MICRO-FINANCE POLICIES AND GUIDELINES FOR ACORD PROGRAMMES

OCTOBER 1998

EXECUTIVE SUMMARY OF ACORD'S MICRO FINANCE POLICY

ACORD has recognised a need to consider its own institutional and programme guidelines and practices as part of a period of reflection and self assessment which began with the strategic plan and includes the process for change task force. The policy writing process is an attempt to push the work in the strategic plan forward to isolate some operational aims and practical guidelines for the field, secretariat and external agencies.

This executive summary draws together the principles, aims and guidelines that follow in the main body of the paper and briefly considers the outstanding issues that the policy consultation process has revealed.

Aims

Micro finance based interventions are one of the tools ACORD uses in its work to reduce poverty and vulnerability. Because ACORD has an integrated approach (one programme may have several different aims and employ a range of different tools to achieve them) micro finance activities may have indirect impacts in achieving ACORD's other strategic aims. However, micro finance interventions can be seen to have two direct goals;

- To stimulate savings and/or internal rotational funds and/or extend micro (and in some cases meso) level loans to its partners (the people with whom ACORD works and who will benefit from its services) to invest in productive activities or for social investment.
- To stimulate and support community based organisations where the interests of poor women and men are represented and which are able to manage and monitor the intervention and act as a community level resource.

ACORD anticipates a range of impacts as a result of these aims. They may have a different emphasis in different contexts and depending on the overall aim of the programme. However, several anticipated impacts can be isolated, although they may not *all* be achieved;

- Improve and respond to the loan recipient's financial needs and strategic interests.
- Improve and respond to the financial needs and strategic interests of the loan recipients household and/or beneficiaries.
- To support and stimulate the local market.
- To stimulate or strengthen local organisations which will have the capacity and desire to continue after ACORD withdrawal.
- To stimulate or strengthen local organisations which partners actively own and control.
- To stimulate or strengthen the ability of local organisations' to innovate with the type and mode of financial and community service delivery.

Principles

This section sets out core principles for micro-finance activities. These are principles that should be adhered to whenever we use credit/revolving funds/

savings as part of our work.

These core principles can be summarised here:

- Be clear about why credit/savings are encouraged.
- Focus on poor women and men.
- Be participatory and responsive to the demands of our selected partners.
- Be aware of the long-term implications of our actions.
- Promote sustainability and avoiding the creation of dependence on ACORD.
- Implement micro-finance activities only when we have sufficient capacity.

Guidelines

The guidelines that follow are a practical reflection of these principles. Each point is expanded in the body of the policy document and different programme approaches discussed.

Using micro finance for the right reasons

ACORD WILL:

- always carry out a thorough evaluation of the need for credit/savings and ascertain that 'up-stream' and 'down-stream' requirements for its viability can be met.

ACORD WILL NOT:

- assume that micro-finance activities can solve all problems.

Keeping a poverty and gender focus

ACORD WILL:

- design and establish micro-finance programmes that reach and empower poor people, while also seeking solutions that have a lasting benefit and efficiently use resources.

ACORD WILL NOT:

- initiate or support micro finance programmes which foster or strengthens unequal relationships between partners and staff and amongst partners.

Being participatory and responsive to the demands of our partners

ACORD WILL:

- respond to demand and provide the type of services that poor people need, establishing a clear distinction between loans and avoiding grants disguised in the form of loans.

ACORD WILL NOT:

- embark on a micro-finance scheme without in-depth research into the practical and strategic needs of the poor.

The need for a long run view point

ACORD WILL:

- always consider ways of maximising the long-run impact per-£-provided when planning micro-finance activities.

ACORD WILL NOT:

- engage in credit/savings activities when we do not have a clear picture of the long-run consequences, or of the permanent institution that will be in charge of such schemes after ACORD phases-out

Sustainability issues

Borrower viability

ACORD WILL

- always consider borrower viability and its enhancement, reflecting the willingness and ability of borrowers to repay loans.
- always include an effective monitoring and evaluation system, not only to understand the impacts of its intervention but also to reveal changes in borrower viability.
- investigate the local MF market and establish if there is a gap that the ACORD services can fill.

Economic and operational sustainability

ACORD WILL:

- always consider operational sustainability, ensuring that a programme can cover its costs.
- always consider economic sustainability, incorporating a wider-ranging definition of viability, where the programme can operate without any external assistance.
- always consider charging a positive real interest rate and be aware of the consequences of extending loans on soft terms.

Institutional sustainability

- always consider institutional sustainability to reflect the viability of the institutional form being established.

Monitoring and evaluation

ACORD WILL:

- Develop M&E systems in response to internal and external changes.
- Incorporate M&E to cover the performance of financial services and the impact on partners.

Ensuring adequate training

ACORD WILL:

- develop an understanding of the training needs of programme staff and respond to these needs.
- plan for and respond to the capacity of partners to maximise the impact of MF services through training and capacity building.

ACORD WILL NOT:

- engage in credit/savings activities when staff do not have appropriate skills.
- engage in credit/savings activities when staff are not fully aware of the training needs of partners.

SECTION 1: INTRODUCTION

This policy paper broadly follows the form of the consultation paper. Some changes have been made for the sake of clarity. During the consultation process it became clear that there was a multiplicity of responses to the "practical guidelines" in the final section of the paper which at times conflicted making it difficult to reach any general policy goals or guidelines. As a result of consultation with the field the section is attached as an annex with a view to modifying it and producing a best practice manual.

This paper begins by defining what ACORD means by "micro-finance", isolates the role of policy in its work and the way in which micro finance fits into the vision of the strategic plan. In section 3, the paper isolates ACORD's key goals for micro finance and discusses some of the issues that arose from the policy consultation process. Section 4 isolates ACORD's core principles and guidelines for micro finance and discusses their implementation. Section 5 considers sustainability issues including borrower viability, operational and economic sustainability and institutional sustainability. Section 6 examines four specific contexts in which ACORD works which are not generally seen as optimal for micro finance and section 7 looks at training needs of staff and partners.

The consultation process

The policy consultation process was circulated to programmes from May to September. It outlined the main issues surrounding micro finance policy and practice and contained a number of guiding questions. The consultation process has shown that commentary and opinions from one programme can stimulate interest and discussion in another. This policy can therefore be seen as an on going part of the consultative process to refine ACORD's goals and practices for micro finance.

Different programmes responded in different ways. Some used other collective meetings to elicit responses and report back, while others asked particular members of staff to comment. Specific programmes were targeted who have particular or long-standing experience in operating MF schemes. This policy also draws on a review of current literature and comments from MF specialists in other organisations.

SECTION 2: MICRO FINANCE AND POLICY

Defining micro finance activities

The Strategic Plan 1997-2001 lays out the aims of programmes with micro-finance components. *Micro-finance* is a term used to cover a range of activities that affect the financial transactions of individuals and groups, such as:

- providing/giving credit in the form of cash or in the form of goods;
- setting-up/supporting savings opportunities.
- providing services that protect against the effects of ill-health, drought and
- death.
- initiating or supporting links with other organisations which provide all or some these services.

The term *micro-finance* therefore includes a wider range of activities than credit alone. Whatever the different viewpoints about definition, all ACORD's programmes should agree that the principles that underlie the use of a micro-finance activity are the principles that should also be considered when setting up a revolving fund or a hire purchase scheme.

The Strategic Plan expects that there will be an increase in the total funds allocated for micro-finance purpose[1]. As a response to these changes this policy has been generated through consultation with ACORD's partners, field and secretariat staff.

Why we need a micro finance policy

The purpose of the policy paper is to collate and learn from the experience of ACORD's programmes. The policy has five specific aims:

- Policy provides a succinct, clear statement of practical goals, the techniques already being employed to achieve them, an assessment of the effectiveness of these techniques and strategies for improving them

---

[1] ACORD's aims are:

- **To reduce poverty and vulnerability:**
  To improve understanding of the specific causes of poverty and find ways to remove them.
- **To help people win their basic rights:**
  To help poor people win their basic right to food and overcome obstacles which prevent them from having a secure way of life as they themselves choose. We will do this by helping people to confront the injustices which prevent them using resources and social services and taking part in civil and political live.
- **To help people cope with conflict and build peace:**
  To help people reduce their exposure to injustice, prepare for future shocks, cope with crisis and promote desired changes.

For finance specifically, the Strategic Plan has outlined the following objectives:

- We will help poor people to save and to make the most of any credit and loan schemes available. And we will introduce suitable financing schemes to meet their specific needs.
- We will increase from 2.5% to 10% the share of our resources used to improve access to finance for poor people.
- We will help to share loan funds equally between men and women.

for programme and field staff.

- Policy provides a coherent statement of aims for partners and funders.
- Both these aims implicitly accentuate the institutional vision of the organisation as outlined in the strategic plan which includes reference not just to practice but the discourse in which it is set and the way in which the policy has been produced.
- The consultation process provided a forum to examine ACORD's experience in its totality, bringing all its experiences together to share and learn from. Its aim is to produce a coherent statement of what ACORD believes and has learnt that micro finance service provision can contribute to achieving its vision[2] and provide a practical record of advice and lessons.
- This policy also includes a number of outstanding issues arising from the consultation process which merit further consideration.

