How to do

Support community-based financial organizations

Inclusive rural financial services

How To Do Notes are prepared by the IFAD **Policy and Technical Advisory Division** and provide practical suggestions and guidelines to country programme managers, project design teams and implementing partners to help them design and implement programmes and projects.

They present technical and practical aspects of specific approaches, methodologies, models and project components that have been tested and can be recommended for implementation and scaling up. The notes include best practices and case studies that can be used as a model in their particular thematic areas.

How To Do Notes provide "tools" for project design and implementation based on best practices collected at the field level. They guide teams on how to implement specific recommendations of IFAD's operational policies, standard project requirements and financing tools.

The **How To Do Notes** are "living" documents and will be updated periodically based on new experiences and feedback. If you have any comments or suggestions, please contact the originators.

Originators

Michael Hamp
Lead Technical Specialist, Inclusive Rural Financial Services
Policy and Technical Advisory Division
E-mail: m.hamp@ifad.org

Francesco Rispoli
Senior Technical Specialist, Inclusive Rural Financial Services
Policy and Technical Advisory Division
E-mail: f.rispoli@ifad.org

Jonathan Agwe
Senior Technical Specialist, Inclusive Rural Financial Services
Policy and Technical Advisory Division
E-mail: j.agwe@ifad.org

Contact

Maria-Elena Mangiafico
Knowledge Management and Grants Officer
Policy and Technical Advisory Division
E-mail: m.mangiafico@ifad.org

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List of acronyms

ASCA	accumulating savings and credit association
CBFO	community-based financial organization
CPM	country programme manager
CVECA	Caisses Villageoises d'Epargne et de Crédit Autogérées (Self-Managed Village Savings and Credit Bank)
FSA	financial services association
FSP	financial services provider
KPI	key performance indicator
MFI	microfinance institution
NGO	non-governmental organization
PDT	project design team
ROSCA	rotating savings and credit association
SACCO	savings and credit cooperative
SHG	self-help group
TSP	technical service provider
VSLA	village savings and loan association

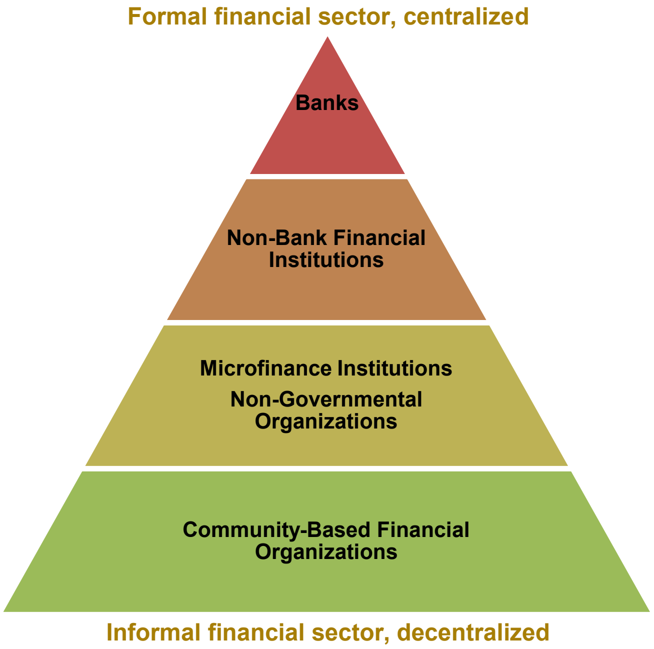
Introduction

IFAD's mission is to enable the rural poor to overcome poverty. One of the main tools to alleviate poverty is creating access to financial services for people who are currently excluded from the financial system. However, it remains a major challenge to successfully create access in these areas on a financially sustainable basis. In many countries, the formal banks are not interested in servicing remote rural areas due to: (i) a lack of economies of scale; (ii) high transaction costs; and (iii) a perception that the poor are not creditworthy. Community-based financial organizations (CBFOs) are often the only institutions available to provide basic financial services to the rural poor, especially in remote areas with inadequate infrastructure. Figure 1 shows the formality of CBFOs compared with other financial service providers (FSPs).

Within the CBFO subsector, there is a wide variation of organizations. The purpose of this publication is to provide information on how CBFOs and support structures might best serve remote rural communities, identifying the basic success factors required and the potential challenges to be overcome. It looks at creating effective interventions and the use of key performance indicators (KPIs).

