

MBP Village Banking Research Agenda: Concept Paper **Executive Summary**

Village Banking is an evolving microfinance technology distinguished by a combination of three characteristics: depth of outreach, a savings as well as credit component, and a participatory management structure at the village bank level. Village Banking programs tend to achieve a greater depth of outreach than other sustainable microfinance approaches: the financial products and delivery system are structured and standardized to meet the needs of lower-income, less educated clients often living in remote areas.

Village Banking programs now seek to increase their sustainability, scale of outreach and quality of services while maintaining this depth. To accomplish these aims, practitioners are fundamentally altering the institutional structures and methodologies of Village Banking programs. On an institutional level, the original Village Banking methodology called for the development of participatory, self-managed peer lending groups that would self-capitalize and become fully autonomous within three years. Village Banking programs have replaced this bank “graduation” in favor of a range of other institutional arrangements that increase clients' on-going access to capital. These new institutional arrangements can enable implementing organizations to achieve greater financial sustainability and therefore larger scale outreach. To do so, accountability and the drive for financial sustainability must be embedded in institutional incentives at all levels.

On the level of methodology, Village Banking programs now seek to maintain their depth of outreach while modifying and expanding their services. Their objectives are three-fold: to increase program sustainability, meet the demand of maturing or higher income clientele, and improve their quality of services. The original Village Banking methodology was designed to cost-effectively extend services to the very poor. Specifically, joint liability, credit linked to savings, and standardized loan terms were designed to manage risk and minimize transaction costs. In addition to serving social objectives, self-management shifted these costs from the lending institution to the village banks.

However, practitioners have recognized trade-offs inherent in the original methodology. Services that appeal to only the very poor have higher per unit transaction costs because of their small loan sizes; in comparison to microfinance programs that provide larger loans, village banking programs require larger volumes of clients and often more time before they are able to achieve financial sustainability. Clients prefer more flexible savings and loan terms; higher income clients may be able to pay for these higher quality services and unwilling to accept the transaction costs and limits of standardized services. Pricing policies must be simple and manageable by the village banks, yet must cover the costs of savings as well as lending services. Finally, the village bank's democratic structure can inhibit membership growth and the security of savings unless ownership rights are clear, simple and rational. Leading Village Banking programs are seeking to resolve these issues while maintaining their depth of outreach and democratic management.

This concept paper highlights the chief institutional and methodological issues Village Banking programs must address to evolve into large-scale, sustainable financial service systems. It then outlines a set of research deliverables designed to address these issues. The research agenda will focus on the following questions:

- *Institutional Options*: What are the implications of each of the Village Banking institutional models for savings mobilization, loan size and quality, governance and management? What can be learned about these models from other community banking models? What incentives are needed at each institutional level to assure accountability and the drive for sustainability?
 - *Internal Account*: How can Village Banking programs avoid the mismanagement of their internal accounts? How can village banks structure ownership rights to be rational, simple and manageable? What options for use of the internal account will balance flexibility, returns, and security for members with cost recovery for the implementing organization?
 - *Demand for Services: Membership Turnover and Loan Plateaus*: What strategy can be taken to address membership turnover in order to support “sustainable” village banking institutions? Do client needs evolve as they mature? If so, what changes in policies best adapt to these changes and what are the trade-offs inherent in these adaptations? Are incentives embedded within the Village Banking methodologies leading to membership turnover, membership stagnation or loan plateaus? If so, how can these be addressed? How does “social capital” affect the dynamics of demand?
 - *Financial Sustainability: Expanding While Deepening Outreach*: How might the methodologies further evolve to meet more demand by expanding outreach while continuing to attract low-income and difficult-to-access clientele? How can Village Banking programs become more demand-driven and responsive to clients while maintaining the level of standardization necessary to minimize transaction costs and maintain secure and sound service delivery?
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- *Financial Sustainability: Cost Management*: What key policy decisions and trade-offs affect the management of costs and how?

The Microenterprise Best Practices research can play a key role in illuminating options, identifying trade-offs, and finding designs that adequately resolve these issues. To do so, this research must be practical and forward-looking. It must build on the considerable thought already put into these topics by practitioners, researchers and donors as well as the experience already gleaned from community banking programs around the globe. If properly applied, these scarce research resources can benefit large numbers of low-income entrepreneurs through the development of higher quality, sustainable microfinance services. The concept paper details a set of steps to assure that these benefits will be achieved. Chief among these is the establishment of a steering committee of practitioners to assist in monitoring research on a monthly basis.

MBP Village Banking Research Agenda: Concept Paper

Village Banking is an evolving microfinance technology originated by FINCA International and first documented in 1988. It is distinguished by a combination of three characteristics: depth of outreach, a savings as well as credit component, and a participatory management structure at the village bank level. Village Banking programs tend to achieve a greater depth of outreach than other sustainable microfinance approaches: the financial products and delivery system are structured and standardized to meet the needs of lower-income, less accessible or less educated clients who often live in more remote areas. This depth of outreach coupled with Village Banking's promise of financial and institutional sustainability has led to its widespread replication by US-based private voluntary organizations (PVOs.)¹

Village Banking programs now seek to expand their outreach and increase their sustainability. To accomplish these objectives, practitioners are fundamentally altering the institutional structures and methodologies of Village Banking programs. On an institutional level, the original Village Banking methodology called for the development of participatory, self-managed peer lending groups that would self-capitalize and become fully autonomous within 3 years. By 1994, the majority of Village Banking programs had replaced the graduation of autonomous village banks in favor of a range of other institutional arrangements that increased clients' on-going access to capital. These new institutional arrangements enable implementing organizations to achieve greater financial sustainability and therefore larger scale outreach. The implications of these new institutional arrangements for accountability, savings mobilization and efficiency needs to be clarified. In addition, the experience of a range of other community banking programs, particularly those of Sub-Saharan Africa and South Asia, can inform the development of these new Village Banking institutions.

