

# **Microfinance in Africa: Combining the Best Practices of Traditional and Modern Microfinance Approaches towards Poverty Eradication**

## **I. WHAT CAN MICROFINANCE DO FOR AFRICA?**

When properly harnessed, microfinance offers a variety of benefits to the African people. Foremost, microfinance initiatives can effectively address material poverty, the physical deprivation of goods, services, and the income to attain them. When properly guided, the material benefits of microfinancing can extend beyond the household into the community. At the personal level, microfinance can effectively address issues associated with “non-material poverty, which includes social and psychological effects that prevent people from realizing their potential.

The economic performance of Sub-Saharan Africa (SSA) and other regions over the past three decades has been closely associated with their savings and investments. In fact, Africa’s relatively slow economic growth has been linked to its poor capital accumulation.

Three approaches could be used to assess the performance of savings:

- ◆ Africa lags behind others regions of similar size and structure. Its gross domestic savings averaged 8 percent in the 1980s, while for the same period South East Asia, and especially Newly Industrialised Economies (Republic of South Korea, Taiwan, Singapore) reached respectively 23 and 35 percent.
- ◆ Africa’s saving performance over time displays a downturn of saving rates over the past three decades.
- ◆ There is a disparity between actual performance and planned performance. The use of the two-gap model revealed that the targeted regional savings rates of 16.6 percent in 1995 and 20 percent in 2000 was needed to achieve overall economic growth of 5 percent in Africa by 2000. Up to 1998, the achieved average saving rate was far from the target (Calgagovski et al., 1991)<sup>1</sup>.

Other patterns of Africa’s saving include its dependence on public savings in contrast to Asia, where private savings are critical. Promoting private savings in Africa is crucial for two reasons. First, evidence from South East Asian countries shows that sustaining high economic

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<sup>1</sup> Calgagovski J., V. Gabor, M.C.Germany and C.Humphreys 1991. “Africa’s Financing Needs in the 1990s” in I.Hussain and J. Underwood (eds), African External Finance, World Bank, Washington D.C.

growth is contingent upon significant levels of capital accumulation. Second, SSA characterised by its heavy dependence on foreign savings, mostly ODA, to fill the investment-saving gap that averaged 11 percent of GDP for the 1970-95 period. Due to the binding lending constraints that SSA countries are facing in the international capital markets or external balance conditionality imposed by bilateral and external donors, the promotion of national saving could boost investment and influence the prospects for sustainability of growth. Identifying policies and institutions that promote saving should be crucial in any strategy aimed at easing the transition to less aid dependence of SSA.

Total saving is low in SSA and even worse, only a small share of it is transformed into financial savings. For instance, in Senegal, the financial savings (the change of the difference between  $M2-M1$ )<sup>2</sup> averaged solely 8 percent of national savings, showing the difficulties of formal financial sector in mobilizing savings and providing financial services, especially for the poor. Microfinance institutions could play an important role in meeting the financial needs of households and microenterprises. Above and beyond the microcredit facet, microfinance could contribute to poverty reduction by offering adequate savings services. On the supply side, microfinance could be the best instrument to bring about poverty eradication by loosening constraints on capital, opening the door to investment, smoothing consumption over time, and meeting emergency needs for liquidity. On the demand side, empirical evidence shows that a significant segment of the poor are savers and that the microfinance institutions could support them by looking after their savings in a secure manner and by helping them accumulate interests on their deposits. The poor will be able to deal with emergency and to make significant investment expenditures.

The performances of microfinance institutions could be caught through their institutional financial viability and their outreach to the poor people. Technical, political, social factors could influence these performances, reinforcing the need to combine the strengths of traditional and modern Micro-finance approaches.

## **II. HOW CAN MICROFINANCE SUCCEED IN AFRICA?**

African microfinance is as diverse as the continent itself. An array of approaches have been used, ranging from traditional group-based systems, to specialised lending by banks and funded by international non-governmental organisations (NGO) financial intermediaries. Consequently, examples of African microfinance offer an array of lessons of what works and doesn't work. Drawing from these lessons, and those from non-African examples, OSCAL developed a Microfinance model based on four principles:

- i) Pooling together people's resources
- ii) Relying and building upon what people know (tradition)
- iii) Reinforcing microfinance to empower the African private sector
- iv) Striving for efficiency, which include maintenance of tools and better working habits.