In addition, it is hoped that the policy document will stimulate more discussion and improve ACORD's capacity to extend micro finance based services in the future. It forms a general outline of aims and principles in order to cover the rich multiplicity of models and experiences in ACORD's programmes. In order to continue learning and improving ACORD's practice it is important to revisit the outstanding issues that the policy consultation process has revealed, to resolve them and disseminate the lessons learnt.

The consultation process has shown that many of the experienced programmes feel there is a vacuum where new approaches and possible responses should be generated. Concerns focus on two themes; how to respond innovatively to the long term expectations of MF and how to develop their existing capacity through monitoring and evaluation tools, coherent indicators and training. Those programmes considering starting or expanding their micro finance services found that the policy writing process and documents were a useful practical tool at the planning stages. They felt that the wealth of experience from other programmes was useful to learn about effective programme designs.

[2] "To work towards a world in which all human beings have equal opportunities. This can not happen while people live in extreme poverty. So, we are working to reduce poverty. We do this by helping very poor people in Africa to win their basic rights, to maintain and improve their way of life and to cope in situations of unrest and conflict. Strategic Plan P3

SECTION 3: ACORD'S AIMS FOR MICRO FINANCE

ACORD's overall aim is to support and improve the coping mechanisms of vulnerable people. Micro finance should be seen as **one** technique to eradicate or relieve the effects of poverty. A significant amount of the literature on micro finance assumes that NGO credit schemes work with purpose-made or shaped finance-orientated groups. ACORD's experience is in using micro finance not as one strategy but with a variety of other tools and strategies. ACORD's micro finance constituency may already have existed or have been stimulated by the programme. In both cases, ACORD infrequently replicates completely micro finance models from other NGOs or ACORD programmes. Instead each programme isolates its own models at programme level. However, it is possible to isolate some of the goals and hoped for impacts of programmes undertaking micro finance based interventions and underline less effective models from ACORD's past practice.

Goals

Micro finance based interventions are one of the tools ACORD uses in its work to reduce poverty and vulnerability. Because ACORD has an integrated approach (one programme may have several different goals and employ a range of different tools to achieve them) micro finance activities may have indirect impacts in achieving ACORD's other strategic aims. However, micro finance interventions can be seen to have two direct goals;

- To stimulate savings and/or internal rotational funds and/or extend micro level loans to its partners (the people with whom ACORD works and who will benefit from its services) to invest in productive activities or for social investment.
- To stimulate and support community based organisations where the interests of poor women and men are represented and which are able to manage and monitor the intervention and act as a community level resource.

ACORD anticipates a range of impacts as a result of these aims. They may have different emphasis in different contexts and depending on the overall aim of the programme. However, several anticipated impacts can be isolated, although they may not *all* be included in a single programme;

- Improve the loan recipient's financial needs and strategic interests.
- Improve the financial needs and strategic interests of the loan recipient's household and/or beneficiaries.
- To support and stimulate the local market.
- To stimulate or strengthen local organisations which have the capacity and desire to continue after ACORD withdrawal.
- To stimulate or strengthen local organisations which partners actively own and control.
- To stimulate or strengthen the ability of local organisations to innovate with the type and mode of financial and community service delivery.

Other programmes use credit/savings as one of a number of activities, and intend to use credit only for a short time, as a 'kick-start.' For example, a programme that is involved in agriculture might provide credit to encourage people to buy hoes and other agricultural equipment. After the equipment is bought and paid for, the programme will not concern itself with credit again. However, it is important to emphasise that all ACORD's micro finance based interventions should be subject to the principles and guidelines in this document.

SECTION 4: ACORD'S CORE PRINCIPLES FOR MICRO-FINANCE

This section sets out core principles for micro-finance activities. These are principles that should be adhered to whenever we use credit/revolving funds/ savings as part of our work.

These core principles can be summarised here:

- Be clear about why credit/savings are encouraged.
- Focus on poor women and men.
- Be participatory and responsive to the demands of our selected partners.
- Be aware of the long-term implications of our actions.
- Promote sustainability and avoiding the creation of dependence on ACORD.
- Implement micro-finance activities only when we have sufficient capacity.

Using micro-finance for the right reasons

Micro-finance programmes are seen as good at reducing poverty and are also thought to be an efficient way to use donor funds as a well-designed programme will ensure that many more people benefit than if the funds were given as grants. We accept that micro-finance programmes can have important and cost-effective impacts. However, our experience also leads us to be cautious.

ACORD should initiate a micro-finance programme only when improved access to credit or better opportunities to save will be accompanied by a release of other constraints to income-generation, like land, labour, technology, inputs and access to markets.

ACORD often works in areas that are extremely hostile to credit, where there are high risks associated with economic activities; high inflation; small markets; and lack of infrastructure. In the light of these concerns, we need to consider the conditions necessary for an effective micro-finance scheme. Due to these factors, we believe that micro-finance intervention may only be effective if complementary activities also occur. These complementary activities could include marketing assistance and technological advice. These issues are returned to again in Section 6 when considering four particularly harsh contexts in which ACORD works.

Finally, in communities with limited experience of micro-finance activities, it is often preferable to test the ground by starting with short-term micro-credit (e.g. seasonal credit) before expanding to medium-term credit. Some commentators emphasised that any pilot schemes must be carefully planned to avoid generating a belief amongst partners that ACORD's presence is short term and will not follow up on loan recovery; fostering a grant mentality and undermining efforts to foster partners' ownership of the scheme.

ACORD WILL:

- always carry out a thorough evaluation of the need for credit/savings and ascertain that ‘up-stream’ and ‘down-stream’ requirements for its viability can be met (for a definition of viability, see Section 5)

ACORD WILL NOT:

- assume that micro-finance activities can solve all problems.

Keeping a poverty and a gendered focus

ACORD’s intention in establishing micro-finance programmes is to help the poor, particularly poor women. However, micro finance programmes often fail to reach the poorest. Many NGOs have re-focused their micro-finance activities to ensure that women are included. However, some commentators have argued that in some of these cases, poor women are only targeted as they are thought to be better at repaying loans. Their practical and strategic needs may not be fully considered in the design of these programmes. Taking account of the strategic needs of the poor, particularly poor women, will encompass an analysis of the factors that may need to change before a significant improvement in income can be achieved. To do this, we must develop an understanding of the specific constraints on poor men and women's access to credit and other financial services.

Similar cultural constraints on the poorest members of communities also effect their ability to benefit from micro finance services. The ability to benefit from MF services is not only to do with the availability of financial services but the capacity to maximise the benefits of micro finance services when they become available. Programmes who are heavily involved in micro finance service provision emphasised that while they recognised that they were not fully addressing the needs of the poorest sections of communities, they found it difficult to adapt their intervention within existing programmes.

ACORD WILL:

- design and establish micro-finance programmes that reach and empower poor people, while also seeking solutions that have a lasting benefit and efficiently use resources.

ACORD WILL NOT:

- initiate or support micro finance programmes which foster or strengthens unequal relationships between partners and staff and amongst partners.

Being participatory and responsive to the demands of our partners

ACORD should always employ participatory techniques and foster partners ownership of micro finance CBOs.

This means:

- setting the conditions of our micro-finance scheme with the practical needs of the target community in mind.

- developing savings and credit schemes that address the long-run economic empowerment of the target group.
- carrying out activities in a way that promotes the social empowerment of the target group.
- developing institutions that are easily accessible to the poor and are able to disburse loans quickly to them.
- establishing institutions are democratic and that promotes local ownership and control by the poor majority.
- providing complementary training.

Poor people in the South are no less rational than economic agents in the North. If it appears that expressed needs cannot be reconciled with the basic features of a viable micro-finance scheme, then it is likely that:

- a micro-finance scheme is not be best way of addressing poor people's needs.
- it is not sufficiently poverty focused.
- the grant-financing partner (e.g. the NGO) has failed to foster a sense of local ownership of the scheme.

It is worth noting that the majority of ACORD's programmes have found that loans for social investment (school fees, building materials, household items) and consumption which may be more appropriate for the more vulnerable sections of communities are inappropriate in programmes which extend credit for productive purposes only. This distinction between "commercial" approaches and "welfarist" approaches to credit are felt to be irreconcilable within the same programme. The latter undermines the ownership and sustainability of models and their ultimate ability to generate independent, autonomous CBOs.

ACORD WILL:

- respond to demand and provide the type of services that poor people need, establishing a clear distinction between loans and avoiding grants disguised in the form of loans.

ACORD WILL NOT:

- embark on a micro-finance scheme without in-depth research into the practical and strategic needs of the poor

The need for a long-run view point

Whenever we plan a micro finance programme, we need a clear statement of our long-run objective. Experience has shown that it is very hard to mend faulty credit/savings components. Mistakes by ACORD can corrupt the credit culture in a community and attempts to re-launch services often fail. An important aspect of having a long-run viewpoint is trying to avoid partners becoming dependent on ACORD.

If we are using micro-finance activities to create a long-run improvement in terms of access of the poorest to the financial system, we should be concerned about the survival of the programme after ACORD hands over. For this reason, we will need to consider the sustainability of the activity. By sustainability we mean borrower viability, institutional and operational/economic sustainability.