On the level of methodology, Village Banking practitioners are seeking to maintain their depth of outreach while modifying and expanding their services. Their objectives are three-fold: to improve the quality of services, to meet the demand of maturing or slightly higher income clientele, and to increase the sustainability of the implementing organization. The original FINCA methodology was designed to cost-effectively extend services to the very poor. Specifically, a joint liability system, credit linked to savings and standardized loan terms were designed to manage risk and minimize transaction costs. In addition to serving social objectives, self-management shifted these transaction costs from the lending institution to the village banks themselves.

Between 1988 and 1994, the methodology was adopted and adapted to a range of environments by CARE Guatemala, Catholic Relief Services, Freedom from Hunger, Project Hope, Save the Children and World Relief. There now exist more than 80 Village Banking programs in 32 countries.

However, practitioners have recognized trade-offs inherent in the original methodology. Services that appeal to only the very poor have higher per unit transaction costs because of their small loan sizes; in comparison to microfinance programs that provide larger loans, village banking programs require larger volumes of clients and often more time before they are able to achieve financial sustainability. Clients prefer voluntary, liquid savings and more flexible loan terms. As their incomes grow, more mature clients may also be increasingly able and willing to pay for these higher quality services. Furthermore, they and higher income potential clients may be unwilling to accept the transaction costs and limits of standardized services. Finally, the village bank's democratic structure can inhibit membership growth unless ownership rights are clear, simple and rational.

Leading Village Banking programs seek to address these issues while maintaining their depth of outreach and democratic management. Innovations will require a careful consideration of how to maintain the features of the village bank that enable it to reach its existing low-income, minimally educated clientele. New services must also be designed to fit within the management capacity of the village bank or feasible complementary delivery systems must be identified.

This concept paper highlights the issues Village Banking programs must address to evolve into large-scale, fully functional financial service systems. The Microenterprise Best Practices research can play a key role in illuminating options, identifying trade-offs, and finding designs that adequately resolve these issues. To do so, this research must be practical and forward-looking. It must build on the considerable thought already put into these topics by practitioners, researchers and donors and the considerable experience already gleaned from community banking programs around the globe. If properly applied, these scarce research resources can benefit large numbers of low-income entrepreneurs through the development of higher quality, sustainable microfinance services.

I. RESEARCH TOPICS

A. Institutional Issues: Institutional Options for Sustainability

Village Banking is a methodology for delivering microfinance services. Originally, practitioners anticipated that self-capitalized, autonomous village banks would "graduate" after 3 years. Practitioners have since recognized that village banks do not choose to graduate because graduation limits clients' access to capital. Graduation is also counter-productive for the implementing organization: it systematically discards the most profitable portion of the loan portfolio and the sunk costs of obtaining client information.

For these reasons, Village Banking practitioners are exploring a range of institutional paths to scale and sustainability. These can be categorized into three types:

- a permanent relationship between the village banks and the implementing organization which intermediates with a bank or credit union (e.g. FINCA, World Relief). In this scenario, the implementing organization may eventually transform into a regulated financial institution (FINCA Honduras).²
- a permanent relationship between the village banks and a bank or credit union facilitated by the US PVO affiliate. This relationship may exist from the outset of the program (e.g. Freedom from Hunger, Save the Children Mali) or clients or village banks may graduate to become clients of the bank or credit union. (Katalysis)
- formation of a federation of village banks which replaces the support functions of the implementing organization and accesses commercial sources of funding. (CRS Benin and Senegal)

In addition to enabling the development of large-scale, financially sustainable service delivery, a village banking institution should provide long-term stable governance and management, the potential for savings mobilization, and the capacity to provide quality loans to a range of clientele. The latter may entail the delivery of new services through an alternative complementary delivery system. A clear understanding of the capacity of each of these institutional options to meet these objectives would provide useful guidance to Village Banking practitioners.

For any of these Village Banking systems to succeed as viable microfinancial systems, accountability and the drive for financial sustainability must be embedded in institutional incentives at all levels. The organizational design of the international NGO, the national affiliate and the village bank and the relationships between them and with the client must all embody an orientation towards these objectives. Obstacles to achieving scale and sustainability, from inadequate controls and management information systems to loss of high quality staff, can often be traced to issues of organizational design and the absence of appropriate incentives.

