing, education and nutrition.

Human Dignity

Each individual is a person worthy of dignity and respect. One's dignity is not related to one's race, ethnicity, gender, age, nationality, physical ability, religion, economic status or any other potentially discriminatory factor. Rather, it is an inalienable right that has been granted to us by the very fact of our human nature.[5]

In microfinance, we respond by dignifying the poorest clients with the services they need to grow their businesses. CRS gives borrowers the same respect a traditional bank gives a commercial customer. We treat our poorest borrowers as clients, worthy of professional services and able to put financing to good use.

STELLAR EXAMPLE

The Village

The "Zadruga," a multi-ethnic village bank project, has broken with tradition and shattered myths in Bosnia. In the city of Kakanj, the bank members had come from widely varying backgrounds: some were refugees or displaced persons, others were returnees from foreign lands, and some were permanent residents. Working together, these women found that they could accomplish great things with small loans. They also reported that forming a Zadruga provided a way for people of all religious backgrounds to get together for the betterment of all.

Community

Human beings can only thrive and achieve their full dignity in community with other people. People see their individual dignity and equality expressed and confirmed in social situations and relations – how they are treated by society, by their community, and by each other.[6]

In microfinance, we respond by delivering financial services through group-based means – village banking, Grameen banking and solidarity group lending. These group activities rely on and strengthen the web of economic and social connections that bind

5 *The CRS Summary of Catholic Social Teaching* (Baltimore:CRS, August 1997), 2.
6 *Closely paraphrased from The CRS Summary of Catholic Social Teaching* (Baltimore:CRS, August 1997), 4.

individuals to each other and to their communities.

Rights & Responsibilities

Catholic Social Teaching understands "human rights as moral claims that each person is able to make on a variety of goods and necessities because of his or her human dignity."[7]

Among the six categories of inalienable human rights identified by CST, two stand out as particularly relevant to microfinance: the "Right to Life," which includes the right to a worthy standard of living and "Economic Rights," where individuals have a right to meaningful employment.

In microfinance, we fully acknowledge our "responsibility not only to recognize the rights of individuals but also to promote their rights and assist them in the same pursuit of a full life."[8] We respond by granting economic opportunity to clients through provision of important financial services and by supporting the very work that clients deem most meaningful.

STELLAR EXAMPLE

The Household

In Lebanon, brothers and husbands initially repudiated village banking, deeming it inappropriate for women and forbidding their wives and sisters to join. Now that the women are prospering, they see the importance of the service. Husun Aloud, a hairdresser, says," I feel the social impact on the relationship with my brothers, most of whom are jobless and are turning to me for pocket money. I am now feeling respected, and I am making an important contribution to the household."

The Common Good

The common good is understood as the total of all conditions necessary – economic, political, material, and cultural – which allow all people to realize their human dignity and reach their full human potential... The common good is best protected when the rights of the person are preserved and promoted, and it is the state which should be responsible for the protection of our basic human rights.[9]

STELLAR EXAMPLE

The State

In Cambodia, Bosnia, El Salvador, Bulgaria, Senegal, Vietnam and other countries, CRS is playing a major role in shaping judicial and legislative reform as it pertains to economic services for the poor and oppressed. New regulations to capture savings, lower capitalization requirements for microfinance institutions and eliminate interest rate ceilings can make the difference between distributing temporary economic charity and creating lasting financial services for the poor.

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7 *The CRS Summary of Catholic Social Teaching* (Baltimore:CRS, August 1997), 3.
8 *Ibid.*, 4.
9 *Ibid.*, 6.

In microfinance, we respond by viewing our local role in connection with larger social structures. We advocate for systemic change in legal, political and government policies to foster the institutions we support. Our hope is that financial services for the poor may find a permanent home within the greater framework of the local sociopolitical environment.

Subsidiarity

Just as it is gravely wrong to take from individuals what they can accomplish by their own initiative and industry and give it to the community, so also it is an injustice and at the same time a grave evil and disturbance of right order to assign a greater or higher association to what lesser and subordinate organizations can do.[10]

> STELLAR EXAMPLE
>
> **The Partner**
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> *Caritas Thies, a CRS partner in Senegal, was one of the first organizations to become a CRS microfinance partner using the village banking model. Soon, Caritas Thies reputation as a very strong example of village banking spread throughout West Africa. Along the perimeters of the famous Djoud wildlife refuge, the villagers outside of the refuge had little economic opportunity. When another NGO decided to establish a village banking program in that region, it was not CRS that was solicited for assistance, but Caritas Thies.*

In microfinance, we respond by placing the power to make decisions with those who are most affected by the consequences of those decisions. The village banking method, our preferred model, relies on the community to decide the composition of the village bank itself and the nature of its services.

Our preferred strategy for delivering financial services to a community is to continue working through local partners until such time that the partner no longer requires our support. In this way, we can be assured that resources for our clients will be available on a lasting basis.

10 *Quadragessimo Anno (After Forty Years): On Social Reconstruction.* Encyclical of Pope Pius XI promulgated on May 15, 1931.

Solidarity

Solidarity is a call to recognize each individual person as a part of one human family – regardless of ethnic, national, racial, gender, economic, political, or ideological differences... We are called on not only to recognize the dignity of each individual in word only, but also to fully respect that person's or group's human dignity in our daily lives – by seeing and understanding others as our brothers and sisters for whom we have responsibility.[11]

In microfinance, we respond by honoring the connection between the business-like attitude of our clients and our own perspective as financial practitioners. Perhaps of all our stakeholders, we stand most in solidarity with our poorest clients who in order to survive must be spare, resourceful, disciplined and diligent in reaching their economic objectives. Our responsibility then becomes to meet the entrepreneurial goals of our clients with a corresponding level of professional services.

STELLAR EXAMPLE

The Community

Some of the village banks in Senegal, are truly banks for the community. For various reasons, including lack of familiarity with borrowing, fear of making a time commitment and lack of self confidence, some of the poorest village members initially chose not to join the bank. In response, bank members set Internal Account loan terms to be attractive to others in the community: very small loan amounts, short loan terms and little time commitment. Through the Internal Account loans, villagers learned more about the village bank and increased their self-confidence about being able to repay a loan. In time, some even became bank members. Their savings then contributed to making loans accessible to others, as had been done for them.

Stewardship

At its foundation, stewardship is based on the principle of responsibility and is intrinsically linked to the common good. [As individuals in the human community,] we are called to respect and justly share the resources of the earth in a way that provides for the needs of all. The resources of this world are reflected in the many goods found in society, and those goods are intended to be for the benefit of all persons.[12]

11 *The CRS Summary of Catholic Social Teaching* (Baltimore:CRS, August 1997), 8.
12 Closely paraphrased from *The CRS Summary of Catholic Social Teaching* (Baltimore:CRS, August 1997), 10.

In microfinance, we respond by caring for the resources entrusted to us with the same regard evidenced by clients in caring for their own resources. We seek partners who share our commitment to good resource management, including: a drive to keep costs to a minimum; dedication to transparency and accountability; a mandate to retain high-performing staff; and a plan for ensuring the permanent availability of economic services to the entrepreneurial poor.

STELLAR EXAMPLE

The Partnership

The CARD Bank, a CRS partner in the Philippines, served 20,000 clients in 1999. CARD agreed to test the new CRS system of assessment/accreditation, the MAGI (Microfinance Alliance for Global Impact), because they believed it was important to establish a system that measures the performance of partners against standards. Equally important, CARD believed that by diagnosing weak areas, they and CRS could find appropriate ways to support a partner's efforts to improve its organizational capacity.

