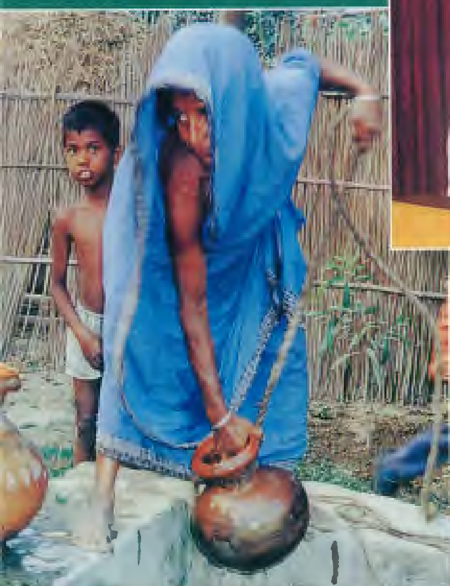
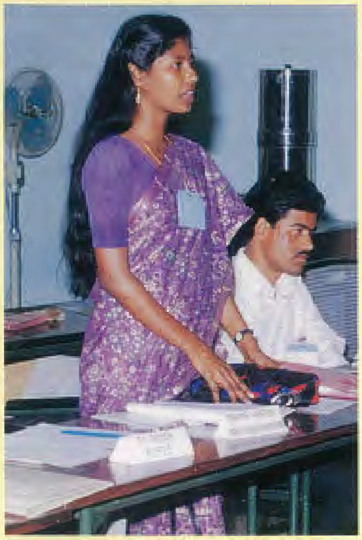
Best Practice of Banking with the Poor



THE FOUNDATION FOR DEVELOPMENT COOPERATION

Peace has brought a population boom to Cambodia: will it also bring a financial system capable of providing credit to the parents of these children?

Outside Kathmandu, children crowd around an NGO fieldworker while he calls the roll at a meeting of a self-help group.



An NGO leader addressing a forum of non-governmental organisations in Bangalore. NGOs must exchange information and coordinate, to deal with banks and government and to attract external assistance.

THE FOUNDATION FOR DEVELOPMENT COOPERATION

Best Practice of Banking with the Poor

A review of Asia–Pacific experience in implementing Banking with the Poor with conclusions and recommendations adopted at the Third Asia–Pacific Regional Workshop on Banking with the Poor held in Brisbane, 21–25 November 1994

Prepared for the Third Regional Workshop and edited by a research team consisting of

J. D. Conroy, K. W. Taylor and G. B. Thapa

The report is based upon information supplied to The Foundation for Development Cooperation by leading Asian banks and non-governmental associations, governments, central banks and bank associations, and by international financial institutions and aid agencies.

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Foreword

Perhaps the most significant landmark in the advance of development cooperation during the 1990s has been the establishment of sound commercial mechanisms to provide access to credit for the very poor.

The Foundation for Development Cooperation has undertaken a major project, **Banking with the Poor**, over the last four years. This project has involved action research through case studies carried out in conjunction with commercial banks and non-governmental organisations (NGOs) in eight Asian countries. Its findings have been progressively reviewed through a series of seven national and three regional workshops.

Most importantly, the whole project has created a unique network of central banks, leading commercial banks and NGOs throughout the Asia–Pacific region (the BWTP Network), strongly supported by national governments.The BWTP Network is dedicated to exploring, demonstrating, sharing and publicising the scope and the means for increasing access to credit for the very poor — not on a 'handout' basis but on a commercially viable basis.

The Third Regional Workshop, held in November 1994, was the largest, most representative, and most ambitious yet. It built on the Foundation's seminal report and recommendations on **Banking with the Poor**[1] and considered field reports on progress being made in implementation of these recommendations, and in new initiatives. As a result, the present report, *Best Practice of Banking with the Poor*, highlights and documents the best approaches and best results being achieved by banks and NGOs, and the best forms of support and encouragement which can be provided by governments, central banks, international financial institutions and aid agencies.

During these past four years, The Foundation for Development Cooperation has been pleased to observe the establishment of thousands of new self-help groups of the poor, anxious to gain access to credit for productive projects. Moreover, scores of commercial banks in the region have taken up the challenge, and have been encouraged to link up with these self-help groups through NGOs, to provide the additional financial resources needed for the poor to help themselves.

A conservative estimate suggests that over 100,000 people have joined self-help groups already as a consequence of the BWTP Network initiative, and that number is growing daily. The enthusiasm of people in the Network is an inspiration to keep building this momentum.

However, notwithstanding these encouraging beginnings, there is still a long, long way to go. There are an estimated 800 million people living in absolute poverty in the Asia–Pacific

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[1]The Foundation for Development Cooperation, ***Banking with the Poor: Report and recommendations based on case studies prepared by leading Asian banks and non-governmental organisations,*** The Foundation for Development Cooperation, Brisbane, 1992.

region, and access to microcredit finance is still very limited. Widening access will provide an enormous challenge in development cooperation initiatives for decades to come.

The Foundation sees that rapid replication and expansion of BWTP Network methods are vital. This can only be accomplished through ever-widening involvement of commercial banks and NGOs in the region, as well as substantially increased support and prioritising from national governments and the international community as a whole.

The Foundation sees a campaign of advocacy to promote these principles and practices as an important part of its BWTP project. It has worked with the support of UNDP in conducting a series of national workshops during the last two years. It is worthy of note that the Governors of the central banks concerned have participated in all seven national workshops held to date.

In addition to the UNDP, the Foundation gratefully acknowledges the financial support given to BWTP activities by the World Bank, the Asian Development Bank and the Australian Government in recent years. The Foundation is also now seeking to widen the awareness of BWTP in developed countries. We are pleased to have received significant financial support from the Australian Bankers' Association, and we hope that other major private philanthropic institutions will also support awareness programs.

The present report will help the ever-widening BWTP Network to adopt and adapt best practice experiences into their own implementation programs. The Foundation will continue to support action research and policy information exchange initiatives, and is planning a Fourth Regional Workshop in the later half of 1996 to assess further progress in BWTP.

We are delighted to publish this report and salute the commitment and achievements of those individuals and organisations working to make access to credit a reality at grassroots level throughout the region.

Brian W. Scott, AO
Chairman
The Foundation for Development Cooperation

Preface

This report reviews the experience of banking with the poor, primarily among the members of the **Banking with the Poor** Network, but also drawing upon the variety of experience in the Asia–Pacific region. The report is concerned chiefly with the four years since the Network was created at the first regional workshop on **Banking with the Poor** in Manila in May 1991. The ideas that the poorest of the poor could be enabled to help themselves by securing access to credit to finance their productive activities, and that this credit should be supplied from commercial sources in a sustainable fashion rather than being treated as a redistributive or social welfare exercise, seemed more novel at that time than they do now.

In the meantime, motivated by the experience of the Manila workshop, the bankers and NGO leaders who form the membership of the BWTP Network have pursued programs of banking with the poor in their home countries. They have accumulated considerable experience and expertise while managing linkages between their banks and NGOs and the self-help groups of the poorest of the poor with which they work.

The purpose of this report is to review the experience of implementing banking with the poor. The intention is to focus on 'best practice' in methods of instituting, operating and sustaining linkages designed to assure a commercially sustainable flow of credit to the poor, from the viewpoint of the major 'actors' capable of playing a role in this process. After reviewing the experience of implementation, the report comes to certain conclusions about the elements of best practice in banking with the poor. These are determined in relation to the recommendations to commercial banks, NGOs and self-help groups, governments and central banks of Third World countries, and external agencies involved in development assistance and financing, contained in the Foundation's landmark report on **Banking with the Poor**, published in 1992.

These conclusions concerning the elements of best practice, and the recommendations arising from them, were extensively reviewed and endorsed by participants in the Third Regional Workshop on **Banking with the Poor** held in Brisbane on 21–25 November, 1994. Now revised and published by The Foundation for Development Cooperation, they will be disseminated as part of the BWTP Network's continuing campaign of advocacy in support of the sustainable provision of microcredit for the productive activities of the poorest of the poor. The workshop was supported by UNDP under RAS/92/006, the Asia–Pacific Regional Poverty Alleviation Programme. In implementing this and other components of the program, the Foundation was responsible to the Asian and Pacific Development Centre in Kuala Lumpur, as Executing Agency.

We acknowledge with gratitude the financial assistance of the Asian Development Bank for the preparation, printing and distribution of this report.

J.D. Conroy
Executive Director
The Foundation for Development Cooperation

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Notes The expression, **Banking with the Poor** refers to the Foundation's project, in operation since 1991, and also to the Foundation's report on **Banking with the Poor.** We also refer frequently in this document to the *process* of banking with the poor, used as a shorthand for the mechanism for linking banks with NGOs and self-help groups of the poor in a commercially sustainable manner. Finally, there are many references to the **Banking with the Poor** Network, or BWTP Network. The original report on **Banking with the Poor** and this successor report owe a great deal to the support of the members of the BWTP Network, the genesis of which is explained in Chapter 1.

Unless otherwise designated, all dollar amounts in this report are in United States dollars.

Acronyms

ADB	Asian Development Bank
AIDAB	Australian International Development Assistance Bureau
AKRSP	Aga Khan Rural Support Program
AIM	Amanah Ikhtiar Malaysia
APDC	Asian and Pacific Development Centre (Kuala Lumpur)
APPEND	Association of Philippine Partners in Enterprise Development
APRACA	Asia Pacific Rural and Agricultural Credit Association
ASKI	Alalay Sa Kaunlaran Sa Gitnang Luzon Inc (The Philippines)
AusAID	Australian Agency for International Development
AVARD	Association of Voluntary Agencies for Rural Development (India)
BAP	Bankers' Association of the Philippines
BARD	Bangladesh Academy for Rural Development
BIDS	Bangladesh Institute of Development Studies
BKB	Bangladesh Krishi Bank
BSCIC	Bangladesh Small and Cottage Industries Corporation
BPI	Bank of the Philippine Islands/Family Bank
BRAC	Bangladesh Rural Advancement Committee
BWTP	Banking with the Poor
CGAPP	Consultative Group to Assist the Poorest of the Poor (World Bank)
CGC	Credit Guarantee Corporation (Malaysia)
CICTAB	Centre for International Cooperation and Training in Agricultural Banking
CIDA	Canadian International Development Agency
CIGAP	Credit for Income Generating Activities of the Poor (UNDP Asia-Pacific Regional Poverty Alleviation Programme)
ESCAP	Economic and Social Commission for Asia and the Pacific
FDC	The Foundation for Development Cooperation
FTCCS	Federation of Thrift and Cooperative Credit Societies (Sri Lanka)
GTZ	Germany Agency for Technical Cooperation
GVDB	Gundu Village Development Board
IBA	Indian Banks' Association
IBP	Intensive Banking Program (Nepal)
IDT	Inpres Desa Tertinggal (The Presidential Instruction Program of Rural Poverty Alleviation, Indonesia)
IFAD	International Fund for Agricultural Development
JTF	Janasaviya Trust Fund (Sri Lanka)
KMBI	Kabalikat Para sa Maunlad Na Buhay Inc (The Philippines)
MED	microenterprise development
MPCS	multipurpose cooperative society
MYRADA	Mysore Resettlement and Development Agency (India)
NABARD	National Bank for Agriculture and Rural Development (India)
NGO	non-government organisation

NORAD	Norwegian Aid Agency
NZODA	New Zealand Official Development Asssistance
OECD	Organisation for Economic Cooperation and Development
OPP	Orangi Pilot Project (Pakistan)
PCRW	Production Credit for Rural Women
PERBANAS	Association of national private banks (Indonesia)
PHBK	Project linking banks and self-help groups in Indonesia
RBI	Reserve Bank of India
Repelita	Five-year development plan (Indonesia)
RBB	Rashtriya Banijya Bank
RRDB	regional rural development bank
SB	Swanirvar Bangladesh
SEEDS	Sarvodaya Economic Enterprise Development Service
SEWA	Self-employed Women's Association (India)
SFDP	Small Farmers Development Program
SFLCP	Small Farmers and Landless Credit Project
SHG	self-help group
SHPI	self-help promoting institution
SPFS	South Pacific Forum Secretariat
TCCS	Thrift and Credit Cooperative Society (Sri Lanka)
TSPI	Tulay sa Pag-Unlad Inc (The Philippines)
UNCDF	United Nations Capital Development Fund
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
UNIFEM	United Nations Fund for Women
USAID	United States Agency for International Development
VO	voluntary organisation
WO	women's organisation

Part 1

Introduction

Chapter 1
INTRODUCTION

1.1 Overview
Since its commencement in 1991, the **Banking with the Poor** project has pursued two main objectives. First, it has sought to explore, demonstrate and publicise the scope for increased access to credit on a sound commercial basis for the very poor in developing countries. Second, and in support of that goal of access to credit for the poor, it has worked to promote commercially sound linkages between the formal financial sector (including commercial banks), well-managed non-governmental organisations (NGOs) and self-help groups (SHGs) of the very poor in those countries.

1.2 Access to credit and poverty alleviation
The arguments for the importance of credit for strategies of poverty alleviation among the poorest of the poor in the Asia–Pacific region are stated in the report on **Banking with the Poor.**[2] In brief, we have argued that lack of access to credit, provided in timely fashion and at commercial rates of interest, is a crucial constraint upon the capacity of the working poor to help themselves through informal-sector income-generating activities. As we noted in that earlier report, poverty in Asia is concentrated primarily in countries whose labour forces are still predominantly rural, with the majority engaged in agriculture (as in India, Pakistan, Bangladesh and Nepal). In such economies open unemployment is relatively rare. In order to survive, the poor must undertake low productivity and low-earning activities within and beyond agriculture. Most are self-employed or members of family working units, and even rapid growth of wage employment in the formal sector is unlikely to benefit them directly. As noted in the earlier report, 'efforts to increase the productivity of their labour are necessary if surpluses generated by growth in agriculture and industry are to "trickle down" to them'.[3]

While many factors constrain the productivity and earnings of the working poor within the informal sector, our belief in **Banking with the Poor** has been that 'lack of access to credit, or its unavailability on terms that make possible a proper return to enterprise, is a crucial constraint upon self-help by the poor'.[4] In this respect, and remembering that the target group for **Banking with the Poor** is indeed the very poorest among the poor, we share the basic assumptions of the 'minimalist' model associated with the Grameen Bank. Where we go beyond the Grameen model is in our emphasis on domestic financial development by means of linkages between self-help groups of the poor and commercial financial institutions, with NGOs performing a range of intermediary functions.

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[2] **Banking with the Poor, see especially pp. 10–15.**
[3] **Banking with the Poor, p. 12.**
[4] **Banking with the Poor, p. 13.**

Banking with the Poor approach

Our approach requires the payment of positive real rates of interest to savers (to encourage the mobilisation of domestic savings) as well as market-related interest rates for borrowers, which reflect the scarcity value of capital. Ultimately, **Banking with the Poor** depends for its viability on the maintenance of a stable, low-inflation macroeconomic environment. And in so far as **Banking with the Poor** contributes to 'financial deepening' and the mobilisation of domestic capital resources, it also contributes to the creation of a domestic financial system through which macroeconomic goals including economic growth can be pursued more effectively.

Banking with the Poor operates to overcome the diseconomies of scale which prevent commercial financial institutions from mobilising the savings or meeting the capital requirements of microentrepreneurs. By using NGOs and self-help groups to reduce the transaction costs of dealing with the poor and provide forms of security alternative to conventional collateral requirements, **Banking with the Poor** improves the efficiency of domestic financial markets in ways beneficial to the poor.

The repayment performance of micro-borrowers organised in SHGs is excellent, and they are willing and able to pay market-related rates of interest. Despite their doing so, their cost of funds (by comparison with rates in informal capital markets which at the extreme are controlled by usurers) is considerably cheaper when they are given access to credit from commercial financial institutions. This points to the improvements in financial market efficiency achievable by applying the principles of **Banking with the Poor.**

Economic and social benefits

In terms of social benefits, **Banking with the Poor** has merit in being targeted at the poor and in being particularly beneficial for women, who form the majority of borrowers. This tends to increase both women's participation in economic activities, and their earnings in those activities. Given the extremely limited capacity of formal sector employment to absorb increments in the labour force resulting from population growth, increased female participation, and technical change in agriculture, the creation of income-generating opportunities in the informal sector is very effective in both productive and redistributive terms. As noted in our first report, the informal economy:

> may be, at one extreme, a dynamic sector in which innovation, rising incomes and capital accumulation occur, or at the other extreme it may be simply a statistical category, a residual sponge into which growing numbers of landless and other poor are absorbed, with little hope of improvement in the material conditions of their lives. Interventions aimed at increasing the productivity of economic activity among the self-employed in the informal sector may assist in releasing the potential for dynamism that exists there.[5]

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[5] Banking with the Poor, p. 12.

The intervention which **Banking with the Poor** suggests is crucial to dynamising the informal sector is the provision of access to credit to people within the sector. The investments in institutional and human resource development necessary to prepare NGOs and community-based self-help groups to engage in financial operations, and to prepare commercial banks to deal with them, are quite small in relation to the scale of public investments in physical infrastructure and human resource development which form the primary focus of conventional development policy. The resources required are not excessive in relation to those employed in redistributive and social welfare programs, some of which (as documented in the report on **Banking with the Poor**[6]) have been extremely wasteful and ineffective. Moreover, **Banking with the Poor** is notable for the resources (both physical and capital) it calls forth from community and private sector sources to support its activities, thus tending to reduce dependence on government or external sources of support.

1.3 Genesis of the Banking with the Poor Network

The **Banking with the Poor** (BWTP) Network came into existence at our first regional workshop in Manila in 1991. There representatives of leading commercial banks and NGOs from eight Asian countries[7] met to discuss the possibility of cooperating to provide better access to credit for the poor on a sound commercial basis, and to identify key issues requiring further study for this basic aim to be fulfilled.

The participating banks and NGOs agreed to maintain their dialogue, and to progress the search for workable solutions by conducting a program of 'action research' in each of their countries. These took the form of country case studies based on the common framework of issues identified at the Manila workshop, and upon guidelines agreed by all participants. The studies, conducted by the network NGOs and banks, were concerned with the scope for increased access to credit for the poor on a sound commercial basis, and with the possibility of establishing commercially sound linkages between banks and NGOs to help achieve that goal.

1.4 The Banking with the Poor report

The completed country case studies, together with the Foundation's analysis of their conclusions, formed the basic documents tabled for the second regional workshop conducted in Kuala Lumpur in 1992. The Foundation's drafting team[8] proposed recommendations for consideration by the Kuala Lumpur Workshop, directed to the principal 'actors' or agencies responsible for implementing **Banking with the Poor**, or capable of influencing the

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[6] **Banking with the Poor**, see especially Section A.6.

[7] Pakistan, India, Bangladesh, Nepal, Sri Lanka, Philippines, Malaysia, Indonesia.

[8] The team comprised Mr Ganesh B. Thapa, former Governor of the Nepal Rastra Bank and Ms Jennifer Chalmers, seconded by the Australian Bankers' Association, together with Foundation Vice-Chairman Mr K. William Taylor, and Executive Director Dr John Conroy.

environment in which linkages between NGOs and commercial banks could occur. These principal agencies were seen as being:

- NGOs and self-help groups of the poor
- commercial banks
- governments and central banks of Third World countries
- external agencies (bilateral and multilateral agencies, and international financial institutions)

The draft report, together with the conclusions and recommendations derived from case study experience in eight Asian countries, was vigorously debated and constructively amended at the second regional workshop. With the endorsement of the BWTP Network, the Foundation subsequently published the report and recommendations on **Banking with the Poor** and considered how it might bring these recommendations and the report containing them to the attention of the major categories of agencies for which it had been written.[9]

1.5 UNDP's Asia–Pacific Regional Poverty Alleviation Programme

The attendance of representatives of UNDP at the Kuala Lumpur workshop offered an opportunity for the Foundation to explore the issues further. UNDP had used the second regional workshop as a forum for consultation on a proposed regional project (RAS/92/006, Credit for Income-Generating Activities of the Poor, or CIGAP). The Foundation accepted the suggestion of UNDP to prepare activities for a new phase of **Banking with the Poor,** to be incorporated as part of the CIGAP program. For the Foundation, RAS/92/006 was an opportunity to commence a campaign of advocacy, initially in the eight member countries of the BWTP Network, to disseminate the conclusions of the report on **Banking with the Poor.**

UNDP's proposed CIGAP program was subsequently incorporated into a broader Asia–Pacific Regional Poverty Alleviation Programme (retaining the number RAS/92/006) in which the Foundation was an implementing agency. In the interim, prior to final approval of RAS/92/006 by UNDP, the Foundation commenced certain activities, funded from its own resources, in order to maintain the momentum generated by the Kuala Lumpur workshop. After the approval of the project by UNDP, the Foundation was responsible to the Asian and Pacific Development Centre in Kuala Lumpur, which was the Executing Agency for credit components of RAS/92/006.

1.6 Campaign of advocacy for banking with the poor

Culminating in the Third Asia–Pacific Regional Workshop on **Banking with the Poor**, the campaign of advocacy consisted of the following elements:

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[9] The complete set of recommendations has been reproduced in Annex 3.

- national workshops on **Banking with the Poor**, held so far in seven of the BWTP Network countries in Asia
- preliminary consultations in nine South Pacific countries
- research studies of the transaction costs of lending to the poor through the intermediation of NGOs and self-help groups, conducted in India and the Philippines
- the Third Asia–Pacific Regional Workshop, in November 1994.

UNDP has supported the Foundation in distributing the report on **Banking with the Poor** widely throughout the Asia–Pacific region, and to relevant external agencies. The report itself had earlier been published with financial assistance from the World Bank. Some 1600 copies of the report have been distributed, primarily in conjunction with the national workshops and consultations mentioned above. The workshops have employed the report as their basic text, and the Foundation has enlisted the support of central bank governors, senior commercial bankers and NGO leaders in all seven countries to endorse the conclusions and recommendations of **Banking with the Poor.**[10]

Strong positive endorsement of the Foundation's approach by monetary authorities in every BWTP Network country has served to focus the attention of national bankers' associations and the banking community in general upon the potential of the linkage mechanism to mobilise new sources of savings and to develop new markets for lending. The message of **Banking with the Poor** has thus been conveyed to the highest levels of government and the banking industry, as well as to the NGO community, and has received a generally positive response. Indeed, it can be stated that the principles and methods of **Banking with the Poor** have been presented to professional audiences throughout Asia without serious objection to the essential thrust of our arguments.

1.7 Banking with the poor in the South Pacific

The promulgation of **Banking with the Poor** in the small island states of the South Pacific region occurred at the suggestion of UNDP itself. The campaign in this region has been conducted in two phases. The first involved consultations in nine countries[11] enabling policy makers, commercial bankers and NGO leaders to receive information about the principles of **Banking with the Poor**, and to permit the Foundation's consultants to judge their receptiveness to these principles, and the feasibility of their being applied in the particular economic circumstances of the small South Pacific island states.

The second phase of these South Pacific consultations occurred at the Third Regional Workshop in Brisbane where representatives of the small island states, identified during the

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[10] For the reports of these meetings, see *National Workshops on Banking with the Poor,* The Foundation for Development Cooperation, Brisbane, 1994.

[11] Papua New Guinea, Solomon Islands, Vanuatu, Fiji, Tonga, Kiribati, Tuvalu, Western Samoa, Cook Islands.

preliminary consultations, assembled in Brisbane both to learn from the experience of members of the BWTP Network and to discuss among themselves the applicability of **Banking with the** Poor to the South Pacific.

1.8 Banking with the poor in transitional economies

A number of states in Southeast and East Asia are currently experiencing the transition from centrally planned to market-based forms of economy. States such as Vietnam, Cambodia, Laos and China all enter this category. While there are substantial differences between them, their 'transitional' status and the existence of substantial poverty among their peoples justify their being grouped together in this present context.

Since the prerequisites for successful application of **Banking with the Poor** include the existence of autonomous NGOs and commercial banking systems, questions arise concerning how far the linkage mechanism is applicable to these countries in the immediate future. However, the speed with which economic and social change is occurring in this subregion, as well as its increasing economic integration with the world economy, indicates the desirability of disseminating information about **Banking with the Poor** in these countries.

1.9 Significance of the Third Regional Workshop

The significance of the Third Regional Workshop is that it took place after four years experience with the **Banking with the Poor** project — after the completion of case studies to trial the applicability of the linkage mechanism in a wide range of economic and social situations, and after substantial efforts to disseminate the findings in the Asia–Pacific region. Further lessons can now be drawn from the continuing experience of linkages between banks, NGOs and self-help groups of the poor. It is now appropriate to make judgements concerning some of the elements of 'best practice' in **Banking with the Poor**, from the standpoint of the various kinds of organisations involved.

As mentioned above, these organisations consist of NGOs and self-help groups, commercial banks, governments and their central banks, and external agencies. While 'best practice' is a concept borrowed from industrial processes, its application is valid also in the service sector. It can be applied, for our purposes, to the processes of providing financial services to the poor through various forms of unconventional intermediation. Identification of a particular example of practice as currently 'best' implies no judgement of its being optimal in any longer term sense. **Banking with the** Poor is evolving rapidly in the light of experience in a number of countries, and in response to widely varying economic, social and institutional conditions.

For the present, it is sufficient to say that a set of guidelines relating to best practice in the various contexts of Banking **with the** Poor, and for the various organisations involved, would constitute a valuable tool for the further expansion of this approach to poverty alleviation. It is for this reason that this report focuses on best practice in the implementation of **Banking with the Poor**, with special reference to the recommendations made by the second regional workshop.

1.10 Development of this report and sources of information

The introduction to this report explains the context of The Foundation for Development Cooperation's **Banking with the Poor** project, and the role in it of the BWTP Network, comprising NGOs and commercial banks in eight Asian countries. The campaign of advocacy conducted by the network with the support of UNDP culminated in the Third Regional Workshop on **Banking with the Poor** in Brisbane in November 1994. A draft copy of this document was tabled at that meeting, to provide a basis for the discussion of recent experience with the linkage mechanism, and for the review of best practice in that regard. The draft was prepared by a study team comprising J. D. Conroy, K. W. Taylor and G. B. Thapa.

BWTP Network institutions had assisted in the compilation of that draft report by responding to the Foundation's requests for up-to-date information on their activities in **Banking with the Poor**, as had a number of central banks, bankers' associations and NGOs. Foundation staff, and our Senior Consultant Mr G. B. Thapa, former Governor of Nepal Rastra Bank, visited all network countries during 1994 to gather data and to conduct interviews. International and bilateral agencies active in assisting programs of credit for poverty alleviation were invited to send representatives to the Brisbane workshop. They were also asked to respond specifically and in advance to the recommendations in **Banking with the Poor**, to enable information about their programs to be included in the draft report.

That draft report was discussed extensively at the Third Regional Workshop, and additional data were obtained as a result of presentations and other inputs by participants. The final set of conclusions and recommendations for best practice of **Banking with the Poor**, reprinted here, was agreed and endorsed by the participants.

1.11 Structure of this report

Following this introduction, Part 2 of the report is devoted to a review of the implementation of **Banking with the Poor** in the region. Four subsections deal with the main kinds of organisations with roles in the process: NGOs, commercial banks, central banks and governments of their countries, and external agencies concerned with supporting poverty alleviation activities.

Part 3 of this report draws conclusions from the evidence of current developments in the eight network countries. It suggests which methods and procedures appear, in the light of present experience and current economic, social and institutional conditions, to be best practice. As mentioned above, the term 'best' implies no suggestion of optimal practice being achieved in any particular case. **Banking with the Poor** will continue to evolve and improve, and each network member will adapt BWTP principles for application in its own circumstances.