Research: Research into institutional options should proceed along three lines. First, it should assess the potential of each option to achieve the objectives noted above. Second, it should identify institutional lessons learned from a range of other community banking programs, particularly ROSCA-based programs and community-based credit unions of Sub-Saharan Africa and self-help programs of South Asia. Finally, it should develop practical guidance and institutional incentives for

This option takes a number of forms: The implementing organization may be the in-country affiliate of the US PVO (FINCA, Opportunity International, World Relief), a non-profit formed by the in-country affiliate for the sole purpose of providing microfinancial services (Save the Children Lebanon) or an existing non-profit that has taken on this function with the support of the in-country affiliate. It may receive technical support and assistance in accessing loan capital directly from the in-country affiliate or from a microfinance apex institution developed by the in-country affiliate. (CRS)

assuring the drive for accountability and sustainability at all institutional levels. It should analyze existing organizational incentives in Village Banking programs and identify impediments to accountability and sustainability encountered by these programs.

B. Methodology Issues

1. Internal Account

A core feature of the Village Banking methodology is the "internal account." The internal account is comprised of funds that the village bank owns and jointly manages. It consists of member savings and accumulated income from the investment of these funds. Village banks use their internal account in a variety of ways: to on-lend to members or non-members, to capitalize communal enterprises, to leverage commercial capital, as a loan reserve fund, and as an interest-earning account in a commercial bank. For the village bank, the internal accounts provides income and the opportunity to learn about fund management. However, the internal account has posed three challenges to Village Banking programs.

First, mismanagement of the internal account has put clients' assets and bank stability at risk. In a significant number of cases, the internal account has been subject to fraud or mismanagement. Implementing organizations have generally attributed this to the lack of standardized, transparent systems of control and accountability. They also assume that the flexibility of the internal account has overstretched village banks' limited management capacity. In response, implementing organizations have increased their support to village banks in their internal account management.³

In another move to increase the security of the internal fund, a number of implementing organizations now encourage village banks to deposit their internal funds in commercial banks. The investment represents a trade-off between security and profitability; the village bank typically earns significantly less on these accounts than it might through its other investment options. In addition, depositing the internal account in a commercial bank curtails its use as investment capital. An important avenue to explore is why the ownership and incentive structure of the village bank methodology has not led to tighter management and supervision of the internal account by bank members themselves.

Second, the internal account imposes costs on the implementing organization but does not contribute to its financial sustainability. Implementing organizations receive no income for the internal account management support they provide to the village bank. However, as banks increasingly capitalize

US PVOs, through the vehicle of the SEEP Poverty Lending Working Group, are now conducting an inventory of systems, policies and their success in improving internal account management. The output will be a tool box for the management of internal accounts. Its objective will be to maintain the flexibility and benefits of the internal accounts while assuring the security of village banks assets.

their internal account, it often attracts an increasing share of members' demand for loans. In addition, the implementing organization is unable to capitalize its operations with the savings, because it lacks the supervision, legal environment and security to manage savings mobilization.

Finally, the structure of ownership rights over the internal account may adversely affect bank membership and the demand for bank services. Ownership rights over the internal account are not always clear or may not relate to the value of a member's investment in the village bank. Upon withdrawal from the bank, a member usually can access his or her share in the village bank's accumulated earnings. However, the apportionment of shares of earnings is not necessarily tied to the length and size of the member's investment in the village bank. In addition, governance and investment decisions concerning the internal accounts are usually based on a one member - one vote system, rather than on the member's investment in the bank. These systems were developed in response to the limited management capacity of the village bank. Yet, unclear or irrational ownership and governance of the internal account could inhibit membership growth, cause membership attrition and provoke irresponsible management of the internal account.

Research:

Internal Account Management: Village banks would benefit from an analysis of the incentives and other causes of internal account mismanagement and the generation of solutions to address these;

Options for Use of the Internal Funds: Identification of options for village banks' use of their internal funds would be valuable. Options should identify mixes of services or instruments that balance flexibility, returns, and security for the member with cost recovery to the implementing organization;

Ownership Rights: An assessment of the incentives embedded in the ownership rights of the internal account should be included in the analysis of membership turnover described below. Feasible options for apportioning shares of the internal account and for structuring withdrawals would also be valuable.

2. Membership Turnover

Village Banking programs often experience high levels of membership turnover as clients regularly suspend or terminate their lending and saving. In addition, the average loan size clients demand often plateaus after increasing for a number of years. Understanding the causes of membership turnover and loan plateaus is a first step to improving service quality and increasing sustainability. Where the causes are inherent to the terms of credit and savings, changes in these terms can benefit the client, increase client retention and improve the financial sustainability of the village banking institution.

Membership turnover and loan plateaus may be a response to factors that are external to the terms of credit and savings services. For example, terminations can result from self-capitalization of the microenterprise perhaps due to the successful use of credit. However, membership turnover and loan plateaus may also indicate client dissatisfaction over time with the terms of service.

Research: A number of studies have and are investigating the causes of membership turnover and loan plateaus. In particular, Freedom from Hunger has completed an empirical study on loan plateaus and the impact of membership turnover. A similar study is being expanded to 38 sites by the SEEP Network. The research has focused on interviews with group members and staff. The following complementary analysis would be useful.

Causes of membership turnover and loan size plateaus that are internal to the methodology should be investigated theoretically and empirically to illuminate options for greater client retention. A useful analysis will clarify the structure of incentives embedded in the loan and savings terms, social components and ownership rights of a range of leading Village Banking programs. On an empirical level, an analysis of demand dynamics should investigate how the actual levels of temporary drop-out, attrition and loan plateaus correspond to these incentives. Conclusions should be drawn concerning feasible options for redesigning services to redress these negative incentives.