ACORD must take care not to destroy existing financial systems. A particular criticism levelled against development agencies is that they have failed to consider the beneficial aspects of informal financial systems. When entering local markets with large-scale, subsidised credit schemes, such agencies can destroy informal systems. However, where the terms of formal and informal financial transactions are likely to work against the interests of poor people, intervention may rightly attempt to compete with and possibly replace part of the system if a long-run substitute is envisaged.

ACORD WILL:

- always consider ways of maximising the long-run impact per-£-provided when planning micro-finance activities

ACORD WILL NOT:

- engage in credit/savings activities when we do not have a clear picture of the long-run consequences, or of the permanent institution that will be in charge of such schemes after ACORD phases-out

SECTION 5: ESTABLISHING SUSTAINABLE MICRO-FINANCE INSTITUTIONS

The need for borrower viability

The fact that a loan is repaid does not tell us about the degree of borrower viability. The key condition for borrower viability is that clients benefit from the loans that they take out. In economic terms, clients are considered to have benefited if they are better off after taking and repaying the loan. Where the loan is used for investment in an income-earning activity, it is relatively easy to see whether a client is better off. In this case, we would expect that his/her income would be higher after taking the loan and making the repayments.

An important aspect of borrower viability is that the micro-finance activities of the programme are seen to be at least as good as those offered elsewhere. For example, the programme would not be viable from the borrower's point of view if they could obtain credit on more favourable terms from other sources. For this reason, the popularity of the scheme and the number of repeat applications are important indicators of the way it is viewed in the context of the local market. ACORD should, therefore, keep out of credit schemes in areas where subsidised credit is likely to undermine our own activities (unless we can ensure co-ordination with other actors).

It should also be stressed that borrower viability is a dynamic process involving partners and programme staff that constantly shifts and changes. The willingness of a community to participate, govern and innovate with micro finance is a key to success and is a sound indicator of the appropriateness of the scheme itself. Similarly, external factors have a direct bearing on borrower viability and include other micro finance providers in the area. NGO interventions can sometimes lead to micro finance saturation with a number of organisations offering the same kind of services but with different terms and conditions. ACORD should be aware of such factors when establishing borrower viability.

ACORD WILL:

- always consider borrower viability and its enhancement, reflecting the willingness and ability of borrowers to repay loans.
- always include an effective monitoring and evaluation system, not only to understand the impacts of its intervention but also to reveal changes in borrower viability.
- investigate the local MF market and establish if their is a gap which ACORD's services can fill.

Defining operational and economic sustainability

A programme is financially sustainable if its net operational income (i.e. the income from interest and fees minus any interest paid on savings deposits) is greater than its operational costs (current and capital costs). A programme needs at the very least to cover its operating costs from its income if it is to be handed over to the community and cut its funding dependence on ACORD.

However, operational sustainability might not prevent a programme from having financial difficulties after ACORD pulls out:

- the programme may find that high inflation reduces the real value of its loan fund, i.e. it cannot cover the effect of inflation on its funds.
- the programme might want to expand the size of its loan fund by borrowing money from a bank. To borrow from a bank, the programme would have to earn enough income to pay the interest charged by the bank, as well as cover its general operating costs.

To capture all of these effects, the term 'economic sustainability' is used. To be economically sustainable, a programme must generate sufficient income to cover its operating costs, the inflation cost and the full commercial cost of its funds. A number of the programmes emphasised that it is vital to consider issues of institutional sustainability from the outset as changing partners attitudes to sustainability issues after initial phases is difficult. Moreover, the programmes felt that sustainability issues are inseparable from other services. While operational and/or economic sustainability is recognised as an important indicator or programme performance they felt that training and infrastructure strengthening had a dynamic, symbiotic relationship with economic performance. Such inputs increase borrower viability and therefore impact on financial sustainability and to separate them creates a false divide.

ACORD WILL:

- always consider operational viability, meaning that the programme can cover its costs.
- always consider economic sustainability, incorporating a wider-ranging definition of viability, where the programme can operate without any external assistance.
- always consider charging a positive real interest rate and be aware of the consequences of extending loans on soft terms on lending distortions and on savings disincentives.

The need for institutional sustainability

ACORD can only successfully hand-over its micro-finance programmes if it has established an appropriate institutional form. The importance of stimulating sustainable institutional forms is a pertinent issue for those contemplating ACORD's phase out in 2001. Their wish to promote self-sustaining autonomous micro finance service providers is a core aim. Although the forms and processes differ they all see this aim as a central part of their work. For an institution to be sustainable, ACORD needs to consider:

- its organisational structure
- its operational methodology
- its legal position

These factors need to be considered in detail *prior* to the implementation of a programme. The design of institutions should encompass gender equality criteria, as well as degree to which the poor are represented in management of the scheme.

ACORD WILL:
- always consider institutional sustainability, reflecting the viability of the institutional form being established

Monitoring and evaluation

In the discussion above, we have identified three requirements for any monitoring and evaluation system:

- measuring the impact on partners.
- looking at the progress towards operational and economic sustainability.
- charting the degree to which institutional goals are met.

An effective monitoring and evaluation system uses a variety of tools to investigate these factors. Two broad areas emerged from the consultation responses to M&E; covering the performance of loan funds or financial services and the impact of those services on clients. ACORD has learnt from experience that it is important to be aware of both of these elements from the outset and avoid judging success and progress on size of amounts dispersed, repayment levels and numbers of clients in a scheme. Programmes must have the capacity (both time and skills) to develop both areas of their M&E system drawing on quantitative and qualitative methods. In addition, programmes emphasised that a baseline survey formed a vital foundation on which to rest any M&E system. Other tools that programmes mentioned included the need for context specific indicators as well as any general indicators (such as repayment levels, increase in income, improvement in material well being) and the importance of building an element of responsiveness into M&E systems.

The need to handle large amounts of financial data often leads programmes to use a computerised system to track data on loans and savings for financial and administrative purposes. These computer packages can also be used to produce information for monitoring and evaluation.

An important dimension that is often neglected by programmes is the monitoring of external factors that affect the performance of the programme. These include changes in inflation and exchange rates.

ACORD WILL:
- Develop M&E systems in response to internal and external changes.
- Incorporate M&E to cover the performance of financial services and the impact on partners.

SECTION 6: ESTABLISHING MICRO-FINANCE INSTITUTIONS IN THE AREAS IN WHICH ACORD WORKS

Earlier sections discussed the general principles and challenges of implementing a micro-finance programme. However, we should recognise that ACORD works in particular types of environment, some of which make implementing micro-finance programmes more difficult. This section highlights several areas that warrant more attention:

- working in countries with high inflation
- working in countries which have suffered (or often suffer conflict)
- working with people who are HIV-positive or have AIDS
- working in countries where we must use Islamic forms of finance

Micro-finance in areas of high inflation

This sub-section discusses inflation. High inflation is often found in contexts with a number of other problems, such as conflict, which are discussed separately here. The division can be a bit artificial but it is useful to highlight the specific impacts of high inflation on micro finance services in order to suggest ways to respond.

There are three types of changes that occur when there is high inflation: changes in savings behaviour; changes in the credit behaviour; and changes that affect the internal workings of the programme.

Changes in savings behaviour have certain implications for ACORD programmes. Fundamentally, the scheme should realise that if it cannot offer real benefits for people to save, it should not expect high savings nor should it encourage people to use the scheme if they can put their savings to better use elsewhere or in a different form. Secondly, if the scheme has being tying access to credit to ‘good’ savings behaviour, staff should be aware that this could exclude the poorest households. Policies linked to savings may have to change in recognition of the fact that people’s ability to save and the benefits of savings change in areas subject to high inflation.

Changes in credit behaviour have a number of implications for ACORD programmes. If the programme does analyses of the soundness of the loan, it may have to change the way that these are done to reflect changes in economic conditions. For example, the costs of inputs may change so radically that activities, which were once profitable, are no longer profitable. The programme may need to change its policy about the use to which loans are put if it becomes aware that there is widespread diversion of funds. The maximum sizes of loans may need to be adjusted frequently enough to respond to inflation but avoid losing a poverty focus.

The implication is that programmes will have to pay even more attention to financial issues when there is high inflation. Otherwise, income and costs could be thrown out of balance, quickly putting the programme in a position of crisis.

There are two different ways of responding to the negative impacts of high inflation on micro finance schemes:

- Increasing financial efficiency, by finding ways to reduce costs and increase income. These measures might include raising interest rates; lowering staff/client ratios; minimising 'non-essential' activities (training, reporting, portfolio assessment, application assessment, CBO support); improving repayment levels by minimising defaults and late repayments. Increasing financial efficiency may mean that some of the 'empowerment' activities of the scheme are reduced. It is likely to mean that clients pay more to access credit as interest rates are increased.

- Structural changes that seek to make the scheme less vulnerable to inflation. These work by changing the way that the programme works and include; switching to short term loans, extending loans in non cash forms, or linking loan values to other currencies.

These two methods (financial efficiency and structural changes) are not mutually exclusive. However, structural changes may be more effective at very high levels of inflation and/or where the programme feels that it is not able to increase efficiency more than it has already done.