Key issues

The term "community-based financial organization" (CBFO) covers a variety of entities that provide a range of financial products and services to a small target market in a limited geographic zone. CBFOs often operate in remote areas that lack access to the formal financial services, and often without government regulation and oversight (Hirschland, Jazayeri and Lee 2007). Most CBFOs are self-governing; they rely partially or wholly on volunteers and, therefore, they can play a powerful role in achieving other goals set in IFAD's social mission, such as empowering women and helping isolated communities to access public services. Self-formed CBFOs are primarily savings-driven, mobilizing funds from their members. This funding contributes towards ensuring CBFOs' sustainability, so that they will not have to rely on temporary sources of external funding.



Source: (IFAD 2013)

Figure 1. FSPs within the financial sector

Other characteristics of CBFOs and how they differ from microfinance institutions (MFIs) are shown in Table 1.

Table 1: Comparison of main characteristics of CBFOs with those of MFIs

Characteristics	CBFO	MFI
Client-based	Common membership, e.g. women living in a particular village • Eligibility determined by group members/governing committee • There must be a high degree of trust among the membership	Varied clients • Eligibility determined by MFI
Staff	Volunteer members (localized and small CBFOs), low-cost/part-time (larger CBFOs)	Paid full-time staff (not necessarily clients)
Management	While often managed by members, larger CBFOs are often run by professional staff and management	Managed by recruited staff
Governance	By board – elected by members	By board – appointed/salaried and elected
Regulation and oversight	Not compulsory – often unregulated in the case of the more fragmented CFBOs, e.g. village loan and savings associations (VSLAs), but usually in place for entities such as credit unions	Compulsory but not always developed (e.g. post-conflict countries or countries where the sector is relatively new)
Collateral for loans	Includes savings, use of guarantor, social collateral of the entire local group	Often Grameen group guarantee (group of clients co-guarantee each other), property, occasionally guarantor
Range of financial products	Normally narrow (except credit unions, which can have a full range of financial services) • Savings-driven (choice of products dependent on group type) • Credit (small loans, rigid loan terms) • Sometimes some forms of solidarity insurance • May be possible to link to more formal financial institutions to access other products (e.g. larger loans; insurance)	Broader (depending on the the type of MFI) • Savings normally voluntary; different products available • Credit (larger loans available with longer loan-terms; more than one credit product on offer) • Other products offered (e.g. insurance; specialized credit products)
Size of outreach	Small – typically, five to a few hundred members; savings and credit cooperatives (SACCOs) and credit unions can reach thousands of members)	Normally large – typically in thousands of clients)
Size of geographic coverage	Limited – individual groups cover a community/village, unless part of a network	Wider – large branch infrastructure and points of sale

Despite generic commonalities, there is a wide range of modalities within the CBFO subsector. CBFOs can range from being highly decentralized, unsophisticated entities (“informal”) to entities with slightly more varied products and functions, possibly with bank linkages, to the more “formal” CBFOs with more sophisticated products and services, paid staff, and often centralized management and governance structures. These institutions are sometimes supervised by governments. CBFOs can be divided into three main subgroups as defined by their main mode of operation.

- **Small community-based time-bound savings groups**: In these informal groups, savings are compulsory to part of a group. Being time-bound, these CBFOs disburse all funds after each cycle. Groups are dissolved once everyone has had their turn to receive a loan. Generally, these are indigenous organizations. They often form and operate without any external intervention or support. Table 2 shows some examples such as rotating savings and credit associations (ROSCAs), village savings and loan associations (VSLAs) and village banks (VBs).