The empirical study should also look at reasons for membership turnover and loan plateaus as reported by clients who have suspended or terminated membership. An analysis of membership turnover should be disaggregated according to its causes, such as turnover due to sanctions or by choice, and category of client, such as urban, peri-urban or rural. These studies should lay the groundwork for changes in the methodology that will lead to higher levels of client retention and financial sustainability. Conclusions about possible feasible options to offset controllable causes of membership turnover should be identified.

3. Financial Sustainability: Expanding Outreach While Maintaining Depth

To increase their financial sustainability, quality of services and impact, Village Banking programs are seeking to cost-effectively meet the demand of maturing and slightly higher income entrepreneurs while retaining their existing clientele.⁴ Improving existing services or developing new ones will require a detailed understanding of the market, of cost and pricing trade-offs, and of the Village Bank methodology as a delivery system. Armed with this understanding, programs will need to

Village Banking programs also aim to expand their geographic outreach as a key means to increase their scale and financial sustainability. However, the subject of expanding geographical outreach is covered under the Managing Growth topic of the Microenterprise Best Practices research agenda.

determine which services can be delivered through the village banks themselves and which should be delivered through complementary “second tier” delivery systems.

The Village Banking methodology was specifically designed to minimize costs while attracting lower-income, minimally educated clients in less accessible environments. Nevertheless, the high costs and low revenues involved in reaching this clientele slows the achievement of full financial sustainability. Village banking programs seek to offset slow progress towards sustainability by developing financial services that will attract a broader clientele. In so doing, they are challenged to design services that can be delivered by the village banks or to identify feasible, complementary delivery systems. Delivering services through the village bank requires that services be priced to cover their full costs, maintain the village bank's ability to achieve deep outreach, and be within the bank's management capacity.

To enable programs to achieve deep outreach on a sustainable basis, practitioners standardized the terms of credit and savings in the original Village Banking methodology. Standardized terms lowered the implementing organization's transaction costs. They also enabled minimally educated village bank members to bear these transaction costs. In this way, implementing organizations could set their price of services low enough to meet the demand of significant numbers of low-income clients. Yet, as discussed above, membership turnover may indicate that the village bank's credit and savings terms do not meet the requirements of clients over time. Outreach may be expanded by offering services that maintain the demand of these clients and attract new ones.

The further development of services that retain and expand client demand will be based on market research. It will likely involve the development of more individualized terms for credit and savings services. Although some changes in terms may simply increase the value of services to a set of clients, other changes will involve trade-offs such as increased transaction costs to the implementing organization. These higher costs will have to be balanced by the willingness of new clients to pay for higher quality financial products. In addition, these new financial products will have to be designed to fit within the delivery system or will have to be supported by an alternative delivery system.

Determining whether and how the delivery of improved or new financial products can fit with core elements of the village bank will be critical to expanding outreach. Beyond the credit and savings terms themselves, the structure and dynamics of the village bank appear to be essential to its ability to reach low-income and difficult-to-access populations. Innovating to expand demand will require a careful consideration of how to maintain the features of the village bank that are essential to reaching this clientele. This, in turn, will require understanding what elements of these self-managed, peer lending and savings groups attract this population. Furthermore, the management capacity of the village bank has a limit; village bank members are often illiterate and volunteer their services to the bank. New credit and savings terms will have to be designed with this limit in mind.

For example, a number of Village Banking programs have reduced or eliminated mandatory savings requirements and have replaced them with voluntary, liquid savings options. These new savings terms increase the village bank's transaction costs, require more sophisticated cash flow management and have implications for the ownership and governance of the bank. Other programs are experimenting with offering a second tier of larger size loans, either through the village bank or as a new financial product offered separately from the village bank. As practitioners work to develop these new services, they are challenged to structure their terms and delivery in ways that will maintain the strength of the village bank, will not threaten its existing clientele and will cover the full costs of delivery.

Research:

Evolution of Financial Products and Methodology: Research should develop feasible, secure, and financially sustainable options for evolving Village Banking methodologies and institutions to meet more demand. These options should address ownership rights; the terms, costs and pricing of credit and savings services; social components and transaction costs; internal account management; and delivery systems. Trade-offs inherent in adopting changes should be highlighted. Options that are to be implemented by the village banks themselves should be consistent with village bank management capacity and should not compromise core elements and services that attract Village Banks' low-income and difficult-to-access clientele. As a basis for the design of new services, researchers should identify the features of village banks that attract this clientele. On the other hand, the prescription of alternative delivery systems should be feasible within the institutions and environments in which these systems would be operating.

Cost Management Strategies: Research should assess the effectiveness of different strategies and policies for maintaining deep outreach while achieving financial sustainability. Such an assessment should identify key policy decisions and trade-offs that affect the management of costs.

II. DELIVERABLES

The following deliverables address the research questions described in Section I.