The central issue when running a micro-finance scheme under conditions of inflation is how the costs of inflation are borne:

- The programme may feel that it cannot raise interest rates, as it will hurt its poor clients. By failing to adjust, it will find its loan fund quickly eroded. As its costs rise due to inflation, it will lose its sustainability and may grind to a halt. In this case, the programme (and potential clients who could have been reached in the future) has borne the entire costs of inflation, at the expense of its survival.

- The programme may react to inflation by continually raising interest-rates. It may be able to raise relatively high income for a while, but only by putting the entire burden on its clients. In extreme cases, people will be unwilling to apply for further loans as the costs of getting credit become high relative to other sources of credit or to the income that can be earned from productive activities.

The ideal response is clearly one where the costs of inflation are borne between both the programme and clients. It is essential that the programme makes itself as efficient as possible, while also looking at some of the structural ways to reduce the impact of inflation. The programme may have to compromise some of its empowerment activities in order to maintain its survival. In extreme cases, ACORD may feel that it cannot establish (or continue to run) a micro-finance scheme under inflationary conditions.

Micro-finance institution building in post-conflict or conflict-prone areas

ACORD often works in countries that have experienced conflict in some form.

Post-conflict societies can pose particular problems for the use of micro-finance. Some of these problems overlap with others, such as high inflation.

In some cases, ACORD may feel that it is not appropriate to start micro-finance programmes, where the economic and institutional problems appear insurmountable.

To move towards a more development-oriented micro-finance programme, we might have to overcome people's expectations that we will give 'soft' loans. We will have to strive for co-ordination with other NGOs to ensure that our efforts are not undermined by others (or vice versa). To change expectations, we will have to engage in a slow process to build capacity to ensure that people 'own' the process. This will be necessary to help people understand how the scheme works and to generate confidence during economic instability and uncertainty. Furthermore, if people are saving with a scheme they will develop a keen awareness the effect of soft terms on their income from savings and may decide to resist the provision of loans on soft terms as a consequence.

To reduce dependency, ACORD should ensure that it develops local capacity to run the scheme. If staff travel in the region is difficult, it will be important that local people are given responsibilities as quickly as is possible to ensure that decisions about loans/savings are not delayed. Any micro-finance scheme should be modest and built on local institutions to prevent problems of hand-over and sustainability.

However, there may be no local informal micro-finance groups. When these structures do not exist, we might attempt to recreate them. ACORD will have to work to rebuild the trust and confidence necessary for local groups to work. Furthermore, it is likely that for micro-finance to be effective there is even more need for complementary investment in transport and infrastructure in situations of conflict. In many cases, investment in these areas will take priority over micro-finance schemes.

The conclusion is that if a programme wishes to give immediate, widespread credit assistance in a post-conflict situation, it is unlikely to be able to do so using a form that is institutionally or financially viable. One must remember that a disguised grant in the form of a loan will undermine the credit culture of the poor for a long time. The issue is whether credit is envisaged as a 'kick-start' for a range of income-generating activities or whether we think that there are no alternatives to the development of accessible and sustainable financial services.

Both these contexts require a high level of competence in a number of areas that ACORD should recognise when planning MF interventions in such areas. They include;

- Rigorous monitoring systems.
- High degree of staff capacity.
- Responsiveness in programming in order to respond what can be rapidly

changing contexts.
- Awareness that micro finance institutions in these contexts may not reach financial sustainability.

Establishing micro-finance institutions to serve those people with HIV or AIDS

The experience of ACORD programmes and those of other NGOs seems to suggest that two key problems arise when running a micro-finance programme in a community where a high proportion of people have AIDS:

- Sustainability of the programme suffers: loan repayments fall as people become sick; or people may divert loan funds away from income-generating activities to pay for medical treatment or other essential expenditure
- Discrimination or staff worries about repayments can lead to people with aids (PWAs) being excluded from the loan scheme, thereby preventing the most needy from benefiting

The challenge appears to be maintaining the sustainability and operationality of a micro finance scheme, while also benefiting needy households. Sustainability becomes particularly important when the number of people affected by AIDS is rising in a region. When the programme is faced with rising numbers of vulnerable people, the need to maintain the value of the loan fund becomes extremely important.

Several important lessons have been learnt and various methods for running a micro-finance scheme to assist communities suffering from high rates of HIV and AIDS:

- It is important to spell out expectations and procedures for handling loan defaults and non-compliance in a transparent manner prior to operation and disbursement of loans.

- NGOs have dealt with the special problems of people with HIV or AIDS in two ways:
  - either by encouraging PWAs to take loans as a group, so that they can guarantee each other and assist each other during times of illness.
  - by setting up a separate fund which is aimed at people affected by AIDS, as part of a general micro-finance scheme. The separate fund will usually have different conditions to the main fund.

- In some ACORD programmes, families affected by AIDS have been encouraged to undertake short term activities that will quickly generate income. These are linked to short loan repayment periods that are seen as more appropriate.

- To guarantee as high a repayment rate as possible while dealing with the effects of AIDS, some schemes specify that PWAs are only eligible if they do not show signs of sickness. Other schemes have been aimed at the families of people with AIDS (e.g. orphans, widows) or their carers, rather than at PWAs themselves.

A final area for contention is the extent to which loans to families affected by AIDS are given on 'soft' terms, i.e. with interest charges that will not ensure sustainability of the scheme. On the one hand, it is thought that the economic problems of families affected by AIDS will not enable them to pay high interest rates on loans. On the other hand, charging lower-than-needed interest rates will erode the value of the loan funds, and this will negatively affect other people's chances to benefit from the scheme.

Rather than confusing loans and grants, the best option may be to distinguish grant-based funding for such items as training or health, and unsubsidised credit for income-generating activities and provide both separately as some programmes have suggested that mixing terms and types of advances is problematic.

Running a micro-finance programme under Islamic systems

Banks or other financial institutions are not allowed to charge interest if operating in accordance with the principles of Islamic banking. Instead of earning revenue in this way, Islamic financial institutions are allowed to earn profits in other areas.

In ACORD, most of our experience with Islamic forms of finance has come from the micro-finance programmes in Sudan. This has given us some idea of the advantages and disadvantages of different methods of working. Rather than be restrictive, we have found that well-chosen and well-managed Islamic methods can be sustainable and can reach the poor. However, there are also drawbacks and potential pitfalls with certain types of finance.

Islamic banks are also allowed to cover the costs incurred in providing a credit service by making an additional charge to clients. In the case of ACORD programmes, this amount has been called a registration fee. Islamic law allows the imposition of a service charge in order to cover the actual costs of the programme, such as rental of premises, workers' wages, stationery etc. However, these charges are not supposed to be like interest-rates and there may be legal stipulations that prevent them being linked either to the size of the loan or its length. In practice, ACORD programmes in Sudan have been able to link this charge to the size of the loan (at 2%), which appears to follow accepted practice in the country.

Islamic banks are able to accept deposits, in the form of savings accounts. Under Islamic rules, the bank is able to use these funds for investment and may, *under its own discretion*, reward clients from time to time by returning a proportion of the profits generated, i.e. there is no interest paid to depositors. Clients are also able to deposit funds for investment, in order to earn a more significant income. Funds are treated as if the client has invested funds in the bank. In practice, Islamic banks may return 60-80% of profits back to people who have deposited investment funds with them. This ratio may vary according to accepted practice and regulations in a country. Unfortunately, ACORD's programmes in Sudan were unable to collect savings due to national financial regulations, which only allowed registered banks to take deposits.

Islamic forms of finance will be appropriate:

- where the entire financial system of a country has moved to Islamic forms of finance
- where the groups that we work with are more comfortable with Islamic modes of finance, although the national system does not make this mandatory.

In ACORD, programmes have mostly used two forms of Islamic finance:

1. Finance linked to trade: in this case, the basis of the finance is a cost-plus contract in which the client, wishing to purchase equipment/goods, requests the institution to purchase the items for him/her. The most common form of this in ACORD programmes is as *murabaha. Murabaha* also appears to be the preferred form of finance for borrowers in the Sudan, in the expectation that the loan will be eroded through inflation.

The finance-provider (institution) purchases the goods and sells them on the basis of a fixed mark-up. The size of this mark-up may be limited by local custom or by financial regulations. For example, in Sudan the maximum mark-up on *murabaha* is 4% per month on the value of the loan. The mark-up is not interest but is for the service that the finance-owner provides (e.g. seeking out the goods). The mark-up is not related to time and so will not increase if there is a delay in the payment.

Disadvantages for the programme:

- requires a great deal of time for purchasing
- fixed payment may not be sufficiently adjustable to cover costs
- may need additional methods to encourage timely payment

2. Finance linked to profit-and-loss-sharing (PLS): the provider of finance shares the profits directly and is contracted to bear the losses, if any, of the investment. Two forms of PLS found in ACORD programmes are *musharaka* and *mudarabah*.

Musharaka - this is a financing technique in which a finance-provider finances investment in someone's business. Additional finance is provided to the person (or group) who already have some funds for investment. The finance-provider makes available additional funds on the condition that s/he shares in the profits from the business. The ratio by which the profits are shared will be predetermined and may be fixed by cultural or legal norms. This profit-sharing ratio may be different from the ratio in which the two parties have provided capital (i.e. ACORD may get 50% of the profits, but have contributed 75% of the capital).