Section Two:
The Microfinance Sector

The Microfinance Sector

History, Trends and the CRS Niche

More than 1.3 billion people live on less than $1 per day, and more than 3 billion live on less than $2 per day[13]. Most survive through their skills to operate very small businesses. Many are women. For them, self-employment is the mainstay of their economic life. They harvest rice, bring fruit to market, craft pottery and perform thousands of other tasks to support their families. Most operate without financial resources and therefore cannot expand their businesses beyond a minimum level of subsistence.

Microfinance – the practice of bringing financial services to the poorest – evolved as a sector to meet the needs of the poor, especially the women. A modest loan, perhaps as little as $50, buys a box of merchandise, a few tools, or helps build a vending kiosk. Microfinance also provides options for clients that encourage them to save and create buffers for family emergencies, send a child to school or re-invest in their businesses.

History

Microfinance was made possible by two discoveries in the late 1970s. The first discovery proved that the poor can and will repay loans at market interest rates. Efforts in Latin America, Asia and Africa demonstrated that poor entrepreneurs wanted credit, and that they were prepared to pay sufficient interest to enable the lender to recover the cost of doing business. This discovery dispelled the notion that the poor were unable to repay. Today most microfinance institutions have arrears rates (late repayments) of less than 5%. With these low arrears rates, the

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13 UNDP, *Human Development Report*, 1997
http://www.undp.org/hdro/1997/97overview.pdf

potential for creating sustainable microfinance institutions became a realistic opportunity for efficient service providers.

The second discovery was that peer pressure can substitute for physical collateral. Microfinance practitioners found that groups of women responsible for guaranteeing the loans of fellow group members experienced excellent repayment. Since the very poor by definition lack assets, this discovery opened the door for using solidarity group lending to provide financial services to the very poor.

Pioneering work in Bangladesh became an important catalyst in microfinance when an economics professor wondered if a few dollars might help a very poor woman buy her own materials and make a profit. The first loans of Muhammad Yunus in the 1970's led to the creation of the non-governmental organization (NGO) that became the Grameen Bank, which now serves more than two million clients.

Microfinance came later to other regions of the globe, especially as the needs of the poor escalated in the mid 1980s, and international Private and Voluntary Organizations (PVOs) and national NGOs began to integrate microfinance into their poverty alleviation programming. PVOs, such as CRS, CARE, and Freedom From Hunger, provided funds, training, and technical assistance to local partner NGOs, which became the direct providers of microfinance services to communities.

CRS' Special Niche in Microfinance

Dozens of international organizations, local non-profits and national and local banks currently offer financial services to the self-employed poor. Among these varied institutions, CRS is one of the largest PVO microfinance lenders in the world, reaching over 300,000 clients in 33 countries.[14]

In keeping with our principles of Catholic Social Teaching, CRS practices microfinance with an eye to reaching the poorest clients. Many programs reach the poor, but CRS takes special care to reach extremely poor, self-employed women. We bring financial

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14 CRS Microfinance Unit, *Microfinance Status Report 2001*, Vol 7, No 2 (Baltimore:CRS, August 2001).

services to remote areas and to hard-pressed economic sectors in urban slums. These areas are often ignored by other agencies that seek immediate cost recovery from more promising clients.

Our average loan size of $138 is far lower than that of most other institutions, and our low arrears rate attests to the repayment capacity of even our poorest clients.

Trends

Perhaps the most salient trend in microfinance is the creation of sound financial institutions to provide permanent services to the poor. Banco Sol in Bolivia, Calpia in El Salvador, and BRI in Indonesia have all managed to sustain themselves while reaching a relatively poor clientele. The challenge for CRS is to create sustainable financial institutions while bringing services to the very poorest clients. Few organizations have been able to create formal financial institutions while reaching those with few assets. Grameen Bank and CARD Bank (a CRS partner in the Philippines) are notable exceptions and inspirations. We expect CRS-supported Enlace in El Salvador and our programs in Cambodia and various European countries to transform soon into regulated financial institutions.

How We Operate

Proven Methods

CRS implements several proven methods to achieve our microfinance mission. Each closely adheres to our guiding principles. These methods include village banking, Grameen banking, self-help groups, solidarity groups, and Business Investment Groups (BIGs).

Village Banking

Pioneered by FINCA International – a US PVO then working primarily in Latin America – in the 1980s, "village banking" is widely practiced by CRS and our microfinance partners. The village banking method of delivering services to clients reflects our first five guiding principles and offers full promise to complete our last principle, achieving permanence.

Briefly, CRS implements village banking by first training a local partner – an NGO or specialized microfinance institution – in the village banking methodology. The partner hires credit officers, who in various programs are called promoters, field agents, or by other titles. The credit officer, after building confidence with important community leaders, visits a community and holds a meeting for self-employed members, usually women. The meeting explains who may receive loans and how the community can form a village bank. Village bank services include:

Small loans (called external loans). Relying on group guarantees as "social collateral," small loans – often for less than $50 initially – are disbursed to the self-employed. Loan terms are generally between four and six months. Once a borrower has paid back her/his first loan, s/he may request a new loan that is equal to the first loan plus the amount s/he has been able to save.

Savings. Village bank members are encouraged to save. Many pool savings in an "internal account" and lend these funds to village bank members in need of short-term loans to complement their external loan. Some village banks also lend group savings to neighbors who are not village bank members.

Typically, village banks are comprised of between 30 and 100 members. Thirty is a common size for Latin America, while village banks with as many as 100 members are not unknown in rural parts of Africa. The steps to forming a village bank include:

Creating by-laws. This process asks members to determine the following: how often they will meet to collect payments; who can receive a loan, such as age or residency requirements; how will loan requests be approved; and what happens if a member is late in making a loan payment or misses many meetings? These by-laws form the constitution of the village bank.

Electing officers. Members elect officers – usually a chairperson, vice-chairperson, treasurer and secretary. In their by-laws, members have already established the responsibilities and term lengths for the officers.

Assessing credit worthiness of members. Members assess the enterprises of other members. They visit their places of business, examine cash flow and evaluate their trust-worthiness as borrowers. In some countries, programs focus on a client's personal history in the community. In others, members review economic trends and the kind of business activity the borrower has in relation to those trends.

Requesting and receiving first loans. Borrowers apply for loans, and if the investment committee – usually the village bank officers – approves of the loan, borrowers generally receive their loans within a week of the request.

Institutionalizing the Golden Rule. No member of a village bank may receive a new loan unless all members are current on their last loan.

Why is village banking CRS' preferred model? Because village banking does the following:

Reaches the poorest (first CRS microfinance principle).[15] Since village banks do not rely on collateral to guarantee loans, they can serve those lacking land or other assets.

Places emphasis on savings (second principle). New loan sizes are based on the previous loan size plus the amount saved in previous loan periods.

Uses members of the village bank to guarantee loans (third principle). Members may not get a new loan unless fellow members are up to date on their payments. Social pressure substitutes for collateral.

Fosters a democratic process and community ownership (fourth principle). Village bank members participate in the decisions most likely to affect them. They create their by-laws and are given choices about their services. Because members are involved in key decisions, they feel that the village bank and its future belongs to them.

Is sustainable and able to reach scale (the fifth principle). Village bank loans are issued to borrowers at market rates. The interest charged covers the cost of forming village banks and providing savings education services. The village banking model reaches many individual borrowers through forming large groups and thus allows a program to reach an unlimited number of the rural self-employed. Reaching tens of thousands of clients is entirely possible in a well-managed village banking program.