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<sup>2</sup> MI = transferable deposits + currency outside bank  
M2 = M1 + time savings + foreign currency deposits

The model needs to be field-tested. The Department of Economics, University of the Western Cape (UWC), South Africa, where the model was presented would like to incorporate it in its training program and also field test it. From November 2001, UNDP- Africa will support post-graduate students of the UWC to undertake research and field-test the model in South Africa for six months. Replicating the UNDP-type support, UNIFEM has offered to field-test the same model in a francophone country from January 2002

### **III. BACKGROUND**

The model seeks to identify a microfinance methodology-model adapted to Africa's specific needs for poverty eradication. It draws upon the findings from the project GLO/99/315/A/11/31, titled *Women, Microcredit, and Poverty Eradication*. This project follows up the Second Tokyo International Conference on African Development (TICAD II), and the Asia/Africa Forum on the Economic Empowerment of Women. It reflects the ongoing United Nations commitment towards poverty eradication, a key theme expressed in the United Nations New Agenda for the Development of Africa in the 1990s (UN-NADAF, GA 46/151), at the 1995 World Summit for Social Development in Copenhagen (A/CONF.166/9), and by the United Nations resolution (A/RES/50/107) proclaiming 1997-2006 as the First United Nations Decade for the Eradication of Poverty.

The project also takes into account and builds upon United Nations documents pertaining to microfinance and poverty eradication in Africa, including *Advancing Financial Intermediation in Africa* (A/50/490 of 6 October 1995), the final report of the *Africa Advocacy Forum: Microcredit and Poverty Eradication, The Tokyo Agenda for Action: African Development Toward the 21<sup>st</sup> Century* (TICAD II, October 1998), *Poverty Eradication in Africa: Selected Country Experiences* (UN/OSCAL 1998), *The Constraints and Challenges Associated with Developing Sustainable Microfinance Systems in Disadvantaged Rural Areas in Africa* (UN/CDF, CIDR/Renee CHAO BEROFF, 1999), and *Case Study on Best Practices Aimed at Popularizing Micro-Financing* (UNECA, Working Paper Series, ECA/DMD/PSD/WP/98/8).

The design and execution of this project were overseen by the United Nations Office of the Special Coordinator for Africa and the Least Developed Countries (UN/OSCAL) in close collaboration with the United Nations Development Programme, Gender and Development Programme (UNDP/GIDP). The process consisted of three phases:

**Phase I: Microfinance Factsheets:** Presented in the publication, *Microfinance and Poverty Eradication: Strengthening Africa's Microfinance Institutions* (UN/OSCAL, 2000), over 85 microfinance factsheets are compiled examining successful and unsuccessful microfinance initiatives in Africa, as well as non-African and international initiatives. Emphasis is placed on identifying strategies for a microfinance model responding to Africa's realities.

**Phase II: Women, Microcredit, and Poverty Eradication (Ethiopia, Cameroon, Nigeria):** Three one-week observation missions were undertaken in 1999-2000 to examine initiatives from three different African sub-regions, each region culturally differing in language, population distribution, and management skills. This phase was a direct follow-up of the Asia/Africa Forum on the Economic Empowerment of Women, held in Bangkok in July 1997.

**Phase III: Expert-Group Meeting on Microfinance and Poverty Eradication in Africa:** The Expert-Group Meeting provided a platform for African practitioners of microfinance to exchange experiences and lessons. It constituted a follow-up to the Microcredit Summit, in which OSCAL participated in February 1997 as a member of the Council of Advocates; to the recommendations of the one-day briefing, organized by OSCAL in February 1997, on “Microcredit and Poverty Eradication in Africa”; to the Asia/Africa Forum on the Economic Empowerment of Women, held in Bangkok in July 1997; to the VI International Conference on “Communication and Technology: Impact on Women in the Global Economy,” held in Accra in September 1997; and to TICAD II, held in October 1998. The following microfinance model was adopted during the Expert-Group Meeting held in Addis Ababa, Ethiopia (25-29 September 2000).

## **IV. MICROFINANCE IN AFRICA: THE MODEL**

### **1. Introduction**

The last twenty years have seen significant advances in understanding and providing financial services to better advance development and eradicate poverty. This includes providing the financial means to save, access credit, and start small businesses, with the potential to enhance community development, as well as local and national policy making. When properly harnessed and supported, microfinance can scale-up beyond the micro-level as a sustainable part of the process of economic empowerment by which the poor can lift themselves from poverty.

**Microfinance is not a panacea for poverty and related development challenges, but rather an important tool in the mission of poverty eradication.** Poverty is a multi-dimensional problem, embedded in a complex and interconnected political, economic, cultural, and ecological system. Owing to poverty's large scope and multiplicity of actors, there is no single guaranteed approach to its eradication. Within this system, solutions are as multifaceted as the causes. Such a systems' perspective is critical in creating an enabling environment for sustainable poverty eradication. Problems and solutions are not isolated phenomena, but occur within an interconnected system in which actors and actions have reciprocal consequences.