Table 2: Key features of small community-based time-bound savings groups

Rotating Savings and Credit Associations (ROSCAs)	
Membership	ROSCAs usually have 5-20 members but sometimes as many as 30. They are typically homogenous and must have a regular income to fully participate.
Regulation	Unregistered, informal groups
Products and services	When each member has received the loan and repaid it, the group may disband or start a new cycle with the same or new members. Length of the cycle seldom exceeds one year. **Savings:** • Compulsory (savings fund the loan, which is made available to each member in turn). • No interest is paid on savings. • All members contribute a multiple of the same set amount at fixed intervals. • Contributions are made regularly (during weekly or monthly meetings). • Accumulation may be conducted for the first few meetings before distributing any funds in order to establish the credit fund. **Credit:** • Fixed amount and term (equal to the total sum of members' savings) are distributed to each member in turn. • Each member only receives the loan once, unless they have contributed more than one multiple of savings. • The order of loan recipients is chosen according to either consensus on member need by drawing lots or through a bidding process. • No interest is paid on loans.
Management	Autonomous. Easier for non-literate people to manage since non-accumulating.
Geographic coverage	Africa (especially West Africa), Asia, Latin America and the Caribbean
Village Savings and Loans Associations (VSLAs)	
Membership	VSLAs usually have 5-20 members but may have as many as 30. Homogenous members typically must have regular income to fully participate.
Regulation	Unregistered, informal groups
Products and services	The length of the cycle of a VSLA is typically one year, by which time all loans must be repaid and all savings redistributed together with their share of interest. This distribution is sometimes called *action audit.* After this redistribution, existing members can then leave or new members can join the group. The group then starts afresh. (Please note that this description is of the traditional VSLA model; VSLAs are increasingly being encouraged not to disband.) **Savings:** • Savings are compulsory; they are pooled and on-lent to group members. • Deposits are weekly, biweekly or monthly, with all members saving multiples of the same amount. • VSLAs distribute all savings together with the share of interest back to members at the end of the cycle. The interest is usually distributed in proportion to the amount saved. **Credit:** • Loan repayments are collected and loans disbursed at regular weekly, biweekly or monthly meetings. • Interest is paid on loans. The loan terms are typically short (1–3 months) and the interest, which is decided by the members, can be very high. • All loans must be repaid by the end of the cycle.
Management	Autonomous. Easier for non-literate people to manage since non-accumulating, even though some level of regular external support is often necessary.
Other	Self-contained at the village level – no linkages with banks and no formation into federations with VSLAs from other villages as with other CBFO models.
Geographic coverage	Africa, Haiti, India
Village Banks	Village banks are very similar to VSLAs except that they aim to continue operating instead of disbanding at the end of a cycle. In some cases, the sponsoring NGOs will lend them funds.

- **Small community-based accumulating savings groups**: Savings are compulsory to be part of the group, but size and timing of contributions and withdrawals of savings are more flexible. Accumulating means that these CBFOs have an unlimited life and can continue to take deposits and give credit for as long as they exist. Accumulating groups have more complex operations than time-bound groups. They are responsible for safeguarding members' savings, which means that they can accumulate more capital for lending, and thus vary their loan products. Two types of small community-based accumulating savings groups are accumulating savings and credit associations (ASCAs) and self-help groups (SHGs). Their main features are detailed in Table 3.

Table 3: Key features of small community-based accumulating savings groups

Accumulating Savings and Credit Associations (ASCAs)	
Membership	ASCAs can have around 12 members. May be bigger and more heterogeneous than rotating savings and credit association (ROSCAs) and village loan and savings associations (VSLAs).
Regulation	Normally not legally registered or supervised
Products and services	No set life-span or automatic distribution mechanism. Formed to accumulate savings and to lend member contributions over time. This means that ASCAs can accumulate more capital for lending and, therefore, loans may be larger and have longer loan terms than ROSCAs and VSLAs. Given this mode of operating, there may also be a need for a safe since ASCAs have no automatic distribution mechanism as is the case with time-bound savings groups. **Savings:** • Members can contribute different and irregular amounts. • In some ASCAs, savings can be withdrawn. • Interest is allocated to members according to the size of their contributions (normally a good rate of interest relative to the market rate). • Members can choose just to save, and not take any loans. **Credit:** • Loans are allocated by following a decision-making process rather than automatically; the group decides when and if to distribute funds. • Loans are not compulsory. • Members can choose to take more than one loan. • Loans can be larger and have a longer maturity than ROSCAs – depending on members' cash flow. • Interest is charged on loans.
Management	ASCA operations are complex and rules may be documented. As savings, loans, profit reinvestment and the payment of interest vary by member, they are more difficult for non-literate people to manage.
Self-Help Groups (SHGs)	
Membership	10 to 30 individuals (mainly women) from similar socio-economic backgrounds
Regulation	Regulated by the national financial institution
Products and services	**Savings:** • Members regularly contribute fixed amounts over time that are lent to other members. • Link with formal financial institutions and utilize their deposit facilities for the group's pooled savings. • Interest is earned on savings. **Credit:** • They typically charge rates of interest that are lower than in the informal market. • Linkages with more formal financial institutions allow access to larger and longer-term loans for on-lending to members. **Other financial products and services:** • Members may have the opportunity to access diverse products and services through linkages with formal FSPs.