Grameen Banking

Founded in the 1970s by Muhammad Yunus, the Grameen Bank in Bangladesh has been able to serve millions of the

15 The six CRS microfinance principles were introduced Section One. A more detailed discussion of these principles follows in Section Three of this document.

poorest clients through a method very similar to village banking. CRS practices the Grameen Bank methodology in countries where clients may be best served by Grameen's highly disciplined approach. Where prior government credit programs have not required borrowers to fully repay, many otherwise good clients have adopted lax borrowing and repayment practices. The Grameen banking method supports increased client discipline through precise rules and procedures, extensive training, and fairly rigid services. Grameen banking closely resembles village banking with the following exceptions.

Grameen centres, the local equivalent of a village bank, are physical structures built by bank members. All members are required to attend regular group meetings at the centre.

Grameen centre memberships are an exact number, typically 40 clients, and consist of eight solidarity groups with five members each.[16] Village banking provides the opportunity for greater variance in numbers of members. Similar to the Grameen system, some CRS village banks have smaller solidarity groups within them, but in the village bank system the number of members in the solidarity group is more variable.

Grameen centres do not offer clients the opportunity to create their own by-laws. Moreover, they require clients to memorize and adhere to a list of "decisions" that guide not only borrowing behavior but often social behaviors as well.

Grameen loans often have longer terms than village banking loans, typically one year versus four or six months in the village bank. Repayment schedules also vary. Clients must repay Grameen banking loans weekly, compared to bi-weekly or monthly loan payments in village banks.

Grameen loans are not tied to the same savings formula as village banking loans. The amount of required savings is generally less in Grameen banks.

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16 For more information on solidarity groups, see the following section: *Solidarity Group Lending*

Grameen loans are issued to members (usually five members) of solidarity groups in sequence, rather than to all members. Initially, only two members of the group may take out loans. The next two members wait one month before receiving their loans. Finally, the last member receives her/his[17] loan after another month. This pattern is repeated with each new series of loan releases. In contrast, all members of the village bank receive loans at the same time and repay at the same time.

In countries where government programs have not damaged the credit practices of the self-employed poor, CRS clearly prefers to use the village banking method. Village banking is more flexible, emphasizes client savings and adheres more closely to the democratic principles of self-government. However, CRS is very committed to the Grameen methodology in areas where increased credit discipline is necessary for the creation of sustainable programs.

Self-Help Group Model

The self-help group model was developed in India to reach very poor people isolated from mainstream financing. Self-help group models work best when:

Groups are kept to 20 members or fewer. (This is to comply with Government of India laws, but groups may be larger outside of India, probably up to 35 women members).

Groups may consist of women or men, but not mixed together.

Loans are highly flexible. Loans with terms longer than three months require regular monthly installments. Loans with terms less than three months may be paid in a lump sum fashion. Lines of credit are also possible, though few groups seem to be doing this.

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17 Ninety-four percent of the Grameen Bank clients are female. In comparison, 83% of all CRS microfinance clients are female.

The stages of developing a self-help group include:

The pre-formation stage. An NGO or commercial bank promoter approaches a community and asks if some of the members would be interested in forming a self-help group (SHG). The promoter explains the benefits and mechanics of a self-help group. Community members decide if they would like to participate.

The formation stage. The promoter organizes participants into groups of 15-20 members, usually all women. The group then creates its ground rules, such as, deciding how much can they save on a monthly basis for six months. The group also chooses a president for the group and a secretary. It is the president's job to manage the group and ensure that loan and savings payments are made and disbursed on time. The secretary keeps minutes of the meetings. During the formation stage, the group learns to keep its own financial records. The group can begin lending deposits to its members one month after it has taken its initial savings from group members.

The bank linkage stage. The SHG may link to a local bank after six months, if the group has demonstrated regular savings, consistent meeting attendance, low arrears, good financial record-keeping, and the fostering of strong internal democratic processes. After linking, the bank can lend the SHG up to four times the group's corpus (its total savings, including savings lent out, plus any interest accumulated).

Some Advantages of Self-Help Groups:

- The SHG model eases members into good borrowing habits through very small loans (necessarily small because loans initially are based on group savings).
- The SHG model is easy to understand. It is simple, has clear rewards for good performance and is very adaptable. Loans have flexible terms and can be

tailored to meet client purpose and cash flow. Moreover, members do not need to borrow continuously to stay in good standing with the group.

- The SHG minimizes unnecessary debt by insisting that members save first before becoming eligible to borrow. Since SHG member savings comprise a minimum of one fourth of the loan capital available to the group, at least a quarter of the interest income remains in the community.
- The SHG model allows each actor to play its natural role. SHG members make all lending and saving decisions based on local knowledge that only they can possibly have. Banks lend to groups using their own systems and infrastructure. NGOs conduct community organizing and training. The government—as is the case in India—should assume some degree of risk to motivate the market (banks) to do what they might not do without such measures.
- The SHG system is excellent for remote areas, where groups cannot be highly concentrated--as is frequently required for efficient MFI group organizing. If groups have the know-how, they can link directly with banks.

Solidarity Group Lending

Solidarity groups are often part of village banks and mandatory in Grameen centres. They consist of about five to eight members, depending on the program. Members know each other well and are willing to add a second level of guarantee for the village bank or centre. If a member of a solidarity group is late in her/his payment, it is usually up to the solidarity group to make sure the member makes the repayment or assists the member to pay.

In some CRS programs, solidarity groups alone function as a lending unit, with a single level of group mutual support and guarantee. They are not necessarily part of the larger envelope of a village bank or Grameen centre. Conversely, village banks may exist with no sub-structure of solidarity groups. Members simply meet as large groups and guarantee one another’s loans.

Benji Investment Groups

The Benji Investment Group (BIG) is a relatively new methodology for providing microfinance services, that offers a particularly interesting potential for operation in remote, rural areas. In East Africa, CRS partners are taking a lead in testing this model. Our Kenyan partners – one already has 40 BIGs – are seeking to demonstrate that the BIG model fulfills all six microfinance principles. CRS will continue monitoring the piloting of the BIGs programs before making unqualified recommendations to other interested partners.

Briefly, the BIG model is an adaptation of Financial Services Associations (FSAs) pioneered by Ahmed Jazayeri, a former World Bank expert in credit unions. BIGs organize communities in much the same way as village banks do. However, instead of simply saving money, members invest in “shares” of the BIG. Members may purchase as many shares as they wish and may sell their shares. Potentially, these shares can earn members a high return on investment. The shareholders of the BIG appoint the Board, which hires a paid manager and cashier.

CRS BIGs in East Africa currently average about 125 members. The optimal size for a BIG is about 500 members. CRS is still testing whether the model can cover its costs at the partner level and consistently provide services for the poorer members of the community, CRS’ preferred clients. Eventually, each partner might support 40 to 100 BIGs or more, which would indicate that BIGs have the potential for permanence and to fulfill all six CRS microfinance principles.

Section Three: The Six Microfinance Principles

The First Principle

Serve the Poorest Clients

CRS, in keeping with its mission to reach the poorest, brings financial resources to those most in need. We focus on self-employed individuals who require savings and credit services to help their economic activities grow. For our services to sustain themselves, clients must have the capacity and commitment to repay loans.

Our programs ensure that women have priority in receiving financial services. Women are often the poorest members of their communities, controlling the fewest resources. Moreover, they typically convert loans and savings into productive inputs for their economic activities. They also transfer additional income into benefits for their families, such as paying school fees, improving household nutrition, and building up savings to buffer against emergencies.[18]

Three factors contribute to the success of a microfinance program in serving the poorest clients: organizational commitment, product design, and client identification.