Part 3 concludes by making recommendations for the future improvement and expansion of **Banking with the Poor**, addressed to the same four kinds of organisations bearing responsibility for carrying the process forward. As the report makes clear, replication and expansion of the linkage mechanism on a massive scale are necessary. Only thus can sufficient microcredit be delivered under sustainable conditions to have any significant impact on the circumstances of 800 million people in the Asia–Pacific region living in absolute poverty.

Part 2

Implementation of Banking with the Poor

Chapter 2

IMPLEMENTATION
THE ROLE OF NON-GOVERNMENTAL ORGANISATIONS AND SELF-HELP GROUPS

2.1 Introduction

Many governments and international organisations have proclaimed their commitment to reduce global poverty, and to give this task very high priority for the rest of the decade. While recognising that increased economic growth will contribute to poverty reduction, they know it cannot eliminate poverty without programs of direct action targeted at the poor themselves.

There is also growing recognition that for such programs to succeed, governments and international organisations need the active support of non-governmental and community-based organisations already working at the grassroots level. Increasingly, that recognition is reflected in the share of international aid directed to the poor in developing countries through NGOs. A study of NGOs published by the Asian Development Bank noted that:

> the increasing use of NGOs. . .reflects the generally expressed belief that such organisations have a comparative advantage over traditional government agencies in those situations where, to achieve a sustainable impact, the enthusiastic participation of the target community is required. . .The most effective NGOs live and work closely with the beneficiaries. . .The elements of the NGOs' comparative advantage are thus seen to be proximity, trust, commitment, flexibility and responsiveness [to the poor].[12]

Range of NGOs

Before seeing how this comparative advantage is being applied to achieve better access to credit for the poor, it is necessary to understand the vast number and variety of NGOs in the region and to distinguish among them those that are now, or could be, in a position to facilitate better access to credit for the poor. In purely numerical terms, there are hundreds of thousands of entities in the region that can reasonably be described as NGOs. Some estimates run to as many as 300,000 organisations in India alone; others put the number in the Philippines at somewhere between 20,000 and 50,000. However, it is rather the *qualitative* functions of NGOs that are important in this context.

In every country of the region there exists a wide spectrum of NGOs varying greatly in their origin, size, purpose and approach. These include 'peoples organisations' that continue to

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[12] Asian Development Bank, *Cooperation with NGOs in Agriculture and Rural Development*, vol. 2, Asian Development Bank, Manila, 1989, executive summary.

function in a traditional manner at the village level, and 'welfare NGOs' (by far the largest number) that tend to focus upon health and education and help to fill some of the gaps in government welfare services, particularly to the very poor. One of the main features of these welfare-oriented NGOs is their charitable approach, sometimes unfortunately involving a handout mentality that may encourage dependency rather than self-reliance among the poor.[13]

More recently, we have witnessed the emergence of 'development NGOs', whose main emphasis has generally been 'to help the poor to help themselves'. It is from amongst this relatively small but dynamic category (probably fewer than 5 per cent of the NGO community) that the Foundation is building its network of organisations with a basic commitment to **Banking with the Poor**. Together with selected banks throughout the region they form the BWTP Network.

Identifying successful NGOs

Following a study,[14] published with Foundation support, of a broad range of NGOs in the region operating programs of income generation for the poor, the Foundation selected NGOs in eight Asian countries[15] which it considered to be some of the most successful in the field. (Strict selection criteria were used for the purpose.[16]) The Foundation invited these NGOs to participate in a regional dialogue with leading commercial banks from the same countries on the possibility of **Banking with the Poor**. This commenced at the first regional workshop in Manila in 1991. While all these selected NGOs are certainly 'development' as distinct from 'welfare' agencies, they also reflect two different categories of such NGOs. Some — for example, Swanirvar Bangladesh, MYRADA in India and the Aga Khan Rural Support Program in Pakistan — may be described as 'multi-purpose development NGOs'. They have a wide range of activities of which credit delivery is only a part. Others like AIM in Malaysia, the credit unions in Indonesia and Sri Lanka, and the APPEND NGOs in the Philippines may be categorised as 'minimalist' (like the Grameen Bank in Bangladesh) for which better access to credit for the poor is their major, if not their sole, interest.

While the minimalist/multi-purpose distinction is of relevance to a better understanding of the two groups, it is necessary also to note that the success of multi-purpose NGOs in providing better access to credit has been shown to require very strict separation between those credit activities and all of their other activities aimed at the poor.

Response to NGO success

In this attempt to report on the implementation of **Banking with the Poor** in our region, basic standards and principles against which best practice is judged have been largely set by

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[13] Asian Development Bank, 1989, p. 7.

[14] Joe Remenyi, *Where Credit is Due*, Intermediate Technology Publications, London, 1991.

[15] Bangladesh, India, Indonesia, Malaysia, Nepal, Pakistan, the Philippines and Sri Lanka.

[16] Reproduced in this volume as Annex 2.

the successful efforts and performance of our Asian NGO partners themselves. Their success in reaching the poor on a sound commercial basis has not only impressed some of the leading commercial banks in Asia, but has led these banks to make significant financial commitments enabling NGOs and SHGs to serve as financial intermediaries. Their own governments and central banks, as well as leading international banks and aid donors, are also responsive to their successes, as the rest of this report will indicate.

It is therefore timely to look at the basic principles and performance of NGOs and SHGs in their commitment to **Banking with the Poor**, and to highlight their best practice in responding to the urgent needs of the poor. This can now be done, based on reports from our NGO partners concerning how they have implemented the basic principles and recommendations of **Banking with the Poor** which, together with our partner banks, they framed at our second regional workshop in Kuala Lumpur in 1992.

Basic principles for NGOs

Basic principles underlying the **Banking with the Poor** recommendations to NGOs were:

- Target only the poor.
- Organise self-help groups of the poor to help themselves.
- Train self-help groups in financial disciplines, simple bookkeeping and accountability.
- Respect their autonomy.
- Develop group liability and peer pressure as substitutes for collateral.
- Minimise documentation, red tape and traditional banking procedures in order to reduce transaction costs.
- Charge market rates of interest for savings and credit to achieve financial viability as soon as possible.
- Mobilise savings.
- Extend credit for productive activities.
- Link with banks to secure loan capital for that purpose.

2.2 Reviewing NGO and SHG experience for best practice

The performance of NGO partners and SHGs in eight Asian countries can now be reviewed briefly in the light of these principles.

Swanirvar Bangladesh

This NGO partner (whose name means 'self-reliance Bangladesh') reports further progress in establishing self-help groups amongst the poorest of the poor. It continues to ensure that group members must be virtually asset-less, that is, owning less than 0.4 acres of land or earning less than TK 20,000 ($500) annual cash income per household. It has already organised almost 200,000 self-help groups with a total membership approaching one million. Following in this respect the Grameen Bank model, these groups comprise five persons each and are formed, motivated and trained by credit assistants employed by Swanirvar Bangladesh. Upon the recommendation of the SHG, loans of up to TK 5000 ($125) without physical collateral are issued by one or more of the several state commercial banks participating in the program.

Interest rates, initially set at 13 per cent, have now been reduced by fiat to a range of 8–13 per cent, under the Special Credit for Socio-Economic Development Program of the government. These lower rates have made it difficult for Swanirvar to be effective and sustainable or to provide adequate remuneration for its credit assistants.

In contrast to this, the Grameen Bank and the Bangladesh Rural Advancement Committee (BRAC) now charge 20 per cent to their own equally poor borrowers, without borrower resistance. They are thereby able to achieve or at least approach full financial viability for the operation. For the same reason it is important to allow for a substantial increase in the interest rate presently being charged under the Swanirvar program.

On the positive side, it can be reported that cumulative total loans through Swanirvar rose from TK 977 million ($24.1 million) in 1992 to TK 1120 million ($27.7 million) last year. Group savings also increased, and over 70 per cent of the borrowers are women. Loan repayment rates rose from 74 per cent in 1992 to almost 80 per cent in 1993. While this is far lower than that of other BWTP partners, it should be noted that these figures reflect specific 'debt forgiveness' decisions made by the government following the devastation and floods of 1992–93, that were applicable to all state commercial banks. These decisions did not apply to the Grameen Bank, due to its independent status, and it is noteworthy that Grameen appears to have been successful in taking a firm line with repayments over this period.

With the needed policy changes (especially regarding interest rates) there is every reason to believe that Swanirvar Bangladesh, with its enterprise organisational structure, experience and commitments, and its special linkage arrangements with a number of state-owned commercial banks (see Chapter 3), could soon contribute even more significantly than in the past to the reduction of poverty in Bangladesh.

India: MYRADA and others

The following account is based upon information from network members the Mysore Resettlement and Development Agency (MYRADA) and the Vysya Bank, as well as from the National Bank for Agriculture and Rural Development (NABARD) and the Reserve Bank of India (RBI).

The Association of Voluntary Agencies for Rural Development (AVARD) has listed at least 95 development-oriented NGOs in India that could be recruited for Banking with the Poor, and according to its executive director this list could be enlarged to about 300. Only a very small number of these NGOs, about 28, have thus far been fully and actively involved in programs of credit for the poor on a strictly commercial basis. According to AVARD, the three leading NGOs in the field are MYRADA, the Self-employed Women's Association (SEWA) and the Cooperative Development Foundation.[17]

Since over 300 million of the world's poor live in India, it is natural that the Foundation's interest in **Banking with the Poor** has found a special focus in that country. RBI, NABARD and Indian Banks' Association (IBA) have joined us in exploring, demonstrating and publicising the scope for better access to credit for the poor in that country. It was a happy coincidence that while the RBI and NABARD decided in July 1991 to launch a pilot project in South India to link commercial banks with self-help groups, the Foundation had already selected MYRADA in Bangalore as its major NGO partner in **Banking with the Poor** from India. Hence, in addition to data supplied by the RBI, NABARD and Vysya Bank on the outcome of that pilot project, reference will be made to the method followed by MYRADA in building SHGs.

On 24 July 1991, RBI issued a circular to all scheduled commercial banks inviting them to establish direct relationships with self-help groups (SHGs) of 10–25 persons among the very poor, provided the group had been in existence for six months and had actually promoted the savings habit. The circular clarified that such groups did not need to be legally registered and that they could fix interest rates to be charged to their members, provided these were not excessive. Detailed guidelines for the implementation of this pilot program were then issued by NABARD (see Chapter 3 for further details).

The Foundation's partner NGO, MYRADA, was in an excellent position to take a lead in implementing this pilot project, because it had already established close to 2000 self-help groups of the very poor in rural villages of South India, though not with any commercial bank linkages at that stage.

Achievements to date

Briefly stated, the overall outcome of the Indian pilot program is as follows. Since July 1991, 620 SHGs have established linkages with 16 commercial banks and 12 regional rural banks. The total amount sanctioned by the banks to date amounts to Rs 8.42 million ($0.27 million) and refinance released by NABARD totals Rs 7.64 million ($0.24 million). The overwhelming majority of both SHG members and borrowers have been women, and the loan repayment rate has been between 98 per cent and 100 per cent.

No collateral is required up to $500 in loan size. Interest charged to group members is between 18 and 36 per cent per annum, which includes 12 per cent charged by the banks to SHGs as well as the costs of NGOs and SHGs for their role in loan evaluation, delivery, monitoring and recovery. The bank interest rates to the SHGs are explained in detail in Chapter 4 of this report, and a detailed breakdown of transaction costs between banks,

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[17] AVARD adds that the Friends of Women's World Banking, India, have also disbursed credit of Rs 84,400,200 (or $0.27 million) over five years.

NGOs and SHGs was provided in a separate draft report on that matter to the Third Regional Workshop.[18]

While these 'final borrower' rates may seem high compared with bank rates, they are obviously far lower than those of informal moneylenders charging 10 to 20 per cent per day for working capital.

The MYRADA model

As already indicated, MYRADA is a multi-purpose NGO assisting very poor rural communities in South India in many ways. One of these, flowing from the expressed interest and needs of those villages and communities, has been to form and train groups of 10–25 very poor people to help themselves.

Although this MYRADA assistance may begin with some specific village need (for example, to build a shallow well or pump, or provide agricultural advice on a particular problem with goats, cows, poultry, etc.), it has frequently developed further to provide for the felt need of small village groups for ongoing financial support. In some cases a cohesive village group may already exist. In other cases, villagers may need some help in its formation. In all cases, groups will need some help in organisation and training, which can be given by a sensitive and committed field member of MYRADA.

If the group is eventually to be responsible for the economic and financial welfare of its members, it must receive some practical guidance and experience in savings and credit, and in elementary bookkeeping. Hence, the group begins to save, albeit a very small amount, contributed by its members at regular weekly meetings to build a common fund. That fund is only sufficient in size to help meet emergency needs of group members, such as medicine or care for a sick child. It is rarely sufficient to make loans for productive purposes, for example, to buy a loom, a sewing machine, or extra livestock to produce a somewhat higher income for the borrower. That is where the need for a bank linkage arises — to provide to a well-managed SHG the additional loan capital it needs to meet productive requirements of its members.

A more detailed account of the methods of forming and training SHGs for successful banking with the rural poor, and their cost based upon MYRADA'S experience, is available from the Foundation.[19] For the present, however, it can be stated that the methods followed by MYRADA have already contributed to the establishment of 139 SHG linkages with commercial banks in India and must be considered to be some of the 'better practice' followed for **Banking with the Poor** in the region.

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[18] See V. Puhazhendhi, *Transaction Costs of Lending to the Rural Poor: Non-governmental Organisations and Self-help Groups of the Poor as Intermediaries for Banks in India*, The Foundation for Development Cooperation, Brisbane, 1995.

[19] The Foundation for Development Cooperation, *How to Build Self-help Groups for Successful Banking with the Poor: A Rural Model*, rev. edn, The Foundation for Development Cooperation, Brisbane, 1995.

MYRADA experience

Background

MYRADA was launched in 1968 and was involved for the next ten years in the resettlement of Tibetan refuges (15,000 all told) in the State of Karnataka. From 1978 onwards, MYRADA has been totally involved with programs for the rural poor in backward districts of Karnataka, Andhra Pradesh and Tamil Nadu.

MYRADA works through both full-time staff and volunteers trained in community health care, animal husbandry, forestry, literacy and other relevant areas of community and village need. Most MYRADA staff are village based, working with small and marginal farmers, landless labourers, poor women and rural artisans.

Basic data as of 31 March 1994

The number of self-help groups organised by MYRADA amounted to a total of 2335. Of these, 691 were men's groups, 1069 were women's groups, 528 were mixed groups, and 47 were youth or children's groups.

These groups cover over 50,000 families. They have issued a total of over 180,000 loans, with the cumulative amount disbursed at over Rs 103,600,000 ($3.3 million). The total amount saved by the groups is Rs 12,891,535 ($0.41 million).

Of the 2335 groups, 139 have been linked with commercial banks. These 139 groups have been financed to a total of Rs 1,479,440 ($0.47 million) by the banks. Twelve of the groups have been financed twice.

Indonesia: bank/NGO/SHG linkage program

Since 1989, Bank Indonesia has conducted a project linking banks with self-help groups (PHBK) with technical assistance from the German aid agency, GTZ. Its aim has been to provide better access to credit for small farmers and microentrepreneurs organised into small SHGs with the help of NGOs and certain government agencies (described in this project as self-help promoting institutions, or SHPIs). We are concerned here with the role of NGOs as 'self-help promoting institutions'. SHGs are linked directly or through the promoting NGO to commercial banks to supplement the group's own modest resources (derived from savings) with loan capital to help meet the productive needs of members of the group.

Encouraged by APRACA (the Asia Pacific Rural and Agricultural Credit Association), PHBK pioneered in Indonesia the first major linkage program launched in Asia. It has been highly successful in achieving its goals, and its basic principles and methods have been emulated in other Asian countries and by a number of the Foundation's partners in **Banking with the Poor.**

PHBK guiding principles

The PHBK linkage program works within the following guiding principles:

- collaborating with existing institutions, that is, banks, NGOs (SHPIs) and SHGs, to ensure expertise in financial and management matters
- accepting SHGs as informal financial institutions, bringing credit services to their members
- carefully selecting banks, NGOs (SHPIs) and SHGs by ensuring the eligibility criteria are met
- respecting the autonomy of each of the partners
- promoting savings and linking credit with savings, requiring that only with savings as partial collateral can credit be obtained
- ensuring financial viability by applying market interest rates for savings and credit and cost-covering margins for intermediaries. Rather than depending on subsidised interest, loans and interest are repaid from the proceeds of production. The participants of SHGs must be market oriented and engaged in some sort of commercial activity
- substituting group liability and blocked savings for physical collateral.[20]

Credit linkages with the banks are established using three possible alternative models.

- *Model I.* Directly by banks with SHGs, facilitated by NGOs (SHPIs) through guidance/training and consultancy.
- *Model II.* Indirectly with banks through NGOs (SHPIs) which act as financial intermediaries and facilitators, as well as providing guidance/consultancy and training to SHGs.
- *Model III.* Directly by banks with SHGs. In this case, the banks provide guidance/consultancy and training support through their own institutions/units without the involvement of the NGO (SHPI).[21]

Achievements to date

What have been the results of the linkage program to date? Speaking at the national workshop on **Banking with the Poor** in Jakarta in September 1994, the Governor of Bank Indonesia, Dr Soedradjad Djiwandono, reported that by mid-1994 some 1500 self-help groups with more than 60,000 members were involved in linkage arrangements. Total credit advanced was $6.25 million, and savings of group members totalled $0.97 million.

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[20] These guiding principles have been excerpted from Bank Indonesia, *Linking Banks and Self-help Groups in Indonesia*, PHBK, Bank Indonesia, Jakarta, 1994, p. 5.

[21] Bank Indonesia, 1994, p. 6.

He added that the Asian Development Bank had expressed confidence in this approach by providing a new microenterprise development loan to be disbursed via group lending.

Loan repayment performance of the linkage program as a whole has been reported to be almost 95.5 per cent, and 49 NGOs and 63 banks are already participating in the program.[22] While Indonesia has achieved an extraordinary decline in the level of absolute poverty over the past two decades (from 55 per cent of population to 15 per cent as reported by the World Bank), the government is committed, according to Governor Djiwandono, to achieve further reduction in the numbers of the absolutely poor from 27 million (or 15 per cent of population) to 12 million (or 6 per cent) by the end of Repelita VI, the current five-year plan, in 1999.

An important new component in that plan will be the Inpres Desa Tertinggal (IDT) program, using the group approach to extend financial support valued at $9250 to each of 20,000 villages for a variety of purposes, including credit. Here again, credit will be applied to finance productive activities through self-help groups at the village level, requiring the support of NGOs, many of which will be able to contribute valuable advice and assistance to IDT through the experience they have derived under the PHBK linkage program.

Disseminating expertise

There is no doubt that the experience, principles and methods acquired under this pioneering program of PHBK represent some of the very best practice of NGOs and SHGs in **Banking with the Poor** in Asia. The record is one from which other countries, banks and NGOs in the region should derive inspiration and practical benefit.

At the Foundation's national workshop in Indonesia in September, it was agreed that it would be highly desirable for Indonesian NGOs working in this field to establish a coordinating forum for the exchange of information, training and research, for developing relationships with the banking community, and as a focal point for attracting funding. Participants also recognised that the nurturing of self-help groups by NGOs requires substantial finance, above their fees and interest charges, for institution and capacity building, for which purpose a concerted approach to attract external development assistance was also needed.

Malaysia: Amanah Ikhtiar Malaysia (AIM)

Amanah Ikhtiar Malaysia was established in 1987 'to disburse small loans on reasonable terms exclusively to very poor rural households to finance additional income-generating activities'. It has replicated the Grameen Bank approach to poverty alleviation, with some modifications to suit the Malaysian context. Data from a 1989 official Malaysian survey indicated that a total of 94,600 households, or 2.2 per cent of the total population, were classified as 'hardcore poor'.

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[22] Bank Indonesia, 1994, p. 17.

There can be few other NGO programs of credit in Asia (outside of Bangladesh) that are as painstakingly strict as AIM in targeting only the very poor. Not simply accepting official household data for the purpose, AIM undertakes its own assessments of household income and offers membership of its self-help groups to household members with incomes assessed as being less than two-thirds of the official poverty line figure.

Following the Grameen Bank model, these members are organised into groups of five that meet weekly in larger centres. As of 31 August 1994, AIM reported 6108 self-help groups and 1408 centres, with a total membership of 29,658. A group member can borrow from the group fund with the consent of the remaining group members, for either investment or consumption purposes. At that date, total loans disbursed amounted to RM 37.9 million ($14.8 million) and total savings to RM 4.7 million (or $1.8 million). Some 28 per cent of lending was for agriculture, 46 per cent for trade, 15 per cent for animal husbandry and 10 per cent for other activities.

With the small numbers of poor in Malaysia, opportunities for economies of scale are limited. It is unlikely that AIM will follow (or need to follow) its prototype, the Grameen Bank, in becoming a bank itself. AIM is likely to continue to rely upon linkages with commercial banks and foundations (and indirectly upon the state and national governments) to supply the loan capital needed for its operations. It already has such linkages with four commercial banks and one foundation.

AIM interest rates

In one other respect as well, AIM does not follow the practice of the Grameen Bank. This relates to the issue of market rates of interest to its members. It has three different categories of loan. For the very poorest members (by far the largest category), a service charge of only RM 25 ($10) is levied for the first loan, RM 50 ($20) for the second, and RM 75 ($30) for the third. As the average loan size for this category of members is RM 1044 ($427), the median service charge of RM 50 ($20) would equate to around 4.7 per cent flat over the usual one-year loan term. With the higher categories of loans, flat charges of $40 and $80 respectively are made, equating to higher interest levels. However, these two categories of higher value loans represent only 24 per cent of the total value of all AIM loans to date. Further, it is reported that there is a reduction in the number of borrowers taking second and subsequent loans. This obviously poses a serious problem for the sustainability of the program, should the governing body of AIM not wish to increase basic charges to put it on a sound commercial basis.

Achievements to date

On the positive side, AIM has achieved its goal of lending to the very poor, attaining a loan recovery rate of 98 per cent. AIM is possibly unmatched in the region in maintaining a very high standard of data collection, record keeping and monitoring which, together with the excellent financial discipline observed by the self-help groups themselves, accounts for the high level of performance in loan recovery. In these respects, as well as in its strong commitment to targeting only the very poor, it sets a high standard of practice in the region.

Nepal: Gundu Village and other credit programs

At the time of the first and second regional workshops on **Banking with the Poor** (1991 and 1992), there were in Nepal a number of government-initiated programs aimed at helping the poor. These included the Small Farmers Development Program (SFDP), the Intensive Banking Program (IBP) and the Production Credit for Rural Women (PCRW). However, they were characterised by a relatively 'top down' approach and met with varying degrees of success. Loan repayment rates varied from 62 to 76 per cent, casting doubt upon their long-term sustainability, and the grassroots participation of NGOs was not fully mobilised.

More recently, an internationally initiated program funded by the Asian Development Bank has largely recognised these problems, primarily by providing for a far more significant level of NGO participation in the implementation of lending to the poor. This is discussed in Chapter 5.

In the meantime, in response to these problems, as well as to the relative weakness of the development NGO movement in Nepal at that time, a special program was launched by the Rashtriya Banijya Bank to pioneer, on a sound commercial basis, the implementation of **Banking with the Poor** in Nepal. Targeting the very poorest households in the Gundu Valley area, the Gundu Village Development Board (GVDB), acting as an NGO, set up five groups, each of about 35 members, involved respectively in wool yarn spinning, furniture making, goat raising and local marketing. While these groups, with the GVDB's guidance, have not thus far served as financial intermediaries, they have recommended loans by the Bank for their members and received training in simple bookkeeping and financial management to enable the group to be in a position to receive and administer wholesale loans from the bank.

This model is now being successfully replicated throughout Nepal by Rashtriya Banijya Bank, with as many as 20 NGO promotional and supervisory bodies being established, 206 SHGs formed, and a total of $78,000 in loans disbursed in 1993. Savings amounting to $8,000 were mobilised by the groups that year, and their loan repayment rate was 100 per cent.

Achievements to date

This initiative of **Banking with the Poor** in Nepal can therefore be regarded as very promising. The basic model seems sound. However, with the large numbers of poor still to be reached, it seems important for the lessons of this model to be rapidly absorbed and replicated by the Nepali NGO movement on a broad front. This learning process should extend to those NGOs now actively involved with the implementation of the new ADB microcredit project for women.

It is encouraging to note the progress achieved in this regard by the national workshop of NGOs in February 1994, organised by the Foundation and the NGO Federation of Nepal, and attended by representatives of almost 40 NGOs. That meeting resolved that the recommendations on **Banking with the Poor** addressed to NGOs were entirely appropriate to Nepal, and that they should be implemented by NGOs in close consultation with the central bank and the Bankers' Association of Nepal.

The meeting nominated an action committee to implement another decision of the national workshop: that the NGO Federation should disseminate information about **Banking with the Poor** to all interested NGOs; the Federation should identify, motivate and train NGOs to participate in the program; they should identify existing SHGs and form and train new groups to establish linkages with banks for participation in the program; and the Nepal Rastra Bank (the central bank) should be asked to monitor this process and review the participation of the Bankers' Association of Nepal and the NGO Federation of Nepal in its implementation. The Foundation for Development Cooperation was also requested to provide further information and assistance to Nepali NGOs for this purpose.

Pakistan: AKRSP and OPP[23]

In Pakistan, the Foundation has developed a partnership for **Banking with the Poor** with the Aga Khan Rural Support Program (AKRSP) and the Orangi Pilot Project (OPP), as well as with the Habib Bank. Although these relationships have not yet developed into a substantial NGO/bank linkage, there are clearly some elements in the role and practice of these NGO partners that are both noteworthy and replicable by the NGO community in Pakistan and elsewhere in Asia.

This is very much the case with AKRSP, which may have less need of bank linkages (on account of its own foundation-backed resources) than other successful NGO programs of credit for the poor in the region. Working in one of the most isolated and desolate regions of Asia, in the foothills of the Himalayas amongst the very poorest of subsistence farmers, AKRSP has crafted a unique model to help the rural poor to help themselves. Established in December 1982 in northern Pakistan, its aim has been to reduce poverty through village level participation, creating village organisations (VOs) and women's organisations (WOs), generating their own regular savings and enhancing their own technical and managerial skills.

Over the past ten years, AKRSP has organised 2169 such groups (1598 VOs and 571 WOs) with nearly 90,000 members. Two fundamental rules are applied : firstly, to meet regularly to review their common needs and performance and, secondly, for all members to make savings deposits at all meetings.

At the end of 1992, a total of $6.8 million had been distributed in short-term loans (averaging $20) for fertiliser, marketing, plants and seeds etc., and longer term loans (averaging $840) for capital, agricultural machinery and stock. Only 1.6 per cent of short-term loans and 7.44 per cent of medium-term loans are in default.

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[23] Some of the data in this section have been derived from an AIDAB report on microenterprise development in Pakistan. See H.G. Aklilu, 1993, *Situation Analysis of Microenterprise Development in Pakistan*, Islamabad, Australian International Development Assistance Bureau.

Orangi Pilot Project (OPP)

The Orangi Pilot Project (OPP), by contrast, is an urban project operating in the largest squatter settlement in Karachi with a population of 1 million. It conducts a wide range of income-generating activities for the poor and to date has distributed 1764 loans for about $800,000 for a variety of projects. The average loan size is about $550. Repayment rates have also been good with only 2.45 per cent in default. OPP has a linkage with a line of credit from the Habib Bank to help fund some of the productive activities of the group's members, for example, bakery, carpets, milk cattle, embroidery, fishery, furniture, leatherwork, printing, shoemaking, stationery and woodmaking. There may be some question whether OPP is consistently targeting the poorest of the poor in all these activities; that should be reviewed. However, OPP has achieved a loan repayment rate of 98 per cent for its SHG members which, in the context of the broader credit culture in Pakistan, has greatly impressed commercial banks.