Consequently, poverty eradication is a complex mission and requires commitment, cooperation, and cohesion at all levels of development – individual, household, community, national, and global. While microfinance alone does not improve roads, housing, water supply, education and health services, it can play an important role in making these and other sustainable

contributions to the community. As microfinance becomes more widely accepted and moves into the mainstream, the supply of services to the poor may likewise increase, improving efficiency and outreach, while lowering costs. This, in turn, can have a multiplier effect on people's standard of living. Perhaps the greatest contribution of microfinance is that it empowers people, providing them with confidence, self-esteem, and the financial means to play a larger role in their development. The potential of microfinance far exceeds the micro-level, scaling-up to address macro-problems associated with poverty eradication.

**This report examines microfinance as a strategy for poverty eradication in the African context, extracting common lessons and principles for an African microfinancing model.** Certainly, microfinancing and the context in which it occurs – Africa – are both dynamic and diverse, and can not be limited to the confines of any one model. Thus, this microfinancing model is not proposed as a definitive formula for successful microfinancing, but rather a guideline to inform and be adapted to the specific microfinance contexts that characterize such a vast continent as Africa.

This report could be titled, *Banking on Africa's People*, in that input from **Africans themselves were foremost in designing the methodology and the desired outcome of this study.** Research methodology stressed a participatory perspective, providing a space for Africans to express themselves, listening to and learning from their experiences and lessons. As the foregoing *Preface* notes, the overall study producing this report combined and drew upon not only development literature, but also field observations and dialogue with and between Africans working in microfinance.

**Emphasis has been placed on adapting principles of traditional finance schemes to modern finance methods, building upon existing African culture to improve microfinance initiatives that are well adapted to Africa's specific needs.** The report reflects the conviction that Africa's most valuable resource and ally in poverty eradication is its own people and institutions. Microfinancing, like any strategy for poverty eradication, must involve the people themselves in examining the problems and creating the solutions if it is to be sustainable with those upon whom development is targeted.

## 2. Module I: Key Principles for an African Model of Microfinance

African microfinance is as diverse as the continent itself. An array of approaches have been used, ranging from traditional kinship networks and Revolving Savings and Credit Associations (ROSCAs) to NGOs and development projects, and funded by both the informal and formal financial sectors, as well as domestic and international and donors. Consequently, examples of African microfinance offer an array of lessons of what works and doesn't work. This section summarizes some of the key principles for microfinance institutions (MFIs) to become more ideologically and institutionally sustainable, building their capacity to better serve the poorest while becoming financially viable and self-reliant. It is understood that there is no blueprint for microfinance initiatives; each initiative must adjust to the specific cultural, political, and economic setting in which it operates. Allowing for such diversity, the following general principles are highlighted:

- Pool together people's resources through group organizing
- Rely and build upon what people know – tradition
- Reinforce microfinance to empower the African private sector
- Strive for efficiency

### *Principle I: Prioritize Group Formation and Networking*

Collective and cooperative support is a critical microfinance strategy at both the local level, in the form of solidarity groups, and at the national and regional level in the form of networking groups. Collective organization has several advantages in microfinance initiatives, the foremost that they pool together human and material resources. In Africa, group organizing has proven itself an effective strategy for MFI sustainability that Africans are especially predisposed. Group formation for individual and community goals is a pre-existing, "homogeneous" mode of organization in Africa that already operates in traditional financial schemes and is readily adaptable to new microfinance initiatives. The group has proven especially effective in the rural setting, where 80% of Africa's population reside (Box 1). The relative isolation, small size, and common resources of villages engenders a mentality and approach to problems that are seen as mutual rather than individual.

MFI's can utilize and support groups with regular meeting to reinforce group solidarity, discipline, and consistent repayments. Groups are especially effective for educating and training microfinance participants, enhancing networking and information dissemination. They are also an important participatory tool that can reduce administrative cost by giving certain responsibilities, such as loan monitoring, to the members themselves. Typically, small group size is more effective to ensure that members genuinely know and trust each other.

Microfinance group members are typically more ready to take ownership for and support microfinance initiatives. Mutual trust and peer pressure within savings and credit groups ensure participation and repayment in microcredit programmes. The support and strength of a group often raises community consciousness and creates a common infrastructure to solve problems common to all, pooling local knowledge and resources for initiatives, such as bulk purchasing and transportation, collective bargaining, and common infrastructure development – i.e. water pumps, health care, and education schemes. Groups empower individuals to support each other not just financially, but also emotionally. The group impresses upon members that they are not alone or helpless, but can rely upon the support of their community, and cultivate self-esteem through contributing to each other. This non-material benefit is an important resource, especially during individual or collective crisis.