Summary of Research Deliverables

Deliverable	Learning Objective	Months	Travel	Order
Desk Review I	<u>Institutional Options:</u> a. Develop preliminary assessment of three US PVO models. b. Identify institutional lessons learned from other community banking models. c. Identify 3 West African programs to study in Comparative Analysis.	1.5	U.S. 1	
Desk Review II	<u>Membership Turnover:</u> d. Identify 3 US PVO model programs for study in Desk Review and Comp. Analysis. e. Clarify incentives embedded in 3 programs' methodologies and possible solutions.	1	U.S.2	
Comparative Analysis I	<u>Institutional Options:</u> f. Assess 2 US PVO models according to criteria set out in research agenda. g. Glean relevant lessons learned from other community banking model.	2	West 3* Africa	
Comparative Analysis II	<u>Membership Turnover:</u> Clarify causes of membership turnover by determining: a) correlation between incentives identified in Desk Review and actual membership turnover. Identify possible solutions. b) clients' reported reasons for terminating demand. Identify possible solutions.	2	over-seas	3*
Synthesis Paper I	<u>Evolution of Financial Products and Methodology:</u> Provide design guidance for feasible and financially sustainable evolution of financial products and methodology.	1.5	U.S.	4

Deliverables with same order number can be done simultaneously or either can be done first

Technical Note I	<u>Cost Management Strategies:</u>	2		U.S.5	
h.	Identify key policy decisions and related cost management trade-offs.				
i.	Develop case to demonstrate these trade-offs.				
j.	Compare depth-related strategies to achieve financial sustainability.				
Technical Note II	<u>Financial Product Innovation:</u> Document field testing of innovations set forth in			travel6*	
	Synthesis Paper II.				
Synthesis Paper II	<u>Organizational Design:</u> Build on Ownership/Governance deliverables to identify 1 institutional incentives necessary to assure sustainable Village Banking programs.			U.S.6*	

A) Desk Review I: Institutional Options

1) Describe and perform a preliminary assessment of the institutional options for Village Banking described in section I.A. Based on a survey of existing Village Banking programs, briefly describe the most developed examples of each institutional option.

This desk review should assess the potential of each option to achieve: large-scale, financially sustainable service delivery; stable governance and management; regulated savings mobilization; the delivery of quality loans to a range of clientele, which may require the delivery of services outside the village bank structure; and Village Banking programs' social goals.

The review should also highlight the implications of each option in a number of key areas: For all options, it should clarify the trade-offs between the Village Banking programs' social and financial goals. It should identify the governance, regulation and legal framework each option requires. It should assess the implications of each option for the client, the village bank, the implementing organization and/or in-country affiliate of the US PVO, and the US PVO. Finally, it should define the expectations for sustainability of the implementing organization implied by each option

2) Describe and review other community banking models and identify institutional lessons relevant to Village Banking programs. Focus in particular on the ROSCA-based programs or community-based credit unions of sub-Saharan Africa and the self-help banking programs of South Asia. This review should emphasize the salient issues identified in the assessment of institutional options described above. Particular attention should be given to lessons concerning liquid, voluntary savings mobilization, ownership rights, and governance. Information should be based on experience, interviews with researchers and practitioners, and a literature review.

3) Identify three programs of sub-Saharan Africa to be subjects for the Institutional Options Comparative Analysis. One program should be a ROSCA-based program or a community-based credit union that can provide significant institutional lessons to Village Banking programs in the areas of liquid, voluntary savings mobilization, ownership rights, and governance. Two of the programs should be leading Village Banking programs that exemplify different institutional options. They should have particular promise for achieving large-scale and deep outreach as well as financial and institutional sustainability.

B) Desk Review II: Membership Turnover

1) Choose four Village Banking programs that are leaders vis a vis their terms of loans and savings, internal account management and ownership structure. Each should be testing voluntary,

liquid savings services and all should be on a path to financial and institutional sustainability. In addition, each program should come from the set included in the SEEP research on loan plateaus and membership turnover. The sample should include programs with more and less frequent meetings and with more and less focus on education and peer support.

2) Clarify the incentives embedded in each program and hypothesize their implications for membership and demand dynamics. In particular, clarify the incentives embedded in the loan terms, savings terms, social components and ownership rights of these programs. Recommend options for redressing incentives that might lead to membership turnover and loan plateaus.

An analysis of loan terms should note how incentives change as the loan terms evolve. For example, it should examine how the effective interest rate changes as loan sizes or periods increase and whether this or other changes in costs and benefits to the client could explain attrition. In particular, it should assess how the joint liability structure affects the potential liability of members as average loan sizes increase. It should also assess the costs and benefits to client and implementing organization of actual and alternative repayment structures. It should also clarify the sustainability implications of the relationship between internal and external account lending.

The analysis should also look at the implications of various savings terms for program sustainability, demand for loans and membership dynamics. For example, programs may require a level of savings mobilization before the extension of the initial loan, may link the increase in size of the loan to the level of savings, or may prohibit the withdrawal of savings unless a member withdraws from the bank altogether.

The analysis should also examine the possible effects of Village Banking social components on membership dynamics. Whether clients perceive these social components as transaction costs or as benefits is likely to influence membership dynamics. Regular meetings and member's assumption of numerous responsibilities are inherent to the methodology. In addition, some programs incorporate educational components or emphasize peer support in the meetings. Clients can perceive these meetings, responsibilities and educational components as burdens or as privileges. The valuation of these social components is likely to depend on their exact nature - the frequency and length of meetings, weight of responsibilities, social cohesion of the group and content and style of the education. In any case, these social components are likely to influence membership dynamics.