Management	Although they have autonomous management, they are upgraded and trained by an individual or an institution, such as an NGO, in the required management skills. It is common practice for members to change their leaders annually in order to enhance capacity-building and empowerment.
Other	These groups have social aims beyond providing financial services, such as reducing poverty, building awareness, increasing literacy, catalysing political participation or family planning. Often promoted and part-funded by the government.
Geographic coverage	Prevalent in India where NGOs, banks, government entities and individuals have promoted over 1.6 million SHGs with over 30 million members. Also present in other parts of Asia and in Latin America.

- **Large community-based cooperative groups:** The groups are generally larger than time-bound or accumulating savings groups and have more formal structures of management and governance (see Table 4). Often, these institutions are regulated under "non-banking financial institutions" (as in Figure 1) or "cooperative" legislation, regulation and supervision, depending on their methodology and the regulation in the country. While some groups have voluntary savings and some have compulsory savings, depending on the groups, they are savings-driven. Members own the cooperative through buying shares (sometimes equivalent to savings) or by paying membership fees. Institutions are democratically controlled by members who appoint the board and annually review performance.

Table 4: Key features of large community-based cooperative groups

Caisses Villageoises d'Epargne et de Crédit Autogérées (CVECAs, Self-Managed Village Savings and Credit Bank)	
Membership	Members pay a fee to join, rather than having to buy shares.
Regulation	Included in microfinance regulation laws in some countries (e.g. Mali)
Products and services	Instead of paying dividends to members, the annual surplus is reinvested in the CVECA or the village. **Savings:** Savings are voluntary. **Credit:** Loan size is not linked to savings.
Management	The management committee is composed of representatives of each neighbourhood in a village. It is responsible for many management functions, some of which are assumed by part-time staff. In contrast with a typical cooperative, the CVECA management committee reports to a general assembly of all villagers rather than just to its members.
Geographic coverage	West Africa
Savings and Credit Cooperatives (SACCOs)	
Membership	Each member purchases one or more shares and has one vote. Rural SACCOs are likely to have between 50 and a few hundred members, although in the case of national cooperatives, they can have significantly more members when aggregated under a national apex organization. Rural SACCOs focus on a village or even a segment of the village population such as women. Members often meet regularly.
Regulation	They may be registered under the cooperatives or credit union laws, sometimes as a non-bank financial institution (NBFI) of the country, depending on the law and on the size and sophistication of the SACCO, or, alternatively, they could be supervised by a regional or national cooperative council.

Products and services	**Savings:** There are both compulsory and voluntary savings. • There are set rules for savings withdrawals, although members may be able to withdraw funds at short notice. • Interest can be received on deposits and a dividend is usually paid out of the SACCO surplus. **Credit:** • Interest is charged on members' loans – if this generates a surplus for the SACCO, part of this surplus can then be returned to savers either as a dividend or as interest on deposits, while the remaining surplus may be reinvested back into the SACCO. • Loans are typically individual loans as opposed to group loans. This can suit members with larger financing requirements.
Management	There is at least one paid part-time manager and an elected management committee, and support is provided by an elected credit committee and a supervisory committee.
Geographic coverage	Significant presence in Eastern Europe, Asia, Africa, Latin America and the Caribbean
Credit Unions (CUs)	
Membership	Rural credit unions are likely to have between 50 and a few hundred members, although in the case of a national credit unions movement (often including urban credit unions), the aggregate membership can range up to hundreds of thousands of members. Membership is based on a common bond, shared by savers and borrowers, such as belonging to the same community or place of employment. Each member purchases one share and has one vote in board elections, regardless of their amount of savings or shares in the credit union.
Regulation	Ideally, they are regulated by the central bank or a registrar of credit unions or cooperatives and supervised by regional or national cooperative councils.
Products and services	**Savings:** • Savings are voluntary and compulsory. • There are good rates of interest paid on savings (although this can depend on whether the credit union has generated a surplus so that it can afford to pay interest). • Members' savings and shares finance their own loan (sometimes supplemented by external funds, but credit unions aim to retain a high ratio of internally generated funds to the loan portfolio). **Credit:** • Usually, interest rates charged on loans are lower than the average rates in the market. **Other financial products/services:** • There is full range of financial services, including remittances and insurance, depending on size and development stage of the credit union movement. • In the early stages, loan amounts and terms can be limited.
Management	Usually one part-time manager. Management reports to the board of directors. The board of directors is elected and formed by the membership. Importantly, the internal audit function is elected independently, is usually called a "supervisory committee" and is part of the governance structure.
Geographic coverage	Most prevalent in Asia, Africa, Latin America and the Caribbean

- **Financial services associations (FSAs):** These are membership-owned financial institutions that are similar to a small stock company (see Table 5), although they are regulated by the registrar or department of cooperatives in some countries (e.g. Benin). More often, however, they are registered by other regulatory authorities.