***Box 1: Utilizing the “Yum” Philosophy to Strengthen Group Solidarity in Cameroon***

The Group of Common Initiative of the Women Farmers of Bogso (GICPAB) utilizes traditional group practices to empower members and enhance the village community. Referred to as the *Yum*, this group methodology initially focused on improving cassava production, processing, transportation, and marketing, enabling members to work together to save time, reduce costs, and to share resources, infrastructure, and knowledge. Gradually, the *Yum* scaled-up to other activities, including school and library construction, establishing a village market, and operating a school canteen. The *Yum* now extends into microfinance initiatives, including a credit line for GICPAB members with a child or grandchild registered at the local school to obtain a loan for school fees, books, meals, and other needs to ensure that within three years all village children will attend primary school. A credit line has also been provided for primary health care. The success of these microfinance programs rests in the traditional group practices embodied in the *Yum*, which uses the local proverb, “You can’t wrap a gift box with just one hand.”

The benefits of organizing are not limited to the local group level, but can scale-up through networking MFIs. Microfinance networks enhance MFI coordination, monitoring, advocacy, and outreach. Networks allow MFIs to integrate approaches and better consolidate, share, and disseminate human and productive resources, including technical, traditional, and cultural knowledge. Such collaboration widens the group of stakeholders involved in the microfinance dialogue, and provides a legitimate and accountable vehicle to lobby for State and international actors to channel assistance. Access to these support structures available in networking enables MFIs to benefit from economies of scale and scope, providing certain services at lower institutional costs than otherwise possible. In some case it may be cost effective for MFIs to outsource part of its operation to partner organizations more capable of efficiently performing a service (i.e. establishing an information management system).

***Principle II: Prioritize Local Knowledge and Participatory Planning***

Microfinance initiatives that recognize and build upon local knowledge and tradition are more culturally compatible and hence sustainable with the local community. People feel more familiar and comfortable with concepts that borrow from their own tradition; this, in turn, improves MFI acceptance and outreach. Microfinance approaches rooted in local culture are also more participatory because clients are more ready to identify with and thus participate in the financial decisions and actions shaping their lives. As a result people become more invested in and committed to the sustainability of the microfinance initiatives, assume ownership and responsibility for their development, and become more self-reliant (Box II).

As already noted, the group methodology is an important indigenous institution. Traditional and informal African savings and loan schemes include, *Ekub* in Ethiopia, *Tontines* in Cameroon and Niger, *Esusu* in Nigeria, *Susu* in Ghana, *Gameya* in Egypt, and *Sanduk* in Tunisia. These schemes are based on traditional knowledge and values, and microfinance initiatives that build upon them can count on legitimacy, accountability, and self-enforcement.

**Certainly, traditional methods need to adapt to the modern context, but while they can be rendered more efficient and benefit from modern innovation, they should not be replaced.** When people rely and build on traditional knowledge and values, it is easier for them to go further and learn more because their knowledge base builds on a secure foundation rooted in their own identities and society.

***Box II: COWAN's African Traditional Responsive Banking (ATRB) in Nigeria***

In Nigeria, African Traditional Responsive Banking (ATRB) is a unique loan scheme that draws from the best of African traditional microcredit practices but tempered by modern knowledge. The Country Women's Association of Nigeria (COWAN) was established by merging traditional with modern practices. At its core are the traditional *Esusu* and *Aajo* practices, combined with a community based institutional structure, training and advisory services, and a "social banking" model that is traditional and responsive. ATRB has succeeded on a number of fronts in its first five years: savings mobilization has increased by 100%, the loan fund portfolio over 50%, and loan repayments remain at 98%. ATRB successfully empowers poor and rural women economically, socially and politically, while creating a sense of belonging and ownership.

***Principle III: Reinforce Microfinance to Advance the African Private Sector***

Microfinance and microenterprise are critically linked; microenterprise development is an essential extension of microfinance schemes. If microfinance is to have a sustainable impact on poverty eradication, it must eventually scale-up into creating a private sector of entrepreneurs who function in the formal economy. In other words, microfinance has the potential of formalizing the informal sector, empowering micro-entrepreneurs to participate and benefit from the formal economy.

Microfinance can support initiative for direct supply and market linkages to small and medium businesses targeting promising micro-entrepreneurs in non-traditional, low volume but high value-added products in potential niche growth areas of the economy. Such an approach could reach existing micro-entrepreneurs who are seeking to graduate from the survivalist profile of microenterprises into a more secure and productive foothold of the formal sector of the economy. It would expose microenterprises to larger enterprises "higher up the chain", encouraging forward and backward linkages with established companies. Targeted micro-entrepreneurs can potentially develop, produce, and perhaps market low-volume but higher profit products, expand, and take on additional employees, thus scaling-up.

