

Case Studies in Microfinance

**Non-governmental organizations (NGOs) In Microfinance:
Past, Present And Future - An Essay**

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TABLE OF CONTENTS

INTRODUCTION - 4

NGOs IN THE CONTEXT OF OTHER INSTITUTIONS IN MICROFINANCE - 4

HISTORICAL CONTEXT - cautionary parallels - 7

NGOs IN THE CONTEXT OF RECENT DEVELOPMENT ASSISTANCE HISTORY:
FROM ENTERPRISE DEVELOPMENT TO POVERTY LENDING - 9

THE NATURE OF THE MARKET FOR MICROFINANCE - 15

A TYPOLOGY OF NGOs IN MICROFINANCE - 21

HAVE NGOs BECOME EFFECTIVE MICROFINANCE INSTITUTIONS?
AND WHAT HAS BEEN THEIR IMPACT ON POVERTY? - 24

OPERATIONAL AND ORGANIZATIONAL CHALLENGES NGOs FACE IN
MICROFINANCE - 29

WHY ARE NGOs IN MICROFINANCE?: ARE NGOs BEING SEDUCED BY
COMMERCIAL VALUES? - 38

A MORE SENSIBLE DIVISION OF LABOR - 40

BIBLIOGRAPHY - 44

APPENDIX 1. List of CASE STUDIES 50 - 48

APPENDIX 2. List of Discussion/Technical Papers - 49

ACRONYMS AND ABBREVIATIONS

BHN Basic Human Needs

CAF Cooperative Development Foundation

CGAP Consultative Group to Assist the Poorest

CU Credit Unions

GDP Gross Domestic Product

GTZ German Technical Cooperation agency

ILO International Labor Organization

IRD Integrated Rural Development

MFI Microfinance Institution

MIS Management Information Systems

NGO Non-governmental Organization

SBP Sustainable Banking with the Poor

SDI Subsidy Dependence Index

SME Small and Medium Enterprise

SSE Small Scale Enterprise

UNDP United Nations Development Program

USAID United States Agency for International Development

WWB Women's World Banking

introduction

This essay raises questions about the role of non-governmental organizations (NGOs) in microfinance. Based on research conducted by the World Bank under the Sustainable Banking with the Poor (SBP) project, other literature on microfinance, and the author's own experience over the last 15 years, it makes two main points. First it demonstrates that with a few notable exceptions, the record of NGO in microfinance is a poor one. When judged by the two criteria of success that much of the microfinance world has adopted - outreach to the poor and financial sustainability - the results are disappointing. NGO have thus far had trouble achieving both at once - outreach or sustainability generally suffers. There is also little evidence of any aggregate impact on poverty reduction as the result of NGO microfinance efforts.

Second, the essay suggests that NGO, for all their laudable work, may be making a strategic error in focusing on microfinance. While microfinance is never easy for other types of institutions trying to practice it (e.g., banks or credit unions) It is not, as will be explained, a field where NGO have natural advantages. To the extent NGOs reorient their mission, vision and personnel towards the microfinance agenda, as a large number have done in the 1990s, they risk drawing themselves away from work they are uniquely suited to do. Some of this work, moreover, would play a critical role in preparing the ground for microfinance among poor people.

To demonstrate these points, it is important that NGOs be seen in context. Accordingly, both their relation to other players in microfinance and the history of recent development assistance are described. This background helps explain why NGOs have come in such numbers to the microfinance field, and some of the problems they face. Then the record of NGO achievement to date is examined. Finally, a hopefully more sensible division of institutional labor is suggested.

NGOs IN THE CONTEXT OF OTHER INSTITUTIONS IN MICROFINANCE

In 1995, the World Bank's SBP Project began an ambitious survey. Until then those interested in microfinance had an intuitive sense of the movement's growth, but no systematic attempt had yet been made to gauge its dimensions, nor look comprehensively at its results. Collecting program and project names from many sources, the SBP estimated that as of mid 1996 there were more than 1,000 microfinance institutions in over 100 countries, each reaching a minimum of 1,000 clients and with three years of experience under their belts (absent these restrictive criteria the total number of microfinance projects/programs may well be 5 to 10 times that number). A short survey was sent out to as many of these as could be reached and 206 responded. Of those organizations, 73 percent were NGOs, 13.6 percent Credit Unions (CUs); 7.8 percent commercial banks and the rest savings banks.

These four types of institutions: (i) savings banks (including national and postal savings schemes); (ii) credit unions; (iii) commercial banks; and (iv) NGOs, constitute the world of

formal microfinance.

The total outstanding loan balance reported by the survey respondents as of September 1995 was US\$7 billion, comprising about 14 million loans to individuals and groups. The total of deposits was US\$19 billion, comprising about 46 million savings accounts.

Interestingly, commercial banks accounted for 78 percent of the total number of outstanding microloans, and Credit Unions 11 percent. NGOs accounted for only 9 percent, and savings banks (which are not primarily in the credit business) just 2 percent. Also, commercial banks accounted for 68 percent of the total outstanding loan balance, savings banks 15 percent, credit unions 13 percent and NGOs 4 percent. In terms of numbers of clients, commercial banks and credit unions showed significantly greater overall outreach than NGOs. While NGOs' outreach, on average, was deeper; it was also narrow – NGOs reach some very poor people, but they do not reach many. On the other hand, credit unions and commercial banks also serve some wealthier clients so that their average outreach to the poor is not as deep. Still, the indications are that overall, credit unions and commercial banks serve more under-served poor clients than do NGOs.

Sixty-nine percent of the surveyed institutions were created after 1980. The vast majority of these new institutions are NGOs, and there is strong evidence that the birthrate of NGO run microfinance programs and projects continues at a steady pace. Those microfinance operations which did not meet the criteria for inclusion in the survey (those less than three years old and reaching fewer than 1000 clients) are far more likely to be NGOs. There may be thousands of projects, particularly among the indigenous ("southern") NGO community which are reaching anywhere from 20 to several 100 borrowers. NGOs are also more aggressive in expanding their loan portfolios, an indication of their newness, as well as a reflection of the pressures to go to scale. The 1993-1994 median loan portfolio growth rate of NGOs was 49 percent, a rate twice that of savings banks and credit unions.

In terms of outreach, NGOs stand out in one important respect. Female based programs - institutions with a majority of female clients - are primarily NGO run (63 percent of the NGO Microfinance programs in the sample were female based). The NGOs with a majority of female clients tend to offer small and short term loans in the service, small manufacturing and commercial sectors, while banks and credit unions are more likely to provide funds for agriculture, housing and consumption as well as enterprise development.

Sixty-two percent of funding for female-based programs comes from donors (as opposed to 48 percent for male based programs). Furthermore 63 percent of female based program deposits are compulsory. Also, NGOs were the only type of microfinance institutions that had fewer depositors than borrowers.

As the SBP report states, "the growth rate of the loan portfolio was found to be inversely related to the depositor borrower ratio since programs lending from member savings are likely to be cautious in their expansion...rapid growth has been correlated with higher rates of arrears."

Perhaps the most important finding emerging from the SBP Inventory was the reminder that far more people are being served by savings services than with credit. Worldwide demand by the poor for safe, liquid and interest bearing savings instruments is enormous and their capacity to save is evident. NGOs are not however generally involved in savings services. There are several reasons why, but they begin with a fact: As the inventory report states, "The median number of deposit accounts in NGOs is zero, as most programs are not allowed to collect deposits by law or prefer to use concessional donor funds for financing."

A final note on the SBP Inventory: unsurprisingly, regional differences emerged as significant. In terms of outreach, Asia stands out. Twenty-eight percent of the survey respondents were from Asia. And seven of the eight giants in the SBP Inventory survey were in Asia: BRAC, Grameen Bank, BRI Unit Desa, National Savings Bank of Sri Lanka, BAAC, The Government Savings Bank of Thailand, The Vietnam Bank of Agriculture. Only the first two of these are NGOs (though Grameen Bank is no longer purely an NGO).

Of the three regions (Africa, Latin America, Asia), Asia had the lowest dependence on donor funding. Asia has relatively low inflation, high population density, and until recently, steady growth. And Asian institutions also had the smallest median deposit size (US\$40) and loan size (US\$94) The Asian institutions, dominated by banks, have generally better outreach to low income clientele than the other two regions.

A "glass is half-empty" interpretation of the above survey data might go like this: NGOs appear to be entering the microfinance field in minimalist credit ways; their growth unlinked to deposits. In this respect they lack the inherently conservative grounding that comes from basing growth on deposits and which is at the heart of banking best practices. NGO loan portfolios are growing at rapid rates. There is thus some danger that they may run into financial problems, and since they are not deposit-based, NGOs remain highly dependent on donor funds. Moreover their outreach is not all that significant, except among poor women.

The "glass is half-full" view might be: NGOs venture where others fear to tread, especially in female-based programming. And since NGOs are not banks, and are not taking deposits (because they are after all NGOs and in most countries are legally not allowed to do so) and yet are taking financial risks, they thus need donor backing initially. Moreover, since these practitioners are NGOs, and may either themselves become banks (as has happened in a few well known cases), or "graduate" their borrowers to banks, they bring into the formal financial sector an ethos - as well as a bottom line demonstration - that will help assure access by the poor, especially women.

NGOs are by no means all the same (as will be illustrated in detail later). Not all who say they are involved in microfinance embrace minimalism. Indeed the SBP inventory showed that NGOs are more likely than the other three types of institution to offer an array of social services in addition to financial services. The NGOs surveyed had an average ratio of 1.3 social staff to 1 financial staff (in reality financial roles are often added to the roles performed by social staff). Nor do all NGOs in microfinance fully believe in financial sustainability, or even in an eventual elimination of subsidies. Some may even actively resist microfinance best practices on the grounds that these may render them too businesslike and less responsive to the needs of the

poorest.

But differences notwithstanding, there are undeniable trends and expectations. The clear general trend has been for NGOs to get on the microfinance "bandwagon" and then move towards minimalism and towards balancing sustainability and outreach. And donor expectations - about what microfinance can accomplish; about the natural fit between NGOs and microfinance and the promise of poverty alleviation through microfinance - have fed the general trend.

HISTORICAL CONTEXT - cautionary parallels

In development assistance, rapid upward trends may offer more good reasons for bearish caution than they do in the stock market. Given the proliferation of new NGO run microfinance projects since the beginning of the 1990s, a cautionary note seems appropriate and is bolstered by some intriguing historical parallels with an earlier decade in development assistance, the 1970s.

The 1970s saw the rise and reign of two related themes: Basic Human Needs and Integrated Rural Development. These emphases arose as a reaction to the two prior decades of development, when the focus had been almost exclusively on economic growth. Many of those concerned about the poor had begun to deride growth as having very limited or too slow "trickle down effects". And to the extent there even was sustained economic growth as the result of development assistance, it was seen as doing little to reduce social inequities, much less deal with absolute poverty. As poverty began to move to the center of the official development agenda, "growth with equity" became an overriding objective. Basic Human Needs (BHN) and Integrated Rural Development (IRD) quickly became the operational orientation of much assistance. The BHN/IRD movement - which was promoted, among others, by Robert McNamara at the Bank - was taken on by many donors. But one set of practitioners took it on wholeheartedly, the NGOs. They applauded the movement in part because it put people squarely on the development map. One development historian has indeed called the BHN/IRD movement a form of development populism.

By the early 1980s, however, BHN/IRD approaches were beginning to be less attractive, partly because the results were not what had been expected. Observers like John Mellor believed that the BHN/IRD thrust collapsed in part because of its own weight. It expected, and tried to do, too much.

In the hands of NGOs, BHN/IRD was generally practical and action-oriented. This orientation fit well with the "project" approach to development. Even though experience had taught that development takes time, and often open-ended time, the project approach - with an expectation that in finite periods of time (geared to the budgeting and scheduling imperatives of donors and governments) problems could be solved in measurable ways - was at its height in the 1970s.

But BHN/IRD was an extraordinarily complex set of efforts, trying to engineer solutions to a multitude of technical, social, and economic problems all at once. Its strong point was its populist thread; its commitment to the grassroots and to people. The rural community was its venue. And NGOs engaged in a great deal of community mobilization -- organizing people and training them in countless ways. Basic services like water supply and primary health care were two ubiquitous foci. Teaching farmers new techniques was another. Yet, despite these yeoman-like efforts, the BHN/IRD movement may have misjudged its priorities. Among other things, the institutions of the community (to the extent they could be developed) were often left out. As John Lewis writes, BHN/IRD may have performed less well than expected because it "... gave too low a priority to aggregate agricultural output as well as to building human and institutional infrastructure for development." The parallels with microfinance are not perfect, but they are close enough to justify caution about the rise of NGO involvement as direct practitioners.

Consider development assistance trends in the decades following the zenith of BHN/IRD. The 1980s was a trying decade for official development assistance. It was a time of crisis (the food crisis in Africa in the early 80s, then the debt crisis); a time of public doubt and criticism of aid, and within many development assistance agencies, a time of disappointment and disillusion, of lowered expectations, and even some introspection and self-criticism. A new paradigm for poverty reduction was awaited. Several candidates came along (e.g. popular participation) but none really swept the field. Of course development assistance continued and evolved - dams and roads; technology transfer; community development; relief and food-for-work; educational reform; economic policy dialogue; structural adjustment and so on. But none of these filled the prescription for the donors. Increasingly wounded by their critics, among them NGOs, the donors needed something that was at once socially caring and appeared solid enough to promise poverty reduction. Members of a profession do not like to feel malaise or insecurity. Less still do they like criticism. Inevitably a vocation seeks optimism and confidence; a thrust or a theme with promise. By the late 1980s microfinance provided these, along with a new conventional wisdom, just as BHN/IRD did in the 1970s. By the mid 1990s, judging by the growth in the number of practitioners, donors, conferences, and publications devoted to the field, microfinance had emerged as mainstream.

Because so many microfinance programs and projects around the world have been underway for a number of years now, for the first time we have a substantial body of aggregate data, and we can see some limits to what microfinance has been able to accomplish. We find microcredit in particular to be more problematic than we had thought, but that is less a criticism than a reaffirmation of the nature of development. More serious is the growing evidence that, like BHN/IRD in the 1970s, microfinance, especially in the hands of NGOs, has given too low a priority to aggregate output, and to building the human and institutional infrastructure for sustained development. NGOs have focussed microfinance on the immediacies of poverty, and tended to think (as was the case in the 1970s with BHN/IRD) that what they offer (in this case credit) is what people need and can use effectively.

If the parallels between NGO dominance of microfinance in the 1990s and the NGO BHN/IRD movement in the 1970s are informative, so are the differences. BHN/IRD fell apart partly

because it tried to do almost everything, and at once. It was systems thinking translated hopelessly into project practice. In contrast, the distinguishing feature of 1990s microfinance (which for most NGO practitioners is still microcredit), was that it emerged out of a larger, diffuse, and to some extent integrated approach which in the 1970s was called Small Scale Industry Promotion and then later, Small Enterprise Development. But rather than trying to do everything, microfinance set out in the 1990s stressing minimalism - credit only (or sometimes "credit-first") - thus shedding the complexities and ambiguities of marketing; of technical assistance; of enterprise formation and transformation. This minimalism - reducing enterprise development to credit - was another manifestation of populism. The idea was that people know best. They are naturally entrepreneurial, they do not have to be urged or taught to be. They know their business. What they need is credit.

Therefore NGO Microfinance practitioners since the beginning of this decade have concentrated on getting right a more or less straightforward set of tools and techniques, largely adapted from banking. Context and local conditions - the eternal bugaboo of all development models - wonderfully this time, almost didn't matter -- the techniques and vocabulary of credit delivery were universal. The formulae for portfolio at risk, for measuring an effective interest rate, for determining operational costs could be standardized. Clear goals, an emphasis on repayment discipline, tight financial controls, and other standard (and thus universally applicable) techniques all made microcredit attractive to donors. And NGOs, always closer to the grassroots than other practitioners, saw themselves (and were often confirmed in that vision by donors) as a natural medium for microcredit.

As the SBP survey showed, however, while more NGOs get into microfinance, as a group they continue to have less coverage than other kinds of institutions. And yet they seem to dominate much of the dialogue on microfinance, and remain coveted partners for many donors.

NGOs IN THE CONTEXT OF RECENT DEVELOPMENT ASSISTANCE HISTORY: FROM ENTERPRISE DEVELOPMENT TO POVERTY LENDING

How have NGOs taken a prominent role in many discussions of (and much donor agency planning for) microfinance?

Between the 1970s and the early 1990s several once separate strands in development assistance began to interweave. The first strand was mounting concern that poverty was not responding to growth oriented development efforts. If there was "trickle down", it was neither fast enough nor reaching deep enough. Hence a new sense of urgency entered the development assistance field. Second, NGOs, hitherto somewhat on the periphery of the mainstream actors in development, began to be looked at more seriously as partners, because they seemed to be positioned at the grassroots to deal directly with poverty. Third, the dimensions of the informal sector were becoming apparent as more studies of it were undertaken. Fourth, as some important experiments

involving small amounts of credit aimed at very poor people (notably the Grameen Bank) showed that the poor, especially poor women, were highly reliable borrowers, replications of these experiments spread, with NGOs in the forefront.

As these strands of experiment and concern came together, a degree of conceptual clarity was lost. In particular, as lending to very poor people became of interest, their activities began to be seen as "enterprises". Recognizing that these were smaller than what had been called "small enterprises", the term "micro-enterprise" emerged. Inadvertently, an attempt to make a clear distinction ended up blurring a more important one, for the difference between "micro" and "small" enterprise is more than one of size, as will be discussed below. This conceptual blurring has continued over the years and has had effects on current "microfinance".

A brief look back in history shows how the vocabulary (and hence the thinking) surrounding enterprise changed between the 1970s and the 1990s. In rough chronological order the family of interventions from which today's microfinance emerged changed emphases through the following lexicon:

- Small and medium industry promotion
- Small and medium enterprise promotion
- Entrepreneurship training
- Business development
- Small enterprise development
- Business training
- Business Advisory Services
- Small and Medium enterprise credit
- Microenterprise development
- Credit for micro enterprises
- Micro credit
- Minimalist credit (credit only, credit first)
- Microfinance
- Financial intermediation for/with the poor

What appears to have happened is that some basic notions about what constitutes a viable business became sidelined.

The Core Notion of a "Business" and the Many Interventions Which Can Help it Develop

From the late 1970s to the very late 1980s when major donors discussed small and medium enterprise (SME) promotion, the operative term was "business" or "enterprise" and the thrust was on helping them grow and gain a greater share of the market. The developmental assumption was that small enterprises were important net generators of jobs, and that the backward and forward linkages produced by a vibrant SME sector contributed to economic growth. This modified trickle down theory had its limitations as far as benefits to the very poorest were concerned, but as for the next layer up (poor and low income people) modified trickle down seemed a reasonable characterization of what could and often did happen. For awhile the acronyms SSE and SME (for Small-scale enterprise and Small and Medium enterprise) dominated the field. And even though definitions and measures of what "small" meant were wide ranging in the 1970s and 1980s (one ILO study in 1977 identified over 50 established definitions) , the size and type of business to be helped under the old SME or SSE rubric -- both implicitly and explicitly -- were beyond the scope of what came to be called, in the late 1980s, "micro-enterprises". Still, whether small or medium, the common thread was the notion of a business, and it is this notion which was blurred as micro-enterprises - a fundamentally different segment of the market - became a more popular target for intervention. For, the further down the poverty scale one goes, the less businesslike are "micro-enterprises".

It is useful to recall that the quintessential small businesses in many donor discussions 15 or 20 years ago were in the manufacturing sector - these were the ones, it was hoped, which would generate jobs and contribute to GNP growth. In fact the World Bank had to specify other business sectors as recommended targets for SSE/SME promotion, such as construction, retail trade, transportation, tourism, forestry, maintenance and repair, arts and crafts and personal services, like barber shops etc.

By and large a business was understood as an entity that had assets (e.g., equipment), plant (a location in which to operate), and employees (people other than the owner assisting the business on a regular basis). A central, if often implied, premise was that the entity was ongoing - it could be located at a particular place and visited again at that place later on. Research into the problems faced by small businesses led the mainstream actors in the then "small enterprise" field (the ILO, the World Bank, UNIDO, USAID, suppliers of entrepreneurial training like the UK's Cranfield School of Management, and a few NGO practitioners (e.g., the U.S. based NGOs Partnership for Productivity, TechnoServe, and ATI), to agree that the kind of help small businesses needed involved a mixture of some or any of the following:

- skills (business, production, marketing)
- appropriate tools and technology,

- access to materials and other inputs,
- access to information,
- innovations in production process and product differentiation,
- access to transportation,
- access to markets
- financing for fixed assets and working capital

Here, for example, is a list of possible interventions from a late 1970s publication by the World Bank:

- "Direct institutional procurement to SSEs...
- Encourage subcontracting by large firms to small firms...
- Develop industrial estates...
- Broaden lending by conventional development finance companies...
- Provide working capital...
- Devise alternative means of loan security...
- Develop simpler lending criteria and procedures...

It was also recognized that small businesses needed a significant degree of public sector support, in the form of what came to be called briefly an "enabling environment". This included appropriate policies, favorable regulations, and reliable infrastructure. Among others, agricultural economists at Michigan State University had been working on these indirect factors for some time and in 1986 published an inventory of policies affecting employment and enterprise growth, an inventory that included some 29 enabling environment elements under six different policy rubrics (Trade, Monetary, Fiscal, Labor, Output Prices, and Direct Regulatory Controls).

In addition, it was recognized by most mainstream professionals who studied SSE/SME promotion, that still other factors influenced the prospects for small businesses. The political environment is critical; simple questions like whether the country is stable, or whether corruption is widespread need to be asked. The state of the physical and communications infrastructure is also of great importance, as well as the degree to which market linkages are articulated. Finally, there are cultural questions to be asked, such as whether there is a tradition of entrepreneurship, or whether allegiance of the business owner to the extended family creates a social lien on profits. In sum, the field of SSE/SME promotion, in the days before "micro-enterprise", was viewed broadly and in all its complexity.

NGOs, Credit, and Poverty Enter the Scene.

As we have seen, 15 or 20 years ago small enterprise development meant many interventions, only one of which might be credit. The very idea of a special kind of credit for small enterprises was still strange. M.F. de Jong in 1983 felt it necessary to argue "... that there is a great need among SSEs for credit". He then went on to argue for non-conventional types of finance which, he said, "by their nature require less collateral or financial input from the entrepreneur" and secondly "that a real price should be charged for credit."

And 20 years ago, NGOs by and large were not participants in the mainstream discussion of SSE/SMEs. Likewise, when the discussion centered around appropriate institutions for financial intermediation, it was not NGOs, but DFCs, commercial banks, and sometimes cooperatives that were cited.

Even in the early and mid 1980s (when a few NGOs were already doing an early form of microcredit), they were not considered as likely candidates for credit delivery to SSEs. One SSE finance expert argued that because "effective delivery of finance to SSEs is almost non-existent..." there are three possible solutions: first, to "lure" existing institutions into such lending; second, to create new kinds of institutions; and third, to leave it to moneylenders. He does not suggest NGOs as one of the possible new kinds of lending institution.

The mainstream only began to consider an NGO role in SSE/SMEs in the mid 1980s. An ILO conference report of 1986 on Small and Medium Enterprise Promotion notes:

"NGOs are very much underutilised in SME development...Many arguments are advanced for involving NGOs more directly in the promotion of SMEs...Because of their closeness to SMEs and the community, NGO personnel can often make objective judgements about the creditworthiness of a person, business firm or association. This may open the way to extending credit, not against collateral but on the basis of personal knowledge of the entrepreneur or artisan in question."

Meanwhile, the term micro-enterprise began to come into wider use and to be associated more with the informal sector, and hence with poorer people. As the Grameen Bank (which began as a Bangladeshi NGO in 1976) experience in solidarity group lending and that of others such as ACCION became more known, the idea that credit, by itself, could make a real difference, and get paid back, gained wider currency. Subtly, and again inadvertently, a shift began to occur - in the minds of some, credit started to become something to be offered to people, rather than to enterprises.

The Committee of Donor Agencies for Small Enterprise Development gave impetus and legitimacy to the joining of micro-enterprise development and credit minimalism, and in turn their marriage to NGOs. Mohamed Yunus of Grameen Bank was the principal speaker at the

Committee's June 1988 international meeting in Washington, where a large number of issues were debated. It was there that Judith Tendler reported on projects that only did credit (and may have coined the term "minimalist"), and that Malcolm Harper defended a credit-only approach to microenterprise assistance. It was there that the debate on technical assistance vs. credit, (and technology vs. credit) came to its first head. And it was there that NGOs were called upon as naturals to provide credit to the operators of most microenterprises - the very poor. NGOs could do it, it was assumed, because they were both ideologically motivated, and as grassroots practitioners, appropriately positioned. Banks and governments, it was now claimed, could not be counted upon to reach the poor effectively. By 1988, to the extent credit was emerging as a singular intervention, the Donors Committee meeting emphasized the concept of a specialized, new kind of financial intermediary.

To be sure, while the rough outline of things to come could be discerned in 1988, the perspective of the movement remained fairly broad in terms of interventions. As one of the Donors Committee meeting reports noted, "It is generally recognized that financial assistance alone will often not be enough to help small enterprises establish themselves, overcome their problems and grow..." And enterprise development (the expected outcomes of which were productivity, jobs, and hence purchasing power) was still the central focus. But the seeds had been planted for a shift to microcredit aimed at very poor people whose activities were not so much businesses as "livelihood activities".

Outputs

A decade and more ago measurable outputs were expected from SSE/SME development interventions as a matter of course:

"The ultimate output is, obviously, a contribution to the gross domestic product (GDP)...the success of the SSE finance system should be measured according to the impact in terms of development objectives...Sustained employment and income generation, together with the development of indigenous entrepreneurial capacities are the final test of achievement."

Continuing the reductionist trend of the last 15 years, current microfinance as practiced by most NGOs, has relegated these kinds of outputs to the periphery, to the extent they are talked about at all. Some of today's most successful NGO microfinance institutions, as measured by financial sustainability and outreach, give perfunctory treatment to the issue of employment creation.

As the gradual shift occurred away from business and enterprise as the targets of credit intervention, and towards the poor and especially poor women, with NGOs leading the shift, statistics on how many poor women are reached became a substitute for measurable enterprise-related outcomes (which as was tacitly acknowledged are harder to achieve). Ironically, by favoring direct credit interventions with, and holding themselves accountable to, the poor, NGOs and the donors who support them, seem to be making a strategic calculation similar to that criticized by John Lewis with respect to the earlier popularity of Basic Human Needs. Those

NGOs who practice credit minimalism risk having fewer lasting effects on poverty reduction than if they were to concentrate on aggregate economic outcomes and institution building.

From Enterprise Development to Poverty Lending

In the late 1970s and early 1980s when the development objective of SSE/SME promotion was economic output (a contribution to the GDP), it was assumed, not without logic, that the generation of jobs and income would reduce poverty. Again, as NGOs became more involved in microcredit projects, and the poverty focus became more specific and direct, a further conceptual blurring occurred: jobs - in the sense of wage employment - became synonymous with self-employment. A woman trading in mangoes on a road side was less often distinguished from a person working for a wage in a small carpentry shop.

Business and enterprise began to slip to the side of the agenda as less and less sophisticated entities became the substitutes for viable enterprises. As if tacitly recognizing that most of their clients were not businesses in the usual sense, NGOs began to characterize the objects of their lending more as "livelihood activities" or "economic activities". Soon also, we began to see that many loans were going for consumption and not for productive assets. This too was deemed "OK" because it fit well with the urgency many NGOs felt necessary in order to alleviate poverty. Further, as studies of credit use showed that poor women were not only better repayers than men, but tend to use the benefits of credit to help their families rather than themselves, abstractions about the potential trickle down effects of promoting business growth and productivity held little sway.

Inadvertent as it may have been, the process of isolating the world of microcredit from its larger economic context was underway. Political expediency also played a role in this process. The late 1980s and early 1990s was a time of humility on the part of the large players, especially the World Bank, the latter much criticized by NGOs. Thus, embracing NGOs as instruments and partners in poverty alleviation became "politically correct". Microcredit, as practiced by NGOs with their avowed intention to reach the poorest, was a natural added attraction.

Again, it is striking to look back. A short 15 years ago, financial sustainability was not much discussed because it was assumed that formal finance institutions would do the lending, or because subsidized credit was still deemed acceptable. "Micro" was not a term in use because the focus was on small business. Women borrowers as a generic target (as opposed to women business owners) were not much discussed because few business owners were women, and NGOs were not suggested as intermediaries because there were only a handful practicing enterprise work at the time, and they were not considered experienced in financial intermediation.

By the mid 90s the focus had shifted almost exclusively to the action (credit) and the financial health of the actor (the sustainability of the microfinance institutions). The point of microfinance best practice work, a major activity in the 1990s, has been to promote improved operations of the

lender. The World Bank's involvement in the Consultative Group to Assist the Poorest [CGAP], the UNDP's Microstart Project, and more locally, USAID's PRESTO project (Uganda) which, like Microstart, is aimed at small NGOs, are good examples. And while these donors are of course concerned with long term impact, the subtext of their how-to manuals and technical assistance is that the key to recognition in the microfinance field in the late 1990s has become how well you lend and how many poor people you can reach. Concerns about what your lending does to influence growth or create jobs are less in evidence. As a result, NGOs, who after all, care what donors think, take further license to alleviate the immediate effects of poverty.

What started out in the late 1970s as economic goals have been replaced by social goals: redistribution (via reliable and equitable access to microcredit); providing the safety net of consumption smoothing; enabling small improvements in family welfare by aiming credit at women; and women's empowerment. Meeting these important social goals, however, which indeed appear to be met by microcredit, seems to come at the expense of the economic goals. At the heart of the matter is the classic conundrum of those with an empathetic bent - is the goal to relieve symptoms or to cure the disease?

To the extent NGOs have contributed to this subtle but important shift, it is not only because of an ideological bias in favor of the poor. More mundane factors have been at work, ones that have to do as much with the present status of NGOs within the world of development practitioners as with a particular culture of NGOs.

These factors are a generalized impatience with the development process; an impatience increasingly shared by mass publics in the "North", by bilateral agencies and by private donors. Direct attacks on poverty became the defining agenda. Indeed, once "trickle down" was abandoned in the 1970s, few NGOs seem to have looked back to reconsider economic growth. No agency and certainly no NGO can leave out of its mission statement poverty reduction or poverty alleviation. As J.D. von Pischke has put it, the donor urge to scale-up rapidly - behind much of the pushing of NGOs into the risky waters of microfinance - is based on "the fender-bender assistance strategy, to make a dent in poverty."

THE NATURE OF THE MARKET FOR MICROFINANCE

The SBP case studies (35 were commissioned, of which 20 were NGO run microfinance projects or programs) did not systematically attempt to measure demand for financial intermediation (the focus was, as it has been in the industry generally of late, on outreach and sustainability), but in most of the cases the field researchers did interact with a large number of clients and reported both on demand and loan use.

Loan Use

First the studies reaffirm that money is fungible. The more the case researchers probed into and followed loan use, the more they found a large variety of uses (including using loans provided by one NGOs to pay off loans provided by another NGOs).

By far the greatest need among poor women borrowers were loans used to "help raise the family". In more technical terms what such borrowers are doing is ironing out the ups and downs of fluctuating income so that necessary consumption can be maintained. The term "consumption smoothing" (also income stabilization) has come into use to describe such borrowing. If we were to rank loan uses in order of actual frequency of use, regardless of purported purpose, consumption and housing would rank first, working capital (cash flow) for activities in commerce, trade, small manufacturing, service activities and agriculture (e.g., purchase of an animal) would rank second, and loan use for the development of an ongoing enterprise would rank third.

It is of course arguable that loans for consumption, medicine, school fees and so on are in a sense investments in the person and the family as "productive assets" themselves. And for many NGO lenders, such consumption spending is a sufficient justification for microcredit. But there are just as many NGOs claiming that their microcredit goes to a business related loan use, even though we have evidence from many field studies that this is difficult to demonstrate. Moreover, when loans can be more or less reliably connected to an investment in a productive asset, the expectation that this will lead to increased output has not often been met. One of the SBP's studies involved a survey of financial services to microcredit clients in India. It concluded "...the underlying assumption that any poor household can be raised above the poverty line by providing a loan for an income generating asset, has not been found sustainable in practice."

Demand

Since the shift to minimalist credit was premised on the conviction that credit was a critical "missing link" in the economic lives of the poor, it is crucial that their demand for credit be examined. First, the fact that poor people say they need credit does not equal what economists call "effective" demand. One has to look at their capacity for debt (how much debt can they bear without getting into trouble) and their capacity for credit service (on what terms and by what means can they pay down or pay off their debt). Many NGOs tend to emphasize (and assume) the demand for credit, but to the extent they forget that credit is also debt, and then ask questions about debt capacity, they miss an important part of the demand picture.

The poor themselves are very aware that credit, until repaid, is debt. As a result a great many poor people borrow only because they have an immediate need for cash that they cannot see any other way to satisfy, not because they feel they can make use of credit. While the proliferation of microcredit programs reaches many borrowers, there is as great, if not a greater number who are reachable but do not want to become borrowers.

Take the case of a 22 year old high school graduate in a Kenyan town who quit her job in a local company because wages were stagnant, and used her own savings to begin selling second hand clothing in a space about 2.5 meters square. She operates entirely on a micro version of "just-in-time inventorying". She buys stock in the morning, sells it and buys again the next morning. She has opened a savings account in a local bank and saves monthly. She has heard of credit projects operating in her market area (and has been approached by them) but would not want to borrow from them, as she says she is too small to carry the debt.

Her economic activity is first of all a means of survival, rather than a business she is committed to "growing". This is typical of many micro-enterprises. When third world economies (indeed first world economies) come upon hard times, micro-enterprises come into being at faster rates and their products, which are low quality, low priced, and low margin, become in greater demand. As one of the SBP case studies put it, "the demand for products and services provided by micro-enterprises for the local or domestic market rises with overall shrinking incomes".

A summary of "micro-enterprise" characteristics from the literature on the informal sector shows that most "micro-enterprises":

- are generally one person
- got started using own savings, or money borrowed from family
- find easy entry into the marketplace
- are low skill
- experience low or no growth even with financial services
- have high death rates (go out of business)
- have low productivity
- operate out of home or are mobile
- sell whatever they make or serve directly to the consumer
- operate in a market with very high levels of competition (for women this competition is even fiercer)
- which operate in "manufacturing", are in fact engaged in "making and repairing things" of low quality and low value
- which operate in trade are involved in low margin street vending and food services.

Many microenterprises are thus hedges, not ways to build a sustainable growing business. Few are dynamic firms. In the majority of developing countries only a minority of informal firms with four workers or less experience growth of any sort. Indeed informal sector growth comes not

from firm growth but from net gains in firm "births".

While many surveys on "micro-enterprises" report lack of access to financial services as a high priority constraint (and need), in quite a few surveys the top self-reported constraint is not financing (working or other capital) but "marketing". Marketing refers to constraints like saturation, competition, inability to differentiate one's product from those sold by competitors, lack of information, pricing, etc.

Micro-enterprises, as has been stated earlier in this essay, differ from other enterprises not just in size but in quality. While in terms of percentages, microenterprises can benefit from microcredit (being able to buy 50 kg of rice to sell instead of 25 kg is a 100 percent increase in stock), such a change does not necessarily make the product more competitive, or alter the conditions in the marketplace. Nor does such credit necessarily move the clients forward economically, even when, and perhaps especially when, surrounding conditions begin to improve. Microenterprises are not likely to remain viable in any context which begins to be economically well articulated, dynamic and competitive on the bases of skill and quality. And such a context is increasingly pervasive in this age of "globalization".

To the extent non-governmental organizational (NGO) microfinance practitioners aim credit at the poorest operators in the informal sector, they engage in poverty lending and not in enterprise development. As one of the SBP studies stated about such targets, "this sector might not generate high economic returns in terms of employment creation and jobs sustained..."

In contrast, an analysis of the economic situation in many developing countries shows that long term developmental multiplier effects come from working with those firms which are dynamic and more truly viable. As the Zambuko Trust SBP case study put it: "...the economic and social returns from alleviating constraints to dynamic (underlying mine) microenterprise development could be very high...Economic development efforts...should rest squarely with this sector..." The problem is that such dynamic firms are in the minority, as they are almost by definition, not the poorest.

There are likely to be more firms with potential at a larger scale than "micro", but they are generally left out of present day microfinance as practiced by NGOs. One of the reasons is the commitment to the "poorest", and a discomfort with indirect effects. Another is that the perceived need of many NGOs to be self-sustainable tends to restrict their portfolios (at least initially) to short term loans with high turnover. Two examples of this "missing middle":

1. An urban metal work shop in East Africa, with eight full time employees and several old but working machines. The owner is capable of small manufacturing, but operating in a small poorly organized space, with inefficient machines. He has been able to get working capital only once when he had a big contract with Shell Oil. Production of a block machine (based on prototypes which have been tested) which he believes has a ready market cannot be financed. Rent has gone up by a factor of four in the last three years.

Taxes are also not only going up but collection efficiency and enforcement are also. Whereas this entrepreneur was on his way up (tenuously) two years ago, he is now on his way down. He believes that two to three year term financing would enable him to produce and sell the block making machines he has designed. He cannot get long term (2 to 3 year) fixed asset financing.

2. A woman in her thirties with five children and a husband cultivating their land elsewhere, started a woodworking manufacturing business with no capital and no technical skills. She describes herself as someone who can organize things. She gets a commission to build standard design beds, coffee table sets and bureaus, takes a deposit and then buys the materials and hires itinerant labor to do the job. She sits on a bench watching five workers who supply their own tools. She would like working capital to buy and stock materials so she could make furniture to display, and also capital to buy a large planer. Based on five years of experience she believes that US\$2,000 every six months would enable her to move up in her business significantly. She has two savings accounts in banks. She has been approached by an NGO which has told her to get together a group of 25 persons. She says she will participate in this but is not enthusiastic about it as the maximum loan offered is US\$300. She will probably become a client of the NGO but is not likely to benefit significantly.

Many who can make productive use of accessible and flexible loan products cannot get them under current microfinance set-ups. At the same time many people who cannot make productive use of credit are targeted for microcredit, and in some markets have a choice of lenders, as more NGOs enter the field.

As we have seen, in the case of the poor who engage in informal sector economic activities as a means of survival, the demand for financial services geared to enterprise development is low or nil. A better way to characterize their real needs is to talk about "risk management" or "income protection" instead of credit. To paraphrase Stuart Rutherford, the poor by definition don't have much money, so their need to manage what money they have is great.

This is why they use many of their loans for consumption smoothing, i.e., yet another way to manage risk, to protect and stretch income.

Savings, of course, is the ultimate risk management tool. The SBP studies show that the demand for savings instruments among the poor is significantly greater than the demand for credit. Two cases from Latin America are illustrative:

CARE/Guatemala's Village Banking (VB) program, fueled by donor monies, expanded lending outreach heavily in 1994. As a result outstanding loan balance grew at an annual rate of 78 percent between 1993 and 1995. By contrast, voluntary savings mobilization grew during the same period at an annual increase of 215 percent. Moreover in 1993, no VB deposits were used for on-lending to group members. By 1995, 86 percent of deposits were used for on-lending.

In FINCA/ Costa Rica some of the VB internal accounts are greater than the external accounts, a

function of a growth in voluntary savings.

The SBP case studies have repeatedly shown that the demand for savings opportunities is greater than for any other financial service. For example, many female members of group lending schemes like Village Banks, do not take loans at all, or take one loan and then become inactive borrowers, but stay in the group only to continue to save (see SBP case drafts on CARD/Philippines; SBP case CARE/Guatemala).

The Consultative Group to Assist the Poorest (CGAP), part of whose mandate is to help microfinance institutions improve performance, has concluded "...most micro-finance clients want to save all the time, while most want to borrow only some of the time."

Both the literature and SBP's own research confirm that the propensity to save of even the very poor is greater than used to be anticipated. Moreover what the very poor want from savings is precisely what all of us want, rich or poor: convenience, liquidity, safety, and a return that beats inflation.

As Rutherford has put it, savings being what a great many of the poor want, "...it would be unwise to look to financial services as a direct and sufficient means to [impact levels of poverty, or women's empowerment or local employment]. This is especially true of NGOs who are tempted to work with only the credit element of financial services."

The problem for NGOs in dealing with savings is that from a risk-bearing standpoint, savings mobilization and microcredit are not the same. That is why the law treats them differently. From the client's point of view the risks of saving with an NGO are masked by their growing confidence as NGOs show that they are here to stay. But NGOs are not in most cases operating in regulatory environments which permit them to mobilize deposits; they do not benefit from deposit insurance nor can their operations be controlled by bank supervision agencies. And when covariant risk is high as it is when group members are all from the same sector and necessarily from the same community or locality, the tenuousness of the NGO position is even more dangerous to the saver.

In the face of this central dilemma, CGAP recommends what it calls sequencing: that NGOs which do microcredit begin to develop policy dialogue capacity so that the regulatory regime can be changed in favor of NGOs taking deposits. Then they can gradually build savings into their program. But all of this seems unnecessary if we acknowledge that NGOs may simply not be the right kinds of institutions to engage in savings mobilization in the first place. Lending money is one thing, the risk is on the side of the NGO. But the last thing we want is to transfer risk to the poor. Savings mobilization - probably a more valuable route than microcredit to self-reliance and true poverty alleviation - may simply not be for NGOs. However, few NGOs talk much about savings. Since credit is what they offer, this, they seem to assume, is what is in demand.

Finally, in the history of those institutions which are based on what is called a "common bond"; credit unions and the origins of the "ROSCA" (Rotating savings and credit association), Savings and Credit do go together. In both instances savings (deposit taking) are the input and credit is

the output. When Savings forms part of the basis for Credit in a financial institution, that institution does not have to take a problematic, often tortured, path to sustainability; it starts out on a more naturally sustainable path (which does not of course mean S&Cs cannot get into trouble, or that collecting savings in some markets is not costly). NGOs have gone into microcredit with donor monies, and aim towards sustainability without, in most cases, the enormous benefit of voluntary savings mobilization. In short, sustainability in NGO run programs is hobbled from the start. It looks as if the poor want its product (credit) less than they want savings, and all by itself, credit does little for productive asset creation.

If then, sustainable banking with the poor is to be responsive to the poor as a special market for financial services, savings must move into a prominent position. It is somewhat of a mystery why savings have been so under emphasized (though in the last few years there has been more discussion of its importance). Perhaps the fact that savings mobilization programs would not absorb large amounts of donor money is a partial explanation (it is of interest that India's CDF - the Cooperative Development Foundation, a small NGO with indirect outreach to over 25,000 clients (members of the co-ops CDF assists), focuses primarily on "thrift", i.e., savings, and takes almost no donor money). The irony of course is that donors are major promoters of sustainability - which is another way of saying financial independence. Assisting the poor in protecting and growing their savings is not only a clear route to financial independence on the part of the microfinance institution, it is a clear route to financial independence for the poor themselves, and thus highly developmental. NGOs, by emphasizing credit in part because they are precluded from emphasizing savings, may not be serving the poor with as much transparency as we ought to expect.

A TYPOLOGY OF NGOs IN MICROFINANCE

Not all NGOs are the same, and for those in microfinance this is equally true. Differentiating among NGOs in microfinance promises to put in perspective the relative newness of the field, highlight the small number of organizations who appear to be on a successful trajectory in microfinance, and suggest that there is currently a bandwagon effect which should cause concern.

Recognizing that no typology of institutions can be precise, a possible typology of NGOs involved or thinking about being involved in microcredit might consist of these five types:

- i. **Single Method Microcredit Replication Networks.** Those NGOs (whether directed or advised in developing countries by expatriates or nationals) which are linked to an international NGO "family" (as a branch office or an affiliate) or to an international network that focuses on microfinance using a particular methodology. These are

networks which actively promote microfinance expansion. Examples would be:

- ACCION
- Pride Africa
- FINCA International
- Food for the Hungry (a small network, with programs in Uganda, Kenya and Ethiopia)
- The Opportunity International network (which includes Zambuko Trust in Zimbabwe, TSPI in the Philippines, UGAFODE in Uganda etc.)
- The family of "Grameen replicators"
- Women's World Banking

i. **Multipurpose International NGOs which also have microfinance and microcredit components.** Examples would be:

- Catholic Relief Services
- Plan International
- World Vision
- Christian Childrens Fund
- World Learning Inc.
- Save the Children
- CARE
- ActionAid

i. **Multipurpose National NGOs which also have microfinance components, and which are not part of any formal "family", though they may have informal linkages.**
Examples:

- CARD (Philippines)
- AKRSP (Pakistan)
- Myrada (India)

- SEWA (India)
- i. **Microfinance-dedicated National NGOs which came into being solely as Microfinance organizations, were spun off from international NGOs, or which were helped to become significantly invested in microfinance through international donor support.** Examples:
- ABA (Egypt)
 - K-REP (Kenya)
 - Pradan (India)
 - PPPCR (Burkina Faso)
- i. **National, localized, and sometimes community-based (membership) NGOs, generally very small, with few if any linkages to other organizations.** There are tens of thousands of these registered, and their number is growing. Many are entering, or plan to enter the microfinance field. Some have been characterized as "briefcase NGOs", which have come into existence in the hopes of capturing funds.

The first of these five categories represents a strong network of technical capacity and growing lessons learned about best practices (which does not mean these practitioners avoid the conceptual blurrings referred to earlier, nor that all are successful in terms of either outreach or sustainability). In a particular country, even when the Microfinance project is a start-up, the new member of a replication network starts with the advantage of a "family" which can help raise it, as long as there is money to pay for the help available. Though, as will be shown in the next section, the new member often has to learn some lessons from scratch.

The second group is still behind in terms of best practices but seems to be aware of them, because they are in communication with the rest of the microfinance world. The fact that they operate in organizations with other purposes (like relief) complicates their microfinance work.

The third group is worth illustrating by example because there is evidence that its role in microfinance is expanding and being encouraged by donors.

1. Volunteer Efforts for Development Concerns - VEDCO began in 1992. They have been involved in credit in Luwero, Uganda, using group lending among smallholder farmers. They also provide training and agricultural marketing services. As of the end of 1996 total clients numbered about 500. Loan sizes range from US\$120 to US\$700 (maximum). Loans below US\$300 must be secured by 30 percent of the loan amount in savings (roughly a 3:1 ratio) and loans above that require 40 percent in savings. Supported thus

far by Dutch and other European donors, the lending component involved the use of three Loan officers who also undertook other functions such as agriculture and marketing assistance. The program has had serious problems with repayment because borrowers' business activities were not viable, and the cost of lending was very high because of the intense monitoring required, which could not be done sufficiently because of the officers' other duties.

2. Lira District Development Agency - LIDDA is a long established local Ugandan NGO. It is an example of a respected and capable local NGO, with a basically welfare orientation, but which is viewed by donors as a possible participant in schemes which involve credit. LIDDA's Board is composed of teachers, religious leaders and members of Parliament. It has received assistance from International NGOs such as World Learning Inc. (with USAID funding) to undertake a program of orphan care by providing farming implements and seeds to foster families so they can better provide for the orphans in their care. LIDDA was also provided with a grain cleaning machine and was recently under discussion by donors as a possible link in a food security effort which would involve supplying credit to local farmers to grow maize and sorghum for eventual sale to the World Food Program.

One of the potential problems with this type of NGO is the likelihood that they will lend to the poor at highly subsidized rates. Often they are able to do this because they are using money channeled through them from donors who are themselves NGOs. The Zimbabwe Women's Bureau, another small local NGO which is funded by large international donors (in this case, Oxfam), lends at 5 percent to 10 percent interest rates, when in the same marketplace, Zambuko Trust (which is having its own financial problems) lends at the maximum rate allowed by law – 32 percent.

These are the NGOs no one much talks about in major conferences on microfinance, because by definition they are not using best practices and seem not to care that much about sustainability. Some of these NGOs are simply being true to their mission of serving the poor and are comfortable with the idea of subsidy. Others, including many of the NGOs who have added best-practice-based microfinance on to their existing programs, often come face to face with painful questions about their true identity and mission. They begin wrestling with questions like "What are we here for? Are we a business or are we a charity? Can we be bankers and social workers at the same time? Are we here to do good or primarily to be good at what we do? How much should we alter our mission to be perceived as with it?"

The fourth group (national NGOs dedicated to or significantly involved in microfinance) is being taken very seriously by donors and often encouraged by them to consider bank formation.

The fifth NGO group is made up of those who identify themselves as practitioners of microfinance but do not have a clear sense of what this means. They are, in a way, a default category, and would need to be studied in greater depth. They are included here because there are signs that their number is growing and to the extent they get support, they risk doing more harm than good. Their evident interest in doing microfinance is also a sign of how much microfinance

and NGOs are perceived as an appropriate match. The following instance may represent part of the spectrum in this last NGO category:

A local Malawian organization claimed 20 volunteers and five staff and works with people who are HIV positive. Its representative, when requesting support from an international donor, could not supply data or any documentation about their lending program. He could only say that they wished access to funding for lending, and to date had lent 20 loans, "some of which had been returned".

THE RECORD: HAVE NGOs BECOME EFFECTIVE Microfinance institutions? AND WHAT HAS BEEN THEIR IMPACT ON POVERTY?

Outreach and Sustainability

The demands of microfinance in the 1990s are relatively narrow. Measurement, and hence success, has been largely confined to the twin axes of institutional financial sustainability and outreach to the poor (access to credit by the poor). The record from the SBP cases (20 of which were NGOs) suggests that as NGOs in microfinance, often encouraged by donors, come to accept these two goals of sustainability (subject to tough measurements like the SDI) and outreach, (measured increasingly by loan size as a percent of GNP per capita) the following kinds of trade-offs and adjustments are observed:

- Concentrating portfolio growth in high population density areas (thus focussing less on rural areas). Seventy five percent of the SBP NGOs operated in urban or peri-urban areas, and in cases (like CARE/Guatemala) where coverage had begun in rural areas, some drift towards urban targets was occurring at the time of the case research.
- Emphasizing rapid initial loan volume growth, leading to poor portfolio quality.
- Keeping field staff salaries low (or alternatively raising the number of clients per loan officer) in order to control costs, thus tending to high turnover and low morale.
- Moving towards the retail trade and service sectors, those with high cash flow that enable high repayment rates, and thus tending away from manufacturing and from fixed asset lending.
- Emphasizing short-term loans as a strategy for high repayment and loan size growth, thus eliminating cyclical sectors like agriculture.
- Tending to move up the poverty scale away from the very poorest in order to maintain loan demand and repayment rates (75 percent of the SBP NGO cases showed this "upward creep").

With trade-offs like these, a sustainability trajectory is possible in the short term. Operational cost coverage - a step towards full sustainability - is achievable in the short and medium term (there are instances, such as the Alexandria Business Association, of this having been achieved within 24 months of start-up). There are, however, hardly any NGO Microfinance institutions which have so far achieved true sustainability (as measured by the SDI). NGO Microfinance institutions do genuinely attempt to maintain outreach to the poor. But even where they are able to do so, there is some evidence that they are not reaching people who have never before had reasonable access to credit. In only one fourth of the SBP NGO cases did the lender's clients have no real institutional options for credit other than the NGO. And in a third of the SBP NGO cases there was competition from other NGOs offering credit in the same market.

While competition is deemed a good thing in the private sector, NGOs in microfinance (while they may adopt some private sector values), are not private sector institutions. Their (and their donors') premise when they go into an area is that there is an unfulfilled need for credit. This is different than McDonalds and Burger King lowering prices and (presumably) offering more value to the customer in order to stimulate demand and deal with competition. NGOs are not in microfinance to make money, but to alleviate poverty. By concentrating in high volume areas in order to increase cost coverage, their outreach to less dense, but just as needy, areas is curtailed.

Finally, outreach in terms of sheer numbers (as opposed to levels of poverty) is itself problematic. Some NGO programs which are considered veteran successes often took years to scale up and still do not reach large numbers. ADEMI, in its 15th year, had an active client portfolio of 16,000 in an estimated microenterprise population of 330,000.

In general, most NGOs do not appear to be major successes in terms of outreach. When USAID compared 11 microfinance programs from around the world with good records on outreach (as measured by average loan size as percent of GNP per capita), the Indonesian bank programs BKD and LPD had far greater outreach than the next best NGO.

Clearly, balancing sustainability with outreach is problematic, and may be more so for NGOs than for other types of institutions. Yet the current belief that microfinance is an important response to poverty is so dominant that even when the evidence shows that sustainability and outreach are difficult to reconcile, researchers take refuge in the argument that with more experience and higher volumes (scaling-up), NGOs (and other intermediaries) will be able eventually to be sustainable and reach the poor. Here is what one of the SBP's own studies said in 1997: "Despite the correlation between outreach and dependence on subsidies, one can not conclude that outreach and sustainability are mutually exclusive goals...."

Repayment rates

NGOs newly involved in microfinance tend to point first to high repayment rates as an indicator of their success. If there is one universal in microcredit doctrine, it is that repayment rates of close to 100 percent are within reach if the microfinance institutions conducts its operation along

"best practice" lines. Countless examples of real repayment rates over 97 percent prove beyond doubt that the poor can repay debts on time and with high interest.

But, repayment rates have been, in a sense, a false comfort for microfinance NGOs. They have been taken internally as a proxy, not only for institutional performance, but for impact (under the "willingness to pay" theory, if the poor are repaying their loans they must be doing all right financially). "Best practice" explanations for good repayment rates include high frequency collection schedules, tight controls, a good management information system, loan officer incentives, good follow up, and a quick jump on delinquency. On the borrowers' side, the effects of peer pressure in group based schemes, and the attractiveness of products with relatively low transaction costs also explain good repayment rates. But the SBP case studies suggest that in addition to all these explanations, other things are going on as well.

Many poor women repay by borrowing within the family as they did before the Microfinance NGO came along; some borrow from moneylenders to repay NGOs. Second, in those areas where NGOs enter the same markets to increase their chances for high repayments and volumes, the opportunities for "Peter-to-Paul" transactions are also growing. This suggests that some high repayment rates may even be an artifact of the growth of microfinance as a popular development intervention. Third, despite high effective interest rates, which the best NGO Microfinances, to their credit, have accepted as doctrine, these rates are not necessarily perceived as high by the borrowers. They often have had prior borrowing experience (as in depth interviews revealed, even when they initially say they have not), and because of initial small loan sizes, find repayment relatively easy, especially if they are in a high cash flow position as traders in the informal sector. Finally, as expected in best practice doctrine, some borrowers keep up good repayment on initial loans because they hope for eventual access to much larger loans. But, as programs age, we have begun to see this very element of success (loan size growth) become a problem as debt capacity limits are reached.

Particularly in group-based programs, a domino effect (one group member defaults and the rest follow) is now something practitioners have begun to worry about. One third of the SBP NGO cases had experienced this effect by the time of the case research.

It is also quite possible for high repayment to mask other things, client drop-out rates for one, as well as accounting subterfuges. Sixty percent of the SBP NGO cases experienced high client drop-out rates after the first few loan cycles, and a few long established programs have low client retention rates. (For more on why drop out rates are a problem rather than an indicator of success see next section). In these cases repayment rates can remain high, even though loan demand is evidently questionable, because these NGOs adjust by seeking new clients. In 40 percent of the SBP NGO cases, the researchers found distortions or inaccuracies in how repayment rates were calculated. In 55 percent of the SBP NGO cases, the researcher judged the management information systems to have serious flaws. Some reported rates are simply creative accounting artifacts. Other reported high rates may be because group funds (default insurance) have been used to erase the arrears from widespread default.

High repayment rates are not to be disparaged. After all, NGOs using best practice have

outshone traditional banks (which rarely achieve 100 percent repayment) in this regard. The point is rather that NGOs should not take too much comfort from these rates. They are not full measures of financial performance, and can be especially deceiving if the costs of achieving high repayment are also high. Finally, high repayment rates should not be seen as proxies for impact.

Economic Impacts on Poverty

As noted earlier, NGO in microfinance have, in most cases, been unable to address voluntary savings, possibly a more compelling financial service need of the poor than credit, and one which might have greater long term impact. The impacts NGOs have had through credit programs aimed at the poor, are, as a few good longitudinal studies are increasingly showing, limited to alleviating the immediate effects of poverty - consumption smoothing, cash flow smoothing, and to some extent gains in women's empowerment. These are important, and to some extent also developmental, impacts. But economic impacts like widespread productive asset creation have not yet been seen - and this is true of all institutions who lend to the poorest borrowers, not just NGOs. If NGOs in poverty lending talked more about empowerment and other gains, and acknowledged what appear to be limited economic returns to microcredit, their long term credibility would be enhanced.

In any case, current doctrine about lending to the poor emphasizes outreach, and de-emphasizes impact measurement. Indeed, the NGOs represented in the SBP cases were not systematically measuring impact in meaningful ways. As Rhyne and Otero put it in their widely read book, at the heart of the "new world" of microenterprise finance is a shift in focus to the institution providing services - a financial systems approach. "In shifting focus, the financial systems approach necessarily relaxes its attention to "impact" in terms of measurable enterprise growth and focusses instead on measures of increased access to financial services."

Measuring economic impacts rigorously is hard enough. Attributing such impacts to microcredit is harder still. These difficulties certainly play a role in pushing economic impacts to the sidelines. But to bracket impact in this way is to forget that microfinance institutions are not simply traditional banks. Banks are beholden to their stockholders and are not in business to make a dent in poverty. But microfinance is not a product for the financial marketplace just like any other. If it were, it might make sense to look only at market-determined proxies like willingness to pay, just as the sellers of cigarettes construe their profits as sufficient evidence of the success of their product. Microfinance, however, was originally, and still is, intended as a tool for poverty reduction, and NGO Microfinance institutions, despite their different emphases and short term objectives, do share a single larger purpose; they are in business to have an impact on poverty. In the end, we must find out whether access to microfinancial services results in lasting changes in poverty.

In the SBP NGO cases, the impact evidence that was gathered (by the case researchers themselves through client interviews and some survey work) showed consumption smoothing effects along with signs of a redistribution of wealth (and influence) within the household as the

most common impact (75 percent of the SBP NGO cases). And while these impacts are consistent with the mission of poverty alleviation and women's empowerment, explicit in the mission statements of almost all the SBP NGO cases, there was no evidence of any significant increase in community level accumulation of wealth or of lasting reductions in poverty, which is also explicit in some NGO mission statements.

In the end the critical lesson about poverty reduction and microfinance is that we have to return to the complex causes of poverty. In the years when the focus of SSE/SME was on the enterprises of poor people, complexity was reflected in multifaceted interventions. The fact that these proved to be both expensive and difficult to implement does not in any way change our understanding of poverty. Yet to the extent that NGOs (and the donors who support their involvement in microfinance) take on microfinance believing it to be a new and better tool for significant poverty reduction, they forego that deeper understanding.

"From what we now know about the causes of poverty, it is hard to maintain that poverty can be solved by targeted credit schemes alone. Chronic poverty does not appear to be due mainly to "market failure" in credit or other markets, but rather to low factor productivity, and low endowments-per-person of non labor factors. If these conditions prevail, even perfect markets may leave substantial chronic poverty"

The NGO Record Summed Up

There is little evidence of poverty reduction (enough of an increase in net wealth accumulation at the household level to move across the poverty line) as the result of NGO efforts in microfinance. There is evidence of an easing of poverty's effects through consumption smoothing and of real changes within households in terms of women's empowerment, and a redirection of income towards family welfare. But even these latter changes have tended to make the tough balance between sustainability and outreach more difficult. In the end, however, we come back to what today's microfinance scorecard values most - the two axes of sustainability and outreach (access). In that regard what we see are a number of trade-offs which amount to Hobson's choices:

- a. Sustainability is possible with a high tech management information systems, positive real interest rates, and tight, cost-conscious management which focuses on high repayment and volume growth. But it may be at the expense of taking on high risk clients (e.g., the ABA case). In many urban contexts high sustainability with low outreach to the poor amounts to going where the microfinance institution is needed least and is perceived as a good deal (if not in terms of interest rates, in terms of ease of transaction).
- b. One can be on a sustainability trajectory by maintaining a shoestring budget, keeping such an eye on low costs that longer term results are starved to death (inadequate management information systems, management, and follow up; trends towards lowering repayments and growing arrears), and the institution falls back into subsidy dependence.

- c. When microcredit is really targeted for deep outreach to the poor, it is all the more difficult to become sustainable, even when focusing on high density areas and on high cash flow sectors where high repayment will be more likely. Client drop out, and flat portfolio growth without geographic expansion are signs that debt capacity ceilings are reached quickly in the sectors most sought after for high repayments. In the big banking world loan size covers costs. In the little banking world loan volume covers costs, and where debt capacity ceilings are low, high volume growth can only go on for so long.
- d. The further down the poverty scale microcredit (especially short term) is provided, the less likely are we to see enterprise growth and transformation. Likewise, the more there is the potential for enterprise growth and transformation, the less the borrower can make efficient use of small amounts of credit (especially short term credit.)
- e. In the early stages of a program, a financial intermediary can lend on a widespread basis, and appear to be on a sustainability trajectory. The greater the demand for micro credit, the more we see borrower activities at the least sophisticated, most primitive levels of the economy. In such cases it is least likely that credit will be used for increases in productivity or business transformation, and the more likely that it will be used for other purposes such as consumption smoothing. Also, because the poorest clients are resourceful, they do find other means of repaying, up to a point, and therefore their inability to use credit productively will be masked from those whose main interest is in sustainability and access.
- f. The more we see microcredit operations focussed at higher more sophisticated levels of the economy among more genuine business enterprises, the less useful are the small size loans which most NGO microcredit programs restrict themselves to in the name of outreach.

OPERATIONAL AND ORGANIZATIONAL CHALLENGES NGOs FACE IN MICROFINANCE

If the SBP cases are any indication, the organizational problems that microfinance NGOs encounter may be a function of the pressures they feel to meet the twin goals of outreach and sustainability. Half the cases exhibited initial high portfolio growth and fairly rapid expansion, leading to a straining of organizational capacity. These NGOs then encountered problems, including rising arrears and staff turnover. Half also experienced rising costs, which led to compromises in quality. Another half experienced slower than expected growth which also resulted in a lower trajectory towards cost coverage. In 40 percent of the cases, the entry into microfinance seemed to have been encouraged by donors (in a few of the cases in which the author was closely involved, there were indications that what was driving the organization were the ambitions of a charismatic leader to be seen as successful in terms of sustainability and outreach.)

Drop Outs

Drop out rates are rising in many programs that target the poorest borrowers. The phenomenon is a window on poverty impacts as well as on the microfinance industry itself. While in theory drop-outs from one program can be interpreted as "graduation" (moving to a more formal lender), or having had one's credit needs temporarily satisfied, to return to borrowing later on, these do not appear to be the kinds of reasons for dropping out in many of the SBP NGO cases. First, dropping out appears to be related to poverty itself. There is evidence that drop out rates increase as credit ceilings are raised (as clients get past the first loan cycles). Many poor clients want greater amounts of credit but are not always in a position to carry the additional debt, largely because of limited absorptive capacity. Second, there are socio-cultural externalities which are also part of the poverty environment. Often clients drop out because there are cultural pressures on them (especially true for women), or because of migration or family problems. But the third factor is a function of microfinance itself, and increases as the number of Microfinance institutions in an area grows. Clients sometimes drop out because they go to other MF programs which appear to give them a better deal. While this may be good for the client, it threatens the outreach of the NGO lender, something donors are counting on.

Rising Costs

The SBP Zambuko case states that "Zambuko's operational inefficiencies can be attributed both to inefficient procedures and to insufficient scale of operations." This is a classic answer to a common set of problems among NGO microfinance institutions. But in this case, as in many others, there is more to the story.

For example, in many NGOs expenses are often high in the first years. At Zambuko there were initially too many top level staff, with relatively high pay, while field officer staff were not well paid. Staff training expenses were high as a function of (and despite) the fact that Zambuko Trust has a strategic external partner, Opportunity International, which believes strongly in staff training, and encourages its local partners to participate in overseas training, and as the institution matures, to pick up part of the costs. So when Opportunity sponsored trainings in Ghana, Malaysia and the Philippines, Zambuko staff attended and had to pay for travel.

In the case of vehicle costs, it has been seen in this case and others that vehicle use can become a much sought after "perk" among field staff, and vehicle ownership becomes a matter of status for the program itself. A not always conscious desire for status and legitimacy, not uncommon among microfinance NGOs, can drive costs up, especially when donor money is available for start-up operations.

Staffing Challenges

Many Microfinance NGOs show considerable weakness at staff levels. These are often a function of their organizational culture, as well as externalities like the nature of the job market. Challenges worth highlighting include:

- Many NGOs tend to be loyal to their staff and see them partly as volunteers. NGOs which have moved gradually into best practice-based microfinance try to keep staff who are used to disbursing food or grants and make them into people who are supposed to monitor loans.
- The number of clients per loan officer tends to rise as a program begins to grow since management often sees a high client to loan officer ratio as a clear cut way to keep costs down. But in the growth phase, this trade-off is dangerous: low morale, beginnings of turnover, management information systems backlogs, and declines in portfolio quality can result.
- Recruitment of new staff is often done with cost in mind and thus less qualified people are hired because they are cheaper. In a number of programs, staff do not fully understand the goals of the program.
- Well-trained staff will be poached as newer NGO Microfinance institutions come into the same market.

Management Information Systems and Accounting Challenges

Many NGOs in microfinance have rudimentary management information systems and reporting systems. They have not yet learned the value of reliable management information, and if they have in principle, they still need to learn exactly what information is worth getting and how to get it in timely fashion. On the accounting side, cost accounting is a widespread weakness, especially for those NGOs who have entered the microfinance field from a history of multipurpose development work. These NGOs tend to track expenses but not costs - a holdover from the culture of grants common to many if not most NGOs.

But even among those NGOs in microfinance with experience and considerable professional capacity and credibility, there are accounting and management information systems peculiarities that make it very hard for researchers to make fully objective cross program comparisons. "The devil is in the details" is a useful reminder for those who would seek to understand the true picture. Simple things like comparing effective interest rates become a problem when different NGOs use different ways to calculate. While these different formulae may be legitimate, full transparency would require giving the formula used along with the results obtained.

And because NGOs in microfinance are neither banks nor for-profit companies, the choice of what data to report and how to report them is theirs to make. Terms which are standard in banking, like "liquidity", "owner's equity", "retained earnings" can be and are used by NGO Microfinance institutions without necessarily meaning the same thing. And impressive statistics comparing microfinance programs are often based on self-reported data, with no insights offered on how the various measures and ratios were calculated.

Legal Challenges

When NGOs were engaged in non-financial work, the legal and accountability questions rarely came up. In microfinance they are beginning to. In other than membership NGOs (true grassroots organizations), the question of legal ownership becomes important once money becomes the commodity the NGO is "trading in". In credit and especially in savings transactions, ownership is tied to the question of responsibility and ultimately of liability. Few NGO Microfinance institutions have begun thinking about these questions.

Inefficiencies tied to reliance on donors.

Almost all NGOs in microfinance have started their lending operations using donor grant money, and often continue to use grant money for operations for some time. Moreover, as microfinance grows in popularity, donors often cluster around promising projects or NGOs and thus an NGO will have multiple sources of grants. Even the most enlightened donors tend to want to "buy" a piece of a program that they can identify with rather than put their money into a pool with other donors. Yet NGOs with ambitions to become real Microfinance institutions are not so much "projects" as institutions. They want help running the institution. Donors generally do not want to put money into this. Finally, multiple donors often means multiple reports to write, which uses staff resources.

"Graduation" dilemmas

Many approaches to best practice microfinance in NGOs include the expectation that eventually clients will "graduate" to formal financial institutions. In the case of the so-called Village Bank (VB) methodology, the expectation was that VBs would eventually graduate to autonomy and no longer need the external account relationship with the initiating NGO. But experience since the beginning of the 1990s has revealed some dilemmas in this regard. By encouraging the graduation of VBs who are ready, the initiating NGO often realizes that it is about to lose its best performers and those least costly to maintain, which in turn will affect the NGOs record as a microfinance intermediary. As for the Village Banks themselves, some do not want to lose the sense of protection they gain from being affiliated with the mother NGO, even if they have become capable of managing their own affairs. But the majority of VBs simply are not able to

move very far up the learning curve of financial management and quite plainly need the sponsoring NGO's credit officer to keep them functioning.

Group-Based Lending Challenges

Group-based forms of lending (e.g., solidarity groups, village banking) originated mainly for the benefit of the lender; as solutions to two problems faced by microcredit organizations: i) the problem of lack of collateral, and ii) the problem of high transaction costs involved in loan appraisal, monitoring and enforcement. In theory the group serves as a set of co-guarantors, operating through peer pressure and the group members' incentive to keep each other solvent so that they themselves do not lose the opportunity to receive a loan. The group serves also as a way to get around imperfect information, since members of the group know each other. Thus the transaction costs involved in loan appraisal are reduced if not eliminated.

The challenge in group based programs has to do with the other side of solidarity; solidarity can work both on the way "down" as well as on the way "up". It is because of this that we are seeing instances of the "domino effect" where one member defaults and the others follow. The co-guarantor function can also be two-sided. Two members of a five person group might readily sign the loan application form as guarantors, but when they sense that "their" borrower is running into trouble, they will ask to change their guarantorship. And ironically, when groups are most solid in the sense that the members really come from the same small locale, and share the same kinds of economic activities, co-variant risk, often leading to group default, is greater. More important still is the insight from one Bangladesh study that group default can itself be a function of group success.

A group-based microcredit scheme operated by BRAC in Bangladesh was deemed successful - as measured by increases in income of the members. But because of the increased income, the nature of the relationships in the group, and the culture of the group begins to change. Because not all persons in the group are the same, and not all "life chances" are the same, not all the members of the group prospered in the same way. Some became gradually better off than others. A researcher studying the program showed that some members with new income begin to feel that they had less to lose by ignoring group pressure to repay, and thus became defaulters, as a function of the new power of their money, rather than because of their inability to repay.

Learning

Given all the data and studies on best practices, the number of conferences, the high attendance at the Microcredit Summit in February 1997, and the explosion in the capacity to communicate via the internet and email, there are few if any Microfinance institutions which operate in total isolation. In almost every country there is at least one committee of practitioners, one association, or one donor group which meets regularly on microfinance issues. Microfinance

case studies and manuals of practice abound. One would expect that those NGOs lucky enough to be part of a network (like the Microfinance Network), a "family" (e.g., Opportunity International), or affiliated with an international NGO (Women's World Banking), could start up a new program in a country and benefit from the lessons learned elsewhere. But the evidence again is somewhat confounding.

The degree to which best practices and lessons learned can be transferred and applied with ease seems to be limited. Each institution appears to need to learn many of the same painful lessons from scratch. Yet this is not the case with commercial banks. Why this is so with NGOs is explored in part in a later section.

The Mission of the NGO Microfinance Institutions

The mission of the NGO plays an important role in determining what the NGO does in the field of microfinance and how it performs. The variety of NGOs in the world means a variety of missions. By no means all NGOs in microfinance give prominence in their mission to outreach and sustainability; some feel they must present themselves as committed to financial sustainability even though they have internal doubts about it, and do not consider it as the most serious part of their mission. Other NGOs do microfinance and care little about sustainability. By definition, NGOs are private organizations. To the extent they can afford it, they are free to pursue almost any mission. Two mini-cases are presented here to illustrate part of the spectrum.

1. ABA (Alexandria Business Association) was started by prominent businessmen in Alexandria Egypt, motivated to create the NGO in part as a way to counteract a public perception (influenced by years of socialism) of business as an ignoble profession. They also felt a degree of civic pride and a desire to be of help to those less fortunate. With USAID funding, the ABA began a microfinance project aimed at employment generation. Economic development was an explicit goal from the outset. The target population was low income enterprise owners, but at the same time this was not a direct poverty alleviation effort. Loans were for business improvement and transformation, and intended by ABA to create real gains in employment, labor wage increases, and small and micro enterprise earnings. As USAID put it, the overall goal was significant improvements in "resource productivity".

Significantly, the ABA in its first year of lending focussed on the small industry sector (over 80 percent). Two thirds of its assisted enterprises were formal, and over 90 percent of clients were male.

From the beginning the project's mission was tied to microfinance best practices, and singlemindedly aimed at sustainability. ABA's director was well informed about new techniques in microfinance. ABA's philosophy could be characterized as "minimalist

plus". The project contains a non financial services component which it very much believes in as necessary adjunct to credit. But it is a separate entity, financially, and it too is committed to breaking even, though hopes for that are slim. Within the credit operation, however, the ABA's singlemindedness about repayment and sustainability resulted in its achieving operational self sufficiency ahead of plan, (after a mere two years). The keys to this success lay in i) an immediate feedback, high tech management information systems, enabling instant troubleshooting on the part of senior, middle management, and routine follow up by field officers. ii) a well wrought staff incentive system based on repayment rates; iii) a strong Egyptian law regarding the use of checks - enabling a system of post dated checks as both a control and an enforcement mechanism for repayment; iv) tireless leadership on the part of the executive director who had the full support of his board of directors.