It was generally agreed at the Pakistan national workshop on **Banking with the Poor** that many more NGOs need to emulate the experience and principles of AKRSP and OPP. They need to develop better information sharing and consultation between them and the banks, while the latter need to recognise the legal identity and practical capacity of NGOs and SHGs in Pakistan. Further action is clearly needed on the part of all parties — government, central bank, NGOs and commercial banks — to achieve the goals of **Banking with the Poor** in Pakistan.

The Philippines: APPEND partners

As indicated previously, the Philippines boasts a very large number of NGOs (between 20,000 and 50,000, according to some estimates). However, only a very small proportion is engaged in programs of credit for the poor. Using strict criteria, three organisations were chosen from the APPEND (Association of Philippine Partners in Enterprise Development) network in the Philippines to participate in the regional project on **Banking with the Poor.** Known by their Tagalog acronyms, these three organisations are ASKI, KMBI and TSPI respectively.

The oldest organisation (sometimes referred to as the 'parent' organisation in the APPEND network of NGOs throughout the Philippines), TSPI (Tulay sa Pag-Unlad Inc) was established in 1982 by a group of business and professional leaders based in Manila, to make small loans and training available to microentrepreneurs. With growing support from international NGOs from Australia and the United States, and subsequently with official aid support from Australia, the United States and Europe, TSPI soon became one of the leading microcredit NGOs in the Philippines, with a good track record in creating incomes, jobs and microenterprises for the poor.

Although the Marcos government had previously launched a number of large official programs of credit for the poor (KKK being the foremost), they proved to be politically motivated and notoriously unsuccessful (achieving unsustainable loan repayment rates of less than 30 per cent as in similar subsidised official programs in other countries in Asia). This experience demonstrated the crucial importance of establishing professionally based and commercially viable NGO programs for the poor.

Following the 1986 'people's power' revolution, President Aquino called upon the Philippine NGO community and overseas aid donors to develop an effective program to alleviate poverty, especially in the poorer provinces, and as far as possible using NGOs, community and church-based organisations to increase incomes for the poor. TSPI responded to this challenge by creating six new provincial partner organisations (among them ASKI and KMBI) which initiated programs of microcredit for microenterprise based largely upon the TSPI model.

At that time (1986–87) these organisations were only involved in making individual loans to existing small microentrepreneurs who, while they were unable to obtain bank loans, could not generally be regarded as amongst the very poor. However, the APPEND NGOs did make a valuable contribution to the strengthening of existing microenterprises and, through them, created additional income and jobs over the period 1986–1990.

Involving self-help groups

Subsequently, our Philippine APPEND partners, like many other NGOs in Asia, became aware of the achievements of the Grameen Bank in reaching the poorest of the poor through organising self-help groups. Likewise, the PHBK program in Indonesia to link banks with self-help groups came to their attention. They also participated, over the last three years, in the Foundation's program to explore, demonstrate and publicise the scope for increased access to credit for the very poor through NGO/SHG–commercial bank linkages, and subsequently began to develop their own specific programs aimed at the very poor. The outcome is that these three Philippine members of the BWTP Network have now developed significant programs of access to credit for the very poor by developing self-help groups (following either the Grameen or modified models) as their basic financial intermediaries, as well as entering into significant linkages with major commercial banks, including the Bank of the Philippine Islands/Family Bank, our network partner.

Achievements to date

The consolidated results for the APPEND network in the Philippines are as follows. In the last two or three years, they have already established 775 self-help groups which combine into about 160 centres (an SHG being about five to six members and a centre comprising about six to seven SHGs). Clearly, most of these groups are now clearly reaching the very poor, some using a 'means test' similar to that of AIM and the Grameen Bank. In the last financial year, over 3000 poor borrowers were involved, with loans amounting to $2.4 million. Total savings in the same year amounted to $0.106 million. It is important for the purpose of this report to note that the loan repayment rates of the poor members of SHGs (in excess of 95 per cent) have been demonstrably higher than those of (presumably more affluent) individual borrowers from these NGOs, which have averaged only about 85 per cent over recent years.

How to build SHGs for successful banking with the poor in urban areas

The second regional workshop, in addition to approving 16 guiding principles for self-help groups, also reviewed the Foundation manual, *How to Build Self-Help Groups for Successful Banking with the Poor*. This first version of the manual was based upon the practical experience of MYRADA in Southern India. The context, in that case, was a rural one, amongst very poor villagers with strong local cohesion and common needs. Such groupings of the rural poor provide natural 'building blocks' for the formation and training of SHGs, to mobilise their savings and initiate credit programs under the NGO's guidance and with a small line of credit from a local bank.

The question is, can this process be successfully replicated among the poor in densely populated urban areas. Many of the urban poor, hoping for a better life, may have recently migrated from rural areas to become urban squatters or slum dwellers. Would these groups of such people be too 'transitional' and lacking in the kind of social cohesion typical of more stable rural communities?

One of our Philippine partners in **Banking with the Poor**, KMBI, has started an ambitious program to build SHGs for banking with the poor in very poor squatter areas on the northern fringe of Metro Manila. In the past three years, it has already built 245 small groups of five members each, which combine into 35-person centres. These manage and operate the credit and savings programs of the combined groups, and are now receiving bank lines of credit channelled through the NGO. Calming earlier fears about the problems to be overcome among the urban poor, these groups are now working well, with loan repayment rates of over 95 per cent. KMBI estimates the average cost of establishing an SHG centre, over one year, to be about $1031 (similar to the annual cost in India).

Using material provided by KMBI as well as drawing generally on BWTP Network experience, a draft manual on forming self-help groups in an urban context was tabled at the Third Regional Workshop. A final version of this manual as well as a revised edition of the parallel manual based on MYRADA's experience has since been published by the Foundation. See *How to Build Self-help Groups for Successful Banking with the Poor: An Urban Model* (1995) and *How to Build Self-help Groups for Banking with the Poor: A Rural Model* (rev. edn, 1995).

Linking with commercial banks

Three commercial banks are now supplying loans or lines of credit through these three NGO partners in support of their loan capital requirements for group lending. This already amounts to almost 50 per cent of their loan capital requirements that were previously met — it is relevant to note — by grants from aid donors, particularly AIDAB and USAID.

The APPEND partners (and other Philippine NGOs) are currently negotiating with several leading commercial banks as well as with the Bankers' Association of the Philippines (BAP) (see Chapter 4) to secure the substantial loan capital commitments which are necessary to address the great needs represented by the numbers of rural and urban poor in that country. They believe they have developed sound methods and models for this purpose, and that the banks have begun to recognise the opportunity this represents.

Need for NGO institution building

However, while the commercial banks (30 of which were represented at the Foundation's national bankers' workshop in November 1993) are interested in and responsive to this challenge, the NGOs themselves are also deeply concerned about their own 'absorptive capacity' and institutional ability to employ additional commercial bank funds to respond to this need of the poor. One of the main issues for the future of **Banking with the Poor** in the Philippines is whether the government and international aid donors, seeing the potential for reducing *loan capital* funding, will come to the rescue with significantly increased grants for *institution building* of the NGOs. These are required to enhance the absorptive capacity of NGOs for significantly increased commercial bank loans, thereby enabling them to reach the great numbers of very poor that are not being reached at present.

At the two national workshops (of bankers and NGOs) convened by the Foundation in the Philippines it was agreed that:

1) the main NGO networks involved in programs of credit for the poor should cooperate to be in a better position to relate to, and negotiate linkages with, major commercial banks and with BAP
2) BAP would take initiatives to that end (BAP has since undertaken these initiatives, details of which are provided in Chapter 4).

Sri Lanka

There is a wide range of programs of credit for the poor in Sri Lanka, some of which have been initiated and funded by aid donors such as the International Fund for Agricultural Development (IFAD), the World Bank and the Canadian International Development Agency (CIDA).

All of these programs rely heavily upon NGOs as financial intermediaries to reach the poor with credit — either directly or, more frequently, through self-help groups of the poor themselves. As is the case in other countries, these groups have created a common fund from their small savings that has generally been sufficient to meet only their emergency needs. Supplementary funding has been supplied for productive purposes by larger NGOs which often serve as conduits for the international aid grants or soft loans funds mentioned above.

The National NGO Council of Sri Lanka has a membership of 158 national and secondary-level NGOs. As in other Asian countries, many of these are involved solely in research, cultural, welfare or religious activities. However, some are involved in promoting income-generating, credit and savings activities and in organising self-help groups for the poor.

NGOs which focus on credit

A recent survey[24] lists the following NGOs which have been very active in this field: numerous Thrift and Credit Cooperative Societies (TCCSs) whose umbrella body, Federation of Thrift and Credit Cooperation Societies (FTCCS), is the Foundation's original network partner in **Banking with the Poor**; Multipurpose Cooperative Societies (MPCSs) and the Sarvodaya Economic Enterprise Development Service (SEEDS); CARE International and World Vision International.

TCCSs and SEEDS have played an important role in mobilising savings of SHGs and using them to provide credit for the poor. According to the above survey, TCCSs alone mobilised savings to the value of $10.4 million in 1990 and $11.9 million in 1991, and disbursed almost the entire amount as credit to members during the same period. It may be observed that most other NGO programs of credit for the poor in the region have credit as a very considerable multiple of members' savings, made possible by injections of bank credit.

The poorer members of primary TCCSs, or those societies comprising a majority of very poor members (not regular wage- or income-earning), may not be able to meet the normal credit union requirement of holding deposits/savings of one to four in relation to borrowings. In consequence, this is an area in which supplementary funding either from commercial banks or from subsidised grants may be required. As subsidies are not in keeping with the basic objectives or principles of **Banking with the Poor**, the development of commercially sound linkages with commercial banks is much to be preferred to establish fully sustainable credit for the poor. It is therefore reassuring to know that the FTCCS is actively exploring and establishing bank linkages for that purpose.

Small Farmers and Landless Credit Project (SFLCP)

Among the main internationally supported programs referred to above is the Small Farmers and Landless Credit Project (SFLCP), funded by IFAD and CIDA.[25] This project, to be implemented over six years, commenced in 1990, with target beneficiaries numbering 32,280 and a credit component of about Rs 341.2 million ($6.8 million). The entire disbursement is to be routed through SHGs of 8–10 members formed for this purpose. Here again, TCCSs and SEEDS were among the main NGOs and other self-help promotional institutions (SHPIs) that have participated in this program. After three years of implementation, a total of 20,825 beneficiaries have been reached, 3201 SHGs have been formed, and around Rs 100 million ($2.03 million) has been disbursed in loans. Some 22 per cent of this has been used for agriculture, 25 per cent for animal husbandry, 27 per cent for microenterprise, 22 per cent for trading services, and 3 per cent for fisheries.

While the foregoing are positive achievements, loan recovery rates were reported to average only 89.61 per cent, which is somewhat lower than the average for **Banking with the Poor**

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[24] *Asia-Pacific Rural Finance*, March 1994.

[25] Data for this program are from the survey in *Asia-Pacific Rural Finance*, March 1994.

network partners in the region. Some 460 groups organised by primary TCCSs report a recovery rate of 99.3 per cent.

In addition, there is some concern that this program may encourage dependency upon subsidised credit among NGO and SHG participants, which could diminish their interest in establishing the linkages with commercial banks which are needed for long-term sustainability. This issue should be addressed to ensure that such an undesirable policy outcome does not occur.

Janasaviya Trust Fund (JTF)

Another recent internationally supported program is that of the Janasaviya Trust Fund (JTF), established in 1991 by the government with World Bank assistance. The fund targets individuals with household income below $300 per month and, again, works mainly through SHGs of about five to seven members. These in turn are funded through partner organisations (mainly NGOs) currently numbering about 65.

JTF reports that the number of SHGs established by the end of 1993 was 7910 with total loans of $1.8 million to 14,878 borrowers (average loan size $122). The average repayment rate to JTF has been 99 per cent, and the average repayment rate to the NGOs by the borrowers exceeds 95 per cent. It is JTF's policy that final borrowers pay a market rate of interest (defined as 1 per cent above the average current commercial rate, now 21 per cent).

JTF seems determined to avoid any need for subsidisation of its intermediaries, which is consistent with **Banking with the Poor** principles. Its policy is for NGO partner organisations to cover their costs from the interest rate spread. This has not yet been precisely quantified, but a research program is being undertaken in 1995 to ascertain the viability of NGOs as well as the cost of SHG formation and the cost of delivery of credit. It will be interesting to compare the results of this research with the Foundation's studies of the costs of forming and training SHGs, and of the transaction costs of credit delivery under **Banking with the Poor** in India and the Philippines.

Need for coordinating mechanism

At the conclusion of the Sri Lanka national workshop for NGOs[26] organised by the Foundation, the participants adopted an action plan to establish a mechanism for coordination of NGO efforts and communication with other NGOs in the area of microcredit, to serve as a clearing house for information on the subject, and to communicate with banks on behalf of NGOs. When established, the new apex body will facilitate the linkage of NGOs with banks in sustainable commercial relationships for the supply of credit to the poor, as proposed in the report on **Banking with the Poor**. The action committee with responsibility for progressing this initiative is chaired by the TCCS umbrella body, the Federation of Thrift and Credit Cooperative Societies.

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[26] See *National Workshops on Banking with the Poor*, 1994.

When this decision was reported to the governor of the central bank, he welcomed the NGO initiative and further suggested that the NGO committee should form the basis of a larger body, to incorporate representatives of the major national banks (some four or five, both state and private sector) with a demonstrated interest in 'poverty' lending. The central bank would nominate a representative to this committee.

The Federation has reported progress with this initiative. Dialogue between the NGOs resulted in a workshop on 15 and 16 July 1994 which brought together representatives of the banking industry and NGOs to discuss specific areas of cooperation at some length. It reports that 'the process is still continuing and concrete linkages are being made. In the absence of a central coordinating mechanism for NGO activity in our country, [the Federation] is attempting to fill this void. . .'

Chapter 3
IMPLEMENTATION
THE ROLE OF GOVERNMENTS AND CENTRAL BANKS

3.1 Introduction

At the second regional workshop held in Kuala Lumpur in July 1992, participants unanimously endorsed a set of recommendations addressed to governments and central banks to enhance their efforts for **Banking with the Poor**. Basic principles underlying **Banking with the Poor** recommendations to governments and central banks were:

- Governments to adopt banking with the poor as part of their strategy for poverty alleviation.
- Central banks to encourage commercial banks to adopt alternative systems of credit delivery and to recognise the role of NGOs and SHGs as financial intermediaries.
- Governments and central banks to review banking regulations affecting loan procedures and collateral requirements and to make them appropriate to the poor.
- Central banks to issue specific guidelines to the commercial banks for treating group guarantees as collateral substitutes.
- To remove subsidies and grants, and introduce market-related interest rates in lending to the poor.
- To ensure that partners in the linkage (banks, NGOs, SHGs) are able to cover their transaction costs from loan operations.
- Governments and central banks to recognise the crucial role of NGOs in developing effective SHGs, and to extend technical assistance for their capacity building in association with donor countries.
- Governments to accord recognition to the important role of NGOs in poverty alleviation, and to assist in setting up central coordinating mechanisms for NGOs in this field.

With a view to assessing progress made in implementing the above recommendations, the Foundation for Development Cooperation approached officials of the national governments and central banks in the BWTP Network countries. Foundation representatives also made follow-up visits to these countries. Based on information received and assessments of the working of banking with the poor in our network countries, the Foundation is able to report the following.

3.2 Reviewing government and central bank support for banking with the poor

Poverty alleviation programs receive priority in the economic development plans of most of these countries. The socio-economic imperative of early and speedy upliftment of the poor has propelled governments to redouble their efforts, to set specific targets for poverty eradication, and to encourage innovative approaches for programs oriented toward the poor. Towards that end, over the last few decades governments in the region launched a series of credit programs for the poor, both directly and through financial institutions in their countries. Most of these programs were started, and continued to operate, at varying rates of subsidy.

However, there is a growing realisation on the part of policy makers and planners that subsidised credit programs have not been as effective as envisaged and sometimes have been financially disastrous. This is due primarily to the 'top down' nature of their operation,the absence of grassroots organisations, corrupt bureaucracy, and the apathy of the commercial banks, as well as the rigid regulation of banking systems. Countries in the region are all clearly looking for a better credit delivery mechanism which can achieve the desired result. It is in this context that the recommendations of **Banking with the Poor** are receiving increasing attention from governments and central banks in the network countries.

The Philippines

In the Philippines since July 1992 a number of initiatives have been taken towards democratising credit. In 1993, the Social Pact on Credit was forged by a broad alliance of government, non-government and bankers' groups concerned with credit delivery to the poor. The Bankers' Association of the Philippines (BAP) has also joined the alliance. The Social Reform Agenda approved by President Ramos in June 1994, while admitting the ineffectiveness of the traditional approach, specifically calls for a Credit for the Poor program using the Grameen Bank approach. This is a significant milestone in as much as the mechanism recommended by **Banking with the Poor** follows closely in many respects that established by the Grameen Bank.

In the context of the Philippines, the role played by the central bank is somewhat different from those of other central banks in the region. The informal financial sector, represented by NGOs and SHGs, is outside the purview of central bank regulations. The central bank has, nevertheless, given its green light to banking with the poor by helping to organise our national workshop for banks, with the Governor himself (as keynote speaker at the workshop) exhorting the Philippine banking community to implement the recommendations of **Banking with the Poor**. The BAP has been supportive of banking with the poor, and given assurances that its member banks will be prepared to cooperate with those NGOs possessing adequate organisation and experience for poverty lending. It is hoped that Philippine banks will increasingly incorporate the ultra-poor into their fold.

Indonesia

In March 1994 the Indonesian government announced Inpres Desa Tertinggal (IDT), a special program targeted directly at people below the poverty line in less developed villages. This is a crash program for poverty alleviation. As indicated in Chapter 2, it is to be implemented through the intermediation of SHGs of the poor, and in close coordination with Bank Indonesia's ongoing PHBK program linking banks with SHGs.

Bank Indonesia, under GTZ technical assistance, has been operating the PHBK credit program for six years with increasing success. The leadership role played by Bank Indonesia in implementing the linkage program has been widely lauded.

Indonesian experience with linkage

Indonesia is the first country to take national action through a project called PHBK (Project linking banks and self-help groups) which began in 1989. Its explicit objective is to make the poor bankable through institutional linkages between banks and self-help groups.[27] PHBK works within detailed guidelines and a range of models of linkage, which are discussed in detail in Chapter 2.

Following the completion of pilot and early implementation phases, since April 1994 the project has entered the full implementation phase in ten of Indonesia's 27 provinces. Since the initial work in Yogyakarta in 1989, around 1500 SHGs or over 60,000 group members (40 per cent women) have received loans totalling $6.25 million. The participating institutions have grown with 63 bank branches and 49 NGOs involved in the project today. The project has experienced good repayment rates, with almost 95.5 per cent of loans paid on time at mid-1994. PHBK has proved that the gap between microentrepreneurs and banks can be bridged.

Bank Indonesia has taken an appropriately bold initiative by playing the role of development agency and pacesetter, rather than confining itself to the traditional central banking roles. PHBK has targeted the rural poor in general, and it is hoped that the poorest of the rural poor will also be covered comprehensively by this program, with the emphasis on poverty alleviation in Indonesia in the recently commenced Five-Year Plan, and the IDT program associated with it. Massive enlargement of credit delivery via the PHBK mechanism will be required under the Plan.

Malaysia

The situation in Malaysia differs significantly from that in other BWTP Network countries, in that the hardcore poor living below the poverty line in 1993 were only about 120,000 households or about 3 per cent of the total population.[28] With Malaysia experiencing high economic growth, around 7 per cent per annum during the last two decades, a strong export sector, and an open unemployment rate below 2 per cent, its policy makers feel the country has the required economic strength to deal with poverty. It has nonetheless paid full

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[27] Bank Indonesia, 1994.

[28] Estimate made by Amanah Ikhtiar Malaysia, BWTP Network NGO in Malaysia.

attention to the issue, projecting in the *Second Outline Perspective Plan 1991–2000*[29] that the incidence of hardcore poverty will decline to 2.2 per cent in 1995, and be eradicated by the year 2005.

To that end, the government is pursuing a number of sectoral poverty alleviation programs, and so far as credit to the poor is concerned, intends to support the efforts of Amanah Ikhtiar Malaysia and the Credit Guarantee Corporation (CGC) by providing them needed resources in the form of grants. It has in the past provided AIM and CGC with grants, both directly and through the Islamic Economic Development Foundation. The central bank, Bank Negara Malaysia, does not have a specific policy or program of intervention in the poverty field. Notably, the State Agricultural Bank (Bank Pertanian Malaysia) has been established outside the regulatory purview of Bank Negara Malaysia. In a country with an otherwise freewheeling and competitive financial system, it is perhaps unfortunate that societally imposed limits on the 'service charge' (or rate of interest) which AIM can levy on its loans to the poor place constraints on its capacity to achieve commercial viability.

Bangladesh

Bangladesh has over 60 per cent of its population living below the poverty line. Most of the programs of credit to the SHGs of the poor are operated by NGOs independently of the banks, prominent among which are the famous Grameen Bank, the Bangladesh Rural Advancement Committee (BRAC), Proshika and others. Swanirvar Bangladesh (SB), the BWTP Network NGO in that country, has the major NGO credit program in which nationalised commercial banks engage in lending to SHGs in a linkage relationship on the lines of **Banking with the Poor.**

Bangladesh Bank (the central bank) coordinates the credit flow to SB programs, and is therefore the most important source of support. The bank's commitment to linkage is reflected in various policies and programs. As far back as 1991–92, the Bank incorporated the establishment of linkages by the banks with NGOs and SHGs in its annual statement of Agricultural Land Rural Credit policies.

At the national workshop for banks and NGOs in Bangladesh in 1993, organised jointly by the Foundation, Swanirvar Bangladesh and Janata Bank, Governor Khorshed Alam supported the recommendations contained in the **Banking with the Poor** report and praised the Foundation's initiative in disseminating them. He stated that the poor are bankable, that access to credit is more important than its cost, and that the introduction of market rates would remove current distortions.

The recent initiative of Bangladesh Bank in organising a national seminar on promotion of linkages of self-help groups with financial institutions (in September 1994) in Dhaka is extremely important. International experts participated, together with Bangladeshi banks

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[29] Malaysia, *The Second Outline Perspective Plan 1991–2000*, Kuala Lumpur, 1991.

and NGOs. The seminar endorsed the findings and adopted the major recommendations of **Banking with the Poor.**

It has also been reported by Bangladesh Bank that the Banking Companies Act does not make it obligatory for banks to demand collateral; they may lend to the poor with or without collateral. The government of Bangladesh has shown its support by creating a lending organisation for NGOs and funding it annually on a substantial scale. In the last two years, the Palli Karma-Shayak Foundation has loaned TK 750 million ($15 million) to 105 NGOs for their programs of credit with SHGs. Unfortunately, the climate for credit in Bangladesh is marred from time to time by government measures such as 'loan forgiveness' which affect loan discipline and deter further participation of banks. There is much that needs to be done in changing the attitudes of banks towards support of the poor, a challenge in which Bangladesh Bank has a very important role to play.

Nepal and Sri Lanka

In Nepal and Sri Lanka there are linkages established by the commercial and development banks under specific credit programs for the poor which are donor assisted and funded. Government commitment to poverty alleviation is undoubtedly strong in both countries, but it is not specific with regard to an alternative and innovative linkage strategy of credit for the poor. The role of NGOs and voluntary organisations has been recognised but the credit focus is not so pronounced. In fact, in Sri Lanka, it is only very recently that NGOs have been cleared to take initiatives. The confidence shown by the more recent Sri Lankan governments in NGOs, and the more conducive climate thereby created for them, are bound to help. The value of NGOs is increasingly being recognised by governments in other BWTP Network countries also.

Central banks in both Nepal and Sri Lanka realise the need to adopt concrete measures concerning credit for the poor and, in order to achieve those objectives, have created regional rural development banks (RRDBs): 17 in Sri Lanka and two in Nepal. They are using them for lending to SHGs and to individual poor. In Nepal, the two RRDBs have adopted a Grameen type of operation. Nepal Rastra Bank issued directives to the commercial banks in July 1993 to provide credit to the rural poor through NGOs, and the Central Bank of Sri Lanka has pinned great hopes on RRDB effectiveness in poverty programs.

Pakistan

In Pakistan there are few cases of group formation by NGOs in the rural and semi-urban areas for purposes of loan operation. Most banks have carried out government small-enterprise credits and youth employment programs, but no links with NGOs have been established in these programs. The banks are not ready to consider informal SHGs as legal entities for purposes of loans and the State Bank of Pakistan (the central bank) has yet to make any policy intervention in this regard, despite a speech supportive of banking with the poor by the Governor at the Foundation's national workshop in Karachi early in 1994.

India: developing linkage experience

Dr Rangarajan, the Governor of the Reserve Bank of India (RBI), has drawn attention to the need for innovative forms of financing in alleviating poverty:

> Experience has now shown that many of our programs aimed at providing credit through organised credit channels, such as banks, have not had the required success. New ways and innovative forms of financing, which are based on sound commercial principles and yet help to alleviate poverty, have therefore to be developed.[30]

He went on to say that 'the linking of formal credit institutions with the rural and urban poor through intermediaries such as NGOs must be thought of as an alternative mechanism for meeting the credit needs of the poor'.

Over the years, the government of India and RBI have taken a number of major steps in poverty alleviation, and launched a number of credit schemes such as the Integrated Rural Development Program to enable the rural as well as urban poor to cross over the poverty line and become self-reliant. For various reasons, the rural credit delivery system in India has been weakened by very poor loan recovery, high operating costs of commercial banks, and the burden of subsidised interest rates and write-offs. The poorest farmers, agricultural labour and artisans did not gain satisfactory access under these programs and have suffered the most.

Pilot project on linkage

In July 1991, RBI issued an instruction to all banks in the country to lend directly to SHGs, as an alternative method to serving the credit needs of the poor through relaxing requirements relating to status of institutions, interest rates and margins, collateral, etc. RBI also urged NABARD (National Bank for Agriculture and Rural Development) to launch a pilot project for this purpose. NABARD followed up in February 1992 by launching a pilot project on linkage and issuing detailed guidelines to all commercial banks for linking with self-help groups. In its guidelines NABARD has laid down criteria for selection of SHGs, their working methods, rate of interest applicable, relaxed conditions for security and collateral, decentralised and prompt decision making by the bank branches, and for the training and sensitisation of bank personnel, NGOs and members of SHGs.

More specifically, NABARD set eight major criteria for the selection of SHGs, among which are:

- active existence of the group for at least six months
- saving and credit experience
- democratic working

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[30] Extract from keynote address by Dr C. Rangarajan, Governor, Reserve Bank of India, at Indian national workshop for bankers on Banking with the Poor held in Bombay on 31 January 1994.

- maintenance of proper accounts/records by the group
- homogeneous background of members
- the role of participating NGOs in training, skill upgrading and proper functioning of the group.

The success or failure of the program being dependent upon the effectiveness of the SHGs at the grassroots level, NABARD has recommended that the criteria for group operations should be strictly followed. NABARD has further recommended that the pilot project be implemented in clusters of 'blocks' or districts, rather than in a scattered manner. Initially, this methodology facilitates the operation. Group size according to NABARD should preferably be 10 to 25 members, to enable them to participate effectively in group deliberations.

Further, groups have to prepare credit plans for submission to banks. The rate of interest to be charged by banks to SHGs is now 12 per cent, and the rate to be charged by SHGs to the individual members is to be decided by the group. (In the majority of cases it ranges between 24 and 36 per cent per annum.) NABARD releases 100 per cent refinancing to the banks at 6.5 per cent. This is relayed from the banks to NGOs at 8.5 per cent, and from NGOs to SHGs at 12 per cent, leaving margins of 2 per cent and 3.5 per cent for banks and NGOs respectively, to cover their transaction costs.