This potential, however, is contingent upon a supportive environment at all level and among all actors, supporting business incubation and expansion. For example, at the local level, regulation and standards among MFIs and their respective microenterprises can lend legitimacy to these initiatives, while networking among MFIs can provide a lobby platform to propel enterprises stemming from microfinance into the formal economy. MFIs can work together to ensure that Governments and donors do not support organizations that undermine the market for microfinance services and microenterprises by subsidizing loans.



At the national and international level, actors can promote legislation, business services, and infrastructure to enable African micro-entrepreneurs and producers to increase market opportunities, technical know-how, and management. Government policies are often biased to the formal and urban sectors of the economy, pre-empting opportunities for informal and micro-entrepreneurial initiatives to scale up into the private formal sector. Taxation schemes should be fair, progressive, and economically efficient, with particular sensitivity to the vulnerable sectors of the economy which microfinance serve and in which microenterprises operate.

*Principle IV: Prioritize Operational Efficiency*

If MFIs are to have a sustainable impact on poverty eradication, they must be efficient, financially viable institutions that can develop the financial leverage to expand outreach at a sustainable level. Adequate attention must be given to business practices to make MFIs financially sustainable in a reasonable timeframe. Leaders of African microfinance institutions stressed that practical and efficient operation is essential in achieving self-determined development, as well as accountability to clients as well as donors. This section highlights some of the key principles of operational efficiency underscored in this study:

- ***Target the Poorest of the Poor:*** Microfinance is a means to poverty eradication, and not an end in itself. Efforts for operational sustainability must target not only the less-poor capable of repaying loans, but include the otherwise marginalized poor.
- ***Mobilize Savings:*** Savings services not only provide a valuable financial assistance to low-income clients, but they also strengthen institutional self-sufficiency, membership commitment to microfinance initiatives, and build a sense of discipline, self-esteem, and wellbeing. When funds are internally generated rather than borrowed from or granted by external sources, MFI members become more invested and participatory in the prudential administration of savings towards credit and other MFI services. If priced correctly, savings instruments can contribute to capital mobilization and wider market coverage.
- ***Charge Interest Rates that Cover Operational Costs:*** Successful microfinance schemes are characterized by non-subsidized interest rates linked to competitive market rates. Interest rates should allow to sustain the MFI operation. The administration of many small loans, including processing and tracking services, is a costly operation. Consequently, MFIs need to charge higher interest rates than what commercial banks charge, yet can continue operations at rates that remain lower than the informal financial sector.
- ***Market Research:*** Preliminary and ongoing research is an important investment for microfinance initiatives. Feasibility studies and ongoing research of the target population, geographic scope, and the local economy are vital to propose financial products and services that complement these realities. Market research helps to

predict and control for costs (i.e. transportation or training), to better innovate and tailor services to the target population (i.e. develop effective selection, appraisal, and collection processes), and to maintain practical geographic coverage (i.e. ensure that loan officers are not over-extended and can have effective follow-up with clients).

- ***Streamline and Decentralize Operations:*** Lean, simple infrastructures utilizing basic design of microfinance products facilitates administrative procedures and increases operational efficiency. Simple and clear savings and loans criteria, preferably based on traditional mechanisms, are also easily understandable by local people. When possible, computerization instead of manual administration of accounts helps to reduce administrative costs. Decentralization reduces costs associated with travel for collection and disbursement of funds, risks associated with transferring funds, and inefficiency associated with delays in communication.
- ***Utilize Volunteer Staff:*** Voluntary staff and profit sharing from revenues are effective strategies for reducing operational costs. This is especially true in disadvantaged and rural areas, offsetting the additional costs arising from such constraints. Training can promote the transfer of otherwise costly administrative responsibilities to volunteer staff. This is not only cost effective, but it also reinforces commitment to and sustainability of microfinance initiatives, empowering people to be more self-reliant and take initiative in their development. Furthermore, volunteer staff people are typically intimately familiar with the area serviced, offering valuable knowledge and commitment.
- ***Target Women:*** In Africa, women are a better credit-risk than men and more responsible managers of meager resources. Furthermore, they are more committed to using their loans for the benefit of their household rather than self-gratifying consumption (as common among men). The most compelling reason for MFIs to prioritize women is to assist the poorest, who are disproportionately women.
- ***Develop Monitoring and Assessment Tools:*** Credible and reliable mechanisms to monitor and evaluate MFI operations improve overall institutional efficiency and effectiveness. Assessment tools allow for the generation of systematic information to identify and address weaknesses in MFI services and management systems, streamline procedures, and improve the user-friendliness of programmes. Reliable monitoring also fosters accountability, raising the investment attractiveness of MFIs.
- ***Invest in Training:*** Microfinance training is an investment capable of reducing recurring costs and improving operational efficiency, sustainability, and outreach. Well-trained staff cultivates a sense of ownership and investment in the MFI mission that transfers to the client base, creating client loyalty (Box III). Financial and business training in savings and credit utilization, basic management, bookkeeping, and marketing ensure that clients effectively invest microfinance funds into productive income-generating initiatives.