Mudarabah - this is similar to *musharaka*, but the borrower does not have any funds of his/her own. All s/he invests is labour and skills. The profit sharing ratio may then be different from that of *musharaka.*

Advantages for the programme:

protects the scheme against the effect of inflation (as income is a share of profits and profits will go up according to inflation)

in practice returns are much higher than for *murabaha* finance.

Disadvantages for the programme:

- cannot be used for consumption loans (e.g. housing)
- requires considerable personnel time for evaluation/monitoring, in order to protect against the mis-reporting of profits
- the programme may not be able to predict its income exactly
- PLS loans appear to be subject to greater default than *murabaha* (the problem of risk has led some Islamic banks to shift away from PLS contracts)
- in practice, less women receive these types of loans as they tend to be geared towards male-dominated activities (such as livestock rearing).

SECTION 7: TRAINING NEEDS FOR MICRO-FINANCE PROGRAMMES

There was an almost universal belief in the consultation responses that training for staff and partners was an integral part of ACORD's micro finance interventions. Staff capacity is key to the success of credit programmes. Many credit programmes run by development agencies are vulnerable due to poor training of staff in the management of credit and savings. Initial recruitment of staff has to be done very carefully and continuous upgrading of staff skills is vital. The process of selection, training, career mobility, incentive and a certain degree of autonomy from bureaucratic interference are critical.

Many of the programmes emphasised that partner training such as credit management skills, capacity building and organisational management not only increased the impact of micro finance services but had impacts in and of itself. They included increasing confidence, applying skills to other ventures and areas and stimulating partners ownership of CBO based micro finance based interventions.

ACORD should take every opportunity to continue dialogue with other NGOs, governments, donors and partners on collaboration, co-financing, replication, scaling up, complementary investments and support, and harmonisation of strategies and policies regarding micro-finance for empowering the poor.

ACORD WILL:
- develop an understanding to the training needs of programme staff and respond to these needs.
- plan for and respond to the capacity of partners to maximise on the impact of MF services through training and capacity building.

ACORD WILL NOT:
- engage in credit/savings activities when staff do not have appropriate skills.
- engage in credit/savings activities when staff are not fully aware of the training needs of partners.

SECTION 8: CONCLUSION

This policy and the consultation process that fed in to it have shown that ACORD's experience with MF based interventions is somewhat different to main stream micro finance institutions. In addition, ACORD has an incredible range of experience with different types of interventions and in a number of different contexts.

While the policy has been able to describe a general vision, aims, guidelines for ACORD's micro finance programmes or those contemplating micro finance based interventions. However, the consultation process has revealed a number of key outstanding issues which are dealt with at length in the policy consultation report, which will need to be tackled or at least considered. These issues include; reconsidering sustainability issues and the implications for programmes contemplating ACORD's withdrawal of support; limitations in the impact of credit based interventions, particularly in reaching particular sections of communities such as the poorer groups and women; considering social benefits and material progress; and a desire for advocacy at the macro level.

APPENDIX 1

Judging the suitability of a micro-finance scheme

a) Start a participatory dialogue with the community to assess their specific credit and savings needs. This dialogue should be broad, rather than narrowly focused on the issue of micro-finance.

b) A review should be made of the stability of finance system; the system of financial regulation (as it will impact on what we are allowed to do); the nature of local markets; and general macro-economic conditions. ACORD often works in areas that are extremely hostile to credit, where there are high risks associated with economic activities; high inflation; small size of the market; and lack of infrastructure. In the light of these concerns, we need to consider the conditions necessary for an effective micro-finance or credit scheme.

c) A survey should be carried out to examine how formal and informal financial arrangements are satisfying the needs of the population. The types of questions that might be asked are:
Where are the gaps to be filled and opportunities for the future? What is the geographic scope of services? What is the functional scope of existing systems (e.g. only savings or only credit for social purposes)? What are the conditions of access to financial services? What are the wider transaction costs of getting this access? What are the interest rates? Is there any substantial institutional structure on which a future system could be built? It is important at this stage to consider the relationship between any future ACORD programme and the institutions (both formal and informal) that presently exist.

d) Undertake a baseline socio-economic survey to develop an in-depth understanding of the social spectrum of the programme area. This is necessary if you wish to later evaluate the effects of your finance intervention.

e) Use the PRA and survey results to establish criteria to identify target groups for priority attention, remembering that there are often poor among the poor. These populations need to be identified in their specific environments and be accorded priority access to credit. To assist prioritisation, one would have to devise appropriate targeting instruments. The efficiency of use of such indicators should be considered, e.g. in terms of their likely costs and drawbacks. *The best option is to use a few, well-chosen indicators (or proxy indicators).* In addition, the design of the scheme (e.g. in the setting of a small loan size or nature of eligible activity) might also act to self-select participants. Examples of the types of indicators we might use are:

1. Income, or poverty status
2. Total landholding and/or agricultural landholding
3. Access to grazing areas and forest resources,
4. Asset holding, including livestock,
5. Access to water,
6. Occupation, and employment status,
7. Number of dependants,
8. Gender,
9. Gender of the household head,
10. Physical handicap or disability,
11. Quality of housing,
12. Vulnerability to natural disasters, or conflicts
13. Ethnicity, or refugee status, and
14. Natural resource base and fragility of the environment.

Integrating our gender concerns into the design of a micro-finance programme

Considering what was written in the principles section of this paper, ACORD should consider adopting certain methodologies to ensure women's participation. The following box gives some examples of possible activities:

1. Awareness-raising campaigns can be implemented. Such a campaign has been extremely successful in Dire Dawa.
2. Women should be encouraged to organise in their own right to act as a pressure group.
3. Formation of exclusively women's groups should be encouraged.
4. The gender balance of programme staff should be considered.
5. ACORD should work with government, financial and other institutions to reorient their policies regarding gender issues, especially in resource allocation and service delivery. Provision of support services (input supply, research, extension, transport, storage and marketing) is critical.
6. Lending policies, including collateral and guarantee requirements, must be tailored to be inclusive.
7. Training needs to be designed for the requirements of women. The focus of training has to be on productivity, market access and enterprise management so that female borrower can use the loan profitably and repay it on time.
8. ACORD staff have to seek increased participation of women in decision-making. For this they have to work closely with men, community leaders and government representatives.
9. ACORD has to synchronise programme activities with other partners to ensure that complementary investment is undertaken in support of women's productive, social and family activities.
10. Technologies for women, in particular labour saving technologies have to be promoted. ACORD staff should liase with institutions, which are capable of developing appropriate technologies for women.

Establishing the institutional form for our intervention

Towards the aim of a viable and strong institution, a multi-layer structure is envisaged for an

ACORD-supported credit and savings system: clients, CBOs, village banks (which are community-managed savings and credit associations), and potentially an umbrella organisation. Specific situations may call for different combinations of in the structure, and in some cases the number of layers could be reduced or increased.

The multi-layer structure would have to operate through various linkages, some of which may already be operating while others may have to be established. The nature of these linkages depends on the particular conditions in an area, and also on the stage of implementation of the programme. The links to be considered include, but not limited, to the following:

1. Inter-client linkages to be fostered by the programme under ACORD initiatives.
2. Inter-CBO linkages to be established and strengthened by the programme with support from ACORD, as well as other partners, especially the financial partners since one major focus of these linkages would be inter-CBO financial transactions and resource flows.
3. Inter-village bank and village bank-CBO linkages, which are crucial for strengthening the capital base and the expansion of credit and savings operations over a larger area. This also has the advantage of assisting in the diversification of clients, by including people with varied activities. These linkages would have to be promoted by the ACORD programme with support from other partners. More important, these would have to be institutionalised within the financial system of the country. This would be a way of laying the foundation for an integrated financial system with open access to the poorest and women.
4. Link with ACORD and other donors, which should be established at an early stage to ensure the setting of complementary policies. Such links could also establish additional sources of capital for ACORD programmes. In such cases, ACORD may provide the initial seed capital but this would have to be augmented with capital from other sources, internal and external which is to be facilitated by establishing formal institutional links.
5. Link with the umbrella organisation. Different modules of such an umbrella organisation could be conceived under different circumstances. The umbrella organisation could be the outcome of linkages among elements of other layers of the system. Alternatively an umbrella organisation could be separately established to which all constituent entities could be linked.
6. Links with local, regional, national and eventually international banks as a major step towards full integration in the financial system. ACORD and partners would have to provide strong technical support to establish and strengthen these links, and, the programme would have to operate under the norms of the financial sector of the country. The longer term vision should be one of financial sector integration with the poor fully integrated into the market in their own right.

There is no blueprint to be applied to different situations. ACORD's own experience varies widely as field work and desk review of documents give testimony. Interesting insights have been obtained from Dire Dawa, Eritrea, Uganda, Mali and Sudan. These experiences give examples of two models that can be used to develop a longer-term vision for financial intermediation:

a) One would be for ACORD/partners to provide capital grants to CBOs for on-lending to individual members or sub-groups. No condition is attached regarding savings and/or matching grants by CBOs.
b) The second would be for ACORD/partners to advance capital to CBOs to be reimbursed after an agreed period. CBOs would be required to match this capital (e.g. by 25%). In addition, a regular savings programme would be a precondition. All savings should be rewarded with an interest payment at competitive rate.