Organizational Commitment

No strategy to reach the poorest will succeed without total management commitment. The leadership of an organization must choose serving the poorest clients as its priority and make that priority known to staff and supporters and to all professing to be stakeholders.

Cautionary Advice

A number of programs have tried to build in financial incentives for promoters to target the poorest. But true commitment to reach the poor must be personal and must reflect the philosophy of leadership. Recognition is the best form of behavior reinforcement.

18 See, for example: *Report of the UN Expert Group on Women and Finance: Transforming Financial Systems* (1994). <http://womensworldbanking.org/english.4000/4300.htm>

Principled Practices

Leadership has a clear mission statement of its commitment to providing services to the poor.

Leadership takes an unflagging interest in working with employees to reach the poorest.

Leadership hires staff who share its commitment and then rewards them through recognition.

Product Design

Product design is key to ensuring that the poorest members of a community have access to the financial services they need. The small initial loan size, for example, is purposely geared to accommodate the needs of the poorer client, while being too small to attract wealthier members of the community.

Group-based credit methodologies provide a comfortable environment for the poor. Clients self-select their fellow group members and are able to self-verify the business activities of fellow members. Clients also participate in the loan approval process. The formation of such peer groups for accessing and guaranteeing loans provides added reassurance for poor clients unaccustomed to accessing financial services.

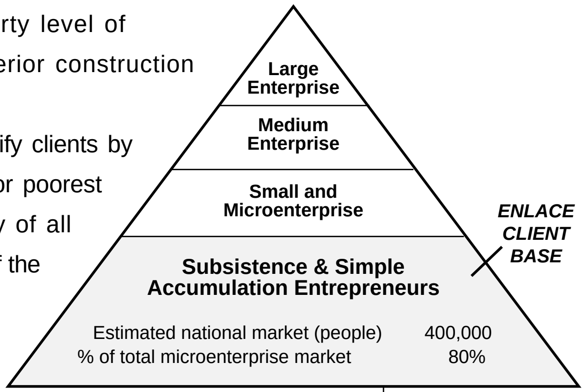
Marketing and Client Identification Strategies

Microfinance practitioners use several methods to identify the poorest individuals in a community. We recommend using these methods during feasibility and piloting phases to profile the characteristics of the poorest. They also can be useful for evaluations. To use them in program implementation is costly and may undermine sustainability.

Two common methods for identifying clients are wealth analysis and housing indices.[19] Wealth analysis involves working with the community to rank its members from wealthiest to

19 For more information about wealth analysis or housing indices, see the following "Favorite Tools and Resources" section.

EL SALVADOR
ENTERPRISE PYRAMID



poorest, and housing indices use proxy indicators to gauge the poverty level of individuals based on the exterior construction materials used in their dwelling.

Other CRS programs identify clients by assessing where the smallest or poorest businesses fit into a hierarchy of all businesses, as in the example of the El Salvador Enterprise Pyramid.

While these methods are useful in identifying the poorest, they can be expensive as a screening method. In some cases, they exclude potentially productive members of a village bank.

CRS practitioners prefer a strategy of **inclusivity**. First-time clients, especially the poorest, may be afraid to risk their time – their only income-producing resource – in order to receive financial services. However, if credit officers set up a village bank in one community, then wait six to twelve months to set up a second one in the same community, the more cautious villagers have had an opportunity to observe the success of the clients in the first village bank. The poor then can more accurately access the value of membership and become interested in joining the second bank. This strategy can greatly reduce outreach costs, as it takes full advantage of word-of-mouth marketing.

> *STELLAR EXAMPLE*
>
> **The Spouse**
>
> *In Homa Bay, Kenya, the social development arm of the diocesan office found that excluding men was harmful to the family. Women needed to share the responsibility of running their business and attending loan meetings. Now, the CRS counterpart offers each family the choice of who "holds" the loan and allows spouses to change their decision from loan to loan. This flexibility increases the involvement of men and has made them more accountable for sharing in the work of the household.*

Principled Practices

Serve the poorest based on need without regard to ethnicity, class, caste or creed.

Use a strategy of inclusivity to reach the poorest.

Use targeting strategies to identify the very poor during feasibility and program design stages.

Client Considerations

Some programs go to great lengths to exclude men. While women are the focus of CRS programming, some programs assist women by helping men. If men are not working to their fullest capacity to responsibly contribute to a household, then perhaps excluding them from activities, such as attending village bank meetings, only hurts their chances to learn and only places a greater burden on women to shoulder the work of the household. Be sure to look at cultural and gender issues in your area before determining how you will focus on women.

☞ Favorite Tools and Resources

☆☆☆☆ **Microfinance and Poverty: Questioning the Conventional Wisdom,** by Hege Gulli, Inter-American Development Bank, 1998. A simple, comprehensive explanation of key issues and myths about reaching the poor. Covers everything from methodology to institution-building. Good for Country Representatives and a nice refresher for seasoned practitioners. Best of its kind. To order, contact: Inter-American Development Bank, 1300 New York Avenue, NW, Washington, DC 20577 or HYPERLINK http://www.IADB.org

☆☆☆ **Cost Effective Targeting: Two Tools to Identify the Poor,** by David Gibbons and Anton Simanowitz with Ben Nkuna. A practical guide on how to do Participatory Wealth Ranking and the Cashpor Housing Index. To order, contact PACT Publications: HYPERLINK http://www.pactpub.com

☆☆☆ **1999 Meeting of Councils, Microcredit Summit, Final Report.** A compendium of plenary papers, some very practical from the Microcredit Summit Campaign. To order, contact: HYPERLINK http://www.microcreditsummit.org

The Second Principle

Link Loans to Savings

Savings and credit are two sides of the same coin. Credit is used to make investments today that are paid back tomorrow. Savings, conversely, constitute the accumulation of assets today to be invested tomorrow. We respect the reciprocity between savings and credit and work to link them wherever possible. Credit linked to savings helps clients build wealth as they borrow.

Savings

Clients save for many reasons. They save to create a cushion for times of household emergency, to pay for medicine, funerals, or other unforeseen difficulties. They save for school fees, for dowries and to make seasonal investments for improving their businesses. Clients save in small bits throughout the year to ensure they have enough to eat between harvest and the next planting. Savings that outdistance planned and unplanned events can be converted into assets, such as an improved home or cattle, gold or other markers of prosperity.

Many clients do

Cautionary Advice

Credit to the lender is debt to the borrower. Some debt is good and creates "leverage" in a small economic activity. Too much debt can become a burden to clients. Savings also can pose risks. Some clients fear holding savings, which can be subject to the needs of kin or to theft. Before offering financial services, program leadership should study the local cultural perceptions of savings and borrowing and the relationships between the two.

STELLAR EXAMPLE

Savings and Sustainability

PT Ukabima, a CRS holding company in Indonesia, recently opened a village banking window in a rural bank that it owns. In this adaptation of village banking, the members of the village bank do not manage an internal account for group savings. Instead, the credit officers deposit the members' savings – still linked to loan amounts – in the rural bank. This allows members to: 1) get a good return; 2) draw on their savings whenever they wish; and 3) feel confident that their savings are safe. But just as important, this allows the rural bank to increase its own sustainability and supports the village banks expansion.

not save cash. Some clients fear the loss of cash and would prefer to protect it from the demands of kin, spouse, or household by converting it to less liquid forms. Converting cash into hard assets is also a way to stem the effects of inflation. Traditional non-cash saving methods range from hiding rice in bamboo to fattening animals to purchasing gold.