- **Confront Problems:** Problems are inevitable, and when they do escalate, it is imperative to identify them and respond immediately before they become serious. This entails developing performance standards, monitoring tools, and institutional integrity to identify and address weaknesses and problems in their infancy.
- **Utilize Pre-Existing Support Organizations:** Utilize pre-existing support organizations, such as the Special Unit for Microfinance (SUM), CGAP, Women's World Banking (WWB), the World Council of Credit Unions (WOCCU), and establish linkages with other NGO networks, bankers' associations, and international groups.

### ***Box III: The African Village Academy's Seven Step Training***

The African Village Academy (AVA) is an Ethiopian NGO that supports self-sustaining development activities that stress participatory involvement. In its Savings and Credit for Enterprise Development program (SCED), a seven step training methodology plays an essential role. Step one introduces various types of financial institutions and tools. Step two encourages participants to discuss and examine themselves and their markets to identify potential microenterprise activities, which they then research individually. In step three, participants discuss in detail their market findings (i.e. material, transportation, and market costs), and then are asked to form groups of typically four to five people. Step four elaborates the purpose of group formation in creating support and collateral for individuals, as well as developing specific business plans and budget planning. In step five, participants meet each other's groups in units of up to ten groups, and discuss specific credit arrangements and requirements of SCED. In step six, group members present their basic plans for final approval of the unit, and in step seven all steps are reviewed to reinforce understanding of the program.

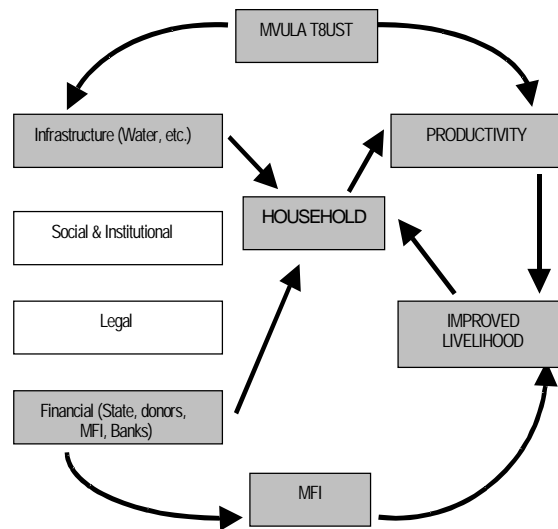
- **Avoid External Dependency:** Whereas donor funding can play an essential role in the start-up of a microfinance initiative, if MFIs are to make a lasting impact, they cannot remain dependent on donor funding, but must become self-sufficient. Self-reliant MFIs are better able to maintain their identity, autonomy, and mission.

### 3. Module II: Linking Microfinance to Poverty Eradication

There is a fundamental linkage between microfinance and poverty eradication in that the latter depends on the poor gaining access to, and control over, economically productive resources, which includes financial resources. For the resource-poor of Africa, survival often depends on subsistence agriculture and/or small income-generating activities at the home or in the local marketplace. In many instances, microenterprises rather than formal employment creates an informal economy that comprise as much as 70% of the national economy. Yet the lack of saving and access to finances creates a state of perpetual scarcity, a poverty cycle that restricts people's potential to improve their livelihoods. As already noted, the lack of financial services is not the only limiting factor in income generation: other pervasive social, economic, and political barriers also play a key role. Within this complex system, however, there is a clear need for better microfinance services for Africa's poor, which can play a key role in poverty eradication (Box IV).

#### *Box IV: MVULA Trust of South Africa*

MVULA is a national South African water and sanitation infrastructure development NGO based upon the principle that an enabling infrastructural environment is a necessary component of poverty relief at the household level. Government funds, however, are insufficient for infrastructure that provides better than basic water provision. In collaboration with the Financial Services Association (a village bank co-operative), MVULA makes financial services accessible to rural villagers. Villagers are encouraged to save for their own infrastructure – particularly yard water taps – in order to enhance the household's potential productive capacities. The principle of water as an entry point for economic development underpins this philosophy, and microfinance is an essential tool in achieving this goal.



**An understanding of how microfinance initiatives impact poverty eradication necessitates a definition of poverty that corresponds to a local definition of wealth.** This, of course, can vary from context: i.e. whereas financial assets may equate with wealth in urban areas, livestock or land may be valued in rural areas. Allowing for such diversity, the following discussion will focus on the material and non-material benefits of microfinancing.