Finally, the analysis should assess the implications for membership growth, membership attrition and internal account management inherent in the ownership structure. (see Section I.B.1.) For

example, the lack of relation between member investment and ownership could discourage older members from admitting new ones.

C) Comparative Analysis I: Institutional Options

This comparative analysis will study three programs in Sub-Saharan Africa, two programs based on the US PVO Village Banking model and one either ROSCA-based program or community-based credit union. The latter should provide significant institutional lessons to Village Banking programs in the areas of liquid, voluntary savings mobilization, ownership rights, and governance. The US PVO-type programs should embody different institutional options identified in the desk review as having the most promise for large-scale and deep outreach as well as financial and institutional sustainability.

The analysis should assess each program using the criteria described above under the Institutional Options Desk Review. It should also touch on institutional development strategy, obstacles encountered and lessons learned. The depth of outreach of each program should be described qualitatively and comparatively.

D) Comparative Analysis II: Membership Turnover

This comparative analysis will study membership turnover in three leading US PVO model Village Banking programs identified in the Membership Turnover Desk Review. It will make preliminary recommendations for changes in the methodology to redress methodological incentives for membership turnover.

- 1) The analysis of membership turnover should investigate how the actual levels of temporary drop-out, attrition and loan plateaus correspond to the incentives delineated in the Membership Turnover Desk Review.
- 2) The study should also look at reported reasons for drop-out and loan plateaus. This empirical work should complement research of Freedom from Hunger and the SEEP Network on membership turnover. Therefore, it should focus on members who have dropped out of village banks, the constituency on which the other studies have not focused. The study should test the hypotheses and conclusions from the Desk Review and SEEP research. It should explore causes external to the incentives embedded in the methodology, such as self-capitalization of the enterprise and the availability of flexible internal account loans, as well as incentives internal to the methodology.

The findings of this comparative analysis are expected to provide data for the synthesis paper on the evolution of the Village Banking methodology. It should recommend strategies for addressing incentives for membership turnover and loan plateaus; these strategies should recognize and address the cost and security trade-offs entailed. The comparative analysis should provide useful information on the development of financially sustainable liquid and voluntary savings services for members, the development of more rational systems of ownership rights, and options for the evolution and expansion of credit services to capture additional demand.

E) Synthesis Paper I: Evolution of Financial Products and Methodology

This synthesis paper should provide detailed design guidance on the development of feasible and financially sustainable options for evolving Village Banking methodologies and institutions to meet more demand. These options should address ownership rights; the terms, pricing, and management of credit and savings services; social components and transaction costs; internal account management; and delivery systems. Options that are to be implemented by the village banks themselves should be consistent with village bank management capacity and should not compromise core elements and services that attract Village Banks' low-income and difficult-to-access clientele. As a basis for the design of new services, researchers should identify the features of the village bank methodology and services that attract this clientele. Trade-offs inherent in adopting changes should be highlighted. On the other hand, the prescription of alternative delivery systems should be feasible within the institutions and environments in which these systems would be operating.

The paper should also:

- address the pricing of services to cover costs related to the internal account, keeping in mind the relationship between internal and external account borrowing.;
- assess options for village banks' use of their internal funds. Criteria should include: security, returns, fit with village bank management capacity, flexibility, capitalization of the implementing organization portfolio, and village bank autonomy;
- consider how village banks might structure, manage, and deliver liquid savings services; and
- develop options for apportioning internal account shares and structuring withdrawals. The latter should correct incentives that may have led to mismanagement of the internal account, membership attrition and the stifling of bank membership growth. The aim should be to assure that ownership rights are rational, clear, and simple.
- consider the costs and benefits of various repayment structures and meeting frequencies.

This synthesis paper should build upon on the Desk Review and Comparative Analysis on Membership Turnover, the Comparative Analysis on Membership Turnover, and practitioner experience.

F) Technical Note 1: Cost Management Strategies

This technical note should assess the effectiveness of different strategies and policies for managing costs while maintaining deep outreach. It should identify key policy decisions and trade-offs that affect the management of costs. It should also identify variables affecting productivity and feasible options for new product development and disbursement. Through a case study, it should examine the policy decisions of a particular program and their impact on costs as well as revenues. To the extent possible, it should examine policy and cost data from a set of Village Banking programs to draw conclusions about the effectiveness of different cost management strategies.

The paper should also compare depth-related strategies for achieving financial sustainability. Specifically, it should assess the cost implications of reaching rural versus urban populations, women versus men, single gender versus mixed gender groups, mixed income versus more homogenous groups, and entrepreneurs engaged in agricultural versus commercial or service activities. Finally, it should also identify cost-effective techniques for serving illiterate or less accessible clients in areas with less developed infrastructures.

This paper should include a case study built on first-hand data from a specific, anonymous program. It should also analyze data from a range of programs to draw conclusions about policy decisions and their cost implications. The development of a policy framework should be elicited from interviews with appropriate donors, researchers and practitioners.

G) Technical Note II: Financial Product Innovation

This technical note will document the field testing of some of the innovations set forth in the Evolution of Financial Products and Methodology Synthesis Paper. The exact topic will depend on the content of the synthesis paper.