In some instances, clients find it difficult to convert a portion of their non-cash savings into cash. For example, it is difficult to sell just part of a pig in an emergency; grains stored as a form of savings are vulnerable to insects, rot and weather; gold can be stolen. Savings in the form of cash can be more useful in emergencies. Sometimes clients shelter their cash by entrusting it to a local money keeper.

Principled Practices in Savings Services

Provide easy, quick access to savings. Programs that allow clients partial or full access to savings are giving them the freedom to manage their household and business cash flows as they see fit. Access also refers to **ease** and **speed** of access.

Offer a safe place for savings. Savings placed in the village bank's internal account are very safe, if most of the money is lent out. If much of the funds are idle, the risks of fraud or theft increase, not to mention the unrealized interest earnings. Wise programs offer villagers a safe place to store individual savings, wherever possible.

Offer a high return on savings. CRS programs do not set interest rates on village savings. These rates are set by the village bank members themselves and are often quite high. In instances where no internal account exists – such as in non-village bank group-lending methodologies – CRS programs should identify local services that offer a reasonable return.

Loans

Clients borrow money to supplement savings, and clients use these loans for the same purposes as they use savings. Loans, however, are best used for productive purposes only. CRS encourages loans for investment in the client's economic activity; these activities generate income with which to pay back the loan and create additional savings for the client. Loans for economic purposes include:

Loans for working capital and seasonal capital. Working capital is the difference between short-term assets and liabilities. It is used to give credit to customers and purchase inventory, agricultural inputs and small animals.

Loans for fixed assets. Fixed assets include equipment, draught animals and any building structures or assets with a life expectancy greater than a year.

Principled Practices in Loan Services

Link loans to savings. Most quality CRS programs increase loan amounts to each client based on the amount that client has saved in the previous period.

Use appropriate loan amounts. The loan product, properly designed, should filter out the more prosperous members of a community. Small loans, building in steps and linked to savings, help clients develop money management skills while keeping pace with the growth of their enterprises.

Use market rates of interest. Underpriced loans with subsidized interest rates encourage wealthier members of a community to use their clout to receive low-cost credit. Loans issued at market interest rates discourage this behavior so that the poor are not edged out.

STELLAR EXAMPLE

Savings Linked to Loans

A client borrows $50. After paying back the loan, s/he may request a new loan that is equal to the first loan plus the amount s/he has saved during the previous period, typically 20% of the loan amount. If s/he borrows $50 and saves $10 (20% of $50), s/he is eligible to borrow $60 for the next loan term.

Avoid usury. Programs may be tempted to cover costs by setting interest rates extraordinarily high. While clients may pay these rates because they have no alternative, usury undermines our goal of social justice. **So price loans reasonably in relation to local market rates and work to reduce operating costs.**

Make loan terms flexible whenever possible. Instead of confining borrowers to rigid loan cycles, look **to matching loan uses with loan terms.**

Offer quick turnaround time and hassle free paperwork. Speedy loans, delivered within a few days of application, win loyal clients.

☛ Favorite Tools and Resources

☆☆☆☆☆ **A3-Partners Loan Tracking and Accounting Systems.** (Forthcoming) Developed as a joint venture between CAYLX, a Seattle-based software company, and CRS, A-3 Partners also allows for increased flexibility in loan services. Check the CAYLX website: HYPERLINK http://www.caylx.com

☆☆☆☆ **Internal Account Management Toolkit.** Developed by CRS as part of a grant from SEEP, this is a comprehensive tool kit about managing the internal savings account of a village bank. Copies can be downloaded in English, French, or Spanish: HYPERLINK http://www.mip.org

☆☆☆☆ **The Poor and Their Money,** by Stuart Rutherford, Institute for Development Policy and Management, University of Manchester, 1999. A wonderful essay on how and why the poor save. Available through HYPERLINK http://www.oup-usa.org/search97CGI/S97-CGI

☆☆☆☆ **MicroSave Africa,** spearheaded by DFID and UNDP. Many tools and articles that can be downloaded. To sign up, email HYPERLINK mailto:msa@info.com.co.ug msa@info.com.co.ug or check their website HYPERLINK http://microsave-africa.com

☆☆☆☆ **How Gambians Save,** by Parker Shipton, World Bank, Pre-Working Paper series, WPS395. A fascinating brief that debunks many of the myths of rural savings. To order, contact: The World Bank, Country Economics Department, Policy Research and External Affairs, 1818 H Street, NW, Washington, DC 20433.

The Third Principle

Use Solidarity Guarantees

Solidarity guarantees comprise the nucleus of CRS microfinance programming. By solidarity guarantees, we are referring to any financial peer agreement in which groups of clients stand behind the loans of fellow group members by promising to repay delinquent loans. In this way, the poorest clients may borrow without pledging collateral.

To clients, one of the key benefits of forming a group is the close working ties that develop among members. Members support one another, offer advice and begin to take on increased pride, discipline and responsibility toward their business activities. Members feel that they have true ownership in the village bank because of their involvement in the bank's most important decisions. The members themselves decide the profile of new members joining the group, the actions to take on a member's late payments, and the interest rate charged on loans they issue from locally-managed internal account savings.

STELLAR EXAMPLE

The Group and the Community

In the Fort Portal Diocese in Western Uganda, the group spirit is alive and well. Members of a local village bank, all women, decided to use a portion of their savings to purchase a cow. They all agreed that the children of the local orphanage needed fresh milk, but just as important, the orphanage could use the extra income from the sale of surplus milk to local retailers. Once the cow was purchased, the village bank members gave it to the orphanage. They also retained the services of a local expert to train the children on how to properly care for their new asset.

The Group Guarantee

CRS encompasses many examples of group-based lending. Among them, village banking, Grameen banking, and solidarity group lending.[20]

The group guarantee is simple and flexible, and CRS programming reflects a wide variety of expressions of this

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20 See Section Two, *How We Operate: Proven Methods*, for more details about these methodologies.

method. Groups work best when all or at least some of the members know each other well. Groups review the first loans of fellow members carefully. If any member of the group is late when her/his loan is due, no other member of the group may receive a new loan. The following examples illustrate how group guarantees differ from program to program.

Single level of guarantee. In many village banks and in some Grameen Replication centres, partners ask clients for only one level of guarantee. In these village banks, smaller solidarity groups of five to eight members may not exist at all, and the solidarity principle functions solely at the bank level. In contrast, in Grameen centres the essential loan guarantee is at the five-member solidarity group level. In yet other group-lending methodologies, only the small solidarity groups provide the loan guarantee, with no functional larger group envelope.

Double levels of guarantee. In some village banks, credit officers form a larger group of 50 members and then also ask members to gather into smaller solidarity groups. The smaller group is the first line of guarantee. If a group member is late on a loan payment, the other members must come up with the payment. If they cannot, then the larger group must make good on the loan.

STELLAR EXAMPLE

The Group and the Village Bank

In El Salvador, Enlace understands the economic rewards of engaging clients in all facets of the credit process. For example, Enlace clients are involved in the initial assessment of the economic activities of village bank members. Enlace has a very simple process where members of a village bank visit one another's homes or places of business and verify the activity and all "collateral" that the client is pledging to the village bank. Members also learn to calculate, on a simple form, the cash flow of the new member to determine how much debt s/he can afford to repay.