### ***Material Benefits of Microfinancing***

Microfinance initiatives can play an effective role in addressing material poverty, the physical deprivation of goods, services, and the income to attain them. MFIs can help people become more economically secure. This, in turn, has a multiplier effect on people's standard of living, enhancing basic household welfare, such as food security, nutrition, shelter, sanitation, health and education services. MFIs can help prevent and extricate people from debt. Oftentimes, they liberate low-income households from moneylenders with outrageous interest rates that often reach 100% annually. Savings and credit services help people start or improve their own small businesses, providing income generation and employment for themselves and their families.

Credit can be used as working capital so that clients' efforts become more productive; for example, clients can buy rice or grains in bulk at wholesale prices and resell it at retail prices or buy a refrigerator to keep produce fresh. As clients become more productive, their income increases and they are able to accumulate savings for other investments and emergencies. Savings serve as reserves for important household expenditures (such as school fees and funeral costs), and as insurance against sudden crises (such as illness, natural disaster, or theft) that can otherwise result in destitution for people already living at the poverty line. In many cases low-income people want to save, and have been saving in a variety of traditional ways, ranging from kinship networks to Revolving Savings and Credit Associations (ROSCAs), but lack appropriate saving facilities that offer a combination of security of funds, liquidity, positive real return, and convenience. MFIs can build upon Africa's traditional savings ethic to enhance outreach and quality of services. It is important to keep in mind that for any financial service to have a lasting impact on poverty eradication, it must be flexible and innovative to adapt to their needs of its clients.

### ***Non-Material Benefits of Microfinancing***

Microfinance initiatives offer more than just material benefits; they can also address issues associated with "non-material" poverty, which includes social and psychological effects that prevent people from realizing their potential. Microfinance initiatives individually and collectively empower people. A steady income, a savings account, training, and the discipline to honor loan repayments usually raise the self-esteem and status of clients, in societies where they are often treated as second-class citizens. MFIs often utilize microfinance groups to provide training in financial management, legal rights, business management, as well as other support-services. Principles of collective organization and solidarity empowered people to bargain for higher wages, better work conditions, health services, child-care, and common forms of insurance to protect their lives and livelihoods.

MFI participants, especially women, are often empowered to speak out more, assume leadership roles, and address issues beyond their workplace, such as domestic violence. For many women, the group is the first opportunity to meet formally with other women to discuss problems and develop joint action. The groups serve as a channel of information. For example, members may tell each other about counseling services that have been established for women victims of violence and drug and alcohol addicts. Many women participants experience a change

in their household and community status. Some experience an increase in financial responsibilities when their husbands noticed that they are involved in lucrative activities.

#### 4. Module III: National, Regional, and International Support

Microfinance initiatives are more likely to succeed in a supportive national, regional, and international environment. Applying a systems' perspective, poverty eradication is recognized as a multi-scale endeavor with different partners participating at the local, national, regional, and international levels. Whereas the foregoing discussion has focused on microfinance lessons for the local level, this section will broaden the scope with lessons that scale up through the state to the global community.

***Acknowledge and Empower African People:*** Outside intervention should adopt learning approaches rather than blueprint approaches to microfinancing that recognize and utilize African insights and experience. In many cases, "outside experts" are paternalistic or distrustful with resource-poor Africans, holding them responsible for their state as a result of low motivation, initiative, and education. This attitude reinforces charity and relief rather than the capacity-building of the poor towards self-reliance and development. Outside assistance must employ bottom-up, participatory approaches that ensure that microfinance schemes are built around people rather than people around them. Participatory approaches are not only more culturally appropriate and hence sustainable for local needs, they foster more equitable distribution of benefits as development is accountable to a more representative community.

***Establish Realistic Expectations:*** Drawing upon participatory input and reliable research, donors must establish practical and culturally sensitive goals for microfinance initiatives. Institutional sustainability typically takes between eight to twelve years in Africa, and in many instances self-sufficiency is not feasible. While an increase in MFI revenue can be achieved by an increase in volumes of loans, pressure to scale-up and achieve greater outreach can over-extend MFIs, which are often unable to recruit personnel and establish a suitable infrastructure to sustain such operational expansion. This is especially true when operating in disadvantaged rural areas, which incur additional costs associated with low and dispersed population density. Research supports that the cost of establishing a microfinance network in remote areas is approximately 80% higher than in more accessible regions. Wherever the MFI operates, it is also important to adjust credit and production expectations to the material needs of the resource poor. Too often outside donors base their expectations on assumptions of unlimited growth imported from industrialized economies; in a world of limited resources, such assumptions are ultimately unrealistic.

***Conduct Research:*** Research is an invaluable tool to better understand and support microfinance initiatives. An analysis of the local microfinance environment, (i.e. population, organizational culture, natural resources, and economy), helps to promote microfinance strategies that complement these realities, utilizing assets of the area, and reinforcing the capacity for social, economic, and organizational innovation. Institutional appraisal is another research tool that allows donors to better access and support MFIs' poverty outreach and impact, the quality of the financial services and the loan portfolio, governance and transparency, management capacity and efficiency, financial performance, and plans for the future.

***Adopt Policies Supporting Microfinance Infrastructure:*** Policy changes can reinforce a supporting infrastructure in which MFIs function, influencing the practices of finance ministries, central banks, the commercial banking system, and donors in the country (Box V). Policies should encourage MFIs to establish themselves as formal, regulated financial institutions, provide low minimum capital requirements, and streamline reporting standards. Other important infrastructure changes should support liberal interest rates so that MFIs can charge necessary rates to sustain operations; develop financial networks for resource transfers among retail microfinance institutions; and establish credit ratings on clients, (thus reducing the risk of clients who repay one institution while borrowing from another).

***Box V: The Tanzanian National Policy for Microfinance***

In May 2000, the Government of Tanzania approved a national microfinance policy. The Government recognized that microfinance systems are and will increasingly become integral parts of the country's financial system, with the potential of better financially serving the people, the majority of who reside in rural areas. The policy formulation process began in 1996 with a comprehensive review of the micro-finance market. The review was followed by a joint Government-donor review mission, along with participatory input from MFIs and other stakeholders. The policy identifies three categories of implementation strategies: regulation and supervision, development and maintenance of standards, and capacity building. Although it is too early to assess the impact of this policy, it does reflect the recognition of microfinance as a formidable economic sector among national policy makers.

***Create a Supportive Legal Environment:*** A supportive legal environment builds credence and confidence in MFIs. With legal authority as a financial intermediary, MFIs are able to improve their outreach and performance. MFI regulations should be flexible, involve microfinance practitioners in policy development, and encourage a range of institutions. A legal framework in which the microfinance community operates can support microfinance standards, and a competent and uncorrupt judicial process can ensure people of prudence in the managing of financial transfers.

***Develop Standards and Assessment Tools:*** Policy leaders in the national and international community can work with microfinance practitioners in Africa to build consensus and commitment on core principles and standards in microfinance. Microfinance standards include organizational, operating, financial and reporting standards that will lead to the recognition of microfinance as a legitimate sector in the financial services industry. Reliable microfinance standards reinforce trust and confidence in MFIs and can be used to enhance operational efficiency.

***Transform Public Structures:*** In many cases, an effective infrastructure for microfinance exists within public agencies, such as the postal system. Postal Savings Banks (PSBs) already exist in countries such as Uganda, Kenya, Tanzania, and Cameroon. PSBs have a comparative advantage to develop microfinance services on a large-scale basis. Their geographic coverage of both urban and rural national territory can offer effective outreach through preexisting networks. This

potential, however, is contingent upon the proper restructuring, guidance, and monitoring of PBSs.

***Supportive Microenterprise Initiatives:*** It is important to remember that microenterprise development is an essential extension of microfinance schemes. National and international actors can promote legislation, business services, and infrastructure to enable African micro-entrepreneurs and producers to increase market opportunities, technical know-how, and management.

***Reinforce Staff Training:*** Staff training improves operational efficiency, sustainability, and outreach. Training includes financial management, credit and savings management and methods, and alternative management information systems, using technological resources from the region when possible. Staff training creates social ties between staff members, and strengthens overall morale, loyalty, and the MFI's corporate identity. Trainers can train and develop a pool of trainers from the local population, who are familiar with local languages, customs, and norms. Typically, qualified trainers who are intimately familiar with the area and people perform better and are willing to accept sacrifices for the cause.

***Utilize pre-existing structures, such as the Postal Savings Banks (PBS):*** In many cases, an effective infrastructure for microfinance exists within public agencies, such as the postal system. Postal Savings Banks offer an important comparative advantage in geographical coverage for both rural and urban outreach. The transformation of PBSs into microfinance institutions is contingent upon proper restructuring, monitoring, and the introduction of appropriate technology and training. Building upon examples elsewhere, such as Japan's PBS, can reinforce this transformation.

***Promote Networking and Cooperation:*** National and international actors should reinforce cooperation and coordination among actors at all levels in the design, management, and assessment of microfinance initiatives. Mechanisms should be created for the exchange of knowledge and experience among African microfinance practitioners, including the use of the Internet, dissemination of written material, field level practitioner exchanges, and best practice workshops. Regional coordinating committees and sub-regional conferences can bring together microfinance policy makers, leaders, and representatives from bilateral, multilateral and inter-governmental development partners to access and compare microfinance progress. Coordination among various microfinance actors also ensures complimentary rather than competing policies.