Under the scheme NGOs and SHGs, despite their being informal and unregistered, are allowed to open accounts with banks. Banks were urged to simplify documentation for availing loans, and arrangements were made to pool experiences in documentation among the banks at periodic workshops organised by NABARD.

Under the linkage package, the main advantage to the banks is the 'externalisation' of part of the work of the credit cycle: assessment of credit needs, appraisal, disbursal, supervision and repayment, reduction in the formal paperwork involved, and consequent reduction in transaction costs. Improvement in recoveries is a distinct gain, and a larger mobilisation of small savings should be equally advantageous.[31] For the groups, the advantages lie in access to a larger quantum of resources as compared with their small pooled thrift funds, access to better technology, and skill upgrading leading to general improvement and economic development.

Beside the policy inputs, training prerequisites and 'exposure programs' for NGOs, SHGs and bank personnel were specifically planned, and NABARD's assistance in the matter assured. Seventeen exposure and dialogue programs for 350 NGO and bank officials have been organised. As mentioned in Chapter 2, 620 SHGs have already been linked with 16 commercial banks and 12 regional rural banks, total loans of Rs 8.42 million have been sanctioned by the banks, benefiting 11,000 poor people, mainly women. About 28 NGOs have joined in linkage partnerships so far.

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[31] Dr C. Rangarajan, keynote address.

Linkage expansion

NABARD has projected that during 1995, 2000 SHGs would be linked to the banks. By the end of March 1997 the linkage is projected to exceed 10,000 SHGs, covering about 200,000 households and around 1 million poor rural people. Besides improving the outreach of the formal banking system, the program is expected to enhance the quality of credit in rural areas, and promote people's participation, self-help and the development of grassroots institutions.

From the standpoint of policy support, commitment and program implementation, the Indian program represents one of the best examples in the region. The RBI has played a commendable role by opening the door for effective participation by the commercial banks, calling upon them to relate directly to the poor through their own approved SHGs. For that purpose it has removed hurdles concerning the legal status of NGOs and SHGs, recognised their autonomy and their right to set their own interest rates, as well as approving alternatives to traditional collateral and executing programs of skill development for banks, NGOs and SHG personnel involved in the program.

Interest rate issues

Some comments should, however, be offered with regard to the interest rate, fixed by NABARD at 12 per cent per annum for SHGs, and to NABARD's refinancing facility of 100 per cent under the scheme. In India, the program has been launched as a pilot project, and if one goes back to the earlier practice of the country in rural lending, the interest rate of 12 per cent (with large and medium credit attracting 15 per cent) may be considered appropriate as opposed to the huge subsidies given in the past. Departure from past practice should be gradual, according to the Reserve Bank of India. As the program gathers momentum, and experience and confidence are gained, the interest rates applicable should be at the discretion of the banks, and not dictated by RBI or NABARD. This will also be in line with the financial sector reform under way in the country, which lays emphasis on decontrol. The same will be true for NABARD's refinance facility, which is being granted at the pilot phase in order to attract commercial banks to the program.

As already stated, India has a large number of poor living below the poverty line. Some 320 million poor may have to be covered by approximately 2.6 million SHGs all over the country whereas only 620 SHGs have been linked during the last two years of the pilot phase.[32] Policy makers are concerned about the implications of such arithmetic. It is a challenge to the ability of the NGO movement to upscale and expand as rapidly as feasible, without sacrificing the essential qualities of the program which have made it successful. It is also a challenge to the government of the country, the Reserve Bank of India, NABARD and the commercial banks to see how best this can be accomplished.

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[32] Assuming five members per family, with one family member joining an SHG, and average SHG membership of 25 persons.

On its part, RBI has offered advice and urged the banks (RBI's circular letter dated 8 March 1994) to accelerate banking with the poor through linkages with SHGs. This circular mentions the Indian national workshop on **Banking with the Poor** initiated by the Foundation. It reiterates the importance of the intermediary role of NGOs and exhorts banks to undertake implementation as soon as possible.

3.3 Banking procedures and regulations

Historically, the attitude of commercial banks towards poor clients has remained apathetic; the poor are still generally considered unbankable. Banks are normally attuned to relatively rich clients who can meet the standard requirements. This has posed the greatest problem in attracting banks to rural areas, and has frustrated the effective operation of many of the credit programs meant for the poor.

A slow change in attitude is perceptible, where the central banking authorities are endeavouring to bring about a change in the established culture of the banks through moral suasion and directives. Banks have started responding to the advice/directives of the central banks. As a result, they have simplified traditional procedure in the case of poor clients by:

- reducing the number of forms to be filled in for loan applications, or the documentary evidence required (Rashtriya Banijya Bank has curtailed the number of loan documents from 15 to 4 categories)
- relaxing in-depth checking of applications for loan amounts less than a certain sum (Ps 500,000/$19,100 or less in the Philippines)
- generally reducing or simplifying the numerous proofs required to be furnished by borrowers
- redesigning the loan application forms to meet the needs of illiterate and asset-less borrowers in the villages
- developing positive attitudes to, and cooperation with, NGOs and SHGs and waiving collateral for SHG loans of less than Rs 5,000/$160 where appropriate
- delegating loan approval authorities to their field-level loan officers (Sri Lanka); posting mobile credit officers in the field to deliver loans at doorsteps (Pakistan); and opening special credit windows for the rural poor (Pakistan)
- most importantly, recognising the key role of NGOs and SHGs as effective financial intermediaries for credit to the poor.

As a result of instructions issued by the central banking authorities, banks have come around to modifying their standard practice to some extent to suit the poor borrowers. They have, to a limited extent, also undertaken reorientation of their staff for this purpose. These positive developments are still limited to a few progressive banks in each country. Such changes have not occurred spontaneously nor without instruction from 'above'.

3.4 Collateral requirements

Existing banking regulations in partner countries, as well as traditional practice pursued by the banks, have demanded tangible assets as collateral security from borrowers, in addition to project feasibility reports, credit references and legal documents to support loan requests. This culture is deep-rooted in the banking system and a great deal of resistance to change still exists.

Nonetheless, reports show that there has been a noticeable change in this regard. Group guarantees in lieu of physical collateral are now the widely accepted norm in lending to the poor through SHGs. In some countries personal sureties (Philippines), two personal sureties (Pakistan), or demand promissory notes (Bangladesh) are also required. In general, group guarantees backed by the savings of the group have been accepted by banks. Groups are also encouraged to increase their savings, based on which they are allowed to borrow from the banks in specified ratios, 1:4 or up to 1:6 (Indonesia). The Reserve Bank of India has waived collateral for all SHG loans below Rs 5000/$160 (which means almost all SHG loans).

3.5 Interest rates

Banking with the Poor recommends that the rates of interest to be applied for credit to the poor should be market related, as the commercial banks have costs which must be recovered. It also recommends that the intermediary NGOs and SHGs should be able to build into their rates sufficient margin to cover the costs of loan administration. However, subsidised soft rates and lower than typical market rates continue to prevail in the network countries. Indonesia is an exception where banks charge full market rates under the PHBK linkage program.

The poor have not asked for concessionary interest rates. Indeed, it is one of the main findings of **Banking with the Poor** that it is the lack of access to credit, rather than its cost, that is crucial. Yet sentiments of compassion, rather than the ability of the poor to pay, rule the minds of politicians and high-level decision makers. Similarly, central banks recognise the need for realistic rates but hesitate to come forward. One central bank governor in a partner country while accepting the logic of market rates, nevertheless indicated he would still like to see interest rates on loans to the poor, in general, be 'lower' than the prevailing market rates.

There is no shortage of argument against such views. For example, a report by the Presidential Commission on Finance and Banking in Sri Lanka submitted in 1992 specifically recommended that since easy and timely availability of credit rather than the cost of credit was important, market rates should be applied.[33] Bangladesh has officially deregulated interest rates since 1990, but allows the banks to operate only within a band of 8–13 per cent. However, some institutions like Grameen Bank and BRAC in Bangladesh

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[33] *Final Report of the Presidential Commission on Finance and Banking*, vol. 1, Sri Lanka, 31 December 1992.

and Janasaviya Trust Fund in Sri Lanka have applied their own rates, which are market related or near to it. It seems certain that subsidised rates will be phased out in due course and market rates brought into play when financial sector reform under way in most network countries is implemented in practice.

3.6 NGO institutional capacity building and technical assistance

In Indonesia a great deal of support is being extended to NGOs for their institutional capacity building under the PHBK program assisted by GTZ and implemented by Bank Indonesia. The Foundation's Indonesian National Workshop on **Banking with the Poor**, held in Jakarta in September 1994, concluded that a forum of NGOs engaged in providing financial services be established. This would provide opportunities for communication to increase the capacities of such NGOs, facilitate training, encourage independent studies and research, and function as a focal point for attracting funding. Bank Indonesia has received the idea of such a forum positively, and the forum is now in operation.

In Nepal, the government has negotiated with the Asian Development Bank a microcredit project for women, a significant part of which will involve institutional support to NGOs. Technical assistance sought by the government will be geared to staff training and strengthening of management, accounting and reporting functions, etc. of NGOs.[34] Other governments are increasingly aware of the potential of external assistance to provide such qualitative inputs, as distinct from financial capital for lending purposes.

In India, NABARD under its pilot project has provided technical and financial support for training banks and NGOs, and for this purpose enlisted the support of MYRADA, an NGO network member. The emphasis will be on practical exposure for bank officials and NGO cadres.

3.7 Recognition of NGOs and need for central coordinating mechanism

Under economic liberalisation and privatisation policies flourishing in the region, the role of non-governmental organisations is strengthening. Such policies are expected to prove beneficial for the NGO movement in general. However, while the Philippines has accorded a very high place to NGOs in the socio-economic upliftment of local communities, in Sri Lanka it is only very recently that NGOs have been allowed to take significant initiatives. Lack of knowledge about NGOs among the decision makers in some network partner countries is an obstacle. Governments may harbour doubts about the motives of the NGO functionaries. Financially, NGOs tend to depend excessively on external aid, and there is limited capital build-up through locally generated resources. Most do not have a national network, and hence are not known nationally.

There does not seem to be one single umbrella organisation for all types of NGOs in most of the network countries. NGOs are generally organised as networks or federations on a sectoral

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[34] Asian Development Bank, RRP:NEP 25088 of June 1993.

basis, and are not yet confederated. All maintain links or have to be registered with the related government department (usually that dealing with social welfare services). The registration is mostly a formality and, in most countries, no monitoring of NGO activities is conducted by the department concerned. Further, NGOs are so widely dispersed that it is often hard to determine the exact number in existence.

Much of this is changing. In the context of banking with the poor, the role of NGOs is expected to be prominent and they must be given recognition by the authorities. Increasingly, there is in the BWTP Network countries a frantic search by the banking community for dependable NGOs for linkage.

In most cases, there would seem to be a clear need for all NGOs operating programs of credit for the poor to establish a national association or federation to enable them to deal more effectively with governments and bankers' associations, which are also committed to banking with the poor. Governments can facilitate this process by using such associations as preferred channels of communication and coordination. Care must, however, be taken to maintain the autonomy of NGO movements, thus encouraging the dynamism of which they are capable, and which is so much required for poverty alleviation.

Chapter 4

IMPLEMENTATION
THE ROLE OF COMMERCIAL BANKS

4.1 Introduction

The second regional workshop in Kuala Lumpur called upon the banking community in the BWTP Network countries to embark upon and expand the linkage of banks with NGOs and self-help groups of the poor. Basic principles underlying **Banking with the Poor** recommendations to banks were:

- Target the poor and lend through NGOs and SHGs.
- Train and sensitise their staff members.
- Simplify loan procedures and introduce alternative methods of credit delivery.
- Treat group guarantees as collateral substitutes.
- Fix rates of interest based on recovery of their transaction costs.
- Disseminate experience among fellow bankers.

Reports from our network partners indicate that many banks have positively explored the possibilities of linkage, taken practical initiatives by identifying NGOs and SHGs with experience in credit and savings, and shown willingness to trial linkages with them.

4.2 Targeting the poor and lending through NGOs and SHGs

In recent years, some commercial banks have developed their own specific rural credit programs implemented through their own branch networks, in an attempt to finance the small- and microenterprises of the poor and their agricultural production activities. Governments have also created specialised development banks dealing with agricultural and small- and medium-scale industrial enterprises. In these cases, banks have lent directly to individuals, rather than through the intermediation of NGOs or SHGs.

There have been in our network countries several earlier experiments of bank linkages with NGOs and SHGs which incorporated some elements of banking with the poor. The most notable of these has been the PHBK program in Indonesia, described in Chapter 2.

More recent examples are described in the **Banking with the Poor** report. Vysya Bank of India, a private commercial bank, has taken a unique initiative in the last four years. Rashtriya Banijya Bank of Nepal has independently developed NGOs and SHGs in certain poor areas of the country over the same period. The First Women's Bank of Pakistan, a private commercial bank managed by women as its name suggests, has quite independently also lent to SHGs of poor women. The nationalised commercial banks and Bangladesh Krishi Bank (BKB) in Bangladesh lend to the SHGs under the Swanirvar program, in which our partner NGO has been involved. These experiences of banks in South Asia have largely been limited to lending directly to SHGs, with NGOs providing 'non-financial' services; cases of bank lending to NGOs are few.[35]

On the other hand, banks in the Philippines do not lend directly to SHGs but through the intermediation of NGOs. Under the PHBK program, Indonesia has both models. NGOs within the Association of Philippine Partners in Enterprise Development (APPEND) have developed linkages with four banks so far: BPI, United Coconut Planters Bank, Solid Bank and the Planters Development Bank.

Linkage experience to date

Despite the relatively limited experience of commercial banks in the region in dealing with linkage, many of them are now positively inclined, partly due to the **Banking with the Poor** report and recommendations, and the program of advocacy in network countries. With respect to linkage experience, countries fall into four main categories:

1) those countries which have taken initiatives independently and are implementing linkages with strong support, programs and resources (for example, India and Indonesia)
2) those whose central banks have issued pronouncements supporting linkage and advising banks to proceed, but which have not fully backed it with strong and specific policy directives and the resources needed for this purpose (for example, Bangladesh and Nepal)
3) those whose governments and/or central banks are aware of the potential inherent in the linkage mechanism, but which have not supported it fully, nor created an appropriate working system (for example, Sri Lanka and Pakistan)
4) those where the central bank does not regard poverty alleviation as falling within its province, and where availability of resources and the limited extent of poverty incline the government more to other approaches to poverty alleviation (for example, Malaysia).

It must be said, however, that these distinctions are not exclusive; they overlap. Moreover, in some cases the main initiative or drive for linkage comes from the NGOs, in others from governments, and in some cases from international financial or technical assistance. Whatever the source of the initial stimulus may be, it can be said that many commercial banks are now beginning to experiment with banking with the poor. In this experimental phase, small amounts have been earmarked or released for lending through NGOs and SHGs. The approach seems to be one of learning through field experimenting.

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[35] Puhazhendhi, 1995.

Issues for banks

Several difficulties affect the readiness of banks to participate in banking with the poor. These are:

1) the question of the legal status of NGOs and SHGs
2) the ability of NGOs and SHGs to offer security/collateral
3) the high transaction costs of lending to the poor
4) the inability of the poor to comply with normal banking procedures and documentation.

It is true that at the experimental phase, banks have not taken these aspects as obstacles to experimentation. They have, in fact, overlooked the informal character of SHGs and have accepted group guarantees as collateral at this stage. There are, however, banks that will not lend to informal groups without collateral because of official regulations (Pakistan). Banks in some countries prefer to limit their loans to 'entrepreneurial poor', not the 'hardcore' poor (Philippines). The outlook is evolving — slowly but certainly positively. Banks have clearly seen the advantages of banking with the poor but have limited knowledge and experience of the key agencies in the process, NGOs and SHGs.

There is yet another dimension which may have an adverse impact on the banks' willingness to adopt linkage. The process of structural adjustment of the economies in the region and the financial sector reforms that are being pursued might prove to be a hurdle. Concern is expressed in certain countries whether the freedom granted gradually to the banks in regard to their loan programs (to whom and where to lend) may not lead to 'drying up' of resources earmarked for the poor, with subsidised support.

There is also some perception of contradiction between deregulation and continuing official encouragement to lend to the poor. We must hope this concern proves unfounded, since one of the primary tenets of **Banking with the Poor** is to lend at going market rates in a commercially viable manner. In Indonesia, for instance, most of the subsidised credit programs were abolished, interest rates were deregulated and credit ceilings removed, following the deregulation measures of October 1988 and the reform measures of January 1990, yet the banks did not reduce their exposure to rural lending. On the contrary, because of the commercial viability and cost recovery mechanisms of the liberalised system, they were encouraged to support rural and micro-lending much more than before.

4.3 Training and sensitising bank staff

Firstly, it is necessary that the commercial banks adopt policies concerning the use of NGOs/SHGs as financial intermediaries for banking with the poor. Once these policies are adopted there will be great need for field staff and branch managers to be given exposure to the conditions of the poor, leading to an in-depth understanding of the mechanisms and dynamics of the SHGs of the poor. Knowledge of the existence of local NGOs and of their activities and functioning will also be necessary. Orientation of staff members at branch level is a prerequisite for the success of the linkage program, though top management needs to be equally sensitive and committed to the program.

Many of the banks in the network countries have their own training capacity in the form of a separate division/section/department of the bank or separate semi-autonomous training institutes. Training courses presented by such entities are generally geared to upgrading banking skills and, in a number of cases, they also focus on rural/microenterprise lending techniques. Additionally, there are bankers' training institutions jointly established by the banks.

There are, as yet, no training courses designed specifically for banking with the poor using NGOs and SHGs as financial intermediaries to the poor. NABARD in India, as part of its pilot project on linkage, has provided 17 exposure training courses to 350 bank officers with the help of MYRADA. These programs have proved a great success and a cadre of motivated bank staff is emerging. The need for such training is much greater in India, considering the vast extent of the coverage envisaged by the pilot project in the next several years. NABARD is also using the facilities of the Agricultural College and the National Institute for Bank Management, both based in Pune.

In the Philippines, the Bank of the Philippine Islands has organised training courses beginning in 1994 for NGO partners, in the area of financial management and credit supervision. The Bankers' Association of the Philippines (BAP) has already devised a training program, Banking with the Informal Sector, through its Institute of Bankers. BAP also plans to undertake action research concerning linkages.

As recently as September 1994, Bangladesh Bank organised a workshop in Dhaka on the promotion of linkages between banks, NGOs and SHGs. Participants included all the commercial banks, prominent NGOs (including Swanirvar Bangladesh), and NABARD and the Centre for International Cooperation and Training in Agricultural Banking (CICTAB) from India. It was an important initiative taken by Bangladesh Bank for promoting linkage on a country-wide scale, in recognition of the encouragement and support given to it by **Banking with the Poor**, and resulted in explicit endorsement of the BWTP principles.

In Nepal, Rashtriya Banijya Bank has taken upon itself the role of motivator, organiser and trainer of the NGOs and members of the SHGs. Nepal acutely feels the need for the staff and officers of banks to receive trainers' training in order to conduct the linkage program effectively.

Since the concept is relatively new to many, experiences of the countries active in this field should be pooled. Techniques perfected by practice by some countries may be made available to others through exchanges, seminars and workshops. With the help of the BWTP Network, the Foundation could play a significant role in this regard, as well as in inventorising the training facilities and capacities available in the region.

4.4 Simplifying loan procedures and introducing alternative methods for credit delivery to the poor

Almost all the bank network members have simplified loan procedures by curtailing formal requirements, reducing the number and types of documents needed, introducing simpler loan application forms which the illiterate and semi-literate poor borrowers can follow, bearing in mind the radical role of NGOs and SHGs in virtually replacing many of these procedures. It is not clear to what extent these improvements are reflected in practice at the field level by the bank branches. In Nepal, Rashtriya Banijya Bank claims to have curtailed the number of forms from 15 to a mere four. Similarly, innovating banks and NGOs have introduced easy-to-understand passbooks for borrowers, on which the loan and interest outstandings on the due dates of repayment and periodic instalments are recorded. This has proved an improvement over the old system. In the Philippines, BPI and Planters Development Bank have simplified credit reports. BPI has limited credit checking to loans above Ps 500,000.

In all cases, the head offices of the banks concerned have delegated loan approval authorities to their field-level officers, to reduce loan processing time. In Pakistan, the First Women's Bank has introduced mobile field staff and has conducted door-to-door banking, greatly facilitating the access of women in more conservative communities to financial services.

4.5 Treating group guarantees as collateral substitutes

Most banks have accepted group guarantees as collateral and some others have done so within certain limits. Others have combined group guarantees with the pledging of groups' saving funds where they exist. Institutions for credit guarantee have also guaranteed credit (against non-payment) on micro- and small loans given by the banks.

In the Philippines, banks require group guarantees together with mortgages on the assets of borrowing NGOs. There are no direct loans from banks to SHGs. NGOs accept the group guarantee as collateral, supported by pledging of the assets of the borrower created out of the loan in question. In Bangladesh, for small loans, group guarantee is accepted together with group saving, and where such savings are not sufficient, demand promissory notes are required. In Pakistan, the prevailing law does not allow group guarantee to be treated as collateral, though the First Women's Bank accepts group guarantees for loans up to Rs 50,000 ($1600).

In Sri Lanka loans below Rs 15,000 ($300) require demand promissory notes, and two personal guarantees are required for loans of Rs 15,000 to Rs 50,000. In Nepal, the prevailing norm is the use of group guarantee combined with group savings. In India, under the pilot project of NABARD, group guarantee is considered sufficient; savings serve as partial collateral. In Indonesia, under PHBK, group liability and blocked savings are considered substitutes for physical collateral. In India, NABARD has urged banks themselves to evolve suitable solutions in keeping with the spirit of the project.

While it may be too early to draw a final conclusion on the issue, it is encouraging to note the large (and increasing) number of commercial banks that are beginning to accept mutual guarantees of members of self-help groups, and the excellent track record and repayment performance of such groups, as adequate substitutes for collateral.

4.6 Fixing rates of interest based on recovery of banks' transaction costs

Interest rates, applied to credit to the poor in general as well as credit under the linkage program, continue to be partly subsidised, though the general intention around the region is to move to market rates in due course.

India has fixed interest rates at 12 per cent per annum to SHGs by the commercial banks, and extended refinancing facilities at 100 per cent of the loan amount. The market rate there is currently around 15 per cent. In Nepal, banks are allowed to charge market rates, but the government provides interest subsidies at the rate of 80 per cent for loans up to Rs 5000 ($100) and 33 per cent for loans up to Rs 15,000 ($300). The Rashtriya Banijya Bank (RBB) has evolved a useful method whereby the amount of subsidies from the government is captured in the form of savings for the group members. Subsidies granted by the government are deposited by RBB into the savings of members of the group, and withheld by the Bank until loans to those group members are cleared. This represents an addition to the savings of group members.

In Sri Lanka, the practice is to charge a rate which is the lowest among the prevailing bank rates for various types of loans. In Pakistan, subsidised rates are applied and the concept of market rates for the poor is not yet accepted. Bangladesh provides the flexibility to the banks to operate in a fixed band from 8 to 13 per cent. In the Philippines, credit to NGOs from BPI has operated at lower than market rates, for example, at 14 per cent to Tulay Sa Pag-Unlad Inc (TSPI). The NGOs that lend to SHGs charge interest rates ranging from 30 to 36 per cent, which takes into account full cost recovery.

It is in Indonesia where banks apply full market rates. NGOs and SHGs lend to their clients at rates which provide sufficient margin for meeting their operating costs. As a consequence, the members of SHGs (the final borrowers) are paying 45 per cent per annum and even higher. Since the poor did not previously have access to bank credit, and relied on local moneylenders who normally charge excessive rates, borrowers have tended to benefit by the linkage program, despite the apparently high lending rates at borrowers' level.

Banks in network countries have been concerned with high transaction costs in servicing small loan amounts extended to poor borrowers scattered over large and remote areas. This has kept them away from lending to the poor. The Foundation's recently concluded study on transaction costs of banks in India in lending to the rural poor shows that, by establishing linkage with NGOs and SHGs of the poor, banks can reduce their transaction cost by up to 41 per cent. The borrowers also experience a substantial reduction (up to 85 per cent) in their transaction cost of borrowing.

Study of transaction costs of banks and borrowers in rural lending with the intermediation of non-governmental organisations and self-help groups (India)

The Foundation for Development Cooperation completed this research in June 1994. The study attempts to quantify the cost-effectiveness of delivering credit to the rural poor through intermediation of NGOs/SHGs when compared with direct lending.

Costs involved were examined under four conditions or four models: Model I (lending directly to the rural poor), Model II (lending directly to the rural poor keeping NGOs and SHGs as non-financial intermediaries), Model III (where banks use SHGs as financial intermediaries and NGOs as non-financial intermediaries) and Model IV (where credit flows from banks to NGOs and then to SHGs before reaching ultimate borrowers, with both NGOs and SHGs as financial intermediaries).

Sample data were taken from banks, borrowers and their accounts in the southern states of India, namely Karnataka and Tamil Nadu, where the bulk of experience regarding linkage exists. Practical experience with regard to Model IV was found to be very limited in India.

The study shows the intermediation by NGOs/SHGs considerably reduced the time spent by bank personnel in identification of borrowers, documentation, follow-up and recoveries, which in turn influenced the reduction in transaction costs of rural lending. The estimated average transaction cost of lending per account was Rs 195, constituting 5.68 per cent of the loan amount, if the loan was delivered via the direct lending channel (Model I). The intermediation of NGOs/SHGs helped banks in reducing the transaction costs by 21 to 41 per cent in the other three models. Among the different models, Model III proved to be most efficient, with only SHGs playing a direct financial intermediation role. There may be scope for improved performance with Model IV, with more experience.

The estimated borrower transaction cost per loan account was Rs 272 of which about 40 per cent was towards cash expenditure and the remainder for opportunity cost of time spent by the borrower negotiating the loan. The intermediation of NGO/SHGs contributed significantly in reducing the transaction cost of borrowers to the extent of 85 per cent.

The intermediation of NGOs/SHGs also proved useful for better recovery. In addition, significant reduction in default risks had a cascading impact on the profitability of bank branches. The finding of a non-significant relationship between the variable interest rate and either loan demand or transaction costs of lending confirms that demand by borrowers was inelastic with respect to changing market rates. The study shows that the success of intermediation lies in effective functioning of NGOs and tapping the inherent strengths of SHGs.

The study was conducted by V. Puhazhendhi for the Foundation and has been published by the Foundation as *Transaction Costs of Lending to the Rural Poor: Non-governmental Organisations and Self-help Groups of the Poor as Intermediaries for Banks in India* (1995).

4.7 Disseminating experience among fellow bankers

For most banks in the network countries, the best channel for disseminating experiences is through the banks' associations/councils in the country concerned, where member banks meet periodically to exchange views on matters of common concern. This can also be undertaken through the training institutions and their programs, bank publications, and the mass media. Through such channels, the BWTP Network has had notable success in publicising the principles and methods of banking with the poor to commercial banks throughout the region, particularly by means of the series of national workshops for bankers organised jointly by the national bankers' associations and the Foundation over the past two years.[36]

Following upon the Philippine national workshop, the Bankers' Association of the Philippines has been implementing an initiative called Banking with the Informal Sector. The project explores solutions to improve the access of marginalised sectors to formal credit. It has three components, namely, credit, training and action research. The design of these initiatives is being evolved by BAP in consultation with mature NGOs.

In Bangladesh, emphasis has been placed on the training courses conducted by Bangladesh Institute of Bank Management, Bangladesh Academy for Rural Development, Comilla (BARD), Bangladesh Institute of Development Studies (BIDS), and Bangladesh Small and Cottage Industries Corporation (BSCIC). A most important initiative was taken very recently by the Bangladesh Bank itself, in organising a national seminar on promotion and linkages of SHGs with financial institutions, in which leading banks and NGOs of the country participated.