Assisting in the evolution of local structures into institutions for credit delivery and savings mobilisation

Many possibilities exist in terms of the initial identification of CBOs. Two approaches used in ACORD programmes are detailed here, both of which appear to be working effectively.

In the urban area of Dire Dawa, the approach involved the following steps:

1. An initial meeting in the area to clarify ACORD activities. The registration of existing CBOs and a general meeting to brief CBO membership.
2. Preparation of CBO analysis sheet by Field Assistants with occasional involvement of Programme officers. In 50% of the cases CBO members also participate in this analysis. In addition, the Field Assistant prepares a credit analysis sheet that contains among others the credit grant recommendation. For group activities, a business analysis sheet is prepared containing a description of group activities.
3. Review of analyses and grant recommendation by ACORD office and revision if needed.
4. A three monthly programme development meeting for all staff to review CBO proposals.
5. Grant committee meeting to approve grants. It is composed of seven members of the Advisory Committee of partners' representatives.
6. Visit to CBO by the Field Assistant and Programme Officer to inform about the credit approval and matching grant.
7. Opening of a bank account by the CBO. Drawing up of an agreement between ACORD and the CBO, laying down terms and conditions of credit grant.
8. Rules and regulations of credit operation are decided by the CBOs.
9. Disbursement of grant (in one or multiple tranches) and training (in organisation and management, book keeping, saving and credit and entrepreneurship). The Field Assistant in consultation with the CBOs decides release of the second and subsequent tranches.

The Southern Zone system (in a rural area) worked as follows:

1. Using available information, villages are selected to hold general meeting to explain the programme and exchange views. People form credit and savings groups (CSGs) and temporary village credit and savings committee (CSC). A participatory rural appraisal (PRA) is undertaken after the selection of the village.
2. After about week, the temporary village CSC is contacted to check applications for membership. If there is a sufficient number of groups, a date is fixed for a return visit by Headquarters staff and credit and savings promoters (CSPs) for orientation about the scheme and guidelines for operation.
3. Programme staff and the temporary village CSC check the formation of groups to identify genuine groups. Groups whose members do not show up are not allowed to attend the orientation. This discipline is considered essential to ensure that groups meet regularly and undertake saving. Also, before orientation, members have to indicate in their application the amount requested and purpose.
4. Members are required to save at least 15% of the requested loan amount. This is strictly enforced. Each group records name of the member and the amount saved. Programme staff checks savings progress every week and record it in sub-province book. Savings stay with the group leader.
5. On completion of the savings process, the loan regulations are explained. Those who accept have to pay Birr 5 to join the scheme. Anyone can withdraw at any time and the group is dissolved if membership falls below the minimum of five.
6. Loan requests by individual members are discussed within the group. The group has to agree with the proposal submitted by the member. Groups may accept or reject a proposal on merit because group guarantee is involved.
7. Agreed loan requests go to CSC for screening. For this purpose, the committee meets once a month, although at the initial stage, they may meet once a week.
8. Loan applications endorsed by the CSC are forwarded to the head office for further analysis of the business plan by the CSPs. If everything is found to be in order, the application is sent to the Project Manager/Credit Officer for approval.

After identification, ACORD should orient the activities of the CBOs towards credit and savings, through training and direct support. ACORD would have to initiate discussions with government and local authorities to clarify the legal status of CBOs. Eventually the interest rate and other relevant policies would, also, have to be brought in line with the general financial regulations of the country.

A number of committees would have to be in place to run the system. The nature and number of these committees and their functions would vary from one situation to another. The following are few suggestions:

1. The programme management committee: responsible for policy guidelines on various aspects of credit and savings operation within the framework of ACORD's micro-finance policies. The committee would also undertake periodic performance review of the programme. It should consist of programme staff, representatives of partners including the government, and beneficiary representatives.
2. The programme advisory committee: representation by the nominated members of the same interest groups as under programme management committee but would have technical, administrative and organisational expertise so as to able to provide operational guidance to the programme operation. The programme advisory committee should have an independent chairperson with ACORD programme head acting as the Secretary of the committee.
3. The programme capital grants committee: decides on the amount of capital transfer to CBOs, the amount of matching grants and the number of instalments. Ideally, it should be as broad-based as possible to represent all interested parties but a balance has to be struck with the need for holding regular meetings attended by all members and expeditious decisions.
4. CBO management committee: would consist of CBO members elected by the general assembly for a given period to be determined by the assembly. This committee has the exclusive responsibility of managing credit and savings activities at the CBO level. The committee would set its own rules of operations within the framework of ACORD's credit guidelines for the field. This body would enjoy considerable flexibility in how it wants to function. ACORD management and staff in light of the experiences of the CBOs would periodically review the credit guidelines. CBO management committee should have elected Chairman, Secretary and Treasurer. Normally, there would be no compensation for the time of the committee members. The CBO would bear the necessary expenses of management.
5. CBO loan committee. The loan committee should have five members to review and recommend loan requests by members. Normally, the base groups of 5-7 members would have had undertaken the first peer review of loan request and provided the necessary advice. The CBO loan committee could further modify these loan requests. The Chairman and Secretary of the management committee together with three other elected members should constitute the committee. Normally, there would be no compensation for the time of the committee members. The CBO would bear the necessary expenses of the committee, which is likely to be nominal.
6. The village committee: in some cases, this committee could play the combined role of the CBO management and loan committees. The base groups would forward the primary recommendation for loans. The village committee would have an elected Chairman, Secretary and Treasurer. Normally, there would be no compensation for the time of the committee members. The village would bear the necessary expenses of management.
7. The sub-office committee: there may be a role for a sub-office committee acting as an intermediary screening body between CBO/village committees and the programme level committees. The programme would pay necessary expenses including those reimbursed to participants. The sub-office committee should meet

once a month.

8. The village bank committee: when autonomous village banks are established a 7-9-member village bank committee would run these with an elected Chairman, Secretary and Treasurer/Accountant. The village committee would perform all the functions of the village committee as well as most of the operational functions of the programme level committees. Initially, the time of the committee members would not be compensated but this may have to change over time to accommodate the level of responsibility and the opportunity cost of lost income of the members.
9. Programme loan committee. The programme loan committee would function as loan committees at other levels and could have a similar structure. Their authority would extend either to all loans or selected loans. The latter would be more feasible since these loans could be above a certain amount and of certain type, for example group loans and loans for social infrastructure. The programme would pay for all related expenses. The programme loan committee should meet once a month.
10. The general assembly. At each level the general assembly of members would meet at various intervals. Groups would meet once a week. CBO members would hold their general assembly once a month unless otherwise decided by the membership. The same is true of the village assembly. However, when autonomous village banks are established their general meeting could be more frequent.
11. Other specific functional committees at the programme and other levels such as those for training or gender sensitisation. The programme and other committees with appropriate jurisdiction would determine the structure and operation of the specific functional committees.

Once issues of the legal status and training have been dealt with, credit and saving activities can be introduced to the CBOs (assuming that these are not already carried out). The CBOs are gradually established as credit and savings associations preferably with a uniform charter.

Securing the capital base of the credit programme

The capital base (or the revolving fund) of a micro-finance programme can consist of both internal and external resources. Internal resources are mobilised from the clients (e.g. in the form of savings). External resources can come from donors (either grants or loans) or from the financial system (e.g. programmes could borrow from commercial banks, village banks or other organisations). The capital base does not have to be held in monetary form: for example, it could be held in animal or grain, if it were an animal or grain bank.

Adequacy of capital is important for longer-term sustainability of a micro-finance programme. Without sufficient capital, the programme may not be able to scale-up enough to make best use of its resources, i.e. to get economies of scale in administration etc. This will make it difficult for the programme to cover its operating costs. For this reason, it is important that the programme provides incentives both for savings and for timely repayment of loans (discussed below). In addition, a greater involvement of the community in loan delivery and credit management can assist by creating a sense of ownership. The initial capital fund and subsequent replenishments should be large enough to support a credible micro-finance programme. In situations of high inflation, it is important that the programme considers how it will maintain the real value of the capital base. Potentially, it could engage in various forms of indexing the rate of interest.

The management of funds

Several possibilities could be considered. What is important is that the members and their representatives get involved in fund management from the outset with appropriate training. Where village-banking module is feasible, as in Eritrea, the village banks management committee could be entrusted with fund management. Other alternatives are management committees of the association/CBO or a committee at the appropriate level. In each of these cases initial supervision by other bodies including ACORD would be essential.

CBOs and village banks would have to open accounts in a commercial or development bank to be operated by the management committee. Different accounts would relate to different purposes and these would have to be carefully managed and supervised. The umbrella organisation may have to do the same unless it is legally established as banking entity.

Eligible beneficiaries of loans

The services provided by ACORD-supported credit and savings system could be extended to a wide-range of beneficiaries. For example, both individuals and groups (or associations) could be eligible.

Important issues arise when one considers group versus individual loans. There are two considerations. First, lending to groups has been found to be a cost-effective method of providing credit in a wide range of cases. Using groups to disburse credit lowers the cost of credit delivery and can simplify loan procedures and paperwork. The use of groups can enhance the bargaining power of the poorest and can also open up new opportunities to individual members, while at the same time provide the programme with a guarantee for timely loan repayment.

Second, one must distinguish between lending to a group for group-based activities (e.g. a sewing group) and lending to a group to finance individual activities (e.g. a group of spice sellers, who work independently). In some cases, considerations of economies of scale and the bulkiness of the potential investment activity may warrant the provision of relatively large, group loans. In such cases, ceilings for groups are usually a multiple of individual ceilings depending on the number of members in the borrowing group. Group activities need to be carefully appraised and closely supervised. Management of group-based loans may be problematic if the groups lack cohesion and the necessary business skills. ACORD's experience with group loans is mixed. Therefore much caution needs to be exercised by the field staff in promoting group loans.

Where the scheme operates through membership of associations/CBOs, this membership should be open to all for a membership fee. ACORD field staff should carefully examine the composition of association membership in order to ascertain that there has not been a deliberate or accidental exclusion of the priority groups. Field experience of ACORD in Ethiopia, Eritrea and Uganda suggests that this may be the case if due attention is not paid by those responsible for screening of membership of associations/CBOs. Poorer families are left out because of their perceived “low capacity” to save and repay.

Setting the operational norms of the scheme

There are a range of requirements that need to be considered when setting operational norms:

1. The operational norms of the credit and savings system would be determined first and foremost by the clients themselves, within the framework of CBOs and/or village banks.
2. The operational norms would have to be periodically reviewed by all interested parties at different levels in order to introduce changes and modifications reflecting lessons from experiences and change in the environment.
3. The operational norms would have to be harmonised with those of other programmes in the country.
4. The operational norms would have to be harmonised with those of the banking sector of the country, if there is a longer-term plan for full integration with the formal financial sector.

In trying to establish a balance between these (potentially conflicting) requirements, programme staff should keep in mind the implications for long-run sustainability of their decisions.

Amount of loan

The amount of the loan (in terms of a minimum or maximum) can act as a filter mechanism, as can other attached conditions (such as use or method of disbursement). A low ceiling has often been successfully used to channel an appropriate share of credit funds to poorer beneficiaries. Loans should not be so small as to be ineffective, but, at the same time, loans in excess of requirements may lead to waste and default. Loan amount should be linked to the type of loans, and whether group or individual. Loan ceiling should be periodically adjusted to account for price changes and changes in activity profile of priority clients. In addition, together with the average investment requirement, the determination of loan amount/ceiling should be linked to the margin requirement defined below.

Loan approval authority should be decentralised, and peer review of loan amounts by the clients should be encouraged. This will reduce the costs of service delivery and could simplify loan procedures, reducing the time it takes to process applications.

Purpose and use of loans

In an environment in which the availability of equipment, inputs, materials and services is not problematic, one should be consider loans in cash. Otherwise, loans in kind may be preferable *provided* the programme has the administrative capacity. Loans provided in-kind can reduce the potential for the misdirection of funds. Again, the debate often boils down to whether or not credit should be directed.

Decisions about the freedom that a borrower has over the use of the loan have implications for the manner in which loans are approved and monitored. If loans are directed to some extent, programme staff may want to supervise their use (or train group leaders and others in loan supervision and follow-up). However, where loan use is completely free, there is a minimum need for supervision. Similarly, the freedom in loan use has implications for the types of advisory services offered prior to disbursement. Where loan uses are directed, the loan management committee together with the programme management may intervene with regard to the choice of investments in equipment, infrastructure and inputs. Feasibility studies may be carried out. Where loan use is free, the decision as to when to make feasibility studies is less clear, and such studies may only be carried out on request from the client. The decision made about feasibility studies and loan monitoring has important affects on the cost effectiveness of the programme.

The use of collateral

Loans should be collateral free as far as possible, as a requirement to provide collateral could be deterrent for credit delivery to priority target groups. A number of alternative options may be considered as collateral:

1. Group guarantee - in the case of default, the group might be liable for repayment. Or the group as a whole may not be eligible for further loans. Group guarantee is usually appropriate for short-term loans.
2. Use of an individual guarantor - many variations are possible such as, a recognised outsider of an standing acceptable to the group on account of means, income, asset, elective office, government affiliation, religious or social leadership and the like. The decision regarding the type of guarantor could be linked to the amount of loan or borrower type on a graduated scale to be determined by the group members.
3. Linking of credit to savings or margin requirements - this is discussed below.
4. Lien against equipment/materials purchased by loan or production generated by loans. Liens are usually more appropriate for longer-term loans.

The choice of option has to be determined in accordance with the circumstances of the programme. In particular, it is likely that changes in the 'credit-culture' would allow different options to be chosen.

Margin requirements and savings

Many micro-finance schemes require the borrower to make a contribution before a loan is disbursed. Often this requirement (called a margin requirement) is set as a percentage of the loan amount, often in the range of 25-30%. In other words, for every USD100 of investments the borrower must put up at least USD 25-30. Such margin requirements as seen as increasing borrower commitment to repayment. However, they should be applied flexibly depending on the nature of business and the borrower. In addition, they may not always be appropriate for every type of loan, e.g. for emergency loans.

Margin requirements are often obtained in the form of obligatory savings linked to loans. For example, a client may be forced to save 25% of the value of the loan. Again the rationale is that the client feels more committed to the loan. An additional advantage is that it increases the capital base of the programme. Beneficiary groups themselves can determine the amount of obligatory saving.

Note that the term used here is *obligatory* and not compulsory saving. The former represents an obligation determined through consensus of a group or CBO. The latter implies a rigid bureaucratic or hierarchical decision by the project management or some other authority, without adequate consultation or participation. ACORD credit and savings programme should avoid such imposition. Compulsory savings and its linkage to credit may act as a deterrent to the participation of the poorest in credit. Low capacity to save and repay may be used prevent their participation, and ACORD staff have to help potential priority groups overcome these obstacles.

Given the importance of savings, some programmes may feel that savings should be obligatory for clients, but voluntary thrift habits should also be encouraged. There should be concerted effort by the field staff to gear the incentive structure and fine-tune it continuously in order to promote voluntary savings. Some of these are mentioned in the box below. There could be others and it is important that when we design incentives, we do not establish a bias against the poorest, by placing more emphasis on the volume (as opposed to the regularity) of saving:

1. Savers should be rewarded with interest payments comparable to financial institutions.
2. A direct link could be established between loans and savings :

a) Adjust loan amount to the amount of savings using the latter as collateral
b) Allow repeat loans to clients with better savings records
c) Allow multiple loans to relatively large savers
d) Be flexible about loan purpose (use of loan) for clients with better savings records
e) Adjust loan duration and repayment schedule to the amount and regularity of savings
f) Adopt a flexible approach to determining the grant period for loan recipients with relatively satisfactory saving records

Repeat loans and multiple loans

Repeat loans should be extended to clients, who repay on time. Poorer groups may need repeat loans to take them above the poverty line. However, the number of repeat loans to be given is an important decision to be taken. An ACORD programme may not be able to provide the required number of loans to all eligible clients given resource constraints. The programme should provide repeat loans within the bound of its resource constraint which points to the importance of augmenting credit funds by mobilising internal savings and linking up with other capital sources. Generally, the number of repeat loans should also be linked to the size of each loan.

Multiple loans should be considered in appropriate circumstances when the borrower needs support to finance two or more elements of an investment package, which may have to be covered under more than one loan. Since it implies higher resource requirements, requests for multiple loans need to be carefully screened by ACORD field staff and should be granted on a selective basis in consultation with the beneficiaries through appropriate committees.

Disbursement and repayment schedules

In terms of capital disbursements to CBOs (i.e. the provision of loans and grants to CBOs by ACORD), the schedule of disbursements should be related to the pattern of capital requirements of the organisation. This is equally true for the disbursement of loans to an individual.

We have already said that the procedure for fund disbursement should be simple and fund delivery should not be unduly delayed, although necessary conditions for disbursement must be satisfied. The most important condition is the absorptive capacity of the recipients, their performance regarding fund utilisation and accounting and the actual capital requirement as determined by the staff concerned/ appropriate committees.

With regard to loan repayment, as a rule of thumb, three to 18 months should be considered as repayment periods for loans under ACORD-supported credit and savings programmes. In specific situations, consideration may be given to extend the repayment period for longer. In determining the repayment period and the repayment schedule, certain principles need to be considered:

1. Repayment period should be linked to the activity or cash flow cycle. This may mean that it is linked to a production cycle, such as the crop production cycle or the animal reproduction cycle.
2. Repayment schedule should include a grace period, which normally should not exceed three months.
3. The choice of repayment period may have implications for interest rate.

Emergency fund/loan insurance

Given the inherent risk involved in all types of activities in ACORD supported credit and savings programmes, especially those in livestock and crops, some kind of insurance scheme is desirable. One option would be to establish an across-the-board emergency fund at 2% of the original value of the loan, to be deducted at source. Setting such an insurance premium would compensate the programme for the overall risk of default. In the case of animal loans, the borrower would have to furnish the amount in cash at the time of loan disbursement. For grains, the amount could again be deducted at source. However, such a fund may not be appropriate in all cases, such as for emergency loans. Instead of deciding on an across-the-board rate, it may be decided that insurance premiums are set with greater attention to individual circumstances.

Setting interest rates

Programmes in the past have experienced a number of conflicting pressures when setting interest rates. Often we may feel that by setting a high interest rate, we are not helping our target group, who is poor. However, by setting a low interest rate, the real value of the loan fund is often eroded and the programme stands little chance of ever being independent. If we start from the premise of long-run sustainability, we will need to aim for interest-rates that will generate sufficient income for the programme to financially and economically sustainable. Without such interest-rates, it will be impossible for the programme to become independent of ACORD's financing. At the same time, we should remember that the poor households might be facing even higher effective interest rates on other sources of credit.

In practice this means that ACORD programmes should try to achieve a positive real rate of interest, that is interest rate should exceed the projected rate of inflation. In addition, the nominal rate of interest charged to borrowers should cover the borrowing cost, administrative cost of credit delivery and the cost of bad debt. Over time interest rates should be harmonised with the market-determined rates.

Where the concept of interest payment presents a religious problem, other forms of payment could be introduced. ACORD has had considerable experience with Islamic forms, which have been found to have had some flexibility (see the earlier section on ACORD's experience using Islamic forms of finance).

> In a situation of high inflation, the Musharaka system might be introduced. Musharaka is an agreement between the programme and the borrower based on investment and profit sharing. Musharaka provides a hedge against inflation since at the time of settlement all accounts are made in current prices. However, it involves greater risk and also a greater need for monitoring.

In the case of animal loans, a rate of return would have to be built in to the reimbursement arrangement. For example, a goat loan could involve reimbursement of the first and the second offspring, which might happen over the first two years. From this one could calculate the implicit interest rate making an assumption of the value of these animals and their offspring at maturity for sale. In the case of grain bank, the rate of reimbursement would have an implicit rate of interest built into it. In either case, the implicit interest rates must adhere to the principles enunciated above.

In general, a relatively lower rate of interest could be charged on medium and long-term loans as compared with short-term loans, to encourage productive capital creation. A higher interest rate for seasonal loans than for medium and long-term loans is justified by their higher administrative costs, particularly if loans are in kind. Similarly, the interest rate on seasonal consumption loans may be slightly higher than for medium-term housing loans.

Loan recovery

A viable credit system should include measures to ensure loan recovery on time and keep late payment and loan default to a minimum. ACORD staff should consider some of the following:

1. Use moral cohesion and group solidarity and pressure to cultivate good repayment discipline.
2. Appraise investment proposal adequately before disbursement.
3. Avoid giving loan in excess of requirements.
4. Ensure that loan is utilised productively.
5. Estimate carefully the cash flow cycle to determine repayment schedule.
6. Deliver loans on time in accordance with business requirement.
7. Consider interest rate rebate for timely payment of loans and impose penalty for late payment without valid reasons.
8. Avoid credit guarantee funds, which tend to reduce incentive of concerned staff to collect repayment.
9. Assist clients to cope with factors beyond their control, which cause repayment problem. These factors include death in the family, market movement (prices and demand) and natural calamity.
10. Good accounting system should be established for both lenders and borrowers. Loan passbooks are helpful.
11. Alert borrowers in time about due date for repayment so that he she can take necessary steps to make the payment.
12. Establish mechanism, which would enable borrowers to avoid selling product when market price is depressed. For example, in Mali South, village grain banks serve this purpose.

Graduation of beneficiaries

ACORD staff would be called upon to take necessary steps to assist clients to graduate out of the programme and link up with other financial institutions. First, clients may graduate out of the poverty trap with the help of repeat loans. Second, clients may otherwise be willing or able to seek financial assistance from other institutions. ACORD field staff can take several measures to assist clients to 'graduate':

1. Clients should be provided with specific training (see below).
2. Savings mobilisation should be strengthened so that they have a source of collateral (see above).
3. Complementary financing could be provided by ACORD.
4. Complementary support services need to be extended (see below).
5. Promotional activities need to be undertaken to prepare other institutions to deal with ACORD's clients (see Section 2).
6. Government and non-governmental organisations should be encouraged to provide infrastructures which are often lacking and keep the clientele dependent on ACORD type programmes.
7. Client motivation exercises should be organised to build up confidence.

Complementary activities and services

ACORD has a role to play in promoting complementary activities that increase the income-earned by borrowers and improve the return from credit for the borrower. Such activities could involve: investments in infrastructure; market analysis to identify new activities; market support to enhance the profitability and reduce the risks of existing activities; technological support to improve client productivity;

Client training could also promote effective management of resources. The critical role-played by training in successful evolution of credit and savings programmes have been brought out clearly by fieldwork across Africa. ACORD's success with credit programmes has been directly correlated with the strength of its training component. Experience also suggests that it is important to focus on building *sustainable* training capacity. Since it is not easy to recover full costs of training always ACORD must find ways of organising training in a cost-effective way.

Programmes should undertake a training-needs assessment survey, and delineate training needs by type of client (e.g. men, women, staff, by trade, age). This information can be used to select appropriate training modes (socialisation, formal training, and informal training, training by trainees and on-the-job training). The programme should also undertake training impact assessment and training follow-up.

Often it may be necessary to give people training on 'what credit or savings mean', to create 'credit mindedness'. In some areas, such as Mali Nord, the development of a viable credit programme has been constrained for many years by the dominance of a 'grant mentality' in potential beneficiaries' perceptions of ACORD. More specific 'finance'-training may have to be repeated and upgraded, as the CBOs raise their level of involvement in savings and credit management. Training which ACORD could focus on includes:

1. credit and savings, links with financial institutions
2. book keeping, accounting,
3. entrepreneurship, business analysis, and marketing
4. PRA,
5. specific skills and other areas highlighted by a training needs survey, such as environment, gender, HIV/AIDS, family planning, nutrition.

The decision to adopt a 'credit-plus' approach (i.e. where complementary services are offered) may affect the speed with which we can expect a programme to achieve economic and financial sustainability. If these activities are to be maintained after ACORD withdraws from the project, the funding for the activities will have to be generated from programme income.

Ensuring financial and economic sustainability

A programme can attain sustainability by combining both a competitive interest rate along with cost-effectiveness. For a programme to be cost-effective, the internal costs of lending must be low. However, cost efficiency may not guarantee financial sustainability if revenue generated from lending and other services is not adequate to cover costs of operations. The level of fees and interest rates affects the revenue earned by a scheme, and assume an even greater significance in an economy suffering from high inflation.

There are a number of measures that could be adopted to ensure sustainability. ACORD staff could focus on the following possibilities:

1. Contain the growth of the cost of credit delivery; gradually scale-up the volume of lending in order to achieve economies of scale;
2. Reduce costs by handing over some credit functions to groups/local structures;
3. Charge sustainable rates of interest and ensure good repayment;
4. Mobilise savings to increase the capital base and allow scaling-up;
5. Assist clients to undertake profitable investments;
6. Promote cost effective training which would call for:

a) organisation of individual training programmes within a consistent framework to gain from synergy;
b) use of trainees as trainers;
c) operation on the basis of a minimum viable intake;
d) decentralisation of training;
e) use of local languages as appropriate,
f) use of staff input;
g) selective use of external trainers;
h) establishment of regional resource centres where appropriate;
i) use of local trainers as far as practicable;
j) introduction of greater practical orientation to training;
k) prioritisation of training programmes in terms of anticipated impact;
l) careful planning of individual training programmes to make optimal use of training resources and capacity;
m) handing over of training to local structures as soon as possible;
n) maintenance of a high quality of training;
o) sending people abroad only under exceptional circumstances;
p) combining courses where appropriate to attain economies of scale and avoid duplication;
q) streamlining of training duration; and
r) making training more demand driven.

Monitoring and evaluation of our programmes

A well-established monitoring system should track the progress towards sustainability. Given the complexity of micro-finance programmes, computerised monitoring systems are a must; otherwise it nearly impossible to find out what is happening at any point in time.

Measures should be taken to collect, verify, edit, format, input, analyse and present financial information:

1. One specified staff member in each sub-office and head office should be responsible for data collation, verification and analysis.
2. Appropriate formats should be developed for periodic data collection on various items
3. Arrange for training of selected staff in computer skills: spread sheet, graphics, data base management, and as well as specific software for the Programme.
4. Data should be entered at sub-offices on a monthly basis at the end of the month

by the designated field staff. He/she should be held responsible for proper handling of data.

5. Monthly reports should be available no later than the seventh of the following month. Designated field staff should carefully double check and edit data for inconsistencies.
6. Database at the head office should be updated promptly on receipt of reports from field offices. Responsible officer should check data against appropriate controls before entering it into the database. Monthly data entry into the central database should be completed by the 20th of the following month.
7. A one-page monthly status report of the summary of operations of the fund should be available by 20th of each month. This should be available for ready reference of all interested partners. A proposed format for this report has been prepared.
8. Member profile should be computerised.
9. Training and other programme related non-financial data should also be computerised.

Monitoring systems also need to help us assess the impact and review targeting of the programme. We need to assess not only the positive impact of the programme but also the negative impacts. One crucial dimension is the monitoring of external factors, which are beyond the control of the programme. These include inflation, level of economic activity, policy changes, interest rate, subsidies, exchange rate policy, level of public sector investments, commercial policy, market and private sector development and peace and political stability. Programme management in consultation with clients, partners and London should determine periodicity and type of reports. Suggested guidelines for reporting and feedback are available in the ACORD M&E guidance manual.