The Work of Groups

Groups, be they small or large, often do more than simply underwrite the loans of fellow members. Group members become very involved in all levels of the lending process. If members know one another well, are committed to their economic activities, and trust and respect the credit officer, the group may be motivated to strengthen lending operations – from increased involvement in initial loan assessment, to attracting new members, to volunteering for bank leadership positions.

Groups have built wells, constructed schoolhouses and taken up collections for the local orphanage. The credit officer can never insist on these collective initiatives, but s/he can encourage them by helping the group leaders run lively, stimulating meetings and by giving members the tools to develop the group's potential.

> ☆ STELLAR EXAMPLE
>
> **Solidarity Beyond Guarantees**
>
> *When an earthquake struck Gujarat, India in 2001, microfinance clients of a CRS-sponsored partner in Andhra Pradesh, a region far from Gujarat, felt compelled to act. Twenty-five hundred women mobilized forty cents each, or about $1,000, to help those left homeless in the earthquake. Nearly all these generous clients were of the "untouchable" caste and struggle to save one penny per day. When asked why they gave to others when they themselves had so little, they responded by saying that they were pleased to give to those in greater need.*

Principled Practices

Group-guaranteed lending works best when keeping in mind our fourth principle, Practice Participatory Management.[21] Other key practices include:

Partner organizations need to understand and use adult education techniques so that they can teach group leaders to conduct lively meetings in which all feel welcome to participate.

Groups work best where members know and trust one another.

Implementing partner NGOs monitor and act quickly to remedy all repayment problems in the group. Nothing demoralizes a group faster than too many members with late payments.

Partner NGOs refuse to accept partial payments from a village bank or Grameen centre. Accepting partial payment sends the wrong signal and can seriously undermine the group guarantee.

21 See the following section for more details.

☛ Favorite Tools and Resources

☆☆☆☆☆ **Internal Account Management Toolkit.** Developed by CRS as part of a grant from SEEP, this is a comprehensive tool kit for creating a village bank's most important solidarity systems. Copies can be downloaded in English, French, or Spanish: HYPERLINK http://www.mip.org

☆☆☆☆☆ **CRS Cambodia Village Banking Manual,** developed by CRS Cambodia. This guide explains group formation, the group guarantee and managing delinquency. Draft copy available to CRS programs: HYPERLINK mu@catholicrelief.org

The Fourth Principle

Practice Participatory Management

Key to Catholic Social teaching is the principle of subsidiarity. Subsidiarity calls for appropriate decisions at appropriate levels. “Let no higher level of organization do what a lower level can do.”[22] This principle is highly democratic; it seeks to justly empower all levels, including grass-roots institutions and the individuals whom they serve.

In microfinance, we seek to engender full community participation as an expression of subsidiarity. In fact, participatory management is built into village banking. Bank members make key decisions regarding loans, new members and the management of group savings. However, more than its implicit reality in our credit models, participatory management can also be crucial in stages of program design, implementation and evaluation.

The Program Design Stage

Engaging a local community in program design is a sure way to shape a strong marketing plan, develop an appealing product and gain strong support during program roll-out. Participatory Rural Appraisal (PRA), a technique for gathering information at local levels, is an outstanding tool to use in the early stages of program design.

PRA tools can be adapted to urban settings as well. The techniques are

STELLAR EXAMPLE

Participatory Program Design

In Homa Bay, Kenya, our partner believes Participatory Rural Appraisal is too important not to use it in every community. The staff argue that in the long term the practice of PRA will increase sustainability. Communities with sound PRA practices prior to program inception, will require less staff time later and enjoy long-run efficiencies. Homa Bay uses a variety of tools, including: a 24-hour activity chart to identify surplus labor in a family; wealth analysis to profile the poorest people in a community; village mapping to identify where the poorest members live; and business and seasonal trend analysis to help microentrepreneurs select the most profitable activities.

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22 *Quadragessimo Anno (After Forty Years): On Social Reconstruction*. Encyclical of Pope Pius XI promulgated on May 15, 1931.

important in determining just how microfinance fits into a community structure. While PRA is excellent for determining general features of communities at large, and informs initial program design, most programs find the process too costly to use in every community.

The Implementation Stage

During the implementation stage, involving the community can inspire creative approaches. Community members may become staff, and both staff and community may have many ideas on how to better serve clients. Creatively engaging all parts of a community, including the faith community, can improve program quality and expand outreach to more clients and to poorer members of the community.

Monitoring and Evaluation

Often monitoring and evaluation procedures call for cold surveys and data collection. Staff and community are removed from the process while external consultants determine program quality. To address this flaw and to improve transparency of CRS microfinance program quality standards, CRS developed and launched a system for assessing and accrediting partners' organizational capacities. The MAGI Alliance (Microfinance Alliance for Global Impact) assessment process encourages partner staff to participate as one member of a team that assesses other partners (when no conflict of interest exists.) Using a standard tool, team members assess and rate a partner's strengths and weaknesses. Information gathered in the process allows CRS and its partners to design appropriate technical assistance plans to assist partners in improving their institutional capacity. By involving CRS and partner staff wherever possible, rather than hiring consultants, CRS and partners can grow and learn together.

Principled Practices

Include clients and staff wherever possible in program design, implementation and evaluation activities.

Listen more than talk. Worry less about formal survey data and more about what clients, staff and partners say that they really want.

Use tools and methods wisely to ensure a participatory structure. Pay attention to costs to strike an appropriate balance between sustainability and participation.

Participate in the MAGI by volunteering appropriate assessment team members and by preparing partners for the assessment process..

✒ Favorite Tools and Resources

☆☆☆☆☆ **The People Part: Common Sense Advice in Motivating Microfinance Clients and Staff,** by Susan Gibson, Catholic Relief Services, 2000. *The People Part* has excellent tips on client appreciation, quality service delivery, marketing, staff development and team building, and much more.
To order, contact: HYPERLINK http://www.pactpub.com

☆☆☆ **Rapid Rural Appraisal and Participatory Rural Appraisal,** by Karen Schoonmaker-Freudenberger, Catholic Relief Services, 1999. This comprehensive guide to PRA includes some sections on microfinance and has broad potential for modification for client identification. Available for downloading: HYPERLINK http://www.catholicrelief.org/publications/index.cfm

The Fifth Principle

Invest in Scale and Self-sufficiency

Together, scale and self-sufficiency form the backbone of success in microfinance. If our partners do not serve many clients (achieve "scale"), or cannot cover costs (achieve "self-sufficiency"), programs will not fulfill our mission to provide lasting services to the poorest. Growing, profitable programs are the first step in creating sustainable financial institutions.

Why Scale?

Scale has a double meaning: to reach many clients and to achieve healthy and consistent financial growth. We are presuming that reaching many clients means reaching them in a concentrated geographic area. Scale offers these advantages:

Scale allows programs to achieve efficiencies. Small programs have high costs per client served. Large programs are able to spread their costs over many clients.

Scale reduces the need to charge unusually high interest rates. Small programs often must charge very high rates to cover costs – primarily for the above reasons. Reaching scale allows programs to charge reasonable rates.

Scale gives programs the best chance of reaching the poor. The more clients served, the more chances that the very poor are reached, assuming appropriate

STELLAR EXAMPLE

Scale in Cambodia

In December 1996, a relatively new CRS microfinance program in Cambodia provided services to almost 2,000 clients. By the end of 1999, CRS Cambodia's microfinance services had expanded to reach nearly 30,000 clients. The benefits of this increase in scale have been dramatic: Due to improved efficiency of service delivery, 100% of operating costs are now covered by interest revenue. At the same time, the rate of interest charged on loans remains well below the rates demanded by local money lenders. Perhaps most significant for long-term sustainability, CRS Cambodia is consolidating its microfinance operations under a single institution. In addition to further anticipated gains in operational efficiency, this structure will enhance staff development and retention, as staff members now see the opportunities for long-term employment and advancement.

product design and targeting methods are in place.