Table 5: Key features of financial services associations

Financial Services Associations (FSAs)	
Membership	Members must buy shares; the price of shares depends on the FSA's financial performance. Voting rights are proportional to the number of shares owned, with a maximum of 10 votes allowed per member.
Regulation	Regulation is included in microfinance regulation laws in some countries (e.g. Kenya and Benin), although, in reality, it is difficult to monitor and supervise un-networked, scattered institutions.
Products and services	**Savings:** • Savings services are traditionally limited and people mainly make deposits for safe keeping. • Interest is not paid on deposits but a dividend is declared from the profits earned and is added to the book value of the shares. • The ability to withdraw funds from the FSA can be circumscribed because of this feature, with withdrawals being based on the book value of the share. **Credit:** • Funds from members' shares and deposits are used to fund short-term loans to other members (often under six month term with weekly repayment). • High interest is paid on loans if the FSA is controlled more by shareholders than borrowers. A borrower-dominated FSA usually pushes for average interest rates, although, in reality, a balanced mix is best. **Other financial products and services:** • The strategy for FSAs is to establish a relationship with commercial banks, to broaden their range of services and access incremental capital.
Management	FSAs are managed by an elected board and by committees supported by professional staff in some cases. They receive initial capacity-building support from entities such as NGOs.
Geographic coverage	Worldwide and found in remote rural areas in South, West and East Africa

Lessons learned

Before choosing CBFO implementation, it is best to consider their strengths and weaknesses. For additional information, please refer to IFAD's *CBFOs*: *Lessons Learned:* http://www.ifad.org/knotes.

Strengths of CBFOs

Greater outreach: CBFOs are capable of achieving considerable outreach in remote areas at a relatively low cost compared with more formal financial institutions. Since they are in close proximity to their members, are self-managing and can operate with a relatively low membership, they can be established in remote areas with low population density, involving people who normally lack access to other financial services and products.

Local ownership and empowerment: CBFOs commonly generate a strong sense of ownership among members. Due to the local character of the organizations, many of the members know their fellow villagers and local operating conditions. Therefore, it is likely that they will take a considerable interest in the CBFO. The groups often include and empower more marginalized individuals (such as poor people or women) who sometimes use the group to become involved in other community initiatives. In addition, local ownership enables members to reject attempts by problematic individuals to join a CBFO. Moreover, local knowledge can help members better assess whether a borrower will be able to repay the loan according to the terms and conditions.

Possibility to link with the formal financial sector: The typical member of a decentralized CBFO is poor and lives in a remote area, making him/her less interesting to the formal financial sector. However, 20–30 individuals working as a group to establish mature savings operations could provide the economies of scale necessary to make service provision financially worthwhile. The typical CBFO becomes more attractive to a bank or large credit union if linked to a network of decentralized self-managed groups that can be serviced as one entity. For members of CBFOs, linkages to formal financial institutions can mean access to larger loans and other financial products and services.

Rural populations that have access to the more formal financial sector will often choose to retain linkages with CBFOs both to diversify their incomes and reserves and to reap the social benefits the CBFO brings.

Encourage savings culture: CBFOs are often compulsory savings-based organizations. Not only can this requirement help encourage linkages with the formal financial sector but it can also promote long-term sustainability. Additionally, compulsory saving helps individuals build equity, create reserves, smooth consumption and mitigate risks. While it is often assumed that access to credit will enable poor people to invest in profitable activities, pay back their loans with interest and improve their economic security, this assumption greatly understates the element of risk. Many poor people are already highly indebted and additional debt may undermine their economic security rather than enhance it (Ritchie 2007).

Allow replication: The simplicity of the models makes it relatively easy for neighbouring villages to replicate and develop their own informal financial sector.

Weaknesses of CBFOs

Limited ability to generate a big pool of savings: CBFOs often operate in remote regions and have relatively small memberships with limited savings capacity. As a result, savings generated by CBFOs are relatively small, which constrains their capacity to mostly micro or small business and consumption activities.

Sustainability is not guaranteed for externally funded groups: CBFOs that receive external credit funds from governments or donors often fail (Ritchie 2007; Rosenburg 2009). Poorly planned and executed, externally funded CBFOs often risk attracting a non-socially cohesive membership whose sole purpose is to access “free money” rather than encourage their members to save and strengthen the group over time. Even though savings are compulsory, members are likely to view these CBFOs as a way to access loans rather than an opportunity to build a savings habit, which would be beneficial to both the members and the group to ensure liquidity and sustainability. A rapid expansion strategy by the government or donors can exacerbate these challenges, undermining the quality and sustainability of the CBFO sector in a country.