In Pakistan, views have been expressed that there is no dearth of credit. The problem rather seems to be how to channel the credit to the poor. The **Banking with the Poor** national workshop held in Karachi last August in collaboration with Habib Bank has stimulated banks to prepare trials of the **Banking with the Poor** linkage model.

Indonesia already has information sharing, orientation and training programs as part of the PHBK project being implemented with GTZ technical assistance, with participation by state and private banks. Outside the PHBK framework, other private commercial banks through PERBANAS (Association of national private banks) are participating in various workshops and seminars and steadily involving their members in the linkage process. In India, NABARD, as already stated, has organised about 17 exposure programs for bank officers with the help of the NGO MYRADA and other bankers' training institutions, and intends to intensify such activities in the future.

In Sri Lanka, there are experiences of group lending by Janasaviya Trust Fund, Small Farmers and Landless Credit Project, and groups formed by two state-owned commercial banks, People's Bank and the Bank of Ceylon. No mechanism for sharing these experiences has been

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[36] Foundation for Development Cooperation, *National Workshops on Banking with the Poor*, Brisbane, 1994.

established so far although specific recommendations to establish one were agreed at the national bankers workshop organised by the Foundation in January 1994. Nepal is in a similar situation.

Summary

As evidenced by these workshops, commercial banks are generally being attracted to banking with the poor. If one were to ask which particular country has the best practice as far as banks are concerned, there would be no easy answer. Judged against the criteria set by the Foundation at the start of **Banking with the Poor**, even the country with the best practices would appear to have some deficiencies. One has to bear in mind that the system itself is evolving.

Indian best practice

However, it must be said that the initiatives and commitments of India have so far proved to be some of the most effective so far, on account of the following coordinated activities.

1) Strong policy support has been provided and directives issued by the central banking authority (RBI).
2) As a result, banks have issued detailed directives to their branches for the implementation of the project. Up to March 1994, 16 commercial banks and 12 regional rural banks had established credit linkages with 620 SHGs. Repayment so far has been close to 100 per cent.
3) Focus of the project is on the poorest segment in the rural areas and particularly on women.
4) Some NGOs have been very active and successful in forming and training SHGs with savings and credit and then in linking them with the banks.
5) SHGs formed and supported within the project have adopted all 16 guidelines recommended by **Banking with the Poor**, with the exception of the interest rate of 12 per cent charged on credit which deviates to some extent from the market-related rates. The Reserve Bank of India has assured, however, that this will be changed and rates of interest in the near future will be fixed on a cost recovery basis. The banks will be granted freedom to apply their lending rates based on the above principle.
6) Training, orientation and information sharing among the participants in the project have been provided for and NABARD has taken the responsibility for this upon itself. The process, as already described in Section 4.3, is already in place.
7) Commercial banks have revised and introduced simplified procedures for credit to the poor. Group guarantees have been accepted as the norm. Certain hurdles of a legal nature, such as the informal nature of the SHGs, have been overcome by RBI lifting such restrictions.

8) Commercial banks including a private commercial bank (Vysya Bank) are implementing the project with great zeal as they see the advantage in servicing the poor mainly because:

   (i) they may not have to open more branches and recruit more staff for rural lending activities addressed to the poor, as the NGO intermediaries will be able to take over most of them at the local level. Development of SHGs will be undertaken by NGOs with local knowledge

   (ii) they will be able to externalise some of their costs by means of NGOs and SHGs of the poor undertaking the responsibilities of identification of SHGs and their development and recovery of the loans, which will have implications for their transaction costs

   (iii) recovery rate being close to 100 per cent, it will have beneficial impact on the profitability of the banks

   (iv) deposit mobilisation in the form of group savings would be an added advantage

   (v) commercial banks will be able to make a substantial contribution to the economic development of the country

   (vi) banks may not have to subsidise or incur losses on this lending as eventually the rates of interest charged will be fixed at market rates based upon the principle of cost recovery.

Only one factor limits the speed of implementation — the limited number of NGOs in the country with adequate experience in SHG motivation and formation and development, without whose intervention the commercial banking community will be unable to reach the poor successfully.

As a result of national workshops for banks and NGOs organised by the Foundation in seven network countries in 1993 and 1994, consultative forums for dialogue between the banks and NGOs have been created in a number of countries. These are expected to improve understanding between the two sets of organisations and assist banks to identify appropriate NGOs through which they can extend credit.

Chapter 5

IMPLEMENTATION
THE ROLE OF EXTERNAL AGENCIES

5.1 Introduction

In this section we are concerned with a range of organisations, including the international financial institutions active in the Asia–Pacific region (primarily the World Bank and the Asian Development Bank), multilateral agencies including the United Nations Development Programme and bilateral aid agencies. The coverage given to the policies and practices of these organisations affecting banking with the poor is based mainly upon their responses to the Foundation's request for information, and on published materials available to the Foundation. In one or two cases the relevant section has been based on or supplemented by secondary information.

The basic principles underlying Banking with the Poor recommendations to external agencies were:

- They should actively support commercially viable linkages between banks and NGOs and SHGs of the poor.
- They should provide loans to countries with inadequate funds for NGO programs of microcredit for the poor.
- Where such loan capital is provided, it should ideally be channelled as seed capital, designed to attract rather than replace commercial bank funding. Wherever possible, it should be offered on a matching basis with the funds of commercial banks.
- Such finance should flow as directly as possible to NGO programs, and on terms and conditions that will ensure it will be onlent to final beneficiaries at market rates of interest.
- International financial institutions are urged to mobilise associated finance from bilateral sources, on a grant basis, for technical assistance and the institutional strengthening and expansion of NGO and bank programs. This is seen as particularly crucial in cases where 'scaling up' programs of credit for the poor is required by national policies of poverty alleviation.
- International financial institutions are urged to establish distinct microcredit units within their organisational structures, to increase the effectiveness of their support for banking with the poor.

We turn now to a discussion of the policies and programs of the major international financial institutions active in the Asia–Pacific region, the World Bank and the Asian Development Bank, relevant to banking with the poor.

5.2 World Bank

Overview

The World Bank exerts considerable influence on national economic policies and it often introduces new policy approaches to the broader development community. For this reason it is useful to give some attention to the evolution of World Bank thinking, as shown by its published analyses of credit and poverty. These include the World Development Report 1989, devoted primarily to financial systems and development. This discussed issues in informal finance, indicating full awareness of the potential value of 'group lending schemes as a means of channelling credit to the poor'.[37]

The subsequent *World Development Report 1990* was devoted to 'poverty'. It reviewed experience with subsidised credit schemes and catalogued the associated distortions and inequities. It endorsed the group lending approach, and saw a role for financial subsidies from external agencies to help cover 'initial administrative cost' of such programs and to 'encourage innovation' on the part of government and NGO credit programs.[38]

The 1990 report signalled substantially increased attention to poverty in the design of Bank projects. It has been followed by a number of internal reviews of project performance. An important trend, from the viewpoint of banking with the poor, is increasing involvement of NGOs in Bank-financed projects. Sixty-eight such projects were operational during 1992.[39] A review of fiscal 1993 activities[40] documented increased Bank working with NGOs, and claimed that some 30 per cent of the Bank's projects (in all fields of activity) now involved such collaboration, while 84 per cent of these involved 'local' NGOs. Of course, relatively few of these involved microfinance elements.

The Bank's 1993 poverty reduction handbook,[41] asserted that 'Bank lending for small- and medium-sized enterprises has had little direct effect on poverty' and acknowledged the need to support microenterprise development. A 1994 World Bank policy paper[42] acknowledges lack of access to credit as one of the major barriers to women's participation in development. The paper cites group lending as one way to overcome this barrier, but the possibility of linkages between NGOs and self-help groups of the poor, and commercial banking institutions, is not suggested. A more comprehensive study of World Bank experience was also published in 1994.[43] It represents a welcome development in the Bank's thinking about microfinance on the basis of studying Bank projects. Of 15 projects offering credit,

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[37] World Bank, *World Development Report 1989*, Oxford University Press, New York, 1989. See chapter 8, 'Issues in informal finance'.

[38] World Bank, *World Development Report 1990*, Oxford University Press, New York, 1990, pp. 65–69.

[39] World Bank, *Implementing the World Bank's Strategy to Reduce Poverty*, World Bank, Washington, 1993.

[40] World Bank, *Poverty Reduction and the World Bank*, p. 10.

[41] World Bank, *Poverty Reduction Handbook*, World Bank, Washington, 1993.

[42] World Bank, *Enhancing Women's Participation in Economic Development*, World Bank, Washington, 1994.

[43] World Bank, *Providing Enterprise Development and Financial Services to Women*, World Bank, Washington, 1994.

12 charged interest rates to final borrowers exceeding the rate of inflation by at least 2 per cent, 'providing an acceptable margin to participate for financial intermediaries which control administrative costs'. A smaller number of projects included savings mobilisation in their design.

This latest World Bank report distinguishes between a minimalist model, which assumes that working capital is the binding constraint, and an integrated model offering a package of services and resources to promote microenterprise development. The minimalist model is judged more appropriate for what the Bank calls 'subsistence enterprises' (seasonal, part-time diversified economic activities, typically operated by low-income women in risk-averse households) and 'new microenterprises' (based on a single economic activity, commonly 'multiseasonal' and requiring 'routine reinvestment'). The report regards 'effective social intermediation services' as the most important factor in establishing sustainable financial services for women. It acknowledges the role of The Foundation for Development Cooperation in working to promote linkages between local self-help groups and financial institutions, listing it as one of a small number of agencies 'working to create visibility and legitimacy for disadvantaged groups, to change public policies, legal and regulatory frameworks that affect them at the local, national and even international levels'.[44]

Among examples of effective 'social intermediation', the authors note the work of BWTP Network member MYRADA, and the Janasaviya Trust Fund in Sri Lanka. But they note that the Bank 'is not in a position to work directly with groups or link them to NGOs and financial institutions'. However, they conceded that 'the Bank needs to consider modifying its own business practices to enable it to support NGOs and financial institutions involved in innovative [financial services for women] delivery'.

Among its conclusions are that the Bank has 'traditionally focussed on small-scale industries and mature microenterprises. However an analysis of the [World Bank] project portfolio shows that South and East Asia region projects are increasingly working with subsistence enterprises and new microenterprises managed by women'. These changes, and the support for more involvement by the Bank with NGOs involved in 'social intermediation', are welcome developments, even if explicit endorsement of linkages with commercial banks is still lacking from published Bank documents.

The World Bank's response to our request for commentary on the recommendations on Banking with the Poor indicates further recent development in Bank thinking on microcredit. An edited version of the response follows. Of particular interest to participants in the Third Regional Workshop was the indication by the Bank of the possible creation of a multilateral facility dedicated specifically to microcredit.

[44] World Bank, *Providing Enterprise Development and Financial Services to Women*, p. 35.

Extracts from World Bank response to BWTP recommendations (prepared by Financial Sector Development Department)

A major objective of World Bank assistance is the promotion of efficient financial systems. . .A full range of Bank instruments are available to support financial sector development.

The World Bank's activities in financial sector development are covered by Operational Directive 8.30 on Financial Sector Operations. . .This directive states that resource transfer alone is not a sufficient justification for financial intermediary lending. It states that financial intermediary loans should be 'selectively used: (a) to promote the development of the participating intermediary institutions; (b) to introduce or strengthen sector-wide reforms; and (c) to catalyse the broadening of financial markets'.

A Financial Sector Development Department was organised as a central unit to guide the activities of the Bank in financial sector operations. . .We have not organised a distinct unit for microenterprise finance as recommended by the second regional workshop. . .we have a flat structure but special disciplines are organised into homogenous groupings. Microenterprise finance is an important program rather than a distinct unit.

Our department and other units in the Bank such as the Private Sector Department and several regional departments are heavily involved in developing programs for poverty alleviation. We coordinate with these units within the Bank and liaise closely with other donor organisations. . .The views expressed herein are those of our department but take into consideration the Bank's experience as well as the progress attained by other practitioners in the field.

We support the promotion of commercially viable banking with the poor. We believe that the ultimate objective is long-term sustainability of programs. This would translate into market rates of interest to final beneficiaries as recommended by the second regional workshop. In addition, it should be equated with the attainment of viability of financial intermediaries. In this regard, our major preoccupation in the department is the development of viable financial intermediaries which would mobilise savings and channel these resources for microenterprise finance.

In line with the objective of broadening financial markets, we recognise the importance of the active participation of commercial banks in the process. This observation should however be qualified. We find that in many country settings, commercial banks are generally reluctant to provide financial services to small borrowers particularly in rural areas by reason of lack of interest and institutional capacity. For commercial banks engaged in lending to small borrowers, loan sizes are significantly larger than loan sizes normally demanded by the poor. In recent conferences which presented the results of research on various types of financial intermediaries, it was concluded that the profit motive alone was not sufficient to encourage commercial banks to go into microenterprise lending. A mission and commitment to serve the less advantaged segment of the population was a common feature of participating commercial banks. In fact, in the Latin American context, commercial banks engaged in microenterprise lending had developed specialisation in this type of lending. It was also clear that these

> commercial banks served a highly diversified clientele and did not limit their lending to the poorest of the poor.
>
> We recognise that in the growth process of NGOs a stage is reached when these institutions can effectively utilise funds at commercial rates to blend with funds obtained at concessional terms. Linkages between NGOs and commercial banks become critical at this stage. There should also be recognition that in addition to commercial banks there are other types of financial intermediaries such as rural banks, cooperative banks and credit unions which cater to the credit needs of the poor. . .The research study in 6 countries being completed by the Inter-American Development Bank will shed more light on the strengths and weaknesses of commercial banks, credit unions and NGOs as institutional channels of microenterprise finance.
>
> The World Bank recognises the role played by NGOs in providing access to financial services of the poor. It has recently announced the establishment of a facility which would provide support to poverty-oriented financial institutions. It will be a multilateral facility which would be partly financed by the World Bank and would solicit participation from other donor organisations. . .seed capital on a matching basis is being discussed as a possible type of support to NGOs and other suitable financial intermediaries. One of the items in the recent meeting of the Donors' Working Group on Financial Sector Development is the eligibility criteria for donor support for microenterprise finance.[45]
>
> These initiatives are being taken recognising the important role the World Bank can play in supporting microenterprise finance, the progress which has so far been attained by the practitioners in the field and the need for further support from the donor community. These are very much in line with the recommendations set forth by the second regional workshop.

The proposal by the World Bank to establish a consultative group focusing on assistance for the very poor, and to commence operations with a 'microenterprise finance' program, alluded to in the response quoted above, is further indication of sympathy within the Bank for a basic proposition of banking with the poor. This is that microfinance itself, rather than microenterprise development in a broader sense, is the crucial focus for poverty alleviation when seeking to assist the poorest of the poor to help themselves. The BWTP Network welcomes this initiative and trusts that donor governments will support it by supplementing the initial capital subscription offered by the World Bank to launch the Consultative Group to Assist the Poorest of the Poor (CGAPP).

5.3 Asian Development Bank

As the development bank with specific responsibility for the Asia–Pacific region, the Asian Development Bank (ADB) has a particular potential to contribute to the institutionalisation of **Banking with the Poor** in the region from which participants at our Third Regional

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[45] Editorial note: these criteria are reproduced in Annex 1.

Workshop were drawn. As early as the first regional workshop on **Banking with the Poor** in Manila in 1991, the Asian Development Bank declared its full support for the principles of **Banking with the Poor.**[46]

The Bank extended its first loan for agricultural credit as early as 1969, but in common with other international agencies has turned its attention to microcredit and the needs of the poorest of the poor only in more recent years. In ADB the trend for explicit action to alleviate poverty dates from the late 1980s. The subsequent establishment of a Social Dimensions Unit within the Bank in 1992, with responsibility for ensuring that relevant social dimensions of development are adequately reflected in the Bank's lending program, should facilitate greater interest in and improved design of microcredit projects in Bank programs. Two social dimensions given special attention are poverty alleviation and women in development, for both of which microfinance is an appropriate tool. In 1995 this unit was upgraded, to become the Social Development Division in the Bank's Office of Environmental and Social Development.

In other respects, elements of the **Banking with the Poor** program have been incorporated into specific ADB projects. NGOs have been used as intermediaries, both financial and for the provision of other services related to credit. Group-based lending has been employed in a number of projects and the Bank accepts the principle that final beneficiaries should pay market rates of interest. Although in no ADB-financed project does the full model of commercial linkage involving banks, NGOs and SHGs of the poor seem to have been employed, the Bank has been active in persuading banks to pursue non-traditional approaches to the issue of collateral.

Details of some relevant projects may serve to illustrate aspects of ADB's approach to the provision of microcredit. The first and second Philippines microcredit projects (the latter approved in 1992) were somewhat deficient in terms of **Banking with the Poor** recommendations, although they were unique among Bank projects in providing support to low-income borrowers through accredited NGOs. Particular deficiencies were in respect of the quantum and method of funding provided for institutional development of Philippine NGOs given major responsibility for implementation of the projects. Associated bilateral funding was both too small a proportion of the quantum of capital provided by these loans, and insufficiently supportive of the NGOs themselves, rather than of 'elite' external training structures. An equation of 'institutional development' with theoretical training, and the failure to consider sufficiently other needs of NGOs, including the necessity of support over a period of five years or more during which self-sustainability might be achieved, were further weaknesses. The Foundation believes that international financial institutions should mobilise associated grant finance sufficient to commit around 20 per cent of total project costs directly to NGOs for institutional and technical assistance support.

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[46] M.Z. Azam, 'Banking with the Poor: The experience of ADB', statement delivered at the first regional workshop on **Banking with the Poor**, Manila, 1991.

A Nepal microcredit project for women, approved in 1993, marks a positive development in the design of ADB projects.[47] Its features include greater attention to self-help group formation and the training of women beneficiaries, and increased emphasis on institutional support for NGOs with associated bilateral grant funding for that purpose. This amounted to a gratifying 30 per cent of total project costs. The interest rate payable by final women beneficiaries was to be set at a minimum of 17 per cent, the prevailing commercial bank lending rate in Nepal. Participating banks and NGOs received loan funds at 6 per cent, leaving an (apparently) ample margin for cost recovery. Though ADB loan funds can be channelled through commercial banks, the project does not seek to draw matching funds from the domestic banking sector, nor does it sufficiently encourage the direct bank/NGO linkage, recommended as the **Banking with the Poor** model.

Participating banks are to lend directly to women in the early stages of the project, while institution building in the NGO sector is proceeding. The profile of the project may switch increasingly to group lending and NGO financial intermediation as it proceeds, depending on the success of the NGO institution-building process pursued in the interim. The Nepal microcredit project clearly marks substantial progress, in terms of **Banking with the Poor** recommendations, in the policies and operational practices of ADB.

Further progress appears to be occurring with the recently approved Indonesian microcredit loan, which has been welcomed by Bank Indonesia as consistent both with Indonesian microcredit policies and with the government's new poverty alleviation strategies. This project, according to ADB, 'seeks to build on the distinct roles of existing small financial institutions and NGOs in rural Indonesia: the institutions to deliver credit and savings services to the poor and near-poor microenterprise sub-borrowers and NGOs to organise groups of the poor for such lending. . .'

A bolder ADB enterprise, of possible interest to representatives of transitional economies who attended the Third Regional Workshop, is the Mongolia Employment Generation Project, approved in 1993. In terms of poverty targeting, this loan (with a ceiling value of up to $5000 per individual) is only partly targeted at the genuinely poor in Mongolia. It does have the positive feature of channelling loan capital via the central bank to three participating commercial banks, which will onlend at market rates. Three 'NGOs' are identified as having the capacity to select final borrowers and to prepare them for participation. There is no suggestion of group lending, and the term 'NGO' probably needs to be defined more carefully in the Mongolian context. However, associated grant financing, in an amount equivalent to 20 per cent of the capital fund provided by ADB, has been secured from a bilateral source. This will be applied to 'the institutional enhancement of executing and participating agencies, and social preparation and skills training of project beneficiaries'.[48]

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[47] Asian Development Bank, Microcredit project for women, Nepal, Loan no. 1237-NEP(SF), 1993.

[48] Asian Development Bank, Mongolia: Employment Generation Project, 1993.

The Asian Development Bank accepts the need for continuing revision and refinement of its approaches. This is clear from its positive response to the Foundation:

> Although the Bank's policy approach to banking with the poor is still evolving, it supports the concept. . .The idea that the poor are bankable. . .has been firmly established in development literature. As a development institution with a prime commitment to poverty reduction, the Bank fully supports the concept of creating sustainable financial service systems for the poor. While continuing to provide support through targeted projects and project components, how best the concept of banking with the poor can be incorporated in the Bank's overall procedures and policies through loan and technical assistance-associated activities is being reviewed by the institution.

5.4 Bilateral aid agencies

Banking with the Poor recommendations to bilateral aid agencies may be summarised as follows.

- Bilateral agencies should redouble their financial and technical assistance in support of NGO programs of credit for the poor.
- Where such financial assistance is given, it should encourage and attract commercial bank support for such programs, while supporting their sustainability by requiring market rates of interest rather than subsidised lending to the poor.
- A particular priority for bilateral assistance is the need of NGOs to strengthen their institutional capacity for programs of credit directed to the poor.
- As a high priority within such assistance, bilateral agencies should provide specific support to meet the cost of NGOs in forming, training and seed-funding SHGs as the basic building blocks of banking with the poor.
- Bilateral agencies are reminded of the potential of experienced NGOs and bankers' associations in their own countries to assist NGOs in developing countries engaged in microcredit delivery.
- Bilateral development assistance can be directed to Third World governments and NGOs, or be provided indirectly in the form of technical assistance grants to be administered by the World Bank or the Asian Development Bank as associated aid, as mentioned above.

The following material is drawn from responses received from a number of bilateral donor agencies, most of which sent representatives to the Third Regional Workshop.

Australia

AIDAB[49] has made a detailed response to the recommendations on **Banking with the Poor.** It accepts microenterprise development (MED) as an important approach to the alleviation

[49] In April 1995 the name of AIDAB (the Australian International Development Assistance Bureau) was changed to AusAID (the Australian Agency for International Development). This report uses the name AIDAB, current at the time of the Third Regional Workshop.

of poverty, and sees a minor role for microfinance within the framework of MED. The current (1994–95) aid budget announced a new MED initiative, costed at A$1.3 million ($0.96 million) for a two-year pilot program for activities in the South Pacific and Southeast Asia. Together with existing activities in current programs, funding for MED activities will increase to over A$14 million ($10.4 million) over the next two years. This will involve recategorisation of some ongoing activities as MED.

With regard to interest rates and the involvement of commercial banks in microcredit activities, 'the Australian government gives priority to approaches which charge market rates of interest, recognising that this is essential to the long-term sustainability of such programs. The Australian government also seeks to encourage commercial bank support for microcredit activities, but recognises this is often difficult'. The response expresses support for the principles of self-help group formation, and of supporting indigenous NGOs for this purpose. AIDAB also stated that it supports the principle of co-financing MED activities with multilateral organisations and is involved in several such projects at present.

Australian policy with respect to microcredit is not yet expressed in any coherent framework of domestic financial development, nor is there yet any direct support of linkages between NGOs and self-help groups of the poor and domestic financial institutions in AIDAB'S country programs. In the South Pacific, an important theatre of operations for AIDAB, the emphasis is on assisting small businesses to gain access to bank loans directly through preparation of 'bankable' proposals. This indicates that the activity is not strictly addressed to the microenterprise sector. Another AIDAB initiative in the South Pacific is directed to supporting the credit union movement as the best option for providing financial services in rural areas. While the report on **Banking with the Poor** has some reservations about credit unions as the optimal approach to targeting the poorest of the poor in the Asian context, AIDAB's strategy may prove the most sensible one in some of the Pacific island states.

AIDAB sees MED as offering payoffs in a number of priority areas, including private sector development, poverty alleviation, women and the promotion of participatory approaches to development. However, these multiple goals and the choice of MED (which is a complex and diffuse activity) as the vehicle to achieve them, make it unlikely that genuine poverty targeting will result. For that purpose, the more 'minimal' approach of microfinance development is preferable.

Canada

CIDA has given considerable attention to microcredit development, both in the region and beyond. Data supplied by the Canadian authorities to the Foundation indicate that CIDA has been involved in 12 principal projects involving microcredit in Asia, with outlays on the microcredit components of these totalling $107 million. More than 70 per cent of this has been allocated to projects in Bangladesh, with some 15 per cent in Sri Lanka and 10 per cent in Pakistan. CIDA's involvement with microcredit goes back to 1981, and the agency has been supporting the Grameen Bank and BRAC in Bangladesh since 1983.

A recent study[50] by CIDA reviews nine of these projects in those three countries. They include a number of well-known projects, which have received multiple inputs of bilateral and multilateral funding, and which have been mentioned at various points in this report, including AKRSP in Pakistan, SEEDS in Sri Lanka, and Grameen Bank and BRAC in Bangladesh. All these projects had multiple activities aside from credit, mobilised savings from their members, and included (to a greater or lesser extent) lending to individuals within groups where the rest of the group acts as guarantor.

The report comments that 'many of the projects are receiving large amounts of donor funds, and, as these funds represent considerably more than 50 per cent of total funds, most of the projects are highly donor dependent. . . '[51] The study provides an extremely valuable overview of the operations of these projects, with a detailed analysis of issues such as loan repayment rates and defaults, the calculation of real interest rates (said to be negative in almost all cases after relating interest received to inflation and an accurate calculation of outstanding balances) and issues relating to long-run sustainability. The analysis is conducted at a high level of sophistication, and indicates substantial understanding within CIDA of technical issues relating to microcredit.

Under the heading 'options for credit delivery', the report discusses three channels a donor might employ to support the delivery of microcredit. These are:

1) making use of existing financial institutions. CIDA's support of credit unions (as in Sri Lanka) is a case in point

2) establishing an intermediary institution, for example, by selecting an NGO to act as an intermediary or broker between financial institutions and the poor. As described, this arrangement closely resembles the activities of the BWTP Network member Swanirvar in Bangladesh, which acts as a non-financial intermediary between financial institutions and the poor. It is not clear that CIDA has, in fact, ever exercised this option, which is one of the models associated with Banking with the Poor

3) establishing an independent credit delivery mechanism. The establishment of Grameen Bank as a formal financial institution, with extensive donor support, is the best example in Asia of this process, in which the independent institution commences life as an NGO. CIDA has provided some $7.4 million to Grameen since 1983.

It seems clear that CIDA admits the Banking with the Poor model as an acceptable one for donor support, that it has a full appreciation of the need for, and the proper objectives of, technical assistance in support of microcredit programs, and that it accepts the need to charge market rates of interest in support of sustainability. It is perhaps significant that most of its support of microfinance has been directed to programs in South Asia under circumstances of strong official control of interest rates, in an environment rife with

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[50] Canadian International Development Agency, *Study of Small-scale Credit in Asia Projects*, Hull, 1994.

[51] Canadian International Development Agency, p. 29.

subsidisation. CIDA microfinance projects are conducted in a context of supporting domestic financial development, and there has been a major effort to support institutions targeting the poorest of the poor.

Germany

German engagement with the **Banking with the Poor** model, as seen by the involvement of GTZ in linkage programs in Indonesia and a number of other countries, is considerable. The pioneering experience of GTZ with the PHBK program in Indonesia is reported in Chapters 2 and 3. The German government's response to the **Banking with the Poor** recommendations notes that 'Banking with the poor also plays a major role in German development cooperation and is increasing in importance'. The response notes that in the financial sector:

> German development cooperation follows a systematic approach, supporting liberalisation and deregulation of the sector, as well as the creation of greater access for additional target groups by promoting competition between the financial institutions ('top-down reform'). Moreover it supports informal and semi-formal savings and credit organisations and helps integrate them in the financial system ('bottom-up reform'), focussing in particular on disadvantaged social groups (eg, microenterprise, the informal sector and women). This approach goes beyond the promotion of credit programs for target groups via NGOs. . .1 feel that the mobilisation of savings should figure more prominently in your recommendations. In addition, individual NGO credit programs should not be given priority support, rather the emphasis should lie with the creation of sustainable financial *institutions*.

These activities can be described as emphasising both poverty alleviation and 'financial sector development from below'.

The response goes on to endorse Banking with the Poor's criticism of subsidised credit and to endorse the recommendations in favour of technical assistance to support the institutional capacity of 'semi-formal and informal financial bodies' such as NGOs. It notes that 'German development cooperation is turning more and more to cooperation with NGOs, which applies also to the financial sector'. The response refers to German sponsorship of 'partnerships' between 'decentralised' savings and credit organisations in Germany and similar institutions in recipient countries. Apart from these partnerships, the response lists the most important aspects of German assistance in relation to **Banking with the Poor,** which include the linking of self-help groups with banks in a number of countries in the region.

New Zealand

New Zealand (NZ) development assistance is of particular interest because of its substantial involvement with the small island states of the South Pacific, which were represented at the Third Regional Workshop. The NZ response to the recommendations notes that the policy guidelines to which its ODA responds are framed differently from the **Banking with the Poor** recommendations, as are the modalities of NZ aid delivery. The 'guiding principles' for

NZ ODA include statements relating to poverty alleviation, women in development and private sector development.

Individual country programs have mechanisms under which microenterprise development and credit schemes may be supported. There is also provision for supporting non-government initiatives in recipient countries. Specifically, indigenous NGOs may be supported by New Zealand aid. Official policy with respect to private sector development includes provision for assistance to rural credit schemes, cooperatives and development finance institutions.

Development finance institutions are described as playing 'an important role in providing concessional finance' to small business. Accordingly, New Zealand development assistance supports a number of national development banks in the South Pacific island states, some of which have instituted 'micro-loan revolving funds'. A number of these funds provide concessional (or subsidised) finance, especially for 'women in development' activities. While a microcredit project for women in Papua New Guinea which also involves savings mobilisation is one NZ ODA activity directly related to banking with the poor, the majority of New Zealand's activities in the sector are not grounded in a coherent philosophy of financial sector development.

Numerous small business development projects and other 'small project' funding are listed for various of the Pacific island states. Some of these are also said to be for revolving credit funds. Some of these activities are conducted in conjunction with village groups or local government authorities. The guidelines refer to the desirability of partnership with local NGOs in a range of activities, including women in development and private sector development.

Norway

The Norwegian agency for development cooperation (NORAD) responded to the best practice recommendations and was represented at the Third Regional Workshop. It described the recommendations to bilateral aid agencies as being 'generally speaking in accordance with the strategy and practices of NORAD'.

The Norwegian authorities have specifically addressed issues of savings and credit in Norwegian aid, with the publication of a 'planning guide for savings and credit schemes' in 1989. This emphasised the involvement of NGOs and the desirability of credit being incorporated in multi-purpose activities. Thus:

> if a credit scheme should operate for several years, it should in addition offer a range of services aimed at poverty alleviation. At the same time the credit scheme itself should be considered 'strictly business', and should not include for instance unreasonably low interest rates or slack collection of repayments. It is recommended that the 'welfare aspects' should be clearly confined to the non-credit modules of the scheme.

While the Norwegian attitude to issues of financial sustainability appears, on the face of it, to be less rigorous than those of some other agencies discussed here, it is likely that these ideas have been modified in practice since 1989. For example, on the subject of interest rate subsidies, the Norwegian response states that:

> NORAD agrees with the principle that market rates of interest should be the main rule, rather than giving subsidised lending to the poor. One should, however, not entirely rule out the possibility of engaging in subsidised activities in special situations where this clearly will have an important impact for promoting activities and economic development. In that case, the decision should be based on a thorough analysis of the socio-economic conditions of the particular area and should only be a temporary measure in an initial phase.

The Asia–Pacific region is a minor theatre of operations for NORAD, with somewhat more than 20 per cent of Norwegian bilateral assistance allocated principally to India, Pakistan, Sri Lanka and Bangladesh. Bangladesh and Sri Lanka have been the major recipients of funding for microenterprise and credit schemes. NORAD supports the Grameen Bank in Bangladesh, as well as employment-generating and small enterprise development projects which include credit components. Similarly, in Sri Lanka its principal activities have been in support of regional development programs in which there have been credit components. Hence, apart from support of the Grameen Bank, Norwegian ODA has been delivered consistent with the principle of supporting multi-purpose activities, as described above. With regard to targeting of beneficiaries, NORAD is committed to 'supporting forms of credit that will reach poor producers of both sexes who do not own land or any other form of security'.

While NORAD is committed to support of NGOs, its views on their needs for institutional strengthening are interesting.

> we agree that it is important to look at the institutional strengthening of NGOs that work with the poor. One should, however, very carefully consider which institutions are to be strengthened. It may be the case that a given NGO only has a temporary commitment in an area, and that in that case it would be more important to strengthen the capacity of either the SHGs themselves, or facilitate the creation of institutions that will have long-term standing in the local community. The sense of ownership is of vital importance. If one is to promote banking with the poor, it is essential that the structures and institutions supported are ones that not only benefit the poor, but institutions that the people themselves feel genuinely related to and take a feeling of ownership in. Only then will the institutions stand a chance of becoming sustainable in the long term.

United Kingdom

The UK response expresses broad general support for the objectives of **Banking with the Poor.** It notes British support for a number of NGOs engaged in credit, including BRAC in Bangladesh, and for Grameen replication in Africa. The reply does not detail any specific instance of UK support for the linkage mechanism as such. However, the UK Overseas

Development Administration endorses the 'standards for intermediaries' proposed by the UN Expert Group, which is reproduced in this report as Annex 1.

An interesting comment from the UK response warns of dangers in the new emphasis by bilateral and multilateral donors on partnership with NGOs.

> Whilst there have been important advances in the whole area of credit for the poor, there are obvious dangers in the attention now being paid by donors to this area. Specifically, there is a danger that donors will 'flood the market' and that local organisations, especially NGOs, will be drowned with a greater volume of funds than they have the capacity to absorb. This highlights the need for close collaboration between donors at country level and the importance of meetings between donors such as your series of workshops, together with the need as noted in the recommendations to bilateral donors in your report — to strengthen the institutional capacity of NGOs.

United States of America

The response of the US Agency for International Development (USAID) to the recommendations of **Banking with the Poor** was tabled at the Third Regional Workshop. Extracts are printed below.

> USAID shares the view espoused in **Banking with the Poor** that the lack of reliable access to savings and credit is a key constraint limiting poor microentrepreneurs' capacity to raise their incomes on a sustainable basis. We support a variety of programs aimed at expanding and deepening the reach of microfinance organisations. Some, though not all, of these programs use methods similar to those endorsed by BWTP. Moreover, many if not most, of our microfinance programs are implemented by NGOs via a variety of delivery methodologies. Many of the programs we support rely on variations of the group lending approach, while others extend services to individuals. In short, we pursue multiple models, recognising that there is likely no single model which universally works best to deliver financial services to the poor. There are, of course, some basic principles and criteria of sustainable microfinance programs which have emerged over the past decade or so, and we seek to support programs which apply these principles.
>
> As noted in the draft report Best Practice of Banking with the Poor, a growing number of NGOs in the Asia–Pacific region have demonstrated their commitment and capacity to deliver or assist in the delivery of financial services to the poor. Bank/NGO/SHG linkage programs, eg, those comprising the BWTP network, are potentially effective means of channelling more financial resources to the poor. In concept, these programs have the distinct advantage of promoting the integration of poverty lending into the overall banking system. This, in turn, can and should increase the pool of domestic loan resources made available to the poor. Given the promise which such institutional mechanisms hold, and in light of their relative newness, USAID appreciates the important contribution of the Foundation for Development Cooperation in examining these innovative microenterprise credit programs and in promoting international dialogue on the subject. . .

USAID assistance for microenterprise development

USAID has made microenterprise development a major program priority. In 1994 alone, total funding for microenterprise activities exceeded $140 million. Support for the expansion of sustainable microenterprise finance forms the mainstay of USAID's program of assistance to microenterprise: approximately two-thirds of budgeted resources consists of support for microenterprise finance programs. USAID's support comprises start-up loan capital, technical assistance and training, institutional development, and policy assistance. USAID places a very high priority on outreach to the poor: it has pledged that one-half of its support for microenterprise finance be committed to poverty lending.

Microenterprise finance: USAID's policy and program objectives

Financial self-sustainability

USAID strongly believes that all microfinance programs and institutions should strive to achieve financial self-sustainability. Microfinance institutions which operate on a financially sustainable basis are better able to leverage non-donor funds, expand their scope, and thereby provide financial services to a far greater number of poor people than would be possible through subsidised credit. As noted in BWTP, there are several levels of financial self-sufficiency. Conceptually, it is useful to identify two categories of self-sufficiency: operational self-sufficiency and full self-sufficiency. Programs which are able to cover all non-financial expenses out of program fees and interest charges are said to have obtained operational self-sufficiency. This is an important hurdle for microfinance programs for it means that, while still subsidy dependent, they are able to maintain (and perhaps expand) their loan capital base. Full self-sufficiency is attained when all non-financial and financial costs are covered where the latter refers to the cost of funds. This is admittedly a high standard which only a few microenterprise finance programs have achieved, but it is the key to longevity and expansion.

To achieve financial self-sufficiency, interest rates must be set on a cost-recovery basis. Full cost recovery implies that microfinance loans are priced such that the resulting income from interest rates and related fees cover all the costs of making the loans. Cost recovery is the ultimate test of a sustainable microcredit program. The basic assumption underlying the principle of full cost recovery is that the poor prefer access to reliable credit at higher interest rates over subsidised but unreliable credit. Subsidies in the form of loan capital, technical assistance, training, and institutional support are appropriate in a program's start-up and/or expansion phase. Eventually, however, the pricing of loans should cover all inflation-adjusted transactions and overhead costs. Moreover, in order to facilitate the transition to cost-recovery pricing, the subsidy element of all microfinance programs should be fully accounted for. Using cost-recovery criteria is the best practical means of determining the appropriate interest rate and fee structure. The term 'market interest rate' is not very helpful, as it raises endless disputes over what the relevant market interest rate is. Often there is no relevant reference rate. Cost-recovery rates tend to be higher than mainstream commercial bank rates on small business loans, and lower than informal sector rates.

Ultimately, USAID's vision is that microfinance will be funded locally and commercially. That is, the main source of funds for lending to microentrepreneurs should be the local private

> sector, both businesses and households. Microfinance providers should be financed through an appropriate combination of such mechanisms as savings deposits from local households, loans from commercial banks, and tapping into local money and capital markets. We support a variety of paths to the vision: NGOs that borrow from commercial banks (eg, ADEMI in the Dominican Republic and TSPI in the Philippines), NGOs that are transformed into special financial institutions (eg., Grameen and Bancosol), and formal financial institutions doing microfinance of their own accord (credit unions, state-owned banks, and private banks). While many of our microfinance projects work with NGOs, we also support development of institutions which provide financial services directly to microentrepreneurs.
>
> *The role of NGOs and SHGs*
>
> In most countries, NGOs have played a vital role in helping to channel credit and other services to the poor. Some NGO microfinance programs have been highly successful. In a few instances, NGOs have even transformed themselves into full-fledged institutions serving large numbers of poor clients. USAID wishes to support NGOs that are willing and have the potential 1) to reach full financial viability, 2) to raise funds from local sources, and 3) to have a concern to reach a significant scale of outreach. Where we have such partners, USAID will structure assistance as a seed capital investment, to enable the NGO to reach these three goals. An important part of that investment is an investment in capacity-building. For example, it is critical that NGOs be able to produce financial information to the standard that would satisfy a local commercial funder (like a bank), and we would assist NGOs in developing their information systems to that point.
>
> USAID believes group lending is an important methodology for working with the very poor, and we support group lending in most of the countries in which we operate. Groups can serve to lower the information costs that lenders face in dealing with informal sector clients and to provide substitutes for conventional collateral. The group approach also fosters "social intermediation", a means by which the poor can improve their access to formal sector service institutions. While we are enthusiastic supporters of the group lending approach, we do not support this method to the exclusion of other methods of outreach. In fact, some of the most successful microfinance programs USAID has supported do not use groups (BRI, BKK and its cousins, ADEMI, and ACEP in Senegal).
>
> It may also be noted that there are many different types of groups, ranging from small solidarity groups (as used in Grameen Bank and its clones) to village banks (a model USAID has supported in many countries). Credit unions and savings and loan organisations are typically larger, more formal types of groups. We believe that the cost of group formation in such programs is an integral part of the cost of making loans, and hence, operational self-sufficiency requires that these costs be covered in fees and interest charged to clients. If programs are to become financially independent of donor support and able to achieve significant scale, such a policy is necessary. . .

The USAID response to BWTP recommendations indicates a coherent philosophy of action based on notions of sustainable financial development. It is notable in expressing support for a variety of approaches ('multiple models') to microfinance delivery. Among these the bank/NGO/SHG linkage, as documented by BWTP is acknowledged as a potentially effective means of reaching the poor, with the particular advantage of integrating poverty lending into the overall banking system.

USAID sees 'microenterprise finance' as a subset of 'microenterprise development'. It is particularly notable that some two-thirds of outlays on microenterprise development (which totalled more than $140 million in 1994) are allocated to microenterprise finance programs. This sends a very clear message concerning the relative weighting given by USAID to credit, as an input for MED, compared with other inputs such as training, marketing, etc.

Among the 'multiple models' supported by USAID are a number which feature lending to individuals; by no means all USAID-supported microfinance is mediated via groups. This is consistent with USAID policy on poverty targeting, which is to allocate 50 per cent of its support for microenterprise finance to poverty lending. This policy is clearly at variance with the call in **Banking with the Poor** for resources to be concentrated on the poorest of the poor.

USAID sets as a goal the full financial sustainability of microfinance programs. This is modified to the degree that subsidies (in the form of loan capital, technical assistance and institutional support) may be provided during a program's start-up or expansion phases. Full accounting by recipients for all subsidies received is a condition seen as conducive to progressing towards full sustainability. Consistent with this approach to subsidies, USAID will support NGOs with seed capital investment, including investment in capacity building.

As mentioned above, USAID supports group lending approaches, but declines to do so exclusively. Further, its definition of 'group' is considerably broader than the 'solidarity groups' developed by Grameen and other NGOs, and supported by **Banking with the Poor**. To include credit unions and savings and loan organisations in the category of groups, as USAID does, may be consistent with its choice of a relatively wide range of target beneficiaries. However, as research conducted for this report and its predecessor has indicated, not all organisations of these types have been successful in reaching the poorest of the poor.

5.5 Other multilateral organisations and international NGOs

The recommendations of **Banking with the Poor** to these institutions, which include the United Nations Development Programme (UNDP) and the Capital Development Fund (UNCDF) may be summarised as follows.

- These agencies should respond to requests for increased technical assistance and institutional support for NGOs, banks and governments assisting NGO programs of credit for the poor.
- They should recognise the need for specific assistance for the formation, training and seed-funding of SHGs, and for their linkage with commercial banks to assure their basic loan capital requirements.

- UNDP and other regional organisations working in this field (including APRACA, and APDC in Kuala Lumpur) have an opportunity to promote the exchange of information and experience on banking with the poor in the Asia–Pacific region. For this purpose it is recommended they should provide financial assistance to groups or networks of like-minded NGOs and banks involved in programs of credit for the poor.
- International NGOs, and NGOs in industrial countries should provide direct support for indigenous NGO programs of credit in the Asia–Pacific region. Specifically, they should mobilise funding for the formation, training and seed-funding of SHGs of the poor by such NGOs.

UNDP and UNCDF are multilateral organisations providing grant funding and technical assistance for activities aimed at the reduction of poverty in the developing world. This clearly includes, as a high priority, technical assistance channelled through governments in support of NGO programs to provide greater access to credit for the poor, as well as some small-scale capital assistance from UNCDF in support of such projects in the least developed countries.

A senior official of UNDP attended the Third Regional Workshop and gave an account of some of these activities. He also tabled for comparison with best practice principles discussed in this report, a set of 'standards for intermediaries' prepared in 1994 by a United Nations Expert Group on Women and Finance, convened by Women's World Banking (and reproduced in this document as Annex 1). Based on a reading of these materials, the best practice report and other sources, UNDP's representative proposed the following principles as representing an emerging consensus on microcredit.

1) the need for full market rates of interest for sustainability
2) that lending to the poor is an expensive proposition (transaction costs leading to interest rates 15 per cent or more above prime lending rates, in many cases)
3) that the intended borrowers are capable of bearing these high interest rates (and still achieving great benefits for themselves)
4) donors need to examine alternative methods of financing this type of activity using performance-based mechanisms and greater flexibility.

Regarding the emphasis of Banking with the Poor on involving commercial banks in these processes, UNDP's representative acknowledged a 'broad consensus that it is vital to mainstream micro lending into these institutions'. Yet he expressed doubt whether financial sector conditions in most developing countries will permit efficient service provision by their commercial banks. From the perspective of the Foundation for Development Cooperation, this is precisely the situation which this best practice report is concerned to address and, by providing evidence of efficient service provision, to improve.

The same official attended the second regional workshop in Kuala Lumpur in 1992, and in association with a colleague presented a draft of a UNDP Asia–Pacific regional project, Credit for Income Generating Activities of the Poor (CIGAP). This project was to have provided support for several major non-governmental regional networks providing effective programs of credit for the poor, including our own BWTP Network. This draft project was subsequently subsumed into RAS/92/006 (Asia–Pacific Regional Poverty Alleviation Programme), for which the Foundation for Development Cooperation is an implementing agency, responsible to the Asian and Pacific Development Centre as executing agency.

The successful outcomes of these UNDP-assisted activities conducted by the Foundation in association with the BWTP Network to promote banking with the poor to regional governments, central banks, bankers' associations, non-governmental organisations and other international and bilateral agencies have been fully described in reports presented to the Third Regional Workshop.

The UNDP Asia–Pacific Regional Poverty Alleviation Programme, incorporating CIGAP, provides for further activities of the regional networks over the period 1995–97, including the BWTP Network. These will include evaluations of the impact of these programs upon the poor themselves (through increased incomes and jobs), exchanges of individuals between different successful programs to enhance their effectiveness, and so on. These, and many other planned activities such as the further refinement of transaction cost studies based upon practical experience, the justification for and acceptance of group guarantees for collateral, and the evaluation of linkages with commercial banks and other activities, are extremely important for the evolution of banking with the poor, and for the reduction of poverty in the region, and it is hoped that they will continue to be supported and expanded by UNDP in coming years.

In the South Pacific, UNDP is about to undertake a project, Pacific Regional Equitable and Sustainable Human Development Programme (ESHDP-PMI/92/300) of institutional strengthening and capacity building for NGOs. One of the aims of this project is to empower NGOs to operate credit schemes effectively. UNDP has sought the Foundation's assistance in the implementation of the project.

Part 3

Best practice of Banking with the Poor
Conclusions and recommendations

At the Third Regional Workshop, participants considered a draft set of conclusions and recommendations, prepared by the study team, and flowing from the evidence and analysis presented in Part 2 of this best practice report. The draft conclusions and recommendations were subjected to detailed examination and analysis by workshop participants, and in their final form were endorsed and adopted by the Third Regional Workshop. They are presented here as a guide to best practice of banking with the poor.

Chapter 6

CONCLUSIONS AND RECOMMENDATIONS NON-GOVERNMENTAL ORGANISATIONS AND SELF-HELP GROUPS

6.1 Conclusions

Information and comments received from all sources in the region, and presented in Part 2 above, confirm the conclusions of our 1992 **Banking with the Poor** report. NGOs and SHGs hold the key to the successful provision of credit to the poorest of the poor in this region. This is not to say that the performance of all NGOs and SHGs is equally good, or that any one of their programs is optimal. It is simply to conclude that experience thus far reported has demonstrated that using NGOs and SHGs to develop and operate microfinance programs has proved to be the best practice thus far devised to reach the poorest of the poor in our region. Specific conclusions are as follows.

1) The poor are entitled to credit.

While giving full recognition to NGOs and their SHGs (as well as to banks, governments, central banks and external aid agencies that have come to appreciate their key role), it should not be forgotten that the success of these voluntary agencies is entirely dependent upon the poor themselves. They are determined to help themselves to overcome poverty, for which purpose the Foundation's first study of **Banking with the Poor** reported as follows:

- the poor are good credit risks; given opportunity and motivation they demonstrate good savings performance, and are fully bankable
- their main problem is whether credit is available, rather than what it costs
- given better access to credit, the poor are willing and able to help themselves
- women borrowers, especially women organised in groups, have proved to be the most reliable and effective borrowers
- non-government organisations and self-help groups are providing better access to credit for the poor; they can mobilise group savings, provide group guarantees instead of collateral, reduce the operating costs of banks, and achieve high repayment rates on loans

2) NGOs succeed through building SHGs of the poor.

NGOs demonstrate the 'best practice' in targeting the very poor; winning their trust and confidence; organising SHGs of the poor to help themselves; mobilising their modest savings into common funds which they control; training them in financial disciplines, simple bookkeeping and accountability; developing group liability and peer pressure as effective substitutes for collateral; minimising documentation, red tape and procedures; providing their own voluntary labour to reduce transaction costs; and achieving high rates of loan repayment. Where they do all these things while charging market rates of interest, they can achieve sustainability.

The generally high standards achieved by NGOs and SHGs in these respects have left one major problem unresolved. The very small savings mobilised by the poor in the common fund of their SHGs, whilst sufficient for emergency needs, are quite inadequate for groups to make production loans to their members — hence the imperative for them to link up with commercial banks, which are in a position to supply the loan capital required by well-managed NGOs and SHGs. The deployment of this capital to serve the poor in commercially viable ways is the culmination of banking with the poor.

3) NGOs have 'comparative advantage' in dealing with the poor.

It has been pointed out before that NGOs have comparative advantage in dealing with the poor due to their proximity, trust, commitment, flexibility and responsiveness. Hence, NGOs are in a unique position to advise and support poor rural villagers or urban slum dwellers to form SHGs. In addition to any immediate objective that the group may have, their kinship or proximity and their common need create a natural bond which they may wish to develop and maintain for mutual support, particularly through mobilising savings and trying to organise microfinance to meet their emergency or productive needs. In recent years the local NGO has played a very significant role in forming and training the self-help group of between five and 30 members as a self-help credit management group. After about six months of training, the NGO then helps the SHG to obtain directly, or through the NGO itself, a line of credit or 'wholesale' loan to help meet the productive needs of the group's members.

In the past few years, the Foundation has worked with two NGOs, one in India and the other in the Philippines, to get a better understanding of their methods in forming and training SHGs as the basic 'building blocks' of banking with the poor (in rural and urban areas respectively). The results of this work have been published as simple 'how to' manuals for NGOs.

4) SHGs need simple but comprehensive guidelines.

Once the groups have been established and trained, they need to adopt and follow certain general principles that will guide their operations and serve also to demonstrate their ability to handle development finance from the banks. Certain principles were approved at the second regional workshop on **Banking with the Poor** and have been tested and found valid in a variety of social and economic conditions since that workshop. They are as follows:

1. SHG membership should be resident in the same area, be homogeneous, and number at least five persons.
2. SHGs should promote savings mobilisation.
3. Savings should be linked to credit: savings first, credit next.
4. The development of financial disciplines and systems should be encouraged.
5. SHGs should begin with a simple bookkeeping system.

6. SHGs should hold regular meetings (once a week if possible).
7. They should have basic rules or bylaws (written or unwritten).
8. Group leaders should be elected by the members, with group functions or positions being rotated among the members.
9. Transparency in business operations and the overall conduct of group activities should be maintained at all times.
10. Basic training and guidance should be provided to members of SHGs.
11. The autonomy of SHGs should be respected.
12. Group liability and peer pressure should be the substitutes for collateral.
13. Loans should be kept small initially and repayments made frequently and regularly.
14. Transaction costs should be kept to a minimum through simplified group procedures and control.
15. Market rates of interest should apply to both savings and credit, to achieve financial viability as soon as possible.
16. Commercial banks should be asked to provide appropriate advances or lines of credit to supplement the group's financial resources and to enable it to lend for productive purposes.[52]

It is significant to note that almost all of our NGO network members have reported that over the past two years they have implemented these principles in practice, with only one or two minor variations in their application to adjust to local conditions (which have been reported here).

5) Interest rates should be market related.

One of the important results from the application of these principles by our network members is the paramount need for interest rates charged by NGOs and SHGs to be at least market related and sufficient to cover the costs of efficient operations (to avoid exploiting borrowers). In one or two cases where this is not being done, with excessive reliance being placed upon subsidies or grants, the long-term viability of the program is in doubt. Rates could vary between commercial bank and moneylender rates, at a level which guarantees financial viability in the long run.

6) Replication and expansion are necessary.

In view of the vast scope of the problem of poverty in the region, and the relatively small, if successful, beginnings in meeting it through the current level of NGO and SHG activity, there is an urgent need for the most successful NGOs in every country to motivate, promote and train other development-minded NGOs to undertake programs of credit for the poor, using the methods and principles of **Banking with the Poor**. Governments, central banks and commercial banks also have important supportive and promotional roles in this process.

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[52] As incorporated into both of the manuals on building self-help groups published by the Foundation: *How to Build Self-help Groups for Successful Banking with the Poor: A Rural Model* (rev. edn, 1995); *How to Build Self-help Groups for Successful Banking with the Poor: An Urban Model* (1995).

7) NGOs need specific training.

One of the conclusions reached in the light of recent experience with banking with the poor is that many NGOs need more training in financial management, record keeping and monitoring of SHG operations in order to establish and maintain viable programs with the poor and sound commercial linkages with banks. Some bankers' associations have recently developed programs to help NGOs with this. The banking sector should be encouraged to offer such support.

8) NGOs need more financial and technical assistance.

In order to reach more of the poor in the region, NGOs need far more financial and technical assistance than they are now receiving from governments and international bilateral and multilateral agencies. They need this primarily for institution and capacity building, to be able to disburse effectively what is a potentially very large flow of capital resources from commercial banks.

Some of our NGO partners report that almost 50 per cent of their loan capital requirements are now being provided by commercial banks. Only five years ago, all of these resources were being supplied by grants, mainly from bilateral aid agencies. Now that more loanable funds are available from domestic sources, particularly commercial banks, which were previously provided by donor funds, the clear challenge to bilateral aid agencies and others providing grant funding and technical assistance is to increase support for institutional development and capacity building for sustainable banking with the poor.

9) Exchange programs are needed for NGOs.

In this rather special field of microfinance for the poor, direct exposure to successful programs in the field is possibly more important, from a motivational and learning standpoint, than any formal institutional training. Certainly, it is a desirable supplement to such training. For that purpose, a larger measure of international funding support is needed to facilitate the exchange of NGO people eager to learn about banking with the poor from NGOs successful in this field.

10) National coordination is needed.

National workshops of banks and NGOs organised by the Foundation in at least four of the eight partner countries (Indonesia, Nepal, the Philippines and Sri Lanka) concluded it was highly desirable for NGOs working in the field of credit for the poor to establish national consultative and coordinating mechanisms. These will serve:

(i) to allow them to help one another

(ii) to promote and train other national NGOs to develop programs for banking with the poor

(iii) to deal with and lobby government and central banks

(iv) to prepare them to negotiate with commercial banks and their associations for loan capital and training.

11) Impact upon the poor should be measured.

Our main aim is not to build NGOs and SHGs as ends in themselves, but as the best means thus far developed to help the poor to help themselves. It must be admitted that this report, like many others, is deficient in analysing the final impact of banking with the poor in reducing poverty. While there is persuasive anecdotal evidence of significant final impact, there is a clear need for more thorough and scientific longitudinal studies of the impact of these programs on the reduction of poverty, involving collection of household survey data by independent researchers, and studies of transaction costs of group and individual lending in a range of situations.

6.2 Specific recommendations

NGOs need to be accountable, transparent and, above all, cost-effective in their operations, and to possess the commitment and potential to build up their capacity to manage (or act in partnership with banks to manage) sustainable microfinance programs. The following recommendations are made to NGOs.

1) NGOs committed to poverty alleviation through provision of credit should be encouraged and supported by governments, central banks, commercial banks and international aid agencies to take the lead in forming and training SHGs for successful banking with the poor.
2) NGOs engaged in building and training self-help groups should assist them to save and establish common funds and to practise financial disciplines, in order to be ready to receive lines of credit or wholesale capital loans from the banks for the productive use of their members.
3) NGOs and SHGs should adopt and follow, in so far as possible, the guiding principles for self-help groups adopted by NGOs and banks at the second regional workshop, reprinted in Section 6.1.
4) NGOs and SHGs involved in credit programs for the poor should charge market-related interest rates in order to cover their costs, to be sustainable, and to grow. These should vary between the rates charged by commercial banks at the local level and moneylender rates, at a level assuring financial viability in the long run.
5) Better training in financial management, record keeping and monitoring of SHG operations should be organised by NGOs with the help of bankers' associations and others.
6) In view of the overwhelming needs of the 800 million poor in the region, NGOs, governments, central banks and commercial banks should concert their efforts to promote and train other like-minded NGOs to undertake programs of credit for the poor, using the proven principles and methods of **Banking with the Poor**. This is a necessary step towards the required expansion of the program.

7) In order to meet that challenge, NGOs should request bilateral agencies and others providing grant funding and technical assistance to increase support for institutional development and capacity building for sustainable banking with the poor. A distinction may be made, in determining eligibility for such support, between 'early' NGOs with positive trends in performance, and 'mature' NGOs, from which full adherence to performance standards should be expected.

   With regard to the establishment of performance standards, reference could be made to work done by a United Nations Expert Group on Women and Finance. The group's recommendations on 'standards for intermediaries' are broadly endorsed in principle, without our committing specifically to particular quantitative targets mentioned. Another useful guide is the Foundation's criteria for selection of NGOs prior to the first regional workshop. These are reproduced in Annexes 1 and 2 respectively.

8) NGOs should also request bilateral agencies and others providing grant funding and technical assistance to offer increased support for the exchange of personnel between regional NGOs working among the poor with credit, and for the training of such personnel.

9) NGOs and banks should create national consultative mechanisms to help each other, to exchange information, to promote participation of other national NGOs, to deal with governments and central banks and with commercial banks and their associations, for loan capital and training and the agreement and review of performance standards.

10) In the interest of exploring, demonstrating and publicising the scope for increased access to credit for the very poor on a sound commercial basis (the basic mandate of the Foundation for this project), thorough evaluations of the impact of these programs on the reduction of poverty should be undertaken. These would focus on incomes, jobs and microenterprise development, together with more qualitative issues such as increased self-reliance and freedom of choice, and should be conducted on a more scientific basis than has been done in the past, with more attention to the collection of baseline data through household and other surveys by independent researchers, and with appropriate international assistance. The results of these studies, if positive, will further validate an increased commitment of the international community to poverty reduction through banking with the poor.

Chapter 7

CONCLUSIONS AND RECOMMENDATIONS GOVERNMENTS AND CENTRAL BANKS

7.1 Conclusions

1) Most official poverty alleviation programs involving credit in the past have not been effective.

Most governments and central banks in the region have been concerned with poverty alleviation programs, to which they have devoted substantial financial resources and provided technical assistance and other support in the last few decades. Over time they have become increasingly aware of the relative merits of the various channels used under such programs to convey credit to the poor. It is now clear that most of the delivery mechanisms adopted had serious shortcomings, and that they largely failed to achieve the purposes for which they were designed. Their shortcomings included the following:

(i) The poorest among the poor, or the 'hardcore' poor whose need for credit was greatest, were not specifically targeted. Programs were geared to improving the condition of the rural poor in general, but did not provide for those who are most disadvantaged. Subsequent program reviews revealed that while a large number of not-so-poor rural entrepreneurs and farmers may have benefited from subsidised credit, the hardcore poor were hardly touched.

(ii) The institutional channels chosen (development banks, cooperative banks and commercial banks) were of such a nature that the methods used by them were incompatible with the conditions and needs of the poor.

(iii) Such programs did not lead to the creation of strong grassroots organisations of the poor, based upon the principles of self-reliance, self-sustainability and commitment. Groups were created by lending banks in certain programs, but these were not properly motivated, and were established only for receiving credit.

(iv) The role of voluntary organisations and NGOs as the necessary change agents was not properly understood.

(v) Financial resources made available were given as outright grants or at best, at highly subsidised rates. Funding was provided without setting up organisational systems to monitor and review the proper use of financial resources.

The end result was that the poor remained as poor as ever; frustration simmered among the masses distrustful of government-run programs. Gaps in understanding (created by inappropriate delivery systems) in some cases ultimately gave rise to social unrest.

This history of failure underlines the importance of governments and their central banks studying, analysing and introducing delivery systems based on the strength of the people's organisations. These must be properly nurtured to imbue them with a spirit of self-reliance and to equip them to operate on sound business principles. The initiative for such measures must necessarily come from governments and central banks, rather than be left to the sole discretion of participating financial institutions. The performance of the authorities in India and Indonesia demonstrates clearly how important the leadership of the central bank can be.

2) The lack of a commercial approach in official credit programs has been counter-productive.

Most credit programs for the poor are still not carried out in a commercially viable and therefore self-sustainable manner. Inspired by so-called genuine (but often largely political) sentiments of concern for the welfare of the poor, decision makers have tended to offer hand-outs and concessions of one kind or another. Such actions, besides destroying any efforts towards self-reliance at the individual level, intensify imbalances at the macroeconomic level through increased budgetary deficits and continued dependence on external assistance. Moreover, policies of subsidised credit have actually shrunk the quantum of financial resources available for the poor, instead of enlarging it.

3) NGOs need technical and financial support from domestic sources.

In the linkage program, the agencies at the implementation level are banks, NGOs and SHGs. NGOs are voluntary private organisations, and generally face resource constraints for their own purposes of institution building and strengthening. Most major NGOs have been depending on external resources for these purposes. Such aid is inherently uncertain and moreover totally inadequate to meet the needs of 800 million people living in absolute poverty in the region. Besides recognising the important role of NGOs in socioeconomic development and assigning them their rightful place in nation building, governments and central banks need to ensure that technical and financial resources are made available to them from domestic sources. Without NGO organisations adequately strengthened and their outreach enhanced, the vital institution of the SHG can neither be developed nor expanded to the necessary scale. NGOs should be given this responsibility; the commercial banks, which are in a position to provide the necessary loan capital, are not the proper agencies to be engaged in building effective SHGs of the poor at the grassroots level.

4) Strong and effective SHGs are essential to a linkage program, and official policies should be supportive of them.

In the implementation of a linkage program the strength of SHGs on the demand side is of prime importance. This is true even though active participation (from the supply side) of commercial banks and related financial institutions (including modifications to procedures and creation of new financial products) is necessary. Without effective SHGs the program has little chance of success. All 16 guiding principles for SHGs recommended by **Banking with the Poor** must be applied in practice, and policies of the relevant authorities need to be supportive of this. The authorities can assist by monitoring and reviewing the operations of

SHGs and encouraging the NGO movement to learn from experience and adapt to emerging requirements.

5) Recent experience supports the original BWTP recommendations to governments and central banks.

The second regional workshop held in Kuala Lumpur in July 1992 made a number of important recommendations to governments and central banks (included in Annex 3) which were considered necessary to create a conducive climate for the successful functioning of **Banking with the Poor.** These are equally valid in today's context. The information presented in this report shows that there has been some progress in implementation since then.

7.2 Specific recommendations

It is heartening to note that governments and central banks in BWTP Network countries have fully endorsed the findings and recommendations of **Banking with the Poor.** As a result of its unanimous endorsement as an effective tool at national workshops in seven countries of Asia, banking with the poor has entered upon a new phase. The most pressing need now is to operationalise the process in all countries and to expand its implementation in order to make significant inroads into poverty. Hence, the following recommendations are made.

1) Governments should adopt the credit and savings principles and practices of Banking with the Poor as outlined in this report and elsewhere. They should, where appropriate, incorporate them into their periodic development plans to facilitate its implementation, or otherwise provide such endorsement of the process as will facilitate its widespread adoption.

2) Specifically, governments should encourage commercial banks and NGOs and others to adopt Banking with the Poor, and advise central banks to take appropriate steps to that end.

3) Governments should accord appropriate recognition to the role of NGOs in the banking with the poor process, encouraging them to form their own central coordinating organisations to provide a forum for active dialogue and consultations.

4) Since the organisational strength of NGOs in forming and developing effective SHGs of the poor is central to the success of the linkage program, governments should set aside funds on an annual basis for NGO capacity building, and also help secure such funding and technical assistance from external sources.

5) Central banks should:

(i) cause surveys to be carried out, in collaboration with banks and NGO umbrella organisations, of the involvement and operations of NGOs in credit and savings activities in various parts of each country, including backward regions with higher poverty concentrations. They should make such information available to government agencies and banks to facilitate speedy implementation of the linkage program, as well as applying their research and information dissemination capacities to other aspects of microfinance

(ii) as a matter of urgency, encourage banks to launch banking with the poor programs, including programs on a pilot basis where necessary, and to approach bankers' associations to adopt these on a wider scale

(iii) encourage bankers' associations to establish a mechanism for periodic exchange of experience among banks involved in linkage programs

(iv) encourage the bankers' associations to plan training and orientation programs for bank and NGO personnel involved in implementation

(v) strive to remove regulatory constraints on lending to the poor, thus creating a conducive climate for banking with the poor. In particular, recognition of group guarantees as acceptable collateral, simplification of banks' loan procedures, and the eligibility of SHGs as loanees despite their being informal in nature, are among issues to be resolved as early as possible

6) Governments and central banks could encourage bankers' associations and NGO coordinating organisations to exchange experience with other countries for further improvement of the linkage programs in operation. They should supplement NGO resources available for this purpose.

Chapter 8

CONCLUSIONS AND RECOMMENDATIONS COMMERCIAL BANKS

8.1 Conclusions

1) Previous microcredit programs undertaken by commercial banks have differed fundamentally from the basic principles of **Banking with the Poor.**

In previous years, commercial banks in the BWTP Network countries have undertaken rural and microcredit programs to fulfil their social responsibilities and to comply with the directives of their governments and central banks. A wide variety of experience, with a mixed degree of success, is to be found among the banks. Undertaking programs using the banks' own branches and field staff or involving the opening of rural branches has been their normal approach to delivering credit to the poor. As well, banks have concentrated more on lending to the rural poor than on mobilising their savings. Whatever deposits are collected in rural areas have come from regular bank customers who are not poor. In a number of cases, banks have also implemented credit programs using groups of small farmers established by them, or existing large farmers' cooperatives. These are not at all comparable with the SHGs that **Banking with the Poor** has recommended as the vehicles for credit delivery.

2) A significant start has been made in the use of NGOs and SHGs as intermediaries for credit delivery by network commercial banks.

The recommendation to use NGOs and SHGs as intermediaries for credit delivery is relatively novel for the banks. It has not yet been practised on a significant scale, except perhaps in Bangladesh under the Swanirvar program and in Indonesia under the GTZ-assisted PHBK program, though in India it is now expanding. As this report has shown, the network banks in eight countries have endeavoured to apply this most important feature of banking with the poor with varying degrees of success.

3) Continuing development of appropriate banking practices and approaches is needed, including ongoing consultation between NGOs and banks.

For banking with the poor to be successful, banks must redesign their practices and procedures, introduce new financial products, and devise new ways to address the needs of poor borrowers. These revisions should be concerned with simplifying of loan procedures, recognising collateral substitutes, and accepting the informal status of NGOs and SHGs. As described in the preceding chapters, there has been tangible progress in this direction, but a number of impediments still exist in specific countries. The Foundation, through its contacts with bankers' associations, central banks and certain progressive banks in the network countries, and by organising national workshops of bankers, has tried to convey the message of **Banking with the Poor** to the industry in Asia. In all the network countries, national workshops fully endorsed banking with the poor, and many pledges were received for the early implementation of its recommendations. We hope that progress will continue to be made in this respect.

Of particular importance is the role of the central banks in solving legal and regulatory problems. As a result of national workshops, consultative committees of banks and NGOs have emerged in most network countries, with lines of communication to the central banks. It is expected that these committees will be able to play a constructive role in operationalising banking with the poor, and that similar committees will eventually be established in all countries.

4) Reduction in banks' transaction costs is achievable through the use of NGOs and SHGs as intermediaries.

Banks have particular concerns about their transaction costs of extending credit to the poor in small amounts, especially when borrowers are scattered over large geographic areas. This concern has been addressed by recent research studies on transaction costs conducted by the Foundation in India and the Philippines. These were tabled at the Third Regional Workshop, and are now published by the Foundation. These studies have indicated that banks can achieve substantial savings if they lend through NGOs and SHGs as intermediaries. Borrowers are also in a position to save to a significant degree on their transaction costs of borrowing. The saving in cost occurs mainly due to externalisation of banks' loan functions and to their dealing in bulk with groups rather than with individual borrowers. In addition to reductions in transaction costs, the banking with the poor mechanism also results in improved bank profitability, due to rates of loan repayment close to 100 per cent and the mobilisation of deposits in the form of group savings. Banks cannot overlook these clear advantages, and should pay increasing attention to the reduction of transaction costs through the use of NGOs and SHGs of the poor as intermediaries.

5) Effective banking with the poor requires change in the banking culture.

Banks operate within a certain regulatory environment and follow standard practices on which they do not normally compromise. The great bulk of bank staff have lived and worked within this banking 'culture', and are largely unconcerned about the needs of the poor. There is an acute need for banks to have a different outlook, and to introduce simpler, less rigid procedures conducive to working with NGOs and SHGs of the poor. These changes will have to be accomplished by bank staff themselves. Exposure training of bank staff at all levels to this 'new culture' is a prerequisite of the program's success.

There are many training programs conducted to upgrade banking skills but, with the exception of MYRADA, there are none in the region which deal exclusively with the linkage mechanism and associated techniques. Since this is a newly emerging subject, on-the-spot study of NGOs and SHGs has commenced in some network countries. Joint discussion groups consisting of bank and NGO personnel are being conducted. NABARD in India has taken admirable initiatives in this field. Such training methods may prove quite beneficial to participant banks at this stage. In view of the newness of the system, there is the possibility of pooling experience on a regional basis and disseminating information through exchanges and by holding workshops and seminars combined with field observation. Bank associations in the respective countries are appropriate institutions for such training programs. The Bankers' Association of the Philippines has done exemplary work by initiating a training program, Banking with the Informal Sector, and by involving NGOs in it.

8.2 Specific recommendations

Recommendations to banks made by the second regional workshop in Kuala Lumpur in 1992 have subsequently been discussed with meetings of professional bankers in seven Asian countries without serious challenge or question. The following recommendations derived originally from the Kuala Lumpur meeting and revised in the light of subsequent experience are made to commercial banks.

1) Commercial banks and other financial institutions (as appropriate in country-specific conditions) should engage in lending to the poor via NGOs and SHGs of the poor that meet agreed standards of operation. Excellent repayment rates, sound operating and financial structures, and competence in expanding outreach to large numbers of low income borrowers should be among the indicators of performance chosen for this purpose.

2) Commercial banks and other financial institutions should operationalise linkage programs in their organisations as early as possible. Where these have not yet been started, banks may also consider introducing pilot testing in particular regions of the country with greater potential and availability of NGO service. Based on the successful conduct of piloting, banks should expand the scope of such coverage. A staged approach will allow banks to acquire experience in practice.

3) Commercial banks and other financial institutions should review and redesign loan procedures applicable to their linkage programs, introduce new financial products, and devise new ways to address the needs of poor borrowers. These revisions should be concerned with simplifying loan procedures, accepting collateral substitutes, and accepting the informal status of NGOs and SHGs.

4) The group guarantee as collateral substitute has been found to be most suitable for small loans to the poor and ensures high repayment rates through group pressure. It should therefore be accepted by commercial banks and other financial institutions.

5) Banks, with the help of bankers' associations, other regulatory bodies and central banks (as appropriate in country-specific situations) should establish a mechanism for periodic dialogue and consultation with NGOs and (if appropriate) governmental organisations involved in group credit in order to assess their needs, solve emerging problems, and build an understanding of the successful conduct of banking with the poor. The agreement and review of performance standards is an appropriate task for such consultative processes.
6) Banks may also create forums for exchange of experiences among banks engaged in linkages, for consolidation and strengthening of the system.
7) Bank and other financial institution staff should attend regular training and orientation programs designed to impart knowledge about linkages; their concerned personnel at all levels should be involved in this sensitisation process.
8) Banks and other financial institutions should regularly monitor the working of the linkage and disseminate the information among all related institutions and personnel. They should accord a place of importance to this work, and publicise its achievements regularly through their own publications as well as through the media.

Chapter 9

CONCLUSIONS AND RECOMMENDATIONS EXTERNAL AGENCIES[53]

9.1 Conclusions

The potential for external agencies to contribute to the creation of sustainable banking with the poor is the subject of this chapter. It follows upon discussion (in Chapter 8) of the potential for commercial banks to supply loan capital requirements, suggesting the possibility of some consequential reallocation of the resources committed to these programs by external agencies.

Chapters 6 and 7 dealt, respectively, with the contributions of NGOs/SHGs, and the governments and central banks of Third World countries. The latter are urged, among other things, to provide an enabling environment for NGO/SHG activities and to help fund their capacity building, while NGOs and SHGs are enjoined to achieve acceptable standards of performance and to strive for commercial viability in their operations. The 'civil society' from which such voluntary organisations spring (including the private sector, which they are equipping the poor to enter) must also be regarded as a potential support base for their activities.

The recommendations to external agencies in **Banking with the Poor** distinguished between international financial institutions, bilateral aid agencies and other agencies. However, there are some general conclusions arising from recent experience of banking with the poor which are relevant to the concerns of all external agencies. These are as follows.

1) Microfinance programs contribute to the broader process of domestic financial sector development.

We stress the importance of the analytical framework in which the external agency conceives microcredit activities. Those agencies which most explicitly conceptualise microcredit within a framework of domestic financial sector development are likely to pursue policies (for example, with regard to savings mobilisation, interest rates, cost recovery and sustainability) which are consistent with both financial sector development and with the creation of viable microfinance-providing institutions. 'Financial sector development from below' is an objective of **Banking with the Poor.**

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[53] 'External agencies' is a shorthand term for the various agencies external to the recipient country which are capable of rendering assistance in implementing banking with the poor. These include multilateral and bilateral donors, international financial institutions, regional and intercountry agencies, and international NGOs.

2) Targeting the poorest of the poor requires that primary emphasis in external assistance programs be directed to the provision of microfinance leading to microenterprise development (MED).

The issue of whether emphasis should be placed primarily on MED, with credit relegated to a subsidiary role (as simply one of a number of the necessary inputs for MED) is closely connected with the issue of targeting the beneficiaries of such programs. If we accept the World Bank's distinction between a 'minimalist' model, in which lack of access to working capital is assumed to be the binding constraint on the ability of the poor to raise their incomes, and an 'integrated' model offering a package of services and resources, it will be obvious that the latter is more appropriate to MED programs. But if the objective is to target the poorest of the poor, as is the BWTP Network's explicit mandate, then the minimalist model which the Bank describes as suitable for 'subsistence' enterprises and 'new microenterprises' is more appropriate. These are the enterprises of the poorest of the poor, and especially of women.

3) External agencies should endorse the banking with the poor linkage mechanism for microfinance delivery.

External agencies should give explicit endorsement to the banking with the poor linkage mechanism, involving commercial banks, NGOs and self-help groups of the poor in a variety of intermediation relationships, as among the best methods of microfinance delivery consistent both with targeting the poorest and with positive financial sector development.

While a number of agencies stress the desirability of having a diverse range of financial channels for the delivery of microfinance, they also acknowledge the effectiveness of NGOs acting as intermediaries in the credit process, whether in a financial or a non-financial capacity. Other agencies are less explicit in acknowledging this and/or have not yet supported NGOs involved in linkages with commercial banks.

Similarly, the efficacy of group lending appears to be widely acknowledged, whether or not agencies regard poverty lending on an individual basis as also being feasible. As in the case of attitudes to the microfinance/microenterprise distinction, the position taken by an external agency on the group/individual lending issue tends to indicate which social group is its primary target. The more complete the poverty orientation of an agency, the more likely it will be to focus on lending via groups.

4) The principle of full cost recovery should not be extended to include establishment costs.

Commitment to full cost recovery in microfinance programs is necessary while recognising the fact that the start-up and institutional development costs of NGOs and SHGs involved in microfinance activities may take a longer time to cover, and are thus an appropriate object of support.

A number of agencies appear not to have recognised the importance of the distinction between these and other costs of NGOs and SHGs involved in microfinance provision, and have therefore not made explicit their policies with regard to which categories of costs are appropriate objects of donor support. The hard line on this issue defines sustainability as requiring NGOs and SHGs to recover start-up and institutional development costs from the outset. By contrast, the recommendations adopted by the second regional workshop on **Banking with the Poor** indicate that these costs are a proper object of donor assistance, since ample loan capital can be supplied by commercial banking institutions, provided they are not expected to meet these start-up or institutional development costs. The trend for international financial institutions increasingly to recognise the need for such inputs, and for some bilateral agencies to supply such inputs either through grants for associated financing or as direct technical assistance in country programs, is a welcome endorsement of the recommendations of **Banking with the Poor** on this issue.

5) Costs of support for the formation, training and seed-funding of SHGs are a particularly appropriate object of support.

External agencies (including international NGOs) can assist this process, augmenting resources available from national governments and the civil society more generally. Relatively modest outlays in support of SHGs will prove capable of attracting commercial bank financing in much greater volumes.

6) Banking with the poor facilitates the redeployment of external funding.

Support for banking with the poor, which will bring the resources of private commercial banks into play, will release substantial external funding now allocated directly to supplying the loan capital needs of microfinance projects.

Recent years have seen increases in the numbers of bilateral projects in which grant aid is made available to NGOs for loan capital and institution building, in proportions of around 75:25. This has been a welcome trend, as is also some recent loan funding by international financial institutions in which proportions allocated to loan capital and institutional development were of a similar order.

However, with increasing interest on the part of commercial banks in supplying loan capital on commercial terms through linkage arrangements, there is scope for the release over time of large amounts of external funding now being allocated to loan capital. More funds could then be allocated to technical assistance and the strengthening of NGO capabilities, while some proportion of such savings could also be used in other needed areas of development assistance which cannot be expected to achieve commercial viability.

Where external agencies continue to provide loan capital for microcredit financing, it should be extended as seed capital, conditional upon its attracting domestic commercial bank funding on a matching basis.

7) External agencies should deal with microfinance as a specialist area requiring appropriate administrative arrangements.

While international financial institutions have made some administrative arrangements designed to facilitate the planning and implementation of microfinance projects, they still lack the distinct and specialised microfinance units which would give a sharper focus to their efforts in this area. By contrast, the suggestion on the part of the World Bank that an international consultative group of donors should be convened to consider microfinance issues and to initiate action in the field is a positive development.

The Third Asia–Pacific Regional Workshop on **Banking with the Poor** warmly welcomes the initiative of the World Bank in proposing to establish a Consultative Group to Assist the Poorest of the Poor (CGAPP) which would implement a microfinance program. The Workshop believes that international leadership in this field is urgently required to fill the need for some permanent institutional arrangements (not now in existence) to organise the response of the international donor community for better microfinance to assist the poorest of the poor. The Workshop encourages the members of the donor community to support this initiative.

8) Networking will develop microfinance expertise in NGOs.

Networking among NGOs involved in microfinance has the potential to increase the efficiency and effectiveness of their operations, and the donor community could usefully facilitate this process.

In several countries of the Asia–Pacific region, groups of NGOs involved in microfinance are moving to establish mechanisms for coordination and communication, both on an inter-NGO basis and also between the NGOs and other actors in the field of microfinance. This is a positive development, which specialised agencies with the resources or expertise to supply technical assistance to facilitate such processes could usefully cultivate. A further extension of this kind of activity would be international networking on the part of NGOs involved in the provision of microfinance. Similar scope for coordination and international exchange is likely to exist within the commercial banking industries of Asia–Pacific countries and also between countries.

9.2 Specific recommendations

The experience of our BWTP Network partners, as well as of governments and central banks in the region and of external agencies, confirms the general validity and applicability of the recommendations addressed to the external agencies in the 1992 report on **Banking with the Poor** (see Annex 3). However, in view of the experience of the last two years in the implementation of banking with the poor, it may be useful to review those recommendations afresh in the light of that experience. Accordingly, the following recommendations to external agencies are offered.

1) Agencies aiming to alleviate the poverty of the poorest of the poor should direct assistance to helping indigenous NGOs build up self-help groups of the poor.

2) Such assistance to NGOs and SHGs should aim to build self-reliance, financial discipline and savings in preparation for the injection of small

loans or lines of credit from commercial banks, to be onlent to their members for productive purposes.

3) Where assistance is provided by *international financial institutions* in the form of soft loans (where there is a lack of adequate domestic resources for that purpose), such financial assistance should be:

   (i) required to be onlent to final borrowers at market rates assuring full sustainability

   (ii) designed and wherever possible required to stimulate commercial banks to supply increasing volumes of loan capital (possibly on a matching basis) to augment the resources available for lending to the poor.

4) A clear distinction should be made between this loan capital assistance and the separate need for technical assistance for institution building, so that where the latter is required in support of a World Bank or Asian Development Bank loan it can be provided through associated bilateral grant aid, as has occurred increasingly in the recent past. In this connection we quote with approval from the recent recommendations of a United Nations Expert Group (portion of which is reproduced as Annex 1): 'Multilateral, bilateral and private funders should encourage, assist and fund institutional development, with a focus on lateral learning among practitioners, and dissemination of success stories, best practice and successful forms of intermediation'.

5) Such bilaterally sourced assistance should be provided directly to NGOs, which are in a better position to assess their most urgent needs, and to do so more economically, than any centralised advisory service created specifically for a project.

6) Assistance of *bilateral aid donors* should follow the same principles, whether it is supplied as associated aid with financial institution loans or directly to the countries concerned.

7) Now that more of the loanable funds, previously provided by donors, are available from domestic sources, particularly from commercial banks and local savings, the clear challenge to bilateral aid agencies and others providing grant funding and technical assistance is to increase support for institutional development and capacity building for sustainable banking with the poor.

8) Recognition is due to UNDP as the major multilateral agency providing technical assistance. The initiative of UNDP in launching the credit components of its Asia–Pacific Regional Poverty Alleviation Programme, with a strategy of supporting non-governmental networks working effectively in the field of credit in the region, is a positive one. The BWTP

Network acknowledges the support of UNDP for its own activities, the positive outcomes of which are detailed in this report. BWTP recommends to UNDP that it should continue and expand its support to the major non-governmental networks in the region to enable them to continue and intensify their advocacy of a range of innovative approaches to poverty alleviation through microfinance, including banking with the poor.

9) Activities which are needed include:

   (i) the inventorisation of training resources available in the region to support the expansion of novel approaches to microfinance provision

   (ii) better monitoring and evaluation of the performance of NGO programs of credit (including proper studies of their impact upon recipients)

   (iii) replication of successful approaches and further research (on matters such as transaction costs, collateral substitutes, interest rate structures, loan repayment rates, and the viability and profitability of various approaches from the viewpoint of banks, intermediaries and other institutions), which is important in persuading the commercial banking community of the region of the commercial viability of banking with the poor.

   To avoid duplication of effort, research in these fields by the networks and by APRACA should be coordinated. Exchanges of personnel between NGO programs throughout the region (which might also extend to commercial bank staff in appropriate cases) could permit technology transfer between programs, enabling best practice to be disseminated widely.

10) Following upon its sponsorship of the important conference on microenterprises in developing countries in 1988, which served to focus attention on the importance of credit issues for microenterprise, the World Bank should take further action to organise the response of the donor community to the need for microfinance by means of some permanent institutional arrangement. As noted above, the Third Regional Workshop welcomes the Bank's proposal for the establishment of a Consultative Group to Assist the Poorest of the Poor (CGAPP), and encourages the donor community to support this initiative.

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Annexes

Annex 1

ESTABLISHING STANDARDS FOR INTERMEDIARIES (UNITED NATIONS EXPERT GROUP ON WOMEN AND FINANCE CONVENED BY WOMEN'S WORLD BANKING)

Establishing good standards for financial intermediaries within the microfinance area will depend on encouraging a range of sound and responsive intermediaries, and the development of performance standards and plans. Factors important to both of these aspects are discussed as follows.

Encouraging a range of sound, responsive intermediaries. A wide range of solid, responsive institutions should be encouraged to participate in the small and microenterprise financing market, provided that the institution is able to meet the established standards. These can include commercial banks, specialised financial intermediaries, business NGOs, cooperatives, credit unions, and grassroots women's groups. These standards will vary by type of institution and stage of development.

Performance standards and plans. In all cases, standards should include strong performance and credible plans in the following key areas.

- Establishing institutional cultures, structures, capacities, and service delivery systems that result in sustainable institutional services to a significant and growing number of low income economically active women. This requires a sound governing structure, freedom from political interference, competent staff, a strong business plan for expansion and sustainability, and mission and vision which create a sense of purpose and ownership by staff and clients.
- Providing quick and convenient access to small, short-term loans, that are increased based on excellent repayments, and the stages of development of a client's economic activities.
- Reducing the high costs of making small loans through simplicity, efficiency, clustering and group mechanisms.
- Offering loans at unsubsidised rates, recognising that poor women are able and willing to pay what it costs an efficient lender to provide sustainable financial services. In most cases this will be the interbank rate, plus at least 18 per cent.
- Achieving excellent repayments with arrears of over 30 days below 10 per cent, and defaults under 4 per cent.
- Promoting economic transformation by building relationships that engender confidence, a sense of ownership, and mutual accountability for results among women clients.

- Offering savings mobilisation services that facilitate small deposits, convenient collections, safety, and ready access to funds — either independently or with another institution.
- Making solid progress toward operating self-sufficiency achieved in three to seven years.
- Making significant progress in expanding client reach and market penetration.
- Sound institutional operations, including management information systems which are actively used to make decisions, motivate performance and provide accountability for funds.
- Building a solid and growing funding base, on the basis of strong performance and business plans, that incorporates capitalisation, institutional development and, for non-bank lenders, an increasing capacity to mobilise commercial funds from depositors and the financial system.
- Institutions that meet the standards need to be capitalised, made eligible for refinance, and receive institutional development support, if they are to reach significant numbers of low income entrepreneurs and producers, particularly women. Funders should provide financial and other support in forms that foster the movement to scale and financial self-sufficiency.
- Funding based on large, ongoing subsidies with a charity rationale has failed. Such programs have drained resources without becoming sustainable, and have contributed to the mistaken notion that the poor are unbankable. Organisations that are highly subsidy-dependent are often destined to remain small.
- Grant funding should be used for institution building, particularly in staff training and building financial, credit and savings, and management information systems.
- Grants are also of strategic importance in enabling organisations to build a capital base. Such grant capitalisation can be particularly important during the three to seven years it takes effective institutions to reach operating self-sufficiency.
- The transition to fully commercial sources of funding requires special forms of support which prepare organisations to become financially viable. Instruments that are important for supporting this transition include:

  – guarantees of loans made by commercial banks to microenterprise NGOs

  – grant capitalisation and equity investments in specialised financial institutions

  – second-tier operations, which raise funds from commercial sources and onlend to microenterprise finance organisations

  – technical support for institutional development including testing lending and savings methodologies.

Annex 2

CRITERIA FOR THE SELECTION OF SUCCESSFUL NON-GOVERNMENTAL CREDIT PROGRAMS FOR THE POOR AND RELATED QUESTIONS FOR NGOS

These criteria were used by the Foundation for Development Cooperation for the selection of NGOs to participate in the BWTP case studies, and were endorsed by the Foundation's first regional workshop in Manila in 1991.

Proposed criteria and related questions

1) *A commitment to improving access to credit for the poor:* that is, the NGO program targets poor beneficiaries who presently have no access to formal (banking) credit because of:

   (a) their lack of *acceptable collateral* or

   (b) the *excessively high transaction costs* or elaborate formal procedures required to obtain such credit.

   Question — Is the NGO directly concerned with and committed to overcoming those problems? How much (how many years) experience in this field has it had?

2) *Successful alternative methods employed:* for example, the program has eliminated or greatly reduced the 'credit risk' through alternative methods, such as recognising 'solidarity groups', whose members can obtain loans only after other members have repaid their initial loans (viz, the Grameen Bank in Bangladesh), or have substituted group liability for conventional collateral, or have a successful record of personal references or guarantees for loan repayments.

   Question — Does the NGO use any of these (or other) alternative methods successfully in lieu of a primary reliance upon conventional collateral? Please describe.

3) *Savings mobilisation:* does the program encourage or require the deposit of savings either

   (a) as a precondition for credit, for example, is there an agreed savings-to-credit ratio reflecting the credit worthiness of the borrower? and/or

   (b) as a means to build the capital resources of the program and to encourage the sense of responsibility and participation of the poor (the borrowers). Are such savings programs a problem under national legislation? Please describe your organisation's policy, practice, targets and results in these respects.

4) *Market rates of interest:* does your organisation charge rates of interest that are

   (a) lower than
   (b) comparable with, or
   (c) greater than commercial rates of interest in the formal financial sector? What rates?

5) *Loan recovery rates in excess of 95 per cent:* does your organisation

   (a) target to recover more than 95 per cent of loans, and
   (b) is the bad debt write-off less than 5 per cent (for loans, say, three months or more overdue) and by how much?

6) *Lending volume in excess of US$100,000 per annum:* total amount loaned last year and total number of borrowers?

7) *Average loan size — less than US$1,000 per borrower:* what is the average loan size of your program?

8) *Average loan duration — less than three years:* what is the average duration of loans of your program?

9) *Impact on increased income and employment:* has the program increased both, and by how much? Please provide any available data on

   (a) average increase in project and family income, and
   (b) on the average amount loaned to provide one additional job and approximate increase in total employment from the program last year.

10) *Financial viability of the program:* is the interest margin sufficient to cover the administrative costs and reserves for bad debts and inflation and how many years has it taken, or will it take, to achieve that goal?

11) *External aid:* has the organisation received any external (official or private) aid funding to capitalise its revolving credit program or to assist in its administration, training or technical assistance? What proportion does that represent of the total capitalisation of the program?

12) *Long-term sustainability:* has the organisation yet reached a level of long-term financial sustainability (that is, without needing further injections of external aid), or when does it plan to do so, and by what means?

13) *Bank relationships:* does the program operate an account with a local bank and/or does that or any other bank supply a loan or line of credit or offer any other interest or support for the development of your organisation's services as a 'financial intermediary' to the poor? Please describe.

14) *Program evaluation and monitoring:* does your program have an established system of loan and borrower monitoring and of self-evaluation? Has any independent evaluation been made of your program as a whole? If so, would it be possible to obtain a copy of such an evaluation report, as it may help to answer or clarify the position with respect to some or many of the questions raised above.

Annex 3

BANKING WITH THE POOR
REPORT AND RECOMMENDATIONS

(ADOPTED BY THE SECOND REGIONAL WORKSHOP ON BANKING WITH THE POOR AT THE ASIAN AND PACIFIC DEVELOPMENT CENTRE, KUALA LUMPUR, 6–10 JULY 1992)

D. RECOMMENDATIONS

On the basis of the detailed analysis and findings reported in eight country case studies, and of the general conclusions thereon in part C, the following recommendations are made:

D.1 Recommendations addressed to banks

1. The poor are not an unacceptable credit risk. Under appropriate circumstances, they are capable of meeting commercial loan obligations without seeking any concessions or subsidies. Hence, banks are urged to follow the example of progressive banks in the eight case study countries by taking significant initiatives to reach the poor. They can do this by making bank credit available in quantities both significant, and rising over time, for productive and income-generating activities of the poor.

2. Banks ought to view the extension of credit to the poor not as a loss proposition but as an additional opportunity for investment with profit. Suitably assisted by banks through provision of credit, the poor will be able to increase their incomes; resultant improvements in the purchasing power and savings of the poor will have beneficial impact on the profitability of other investment projects of the banks. This calls for an attitudinal change on the part of banks towards the poor.

3. Access to credit for the poor can also be improved by banks undertaking orientation and training of their staff members to be responsive to the needs of the poor, backed by appropriate criteria for the assessment of their performance in this area. A trained and positively-inclined cadre of retail bankers will be able to deliver credit effectively, and to overcome obstacles which cannot be foreseen in a creative manner.

4. When creative initiatives are taken by the banks it has been found that the poor do respond positively. By changing conventional banking practices unsuitable for the poor, by inculcating a developmental outlook, and by innovating new and needs-based methods for the poor, banks will be able to make positive contributions.

5. Banks should reconsider the issues relating to collateral for loans to the poor. Group guarantees have proved an effective alternative to collateral in many case study countries. For the small-sized loans needed by the poor, group guarantees may be both economical and appropriate. The requirement of collateral is somewhat different in the case of banks lending to Non Governmental Organisations (NGOs) for onlending to Self-Help

Groups (SHGs). NGOs do not normally possess assets acceptable to the banks except, in certain cases, lien over the savings of the SHGs. A solution acceptable to central and commercial banks and NGOs should be evolved, and a framework created to allow the NGOs to play their role of intermediation successfully.

6. Rates of interest charged by banks to borrowers have been largely controlled in the case study countries until recently. However, as part of financial sector reform, controls have been gradually lifted, granting freedom to individual banks to set up their own interest rates for deposits and loans. There are, however, still one or two exceptions. Policy reforms giving freedom to commercial banks in the determination of interest rates will greatly enhance the prospects of their taking a positive role in programs of lending to the poor. However, where banks already have this freedom, it is recommended that they fix lending rates to cover their transaction costs. Subsidies are more likely to destroy the creativity of the poor and undermine their efforts towards self-reliance than to help them, and should therefore be avoided as far as practicable.

7. In view of the advantages to be gained (in terms of savings in transaction costs, proper utilisation of loans and, above all, the very high rates of repayment) banks in case study countries have shown keen interest in establishing linkages with NGOs/SHGs. They have, in many cases, already extended lines of credit to SHGs in order to reach the poor. The outcome has been quite encouraging and the bank-NGOs/SHGs-borrowers link has proved to be most effective in alleviating poverty. Banks in the case study countries have shown keen interest in this approach and it is recommended that these initial activities be expanded and operationalised in those countries.

   In view of the initial success of the experiment of **Banking with the Poor** it is also recommended that these results be widely disseminated to other commercial banks in Asia. National banking associations and other appropriate bodies such as banking councils may also have a role to play in this. Banks not previously involved are encouraged to examine the performance of NGO programs of credit for the poor and of SHGs being assisted by them, to determine their credit-worthiness and their need for additional loan capital resources. They are also urged to follow the example of the banks participating in this project by offering to advance funds or a line of credit to NGOs or SHGs, on such terms as will help place those programs and the banks' funding thereof on a sound commercial basis.

8. In the light of these positive findings and conclusions, it is recommended that banks should actively explore the possibility of establishing sustainable linkages with NGOs and SHGs to open up an important new investment opportunity.

D.2 Recommendations to Non Governmental Organisations (NGOs) and Self-Help Groups (SHGs)

1. Non-governmental organisations should endeavour to scale-up their operations and increase their absorptive capacity to enable them both to relate to banks, and to help

SHGs among the poor. They should train such SHGs in group organisation, financial discipline, savings mobilisation and credit management. NGOs need to provide seed funding for such SHGs to enable them to approach commercial banks with a view to securing adequate loan capital funding, on a sound commercial basis, for their needs.

2. In order to enable them to operate viably and to sustain their operations, NGOs should charge interest rates adequate over time to cover their transaction costs directly related to lending.

3. In the process of **SHG formation, training and seed funding**, they should endeavour to follow some such set of guidelines as is set forth in Appendix XIII, or to adapt them to their circumstances.

4. It is recommended that, based upon the experience of successful NGO/SHG programs in the region to date, NGOs should encourage SHGs to apply as far as possible the guiding principles set forth below:

Guiding Principles for Self-Help Groups

1. SHG membership should be resident in the same area, be homogeneous, and number at least five persons.
2. SHGs should promote savings mobilisation.
3. Savings should be linked to credit: savings first, credit next.
4. The development of financial disciplines and systems should be encouraged.
5. SHGs should begin with a simple bookkeeping system.
6. SHGs should hold regular meetings (once a week if possible).
7. They should have basic rules or bylaws (written or unwritten).
8. Group leaders should be elected by the members, with group functions or positions being rotated among the members.
9. Transparency in business operations and the overall conduct of group activities should be maintained at all times.
10. Basic training and guidance should be provided to members of SHGs.
11. The autonomy of SHGs should be respected.
12. Group liability and peer pressure should be the substitutes for collateral.
13. Loans should be kept small initially and repayments made frequently and regularly.
14. Transaction costs should be kept to a minimum through simplified group procedures and control.
15. Market rates of interest should apply to both savings and credit, to achieve financial viability as soon as possible.
16. Commercial Banks should be asked to provide appropriate advances or lines of credit to supplement the group's financial resources and to enable it to lend for productive purposes.

Additional assistance for NGOs

5. In order to be in a position to implement the foregoing effectively and to extend the benefits thereof to as many of the poor as possible, NGOs should seek additional financial, technical assistance and institution-building support from their own governments, from bilateral aid agencies, from international financial institutions such as the World Bank, ADB and IFAD, from other international organisations such as the UNDP, UNCDF, APRACA and APDC, and from partner NGOs in other countries as appropriate (see sections D.3, D.4 and D.5 below).

6. NGOs should also be prepared to offer technical assistance and advice to other non-governmental organisations in their own countries and overseas, where their knowledge and experience may be helpful to them; they should collaborate with other NGO programs, and participate in regional networks of like-minded NGOs in order to strengthen their separate and joint endeavours.

D.3 Recommendations addressed to Third World governments and central banks

1. It is respectfully recommended that governments adopt measures removing constraints on the smooth flow of financial resources from the banking sector for onlending to targeted poverty groups. To that end,

   (a) governments are urged to make banking with the poor a part of their development strategy for poverty alleviation

   (b) governments and central banks are requested to review banking regulations affecting loan procedures and collateral requirements with a view to making them more suitable to the needs of the poor. They could also introduce changes, inter alia, to allow Non Governmental Organisations (NGOs) to play an appropriate role in financial intermediation for the poor, including the mobilisation of savings from Self-Help Groups (SHGs) and individuals to whom loan funds are being channelled by or through such NGOs, and the recycling of such funds to them. This might also include recognising the role to be played by informal SHGs in the system.

   (c) financial authorities could encourage commercial banks to adopt alternative systems of credit delivery in as much as they relate to the poor. Such alternative systems would recognise the role of NGOs/SHGs as intermediaries for credit delivery and savings mobilisation

   (d) they could also issue appropriate guidelines to the banks and NGOs with regard to the mechanisms, procedures and roles of the respective actors in the system (i.e. banks, NGOs/SHGs and the borrowers). In particular, they could urge banks to treat group guarantees by SHGs and the good track records of NGOs as sufficient collateral for loans. They could urge the banks to simplify loan documentation procedures, decentralise loan approval processes, and to ensure speedy and timely delivery of credit to borrowers

(e) repeat loans should be granted without let or hindrance in the case of borrowers who have satisfactorily fulfilled repayment conditions. Financial authorities are asked to ensure that this happens.

2. Lending rates charged by banks on loans to priority sectors have been controlled by governments and central banks in many countries, resulting in market distortions and misallocations of resources. Subsidies, in particular, very often destroy the creativity of beneficiaries and undermine their efforts towards self-reliance. Governments and central banks are asked to collaborate to see that subsidies and grants are replaced by market-related interest rates, and to ensure that the partners in linkage programs (i.e. banks and NGOs/SHGs) are motivated to cover their transaction costs and loan losses, and to achieve adequate returns on investment, so that the entire operation is commercially viable and sustainable.

3. Governments would do well to recognise the crucial role of NGOs in organising and developing effective SHGs at the grassroots level, and could assist in making resources available to cover the development costs of their operation until such time as the NGOs are able to recover these costs of development from the borrowers themselves.

4. External grant assistance for loan capital for these programs, which has been instrumental in sustaining NGO activities in the private sector in the past, cannot be depended upon to continue indefinitely. The domestic banking system, which is the major and permanent source of loan funds for economic activities, must be encouraged to step in to fill the gap. Governments need to establish a policy and regulatory environment facilitating this. Technical support should also be provided to the banking sector to upgrade its performance in this field, and international sources of assistance, where available, should be tapped for the purpose.

5. Governments could duly recognise the important role of NGOs/SHGs in poverty alleviation and reserve a suitable place for them in nation-building efforts. In view of their importance, a central co-ordinating mechanism for NGO activities in the country may be promoted, where it does not already exist, to deal with NGO-related subjects. Alternatively, sector-specific NGO coordinating mechanisms may be promoted. This should be done without attempting to impose bureaucratic control over NGOs, as they must function as flexible and autonomous organisations to be effective and useful to the poor.

6. Central banks could follow some recent initiatives in the region by announcing a policy aimed at encouraging commercial banks to establish direct linkages with SHGs, to provide for better access to credit for the poor on a sound commercial basis.

D.4 Recommendations to international financial institutions (World Bank, ADB, IFAD)

1. As a matter of basic policy, international financial institutions should continue to accelerate their efforts to promote commercially viable banking with the poor, with

particular attention to achieving active participation of commercial banks in that process.

2. They should provide loans, as needed, to Asian and Pacific countries with inadequate funds for the assistance of NGO programs of microcredit for the poor conducted on a commercially viable basis.

3. Where such additional financial assistance is needed in support of the loan capital requirements of NGOs developing effective programs of credit for the poor (i.e. where such assistance is not yet available from commercial sources), it should be extended as **seed capital** and designed explicitly to attract rather than to replace commercial bank funding for that purpose. For example, it should be offered wherever possible on a matching basis with the funds of commercial banks, to induce them to support commercially viable programs of credit for the poor.

4. Such international finance should be channelled as directly as possible to NGO programs, and on terms and conditions that will ensure they will be onlent to the final beneficiaries at market rates of interest, rather than on a subsidised basis that would undermine the long-term sustainability of those programs.

5. International financial institutions should endeavour to mobilise associated finance from bilateral sources to be offered on a grant basis for technical assistance, and for the institutional strengthening and expansion of NGO and bank programs in the country concerned. Such assistance should be extended so as to ensure that NGOs receiving loan capital funding will also receive adequate grant funding, offered as performance-based budgetary support, for scaling up programs of credit for the poor, to reach large numbers in a financially sustainable way.

6. International financial institutions serving the Asia–Pacific region should make special administrative arrangements working towards the establishment of distinct microcredit units, to make more effective the implementation of their programs to provide greater access to credit for the poor.

D.5 Recommendations to bilateral aid agencies

Bilateral aid programs have in the past provided financial and technical assistance to NGO programs of credit for the poor. Most of them are keenly aware of the success of these programs, especially in their impact upon women, in tackling the major issue of poverty alleviation over the past decade. Their growing interest and willingness to provide increasing international support in this field is most encouraging. Consequently, on the basis once more of the findings of our case studies and of the conclusions drawn from them, the following specific recommendations are addressed to bilateral aid agencies:

1. First World governments and bilateral aid agencies, having announced their commitment to focus more attention upon poverty alleviation in the present decade, should re-double their financial and technical assistance to Third World governments

and, in particular, to NGO programs of credit for the poor along the lines suggested in this report.

2. Where financial assistance is given, it should be provided in accordance with recommendations in D.4 above to international financial institutions, to encourage and attract commercial bank support for these programs and to support, rather than to undermine, their sustainability by requiring market rates of interest rather than subsidised lending to the poor.

3. Of particular importance and priority for assistance from bilateral sources is the need of NGOs for substantially increased support to strengthen their institutional capacity and outreach to the poor.

4. As a special and high priority component of such assistance, bilateral aid agencies should earmark specific support to be provided by them to meet the reasonable costs of NGOs in forming, training and seed-funding SHGs, as the basic building blocks of banking with the poor (see Appendix XIII for cost estimates).

5. Bilateral agencies are reminded of the potential for successful delivery of assistance to NGOs in developing countries, by experienced NGOs and organisations of bankers in their own countries which have international programs. First World NGOs could do no better in their commitment to poverty alleviation than to offer direct assistance to their partners in the Third World for the same purpose, referred to in D.5 (4) above, i.e. for the formation of self-help credit management groups.

6. Official bilateral aid donors could provide their assistance either directly to Third World governments and NGOs or indirectly by providing for such technical assistance grants to be administered as associated aid by the World Bank or ADB, as recommended to them in D.4 (5) and D.4 (6).

7. In considering the above recommendations, aid donors should recognise that their support for the recommended policy of **Banking with the Poor** (i.e., for commercial bank funding of the **loan capital** requirements of NGO/SHG programs that have proved to be commercially viable) will release substantial grant funding now being allocated in various projects for that purpose. More funds could then be allocated to technical assistance and the strengthening of NGO capabilities, as are urgently needed to help them meet the vast unfulfilled requirements of credit for the poor. The balance of such savings could then be used in other needed areas of development aid which cannot be expected to achieve commercial viability, as banking with the poor is designed to do.

D.6 Recommendations to other multilateral organisations and to NGOs

As indicated in preceding chapters of this report and in the conclusions set out in C.4 above, other international organisations such as the United Nations Development Program (UNDP), the United Nations Capital Development Fund (UNCDF) and First World NGOs have also provided significant assistance to NGO programs of credit for the poor. Multilateral organisations have recently committed themselves to an increased level of assistance in this field. At the regional level, the Asia Pacific Rural and Agricultural Credit Association (APRACA) and the Asian and Pacific Development Centre (APDC) have done likewise and stand in readiness to do more.

Whilst their mandates are not uniform, and the resources available to them vary in volume, the following specific recommendations may be addressed to all:

1. They should give prompt and sympathetic consideration to requests for substantially increased technical assistance and institutional support to NGOs, banks and governments assisting NGO programs of credit for the poor. Such assistance is urgently needed if NGOs are to build their institutional strength and expand their capacity to replicate the most successful NGO/SHG models and to reach out to the vast numbers still living in abject poverty in Asia.

2. In so doing they should recognise and support the specific conclusions and recommendations of this report regarding the formation, training and seed-funding of SHGs, and for their linkage with commercial banks to assure their basic loan capital resources and sustainability, and should direct their own assistance toward those ends.

3. While many of these NGO programs of credit for the poor have demonstrated new and successful programs and techniques for this purpose, but have thus far been working in relative isolation from one another, an opportunity has arisen to promote the exchange of information and experience in the region. For this purpose, it is recommended to UNDP, and to regional organisations working in this field, that they should provide financial assistance to groups or networks of like-minded NGOs and banks involved in programs of credit for the poor in the region.

4. A number of the more successful NGO programs of credit for the poor described in this report have received some encouragement and support in the past from partner NGOs in the First World. In the light of the encouraging findings and conclusions of this report, it is now recommended that they, as well as other NGOs and potential supporters in the First World, should give increased support to these programs. More specifically, they should mobilise substantial funding for the formation, training and seed-funding of SHGs of the poor.

Annex 4

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Annex 5

THE FOUNDATION FOR DEVELOPMENT COOPERATION BACKGROUND INFORMATION

The Foundation for Development Cooperation (FDC) is an independent, non-profit and non-partisan organisation whose aim is to strengthen international cooperation and development. It does this by undertaking, promoting and supporting activities to improve the quality and increase the quantity of aid to developing countries, and to promote development cooperation with these countries. It is the only such organisation in Australia.

The mandate of FDC calls for it to conduct policy-oriented research, foster public awareness, mobilise broader Australian and overseas interest and participation, and support non-governmental efforts to promote development especially at the grassroots level. This mandate has been endorsed by legislation of the Australian Parliament, amending the *Income Tax Assessment Act*, to allow tax deductable status for the Foundation.

The Foundation has developed close working relationships with Australian and international organisations (official, private and voluntary) and with its overseas counterparts (the Overseas Development Institute in the UK, the Overseas Development Council in the US and the North-South Institute in Canada).

FDC's core budget is derived entirely from private sources. It is anticipated that support from other private foundations, corporations and individuals will ensure the Foundation's viability as an independent policy research organisation contributing to international development and cooperation. Funding for specific project-related activities has also been received from government and international sources (the Australian Agency for International Development (AusAID), the World Bank, the Asian Development Bank and the United Nations Development Programme).

The policies and program of FDC are determined by a Board of Governors comprising Dr Brian Scott (Chair), General Eva Burrows, Sir Llew Edwards, Sir Laurence Muir, Mr Stephen Taylor, Mr William Taylor, Professor Roy Webb and the Hon John Wheeldon. The late Sir Gordon Jackson, who chaired the committee whose 1984 report (the Jackson Report) revitalised Australia's official development cooperation program, was a founding governor. The Executive Director is Dr John Conroy. He is responsible for the implementation of policies and programs agreed by the board with the advice and assistance of a Program Advisory Panel.

The Foundation's major activity to date has been a project, **Banking with the Poor,** which has demonstrated the scope for increased access to credit for the poor in developing countries on a sound commercial basis. It has shown that the creative and productive capacities of the poor can be realised by their increased access to credit. The uniqueness of this project lies in the establishment of linkages between commercial banks, indigenous non-government organisations (NGOs) and self-help groups of the poor to provide a sustainable flow of credit, thus helping the poor to help themselves.

Apart from projects of an applied and action-research nature such as **Banking with the Poor**, the Foundation also interprets its mandate as requiring studies of international and regional development issues, and in particular the aid, trade and investment relationships of Australia with its neighbours in the Asia–Pacific region.

Group photograph, Third Regional Workshop on **Banking with the Poor, 21–25 November 1994, Brisbane, Australia**

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Members of a self-help group in Bangladesh. Such groups are the basic building blocks of Banking with the Poor, and women are quick to grasp the opportunities they present.

As many as 800 million people live in absolute poverty in the Asia–Pacific region. Lack of access to credit, which they need for productive self-employment, impedes their efforts to help themselves.

Credit can reach the poorest of the poor, using linkages forged between commercial banks and self-help groups of the poor, through the agency of non-governmental organisations. And it can be done on a sustainable commercial basis. Banking with the poor, involving a variety of such linkages, has been operating for some years in Asia to improve access to credit for the poor.

This book is a study of **best practice** in the field of banking with the poor, drawing on evidence from eight Asian countries. It discusses the best practices, policies and institutional arrangements for banking with the poor, presenting principles which have been endorsed by practitioners from many countries. These give a much needed practical guide to providing credit for the economic activities of the poor on a sustainable basis.

THE FOUNDATION FOR DEVELOPMENT COOPERATION