Moreover this NGO never had a pure social welfare philosophy which other NGOs struggle to overcome later upon entering the microfinance realm.

So dedicated has ABA been to self-sustainability and high repayment discipline that these goals - at best secondary institutional ones - start to become the primary goals and the very raison d'être for the project. It begins to shift its targeting to trade and services and away from manufacturing; its incentive system for staff creates an incentive to take on the lower risk borrowers who tend to be those less in need. Real impact in terms of employment generated can no longer be demonstrated, as an outside study showed. Though its goals were to offer credit to those who had no access to it previously, evidence in the field suggested that many of its clients were regular borrowers elsewhere and were taking on ABA loans as hedges against an insecure future. A new loan source was being offered, the deal was attractive, so why not take advantage of it.

2. The Philippine NGO CARD (Center for Agriculture and Rural Development) began in 1986 with a mission to work with the landless poor. Initially CARD conducted infrastructure and institution building projects (e.g., deepwell pumps; school construction; cattle distribution; the organization of youth groups etc.). In five of the seven organizations it was helping, CARD was also providing loans to individuals through its Landless People's Development Fund (LPDF) (with loan capital provided by the Asian Community Trust of Japan). But repayment was poor, at best 70 percent. In 1988 CARD's president visited Bangladesh and came back impressed by Grameen Bank. CARD agreed to try a pilot Grameen type effort in 1989. With funding from Australia, CARD trained 89 active borrowers in that year with good results. In early 1990 CARD launched a full Grameen Replication Project, in effect institutionalizing the LPDF project into "a bank owned and managed by the grassroots". The LPDF has since become the centerpiece of CARD's activities.

By October 1995, CARD had 4028 member borrowers (99 percent women). Organized in groups of five in centers of 30 to 40, 781 groups had been formed in 188 centers. A total of 32.98 million pesos (US\$1.27 million) had been loaned. CARD also operates a Center Fund (for

emergencies, education and housing), into which 10 pesos is paid by each borrower weekly. This can be borrowed against at a 5 percent interest rate, paid weekly. By October 1995, the Center Fund had accumulated P2.5 million; savings of members were P361,000, and the Mutual Fund (insurance, a relatively new scheme) had reached P128,000. CARD also offers a "productive enterprise loan" which can go up to P50,000. Only 16 of these had been loaned as of November 1995.

While the organization pays some attention to the terminology of banking and enterprise development (including the goal of sustainability), CARD is clear that local reality dictates that its most important objective is augmenting the income of the landless poor. As CARD's operations manual states:

..."teaching a man to fish" is of questionable application to this [landless rural worker] sector because it has neither access to nor prospects of any "water" in which it could "fish".

While each member must report on the progress of her business during the prior week, it is not difficult to use as much as two thirds of a small loan for consumption, and still generate just enough income to pay the loan charges.

Over the lifetime of the program (five years) the member drop out rate has been 29 percent. CARD cites multiple reasons, including poor training, poor judgements on debt capacity, or because loan amounts are too small to be of use in adding value to the business, or because the business is incapable of adding value.

The evidence suggests however that the real problem is the limited absorptive capacity for capital of the activity engaged in. An analysis of 393 loans taken by 143 active borrowers in four centers showed 40 percent of those borrowers changed their "business" activity as they moved up in multiple loans. For example, Colita Tolentino, a member of Center XI, took four loans between 1990 and 1993, the first for Swine breeding, the second for "Buy and Sell", and the third and fourth for "Mini-bakery". Adding value to a business in any real sense is problematic, not the least because often one activity is terminated and another one entered into.

The analysis showed the following activities engaged in by the active borrowers:

Activity	Percent
Hog fattening or breeding	26.6 %
"Buy and Sell"	15.3 %
Sari sari store	12.2 %

Growing fruits and vegetable for sale	9.9 %
Cooked food or mini bakery	3.0 %
Peddling/vending	0.75 %
Animal trading/slaughtering	0.75 %
Dressmaking or RTW	1.5 %
Other	1.0 %

Almost all of these activities are rudimentary, marginal, very part time, and in the case of sari sari "stores", a few shelves of goods set up in or right outside one's house. With the exception of 11 loans out of 393 (for dressmaking, RTW production, transport, toy making, and window making), the other loan activities all involve skills which virtually everyone in the community possesses, and which anyone can apply.

These loans exist principally to provide augmented income. CARD is not lending in a minimalist way; nor is it selecting borrowers on the basis of prior demonstration of "viable" business activity. CARD does not require that first loans go only to a proven existing activity.

Though CARD uses terms like "project" or "business" or "income generating activity", it does not really intend to do anything but what it is doing - using community organizing as a basis for changing attitudes, then building on top of that a small loan program. The loans, a tangible good, reinforce the community organizing, and the community organizing appears to reinforce the viability of the loan program. But the loans themselves, it should be clear, have a modest utilitarian goal: they are to help poor women manage their day to day lives better than before.

At the same time, the organization feels neither great internal nor external pressures to demonstrate sustainability at the expense of other objectives. Rather it has taken on this "new" goal, while remaining faithful to its "old" mission - community organization and conscientization. To the extent that CARD is able to move towards financial sustainability, one major reason is its low staff salaries, a policy dictated not only by cost consciousness but also by its philosophy and mission. In any case CARD is unapologetic both about these low personnel costs and about not yet having achieved sustainability, and insists on anchoring its present financial intermediation role in its founding principles.

CARD exemplifies a large number of NGOs around the world today. They are small, led by committed people, staffed by young idealists, and limited in their scope and their ambition. At the same time they are not so limited in ambition that they are uninterested in expansion and immune to the impulse to seek recognition. They often do want to expand, and seek a modicum of recognition, and both these ambitions are fueled by their being increasingly in contact with others and more and more aware of new ideas and standards of performance for NGOs of all

stripes. As such, CARD is instructive in the microfinance field. It has taken on a microfinance role (initially as just one of its efforts, but one that has come to dominate its program). It seeks to achieve sustainability but does not want to give up its original mission of community organization among the very poor. It has not given much thought to impact beyond what it can see on an everyday basis - women having some small amount of extra income which serves to smooth out some of the roughness in their lives. It hopes still that a change in attitudes will be the real result of its efforts, and to that end microfinance is yet another tool which it has learned to apply. One feels, however that if pushed hard to achieve true sustainability (from a strict SDI point of view) it would opt to continue doing things in the way it has, even if that meant giving up sustainability. Does CARD then represent a case of "old wine in new bottles"? Is its foray into microfinance somehow "ersatz" because its commitment to sustainability is less than total and its approach far from minimalist? Maybe, maybe not. CARD is a reminder that NGOs who feel relatively sure of their work and have modest, often local, goals, can without embarrassment use subsidized microcredit as a supplement to other work, providing they can continue to find a supportive donor.

WHY ARE NGOs IN MICROFINANCE?: ARE NGOs BEING SEDUCED BY COMMERCIAL VALUES?

The NGO lot in general is not an easy one today. They have moved from the fringes of the development assistance world to its center. Their original promise as organizations with deep commitment to the poor, who, unencumbered by bureaucracy, act at the grassroots by working directly with people, has been taken at face value by many donors. It is precisely for these reasons that many NGOs were encouraged to enter microfinance in the first place, and why in the 1988 Donors Committee meeting NGOs were seen as naturals in this field. Indeed, a few NGOs (ACCION, Grameen Bank), were genuine pioneers in microfinance and showed the skeptics that poor people without collateral could repay small loans with interest.

But NGOs must now meet all kinds of new expectations rather publicly. The days of being hard-working voluntary organizations, tackling local problems, and (almost thankfully) ignored by the larger actors in the development industry, seem to be over. As if this was not hard enough, NGOs today exist, like other organizations, in a troubled world of development assistance, as evidenced by the shrinking flow of official resources, and the competing rise of private capital flows to developing countries. Yet, at the same time, the number of NGOs continues to grow, in part as a response to the world's belief that they can make a critical difference. The resulting competition for funding and recognition adds significantly to their dilemma.

NGOs want to do good, but recognize that in today's climate this is not enough, especially in microfinance. They must be seen as tough, accountable, businesslike, and professional. To be taken seriously by most donors, they must strive to meet the twin test of sustainability and

outreach, which as we have seen, almost always means difficult if not wrenching changes in the way they work. In microfinance, many (though by no means all) not only want to be seen this way, they embrace these new values. It appears that many NGOs in microfinance are being tempted away from their origins as well as some of their inherent capabilities. Increasingly, the temptation to achieve greatness in microfinance is based on the same standards used in the corporate sector - success is about numbers and volume, efficiency, product and productivity. Are NGOs in microfinance living in a for profit private sector illusion?

According to Mann, Grindle and Shipton, referring to NGOs in the microenterprise field:

"...their greatest strength is their idealism and their skills in working with low income and disadvantaged groups. Business skills must not be purchased at the cost of these qualities or the organizations will endanger their identity. The deep sense of commitment that motivates these institutions must remain their central feature."

And others, looking at the development field as a whole, also expect much. As economist Jagdish Bhagwati has said recently, "Those values [of civil society and of democracy] are better advanced...by the political and financial support of the numerous and growing NGOs, both here and abroad, that work ceaselessly to nudge the world in the right direction"

But what is the right direction? And how does an NGO keep the pressures on it from subverting the organization's sense of its own path? And how does one maintain the kind of balance that Mann et al., expect? Few NGOs have been able to do this. In NGO microfinance, the tendency to go too far in one or the other direction (too unbusinesslike, or contrariwise, too businesslike) is pronounced. As one of the SBP NGO case writers put it about the efforts of a Colombian NGO (Corposol) to become a formal bank (Finansol):

"The Case of CORPOSOL is one of the few experiences in the world of an NGO "converting" itself into a formal financial institution. The decision was adopted because as NGO they realized their capacity for growth was greatly limited. Nevertheless, the transit has been full of difficulties some of them arising from the Colombian legislation, but also some from an inadequate preparation of the NGO as a financial intermediary...One of the principal difficulties is that by remaining on the CORPOSOL staff, the credit analysts did not identify with the requirements compulsory to a formal intermediary, which led in part to FINANSOL's insufficient control of the default in payments."

As has been seen several times now in NGO microfinance, an institution which used to live in the world of grants, now lives in the very different and tougher world of banking. Before it has the chance to achieve mastery in any one area, it has to grow, control expenditures, and increase the quality of its portfolio all at the same time. How is an NGO, if it is to remain primarily a non-profit voluntary organization, to become sufficiently self-sufficient so that donors one way or the other will not dictate terms that in the end compromise the NGO's own experience, and in general their ability to be responsive to beneficiaries and changing circumstances? How can management plan for the future, when donors and funders do not usually provide unrestricted core support, but instead continue to want to fund "projects"? And how, realistically, can NGOs

work effectively and collaboratively with other organizations - a key to increasing their impact - when much of their effort has to go into creating a distinctive identity that will attract donors?

Naturally, the pressures, the questioning, and even the language of the new roles (the lexicon of banking) have had costs to internal identity. Many NGOs in microfinance ask themselves: What is our role? Are we "hard" or "soft"? Who is our audience? Who is our primary constituency? How do we present ourselves to donors, to our public?

The following conclusion of a review of microfinance projects by one large NGO reveals in an understated way, part of the dilemma:

"The benefits and costs of integrating savings and credit with other project activities in different ways need to be carefully considered in continuing to operate integrated programmes....This analysis therefore leaves the quality of AA's S&C work for poverty reduction open to question and raises the issue of how AA wishes to position itself in regards to wider debates. AA would do well to consider these concerns."

Finally, there are trends which are surprisingly reminiscent of private sector corporations, especially the desire for recognition. The top NGOs in microfinance and their leaders want to make their mark. They know the financial resources for development are dwindling. They are looking for opportunities for public relations. They are also looking for praise; they want a reward for years of real devotion to a cause. But in their hope for recognition and legitimacy within the new world of microfinance, they could be at risk of losing the core mission of their organizations, or believing too glibly their own public relations.

A MORE SENSIBLE DIVISION OF LABOR

This paper has pointed to the difficulties most NGO Microfinance institutions face in coming to terms with both sustainability and outreach, as well as the lack of hard evidence of poverty reduction as the result of their work in microfinance. It has highlighted the limitations of the microfinance market (the very poor, if not the poorest) in which NGOs try to work, the inherent multiple challenges of poverty, the organizational challenges of NGOs in microfinance, and finally has suggested that NGOs have not learned as well as they might from the lessons of development history.