H) Synthesis Paper 2: Organizational Design

Building on the MBP Ownership and Governance deliverables, this paper should identify in practical terms the institutional and organizational design incentives necessary to assure stable, accountable and sustainable Village Banking programs. The paper should analyze examples of existing organizational incentives within Village Banking programs. This analysis should assess actual impediments to the achievement of scale and sustainability encountered by Village Banking programs at each level of their organizations. The paper should go on to develop simple, practical guidance for assuring appropriate incentives at each level. The framework should address the relationship between the in-country affiliate and the US PVO; the appropriate roles of the board and management; incentives to assure that managers act as owners; structures of village bank ownership that promote village bank outreach as well as sustainability of the implementing organization; and the incentives imposed by donor funding.

The paper should synthesize findings from the Institutional Options Desk Review, the Institutional Options Comparative Analysis, the MBP deliverables from the Ownership and Governance topic, and interviews conducted under this deliverable. Interviews should be conducted with microfinance donors, Village Banking practitioners and senior management in US-based PVOs engaged in microfinance. These interviews should examine the proven elements of success as well as obstacles to achieving accountability and sustainability in Village Banking programs. Interviews should be used to identify how these obstacles might be addressed. Examples should come from both smaller, single-sector and larger, multi-sectoral institutions and from a range of relationships between the US-based PVO and the implementing organization.

III. ASSURING FIELD RELEVANCE

The issues addressed by this topic are critical to sustaining and expanding microfinancial services to large numbers of the lowest-income entrepreneurs. However, analysis will be relevant only to the extent that its assumptions are grounded in reality and its hypotheses, tested empirically. And options will be useful only if they recognize the practical management capacity and commitment to deep outreach at the core of the Village Banking approach. The development of more rational

ownership structures and financial products are critical, yet will be relevant only if they can be managed by village banks themselves. The best assurance of field relevance will be for the research teams to review their work with a steering committee of practitioners on a monthly basis.

Research will be useful if it breaks new ground. Practitioners, donors and researchers have already thought hard about many of the issues identified in this concept paper. Not all of this thinking is documented and less is published. It will be important for the MBP research team to review unpublished reports, to interview practitioners, evaluators and donors extensively, and to be in close touch with the SEEP Poverty Lending Working Group. This will ensure that research is not redundant and builds upon what has already been done.

Research should focus on the future and on the Village Banking "frontier," that is programs that most strongly represent best microfinance practices. For example, access to savings and autonomy in savings decisions is now widely regarded as preferable and a priority for Village Banking programs. Advanced programs are currently grappling with how to implement liquid, voluntary savings within the context of village banking. Research that advances the practice will focus on how voluntary, liquid savings services can be designed and managed to maintain security, proper liquidity and cash flow. An assessment of mandatory versus voluntary savings options would waste research resources essential to assisting leading programs to move forward with these new and important services.

The resources represented by this USAID investment in research are scarce. If used in practical, informed, and future-oriented work, they can benefit large numbers of low-income entrepreneurs through the development of higher quality, sustainable services. Together, practitioners and researcher have already identified the key issues that must be addressed to make this a reality. It is now their responsibility to collaboratively assure that it becomes one.

Specifically:

- A steering committee of three to four practitioners and the Development Alternatives, Inc. research coordinator should be formed with the authority to review and provide guidance on the work of the research teams on a monthly basis. Specifically, the research team will present its findings to date, how it had spent its resources over the previous and how it proposed to spend its resources over the next month. This review would cover the direction, assumptions and implications of their work.

x

- The desk reviews should include a questionnaire and interviews with key practitioners to identify and understand those programs that represent the strongest examples of the options to be studied. These should be chosen as case studies.
- x
- Researchers should observe meetings of the SEEP Poverty Lending Working Group to understand the state of the practice.
- x
- Researchers should present and get input on draft working hypotheses and methodology from practitioners before finalizing them and beginning research.
- x
- Field findings should be reviewed with the staff and management of programs studied. This should occur before documentation and analysis to assure that the context and facts are understood correctly.
- x
- Initial research conclusions should be presented to practitioners to elicit their feedback and then tested in the field
- x
- Practitioners should commit to using fora to publicize research agenda. They should be compensated for their involvement in the research work.

V. RELATION TO OTHER WORK IN THE FIELD

There is a paucity of over-arching analytic work on Village Banking possibly because it is a relatively new methodology. The best is: Village Banking: The State of the Practice produced by UNIFEM/The SEEP Network, 1994, and the GEMINI report, APPLE Grants: Accomplishments and Future Challenges in Anti-Poverty Lending, Robin Bell and Arelis Gomez, 1995. The former provides an in-depth orientation to the methodology, its adaptations and current research issues. The latter updates information on a set of programs, highlights some Village Banking issues and places Village Banking in the context of a set of solidarity group and individual lending programs.

Although focused on one program, Financing Rural Micro-Enterprises: FINCA Costa Rica, edited by Claudio Gonzales-Vega, Ronulfo Jimenez and Rodolfo Quiros in 1996 (1993, Spanish version,) provides some excellent analysis of ownership rights, organizational design and savings mobilization issues.