Scale offers staff a career path. Small programs stifle the growth of staff seeking career opportunities. Large programs retain good staff by giving them new levels to reach and new skills to learn.

Scale and growth keep a microfinance institution vital. A dynamic of growth keeps staff busy refining systems, innovating new ways to better serve clients, and generally making for a robust institution.

Principled Practices in Reaching Scale

Plan to reach 1,000 clients in a partner's first year of operations.

Within three years, plan to reach at least 4,000 clients through a single partner.

Ensure sufficient staff are hired in order to organize them into teams to reach the above goals. Four or five credit officers provide the basis of a good team for a brand new microfinance program.

Why Self-sufficiency?

Self-sufficiency simply means that a partner is able to cover costs with interest income from clients. Full cost coverage has many benefits.

Self-sufficiency allows partners to sustain operations without continual external subsidy. This allows other CRS partners in other sectors to access subsidies to support important programs that cannot sustain themselves.

Self-sufficiency gives partners access to more commercial forms of capital to fund expansion. Socially responsible and commercial lenders and investors are more likely to loan funds to self-sufficient partners than those who are dependent on operational subsidies.

Self-sufficiency offers staff and clients a sense of security. Partners capable of efficiently covering costs create a sense of permanence and stability that serves to retain both clients and staff.

Principled Practices in Self-sufficiency

Seek to cover variable and direct costs immediately. Cover the costs of borrowed funds – including the actual costs for these funds if they were unsubsidized – and the cost of inflation. Also cover the cost of loan officers, delinquency and anticipated loan losses. Price loans to cover these costs.

Seek to cover fixed and semi-variable costs within three to seven years, depending on expansion plans. Cover costs of operations including administrative and supervisory staff, rent, depreciation, and other administrative and operating expenses.

If interest rates are high initially to help cover costs, seek to lower them once break-even, full-cost coverage is attained.

Critical Moments of Investment

Many programs reflect similar patterns in growth. They tend to reach certain plateaus beyond which they cannot grow further. At these plateaus, they may languish or even collapse. Program leaders must plan for these “ceilings” that constrain growth and be ready to invest in staffing, structures and systems so that they can move safely past them into a new growth phase. Key Growth Thresholds and Typical Investments for each threshold are suggested in the following table.

Key Growth Thresholds	Typical Investments*
Initial Program Design	• A plan for geographically concentrated services that include market studies. • Investment in at least four to five staff and training. • Investment in low cost transportation. • Hiring/training of bookkeeper. • A plan for permanence (See Principle Six).
1,000 CLIENTS	• Additional staffing and staff supervision. Promote good credit officers. • Additional investment in equipment and vehicles, new branch openings.
3,000 CLIENTS	• Leadership training. • Training in “managing growth.” • Strategic planning. • Investment in internal audit systems.
5,000 CLIENTS	• Training in skills for transforming into a specialized microfinance institution. • Leadership exposure to growth programs. • Training in managing multiple staffing levels. • Investigating plans for transformation.
10,000 CLIENTS	• Investment in a plan for transformation into a formal financial institution (if appropriate). • More investment in leadership and in managing growth.
20,000 CLIENTS	• More of same, real systemic stresses can happen at this stage.

*__The Management Information System__ (MIS) of a microfinance organization should correspond to the needs defined in its strategic plan. If the business plan calls for an aggressive growth strategy and offers a number of different products, the organization should invest in a robust system. Alternately, if the strategy is for slower growth with only a few standard products offered, the organization can continue for a longer period with a basic MIS. **A good rule of thumb is that the organization should be financially capable of realistically amortizing the upfront investment in the MIS within a three to five-year period.**

Principled Practices in Program Investment

Invest up front, before a program begins, in market studies, program design, excellent staffing and in training so that programs can reach scale quickly and maintain vital growth.

Make substantial investments at critical expansion thresholds by investing in increased staffing, systems, training, strategic alliances, and important consultancies.

☛ Favorite Tools and Resources

☆☆☆ **An Institutional Guide for Enterprise Development Organizations,** by Elaine Edgecomb and James Cawley, The SEEP Network, 1993. A dog-eared friend with many relevant chapters. A good reference still. Available from PACT publications: HYPERLINK http://www.pactpub.com

☆☆☆ **Banking Services for the Poor: Managing for Success: An Expanded and Revised Guidebook for Microfinance Institutions,** by Robert Peck Christen, 1997. A comprehensive review of financial management. Available from ACCION publications: HYPERLINK http://www.accion.org/pubs/main.asp

☆☆☆☆ **Financial Ratio Analysis for Microfinance Institutions,** by the SEEP Network/Calmeadow. Good summary of 16 key ratios in microfinance. A companion training guide with case studies is also available. Available from PACT publications: HYPERLINK http://www.pactpub.com

☆☆☆☆ **MICROFINANCE HANDBOOK: An Institutional and Financial Perspective (Sustainable Banking with the Poor),** by Joanna Ledgerwood, The World Bank, 1999. A good soup-to-nuts review of all relevant aspects of creating a sustainable institution. To order, contact: HYPERLINK http://www.worldbank.org/html/extpb/abshtml/14306.htm

The Sixth Principle

Plan for Permanence

Disbursing a loan is the beginning of a long-term relationship. It is not a one-time transaction. The borrower pays her/his loan back over time and the lender collects payments over time. In village banking, we make the further promise that if a borrower and her/his fellow group members pay promptly, each may receive a new loan. We tell the borrower that if s/he fulfills her/his part of the bargain, s/he may rely indefinitely on our financial services. It is a promise without end.

To honor this promise, we, together with our partners, have sought ways to serve clients over the long term. While we know that a very few clients may move on to other credit sources, most will never be attractive to a commercial bank. Their loan sizes are simply too small and the transaction costs too high. So what do we do about the many clients who will never qualify for commercial funds?

To answer this question, we must change our perception of microfinance. Rather than thinking of it in terms of a project – with a beginning, a middle and an end – we must instead view microfinance as a stream of resources flowing to our poorest clients.

From the very inception of a new microfinance program, we ask our partners and our technical advisors to examine possibilities for permanence. In this way, we fulfill our goal of enabling the self-employed poor, especially women, to have access to reliable, ongoing financial services by transforming viable microfinance service providers into permanent financial institutions.

Strategies For Permanence

We may use many strategies to advance our goal of permanence. We may help partners create specialized institutions or spin-offs from their multi-purpose development activities; we may help partners consolidate microfinance activities into a single, vital entity capable of national service; we may establish permanent sources of capital for these institutions to support their stability and growth. The following are just a few options to promote permanence.

STELLAR EXAMPLE

Planning for Performance

CRS Cambodia *lends directly to clients through branches, but also assists local partner organizations in their microfinance activities. As they collectively reach the 30,000 client mark, the various parties are well into discussions to consolidate activities into a new microfinance institution (MFI). To guide the process of creating a new formal financial institution, CRS Cambodia has created a transitional advisory group that not only includes key CRS staff from the Southeast Asia region, but also important members of the Cambodian banking and legal communities.*

CRS Armenia *had been extending credit services to 1,000 clients when an opportunity to localize came from Save the Children. This international organization had created an Armenian MFI that was qualified to manage CRS microfinance activities in addition to its own operations. CRS has transferred its client base, staff and portfolio to the new MFI called Kamurj Microfund. CRS will hold two board seats for six years. This new MFI can now draw on the strengths of both CRS and Save the Children.*

At the partner level. Partners interested in creating specialized institutions may look to develop for-profit companies where the partner plays a key role as shareholder and board member. They also may look to creating a separate NGO. A legal review always helps to determine the structure that is most tax-advantageous and most favorable to preserving our mission to reach the poorest.