In the face of this critique, one could argue that microfinance is a young field; that limited results or even failure are to be expected, especially of organizations with little experience, and so on. In the face of the implication that many NGOs and their donors have put too much hope on credit alone as a key to poverty reduction, one can argue that of course most of them know - even if they do not say it - that credit alone is not enough. While such arguments would be fairer to NGOs, they skirt the issue of what is fairest to the poor.

We do not say here that no NGO should engage in microfinance. Or that some sincerely engaged NGOs should not be allowed a learning curve. (Nor, certainly, that credit should not be made available to and accessible by the poor.)

Rather this essay is an attempt to sort out a number of problems with the NGO involvement in microfinance. First, there is a disturbing "bandwagon effect" at present, one which encourages poor practice and threatens to reverse the positive accomplishments of microfinance. This bandwagon effect can be laid partially at the feet of an undue hyping of microfinance (as witnessed by the Microcredit Summit in 1997), in which both donors and NGOs are complicit. Second, development assistance funds seem to be subject to a zero sum calculus. To the extent microfinance is what donors want to fund more of, it will usually mean funding less of something else. If that calculus is at the expense of more complex (and less sexy) investments in what used to be called enterprise development, more lasting effects on poverty reduction will be foregone. Third, a major source of illusion (and hype) in NGO run microfinance thus far has been the unrealistic expectation of balancing outreach to the poorest with sustainability. As a result subsidies have become something many NGOs are afraid to admit are still needed - and not just to start up operations.

The implicit question is: Does it makes sense for so many NGOs to become involved in microfinance, and so many donors to believe in a comfortable fit between the two? A few NGOs having shown the way, would it not now be simpler and more cost effective for donors to invest in banks and credit unions as deliverers of microfinance? As for NGOs, the great majority may well be better suited to other roles in support of microfinance (some of which are suggested below). And some experienced NGOs in microfinance are moving in this direction. In short, to be effective with respect to credit does not mean one has to offer credit. As a Norwegian report on NGOs in Bangladesh put it:

"An NGO should be able to work with a village organization in strengthening their knowledge about health and sanitation, and then refer them to a Government health clinic...Similarly, an NGO should be able to facilitate access to credit from a bank without necessarily becoming a credit organization itself...This last point is particularly important, since the success of micro-credit programs in Bangladesh has led to a belief among most NGOs that they all have to run their own credit program...."

The social intermediation role

The term social intermediation is meant to suggest that there is another kind of intermediation (other than financial) that institutions can engage in which also supports microfinance. Social intermediation implicitly acknowledges that many poor clients of microfinance are simply not in a position to use loans productively. Social intermediation refers to a range of activities that either prepare people to become good borrowers and savers; better manage their own finances or

their own financial groups; and help them to put whatever "social capital" they have to more productive use.

Because social intermediation activities mean interacting closely with people at the grassroots, these activities are a good fit with the classic characteristics of NGOs. The trade-off of course is that such interventions are not likely to be financially self-sustainable. They need instead to be seen as human capital investments.

NGOs as Poverty Lenders - Accepting Limits

Those NGOs committed to a role in microfinance need to decide what is most important, being sustainable lenders or reaching the poorest with financial services. To do both at the same time, for all practical purposes, is highly unlikely. If some NGOs want to reach the poorest with financial services, they need to face certain realities. First, what they are doing is poverty lending and not economic development or enterprise development. Second, they should realize what the likely impacts will be. Changes in people's lives will be immediate in terms of lightening the burdens of poverty, but small loans to the poorest will not bring them permanently out of poverty. Third, only if it becomes possible for voluntary savings deposits to be the basis for lending (still a doubtful prospect for NGOs in most places), will sustainability be within reach.

Other Non-financial roles in support of effective enterprise development

The recent World Bank Policy Research report "Assessing Aid" concludes that sound policies and institutions are the supreme enabling factors. If official aid is provided in an "unreformed" economy; if aid is provided in a "bad" policy environment with poorly managed institutions, it is essentially wasted. In terms of payoffs, the logic of influencing contextual factors is persuasive; changing the "enabling environment" for enterprise growth would have more multiplier effects than providing technical assistance or credit to a few hundred small enterprises. And even NGOs can influence policy. But certainly NGOs are positioned at the community level to educate and prepare local institutions and people to be able to make more effective use of the opportunities that better policies at the top may create.

There are roles for NGOs in easing the constraints on economic productivity faced by the poor other than providing access to credit. These roles are, however, likely to be harder to undertake, take longer, and may require additional skills, but they are also likely to have more long term pay-off. Moreover, few NGOs are involved in these kinds of interventions. For these reasons,

such new roles would make sense for only a minority of NGOs, those with a particularly good ear to local economic realities on the ground, and those with an institutional culture of patience and perseverance. A few examples of such interventions follow.

Information and the Marketplace

One of the arguments for minimalist credit is that those poor who are engaged in some kind of economic activity already know what they need to know about business and are missing only credit.

But in reality, they do lack quite a lot of information and knowledge. As Joseph Stiglitz has said about farmers: "...while peasants may, in many respects be rational, responding to market forces, they are not fully informed about the consequences either of their actions, or of the institutions through which they operate. Indeed, how could we expect them to be, when we, who have devoted our lives to studying these questions, are ourselves uncertain? Small, poor, traders and farmers are not only not fully informed, but are often surprisingly ignorant of forces operating around them. Likewise, neither markets nor enterprises are perfect, and this is especially so in the developing world. Again information is key. The reality of the developing world's marketplaces is eloquently captured by anthropologist Clifford Geertz:

"The search for information - laborious, uncertain, complex, and irregular - is the central experience of life in the bazaar...In the bazaar information is poor, scarce, maldistributed, inefficiently communicated, and intensely valued. Neither the rich concreteness of reliable knowledge that the ritualized character of non market economies makes possible, nor the elaborate mechanisms for information generation and transfer upon which industrial ones depend, are found in the bazaar: neither ceremonial distribution nor advertising: neither prescribed exchange partners nor product standardization. The level of ignorance about everything from product quality and going prices to market possibilities and production costs is very high, and much of the way in which the bazaar functions can be interpreted as an attempt to reduce such ignorance for someone, to increase it for someone, or to defend someone against it."

Many if not most markets in developing countries are primitive and inefficient, and often do malfunction in the sense that they are not articulated - the parts and the players do not intermesh as well as they could. People of course do their best in such situations, but this does not mean that the system works well. The same can be said for many if not most of the economic activities the poor engage in. They are inefficient and most of all exist in an unarticulated relationship with the local economy, and often in no relationship at all with a regional or national one. Not just the survivalist, but the genuine entrepreneur suffers greatly from lack of knowledge and information. Moreover, entire commodity subsectors can and do go wrong. And NGOs (some of them) can do something about it.

Robert Klitgaard tells, for example, of a major failure in the Pakistani shrimp market:

" The competitive Pakistani shrimp market did not work well... and again a culprit was poor information and resulting distortions of incentives. Because the local auction did not reward fishermen for catching larger shrimp, they caught too many smaller shrimp, and both the catches and the revenues were less than optimal. The export market did not possess institutions to gauge and reward the quality of the shrimp of individual Pakistani processors. This allowed undersizing and other abuses such as the export of decomposed, filthy, and salmonella-infested shrimp to the United States, with the result that the Pakistani shrimp exports were blacklisted by the U.S. Department of Agriculture".

It is not hard to imagine a small, well-run, focussed, grassroots-oriented NGO taking on the task of working with both local fishermen and those who run the auctions to help deepen their understanding of the situation in which they find themselves. At the same time it is easy to see that such a project might not have clearly measurable inputs or outputs, and might depend for success as much on interpersonal artistry as on technical expertise. And if it did work to change things, where would the glamour be in such custom-made and complex solutions?

Innovation and Other Facilitating Roles

Small businesses (and dynamic microenterprises) need to develop skills. NGOs can assist in this by creating institutions to train and teach, or working with existing institutions to make what they teach more relevant to the clients. Small businesses (and dynamic microenterprises) need to develop the capacity to become and remain competitive. NGOs with good community organizing skills can work to get businesses to pool resources within a subsector to develop new products, new product designs, or new techniques for production that maximize local resources. Policy level constraints at the subsector level can be identified by NGOs who know the local market terrain, and NGOs can bring these issues to the policy making table. Information about trends in other markets can be disseminated to small and micro businesses by NGOs. If lack of equipment or technology is a constraint, or lack of knowledge of how to find the right equipment, NGOs can play a role in locating and facilitating the procurement of the necessary equipment for new products. NGOs can provide linkage services that enable apprenticeships, or business to business sub-contracting. These are just some possible facilitating roles.

NGOs are in a position to know their clients and their clients' constraints in detail. That knowledge can be put to real service, and can benefit the poor in lasting ways. But interventions like these are difficult, time-consuming, staff intensive, and not sustainable in the short term. They need subsidy.

The more NGOs who are in microfinance face the challenge of helping to bring about an increased articulation of the parts and the players in a local economy, the more they may need to involve such non financial services. The effects of such services are difficult to measure in the short run. But NGOs can take on such tasks, many already do so. Unlike banking, working to

facilitate the productivity of small businesses is really an art. And again, because of their grassroots orientation; because of their commitment; because they are (in theory at least) less bureaucratic and encumbered than large development assistance organizations, they are capable of overcoming a subtle but important barrier to successful facilitation - the "packaging" of knowledge and skills.

A quarter of a century ago, Judith Tandler wrote:

"Development know-how was spoken about as if it were like capital - a stock of goods capable of being transferred from its owners to the less privileged. But development knowledge is not simply a stock with transferable properties. The peculiar nature of the development task makes knowledge a product of the transfer experience itself.... The transferred resource is both input and output of the transfer process....The rationale behind development assistance, in sum, causes donor organizations to surround themselves with a protective aura of technical competence...This makes it difficult to generate the experimental environment necessary for their work."

If NGOs can recall a time when they were not afraid to experiment, when they felt freer to admit that they did not have all the answers, they could put their natural capacities to these kinds of uses.

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APPENDIX 1. List of Case Studies

SUSTAINABLE BANKING with the POOR

List of Case Studies

- *Albania: Albanian Development Fund (ADF)*. Joanna Ledgerwood. May 1999.
- *Benin: FECECAM*. Cécile Fruman. June 1997. (Also in French).
- *Bolivia: Assessing the Performance of Banco Solidaro*. Peter Fidler. August 1998. (Also in Spanish).
- *Burkina Faso: Le Projet de promotion du petit crédit rural - PPPCR*. Julia Paxton. August 1997.
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- *Zimbabwe: Zambuko Trust*. Peter Fidler and Mohini Malhotra. April 1997.

APPENDIX 2. List of Discussion/Technical Papers

SUSTAINABLE BANKING with the POOR

List of Discussion/Technical Papers

In English:

- A Worldwide Inventory of Microfinance Institutions
- An Inventory of Microfinance Institutions in East Asia and the Pacific
- An Inventory of Microfinance Institutions in East, Central and South Africa
- An Inventory of Microfinance Institutions in Latin America and the Caribbean
- An Inventory of Microfinance Institutions in South Asia
- An Inventory of Microfinance Institutions in Western and West Central Africa
- Credit Unions in Latin America: Recent Performance and Emerging Challenges
- Financial Sustainability for Credit Programs: A Travel Survival Guide
- Indonesia's Rural Financial System: The Role of the State and Private Institutions

- Microfinance Handbook: An Institutional and Financial Perspective
- Microfinance Practical Guide for World Bank Staff
- Outreach and Sustainability of Member-Based Rural Financial Intermediaries in Latin America
- Outreach and Sustainability of Savings-First vs. Credit-First Financial Institutions: A Comparative Analysis of Eight Microfinance Institutions in Africa

In French

- Inventaire mondial des institutions de microfinance
- Inventaire mondial des institutions de microfinance en Afrique de l'Ouest et du Centre
- Le système financier rural indonésien : rôle de l'État et des institutions privées
- Taux de pénétration et viabilité financière des institutions de micro-finance privilégiant l'épargne ou le crédit: une analyse comparée de huit institutions africaines

In Spanish

- Inventario de instituciones microfinancieras en Latinoamérica y el Caribe
- Inventario mundial de instituciones de microfinanzas
- La autosuficiencia financiera: una guía básica para programas de crédito en América Latina