The following work is relevant to specific topics in the research agenda outlined above:

- Documentation of the Freedom from Hunger/WOCCU collaboration in the Philippines could provide useful information on *institutional options*.
- x
- Ohio State University and the World Bank are collaboratively *studying microfinance apex institutions*.
- x
- The SEEP Network is in the process of a highly relevant study *on loan plateaus and membership turnover*. Freedom from Hunger has also recently completed a study *on loan plateaus and membership turnover*.
- x
- Catholic Relief Services, in collaboration with the SEEP Network, is developing a set of resources on *internal account management*.
- x
- Ohio State University is currently engaged in a study of group dynamics in Banco Sol solidarity groups that may be relevant to the *depth of outreach* issues raised in this research agenda.
- x
- FINCA has completed an internal study to generate its research agenda. The study highlights key policy issues relevant to *cost management* and *depth of outreach*.
- x
- In addition the evaluations, case studies and research of individual practitioner organizations frequently address the issues raised in this concept paper and will provide important data and analysis of the issues.

US PVO Model of Village Banking: Published Resources

Besley, Timothy and Coate, Stephen, "Group Lending, Repayment Incentives, and Social Collateral, Working paper, Research Program in Development Studies, Center of International Studies, Woodrow Wilson School, Princeton University.

DAI APPLE Review, Robin Bell

Holt, Sharon, "Village Banking: A Cross-Country Study of a Community-Based Study of a Community-Based Lending Methodology," Washington, D.C.: GEMINI Working Paper No.25

SEEP/UNIFEM Village Banking: the State of the Practice

Otero and Rhyne, New World of Microenterprise Finance, "The Village Bank Methodology: Performance and Prospects" Sharon Holt

Women's World Banking and International Coalition on Women and Credit Foundation for International Community Assistance (FINCA), January, 1995

US PVO Model of Village Banking: Unpublished Resources

Evaluations of grants funding Village Banking programs. Case studies and internal research studies by Village Banking practitioners; partial list as of 1994 appears in the bibliography of Village Banking: The State of the Practice. Proposals outlining current research of SEEP Network into internal accounts management, dynamics of loan plateaus and drop-outs, and savings services.

US-Based Resource People Familiar with Village Banking: Jeffrey Ashe (Working Capital,) Jacqueline Bass (Save the Children,) Robin Bell (Development Alternatives, Inc.,) Elaine Edgcomb (The SEEP Network,) Arelis Gomez (consultant,) Claudio Gonzalez-Vega (Ohio State University,) Ken Graber (World Relief,) John Hatch (FINCA,) Cheryl Lassen (Lassen Associates,) Dev Miller (Lassen Associates) Candace Nelson (The SEEP Network,) Judith Painter (consultant,) Rich Rosenberg (World Bank,) Kathleen Stack (Freedom from Hunger,) Didier Thys (Catholic Relief Services,) Lawrence Yanovitch (FINCA.)

Sub-Saharan Africa ROSCA-Based or Caisse Villageoise-Type Programs: Published Resources

Bernard, Sophie, "Des Tontines aux Caisses d'Epargne" in Strategies, October-November 1996

Chau-Beroff, "Developing Financial Services in Disadvantaged Regions: Self-managed Village Savings and Loan Associations in the Dogon Region of Mali," in Hart Schnider (ed.), Microfinance for the Poor? Paris: OECD, 1997.

Steel, W., E. Aryeetey, H. Hettige and M. Nissanke, Informal Financial Markets Under Liberalization in Four African Countries, draft presented to the Symposium on Markets in Africa, Stanford University, Food Research Institute, 1996

Webster, Leila and Peter Fidler, The Informal Sector and Micro-Finance Institutions in West Africa, World Bank, 1995

US-based resource people familiar with Sub-Saharan Africa ROSCA-Based or Caisse Villageoise-Type Programs: Ann Marie Chidzero (World Bank,) Pierre-Olivier Colleye (World Bank,) Douglas Graham (Ohio State,) Jennifer Isern (World Bank,) Koro Ouattara (Ohio State University,) Ousa Sananikone (World Bank,) William Steel (World Bank,) Leila Webster (World Bank,) Outside of the U.S. Ernest Aryeetey and Renee Chau-Beroff

VI. RELATION TO OTHER MBP CORE AGENDA TOPICS

Most of the other MBP topics are of immediate and direct relevance to Village Banking.⁵ In particular, the study of organizational design under the Village Banking topic is reserved for late in the research agenda in order to build upon the deliverables from the governance and regulation.

A number of Village Banking-specific issues should be included within these MBP topics or should be added into the Village Banking topic. They are:

- Management information systems for community-managed group-based programs should be included in the Information Management topic.
x
- Individual delinquency reporting in community-managed group-based programs should be included in the Special Financial Management Issues topic.
x
- Relative depth of outreach achieved by Village Banking programs should be included in the Loan Sizes, Lending Strategies and Poverty topic.

Finally, Village Banking programs would provide rich case material for the social intermediation, social safety net, evolution of credit methodologies, market access, and sectoral linkages topics.

These include: managing growth, governance, replication, information management, savings services, regulation and supervision, ownership of microfinance institutions, social intermediation, evolution of credit methodologies, alternative financing mechanisms, institutional alternatives for microfinance, sectoral linkages, market access, and social safety nets.