At the CRS level. In some countries CRS has extended financial services directly to clients. This activity has come about in two sets of circumstances: Either we have not identified suitable partners to carry out the service, or partners have asked CRS to take a more direct role in catalyzing the creation of a financial institution. If CRS is directly involved in extending financial services, we have three options to localized services. First, CRS can transfer its clients and portfolio to an existing entity interested in acquiring our portfolio. Second, CRS may spin off microfinance services by creating a new institution. And third, CRS may help consolidate a number of portfolios into a single local institution.

Wholesale institutions. CRS and its partners might look closely at establishing an investment company to extend loan funds to local partners. Funds may be offered in the form of loans, guarantees, or equity investments.

Our Role in Transformation

In approaching an ethical plan for the permanent survival of a microfinance institution, we must carefully look at our role in the process. During the course of a partner institution's expansion, CRS may have different roles, based on institutional need and local conditions. While all of Catholic Social Teaching applies to our practice, four principles may factor most significantly into the evolution of a transforming microfinance program: stewardship, solidarity, subsidiarity and the common good.

We must balance these different principles in relation to the growth stage of the institution. At the start-up stage, stewardship may be most important. As the organization grows, local investors may want CRS continued involvement as a show of solidarity. As the organization matures, subsidiarity plays a crucial role.

Institutions initiated by CRS should have an ownership structure that reflects multiple stakeholders. The institution will include, preferably, a corresponding degree of ownership and commitment from the local Catholic Church. CRS must produce a clearly defined localization strategy for both our investment and our involvement. As a policy, our role in financing, providing technical assistance and governance will increasingly move to local partner agencies. Throughout each stage, the notion of the common good is at play. CRS has expressed this principle by engaging important political and government players in the development of new laws favorable to microfinance.

STELLAR EXAMPLE

Good Governance: CRS Bosnia and Herzegovina in 2001

In 2001, CRS Bosnia and Herzegovina's microfinance program was successfully localized. "Mikra," the new registered microfinance institution, absorbed the CRS microfinance staff, clients and loan portfolio. In this ethnically stratified country, Mikra foresaw the need to recruit the right combination of Board members, representing diverse backgrounds and ethnicities, who collectively brought expertise in microfinance, leadership, and political influence. The founding Board of Directors included the Deputy Minister of Finance (a Muslim), an expert in capacity building for microfinance institutions (a Croat), an NGO board member with expertise in labor issues (a Serb), a Catholic priest (a Croat), and the Executive Director of Mikra, who will serve for one year until the new Board feels cohesive enough to recruit a new member. The Board includes three women members, and all members have a social dedication to reconciliation and poverty alleviation in Bosnia and Herzegovina

The Importance of a Plan

A key concept in “Plan for Permanence” is the creation of a written business plan. A plan works best when all stakeholders have had the chance to participate in shaping its broad strategies. The plan must include strategic, operational and financial elements. Equally important, it should articulate a rational strategy for ensuring ownership and control by local entities and individuals.

Principled Practices

Work with partners prior to launching a program to ensure that a vision of permanence is part of the plan.

Ensure that any direct role that CRS may have is ceded to local actors over time. Work to balance the organization’s needs for stability and the principle of subsidiarity.

Engage key players in political and governmental circles in passing laws favorable to the formation of healthy microfinance institutions.

Work with partners in using business planning models to create a professional business plan.

☛ Favorite Tools and Resources

☆☆☆ **Business Planning and Financial Modeling for Microfinance Institutions: A Handbook,** by Tony Sheldon and Chuck Waterfield, CGAP. Now being revised to improve user-friendliness. Comprehensive analysis tool (Excel model on disk) with guide. Order from PACT publications: HYPERLINK http://www.pactpub.com

☆☆☆☆ **Institutional Metamorphosis: Transformation of Microfinance NGOs into Regulated Financial Institutions, Occasional Paper No. 4,** by Anita Campion and Victoria White, Microfinance Network, 1999. Very useful framework and case studies for guiding transforming institutions. Order from PACT publications: HYPERLINK http://www.pactpub.com

☆☆☆ **Regulation and Supervision of Microfinance Institutions, Occasional Paper No. 1,** by Shari Berenbach and Craig Churchill, Microfinance Network. Useful framework and case studies for guiding transforming institutions. Order from PACT publications: HYPERLINK http://www.pactpub.com

☆☆☆ **Regulation and Supervision of Microfinance Institutions, Occasional Paper No.2,** Craig Churchill. Microfinance Network. Useful framework and case studies for guiding transforming institutions. Order from PACT publications: HYPERLINK http://www.pactpub.com

☆☆☆ **Guidelines for the Effective Governance of Microfinance Institutions, Occasional Paper No. 3,** by Anita Campion and Cheryl Frankiewicz, Microfinance Network, 1999. Very useful tips in creating and managing a board of directors. Order from PACT publications: HYPERLINK http://www.pactpub.com

Final Thoughts

This document is a first effort to define our microfinance principles in light of our agency values rooted in Catholic Social Teaching. A distinction must be made here. Catholic Social Teaching represents the core values of CRS. These values are of an essential nature and they are enduring. They guide us in completing our mission, in choosing our strategies and in creating policy.

Our microfinance principles draw on these values, but also reflect our experience and lessons specifically in microfinance. At any given time, they mirror how we believe we can best honor the values in Catholic Social Teaching.

As our experience in microfinance accumulates along with our collective lessons, we may choose to modify our principles. In fact, we already have. For example, our original principles developed in 1997 did not include “Plan for Permanence”. We chose to add this principle to ensure that we honored the long-term nature of bringing financial services to poor clients. This principle seemed important in light of the values of human dignity, stewardship, solidarity and the common good.

That said, we plan for this guide to be a living document, to be modified and enhanced as we gain more experience. To the extent possible, it will reflect the practical nature of what we do and will attempt to reconcile and challenge the expediency of our practices within the context of Catholic Relief Services’ core values.

Catholic Relief Services, founded in 1943, assists the poor and disadvantaged outside the United States. CRS works in solidarity with all people of good will and similar vision to promote human dignity, alleviate human suffering, promote the development of people, and foster charity, justice, and peace in the world. CRS assists the poor solely on the basis of need, not creed, race, or nationality, and maintains strict standards of efficiency and accountability. CRS currently operates in 88 countries and supports microfinance activities in 33 countries.

CRS Microfinance

West Africa
Benin
Burkina Faso
Ghana
Niger
Senegal

Eastern Africa
Ethiopia
Kenya
Rwanda
Uganda

Southern Africa
Madagascar
Zimbabwe

Middle East and North Africa
Egypt
Jerusalem, West Bank, and Gaza

South Asia
India—Eastern
India—Hyderabad
Pakistan

South East Asia
Cambodia
Indonesia
Philippines
Thailand
Vietnam

Europe
Armenia
Bosnia-Herzegovina
Bulgaria
Croatia
Macedonia

Latin America and the Caribbean
Bolivia
Dominican Republic
Ecuador
El Salvador
Guatemala
Haiti
Nicaragua
Peru

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