Need for thorough technical assistance and monitoring: Typical decentralized financial institutions are self-managed and require a considerable amount of technical assistance (TA) and training at the outset in order for the CBFO to manage itself in a sustainable manner. Furthermore, they require close monitoring and oversight for two to three years after their establishment to help them become sustainable.

Restricted range of products and services: The range of services that rural CBFOs can provide to their members is constrained by their limited ability to mobilize savings, their remoteness and their lack of skilled personnel. As such, many of them are limited to providing basic savings services and a limited range of loan products.

Higher interest rates compared with those of formal financial institutions: CBFOs often charge higher interest rates than commercial FSPs. It may seem that, since the amounts loaned are small, the high interest rates would encourage short-term borrowing, resulting in high repayment rates because borrowers would not want to accumulate high interest fees on longer loans. However, it has been found that high interest rates discourage poorer members of CBFOs from taking such loans. In the absence of other external cash inflows to repay high interest loans, members who take high interest loans for consumption can end up poorer at the end of the business cycle.

Lack of management skills and weak governance: CBFOs need willing leaders with governance and management skills. However, it is often difficult to find such people in rural areas. These challenges are pronounced in an externally funded CBFO, which may become too reliant on outside technical assistance, and thus prevent the transferral of relevant financial management knowledge and skills. Fostering management skills takes time and requires people who are committed to champion the group development process. In addition, there is also a need for a system of checks and balances to control governance and management. When questions of ownership and accountability over the funds remain unclear, the CBFO has no incentive to properly manage them (Ritchie 2007).

Lack of financial management capacity: Many CBFOs are managed by members who have little or no financial management skills and/or volunteer their time on a pro bono basis. Without a salary, the level of accountability can sometimes be compromised, resulting in mismanagement of CBFO funds. It is, therefore, recommended that CBFOs aim for salaried staff in order to improve financial management skills.

Vulnerability to elite capture: CBFOs are often established in small villages with a strong hierarchical structure and power relationships. Given the attraction of accessing “free money”, local elites are often tempted to take over CBFOs for their own ends, with the risk that the CBFOs collapse and members lose their savings.

Guidance for design/implementation

Preconditions for IFAD to Successfully Support CBFOs

IFAD is not ideally equipped to support the creation of new CBFOs. Rather, its resources are better deployed in identifying existing CBFOs that are likely to be successful, building up their capacities and outreach, and helping them overcome their weaknesses. When considering a CBFO intervention, the project design team (PDT) ensures that the CBFO has certain basic features in order to be successful and then identifies the most appropriate type of support that IFAD can provide. The local country programme manager (CPM) and the PDT should be able to answer “yes” to the following questions:

Is there a demand for financial services? A basic market survey combined with a supply-side gap analysis can help answer this question.

Is there an insufficent supply of financial services? There is no need to establish a new system if: there are other financial systems operating in the target area that could provide these services; or there is another system that is adequately providing services that could expand to support IFAD’s target clients.

Is there a culture of savings? Ideally, the potential client base would have a history or culture of saving. In societies that are consumption-oriented or do not save monetary assets (e.g. where wealth is invested in cattle), there may be little demand for CBFOs. But given the rapid changes in economies, livelihoods and ecosystems, CFBOs can be a relevant strategy for adaptation and diversifying income sources.

Can members’ savings be protected? CBFOs are driven by the mobilization of their members’ savings and will only succeed if those savings are safeguarded from loss, which can occur through misuse, poor record keeping, bad credit decisions or physical theft. If the project cannot be confident that members’ savings are not at risk of loss, the project should not be continued. Also, if a periodic review or evaluation of an existing project concludes that savings are at risk of loss, the project should be cancelled immediately and savings should be returned to the members before any further losses are incurred.

Are there controls to prevent elite capture? Local elites can manoeuvre themselves into positions of authority, which allows them to access funds as loans and then default. Elite capture can be guarded against using a variety of approaches, including: (i) limiting the loan size to a relatively modest multiple of the amount of savings the borrower has contributed; (ii) putting a ceiling, expressed as a percentage of the total amount of capital of the CBFO, that can be lent to any individual or group; (iii) specifying that office holders of the CBFO cannot borrow; (iv) monitoring of elite capture by loan officