Fredonia Microfinance Case Study: Wrap Up

The following is a brief list of things to think about when designing a microfinance program back in your Missions. The constraint of the exercise, choosing only one type of institution, will obviously not apply. In fact, having a flexible approach that allows you to work with various actors, including NGOs, credit unions, commercial banks, finance companies, and state development banks (more relevant in some regions than others) can be very effective. Such an approach requires flexible tools to meet the different needs of each type of institution. Please see the examples below.

Option One: FLUSH

PRO: This is the biggest NGO program, with by far the most microenterprise clients. They are growing rapidly, and improving their administrative efficiency. It might be easiest to achieve impressive outreach targets by working with the most well-established program.

CON: FLUSH seems to have serious management problems (three managers in three years, delinquency). Be sure to look for red flags like this with any type of institution you choose.

OTHER THINGS TO CONSIDER. Beware great numbers. This is a somewhat obvious trap in the case study, but in the real world it might not be so obvious. It is important to point out that, while FLUSH's growth has been spectacular, it hides underlying problems. Programs can grow so fast that they don't realize the extent of their delinquency. Also, the drop in the administrative efficiency ratio, while encouraging, is directly related to their growth, so it might not tell you much by itself. Be sure that you look below the surface.

Option Two: 200 Small NGOs

PRO: There are fifteen NGOs using different methodologies, so they are probably targeting different market niches (village banks are typically poorer and more rural, solidarity groups better off and more urban). Supporting this diversity might be a good way to help create a microfinance market. They are familiar with their clientele and interested in institutional strengthening to improve operations.

CON: All 15 institutions offering microcredit are small—less than 1,500 clients. Do any have potential to reach scale expected of best practice institutions (20,000)? Do any demonstrate commitment to achieve sustainability and reach large numbers of clients? The social orientation of NGOs can be an obstacle to sustainability.

OTHER THINGS TO CONSIDER. For small programs, you will probably need to use subsidies to support institution building (e.g., technical assistance and capitalization). They should be designed to encourage eventual sustainability. Also, for multi-sectoral NGOs, it is important to separate credit programs from other services. For small NGOs, this can be a real problem, since they don't have the systems to handle it. This approach is best suited for a nascent microfinance market. You might want to support several institutions as a way to see who will rise to the top, and then reassess the situation. It is also important to assess management capability early on in the process.

Option Three: Fredonia Foundation

PRO: Fredonia Foundation has a good reputation and a good track record with USAID. In addition, one of their board members has shown visionary leadership. As with the other NGOs, they are committed to working with the poor and know their target market well.

CON: Like the example above, they should separate their microfinance program from their social services. In this case, they will be starting from scratch, so it will take a lot of work. (This may actually be a plus, since you don't have to fix existing problems).

OTHER THINGS TO CONSIDER. The role of the visionary board member is clearly critical to the success of this effort. Ultimately, establishing a new microfinance program is about institutional change, which can be a lengthy and arduous process. This is true for other types of MFIs as well, especially for commercial banks that are downscaling into microfinance. Without board leadership and continuing commitment, establishing a successful program will be difficult. Be aware that relying on one board member can be a risky proposition.

Option Four: State Development Bank

PRO: The State Development Bank is the largest institution in the country, with an extensive branch network and good coverage in rural areas. They have eight times as many borrowers as their nearest competitor, and offer savings services as well. They have the support of the government.

CON: Their interest rate is five points below the best prevailing market rate, which calls into question their commitment to sustainable operations and also attracts rent-seeking behavior. Moreover, repayment is a major issue: 70% is disastrous. Finally, there is no evidence that bank management is interested in offering microfinance services.

OTHER THINGS TO CONSIDER. They have the support of the government, often a blessing and a curse. While the nature of the policy environment is not clear, the available evidence is not encouraging. Working with larger banks, public or private, can be a challenge. In addition to the issues related to institutional change and board engagement noted above, best practice microfinance methodology, which relies on highly autonomous loan officers who are paid based on competing incentives (many clients, low delinquency), can clash with a traditional bank's culture of stable office workers who are paid a fixed salary. There are several very successful examples of state banks that built large microfinance programs through subsidiaries: Banco del Estado in Chile, Banco do Noreste in Brazil, and BRI in Indonesia.

Option Five: Credit Unions

PRO: The credit union system also has broad rural coverage. Credit unions are community-based and oriented towards providing services to their members. They offer savings and multiple credit products and typically have very low operating expenses.

CON: The credit union system is weak — only 20% of the institutions are solvent. Their average loan is $1,000, larger than the state bank, so their commitment to the micro market is questionable. They are supervised by the Ministry of Labor, and thus not held to prudential financial standards. Governance with member-owned institutions can be challenging.

OTHER THINGS TO CONSIDER. One approach that has been successful is to work with a select group of credit unions rather than the entire federation. The solvent ones are an obvious choice; there may also be others interested in the microenterprise market. If the program is successful, eventually you will want to consider policy issues like supervision. Often, credit union systems are weak because they served as vehicles for donor or government credit programs, and thus not committed to mobilizing savings or financial discipline. Those that are solvent have become so by focussing on savings as the source of their funding, and on discipline to protect their members' deposits. Donor programs should encourage this discipline by providing institutional support to strengthen systems, not soft credit that will only weaken credit union resolve. There are good examples of credit strengthening programs in Ecuador and Guatemala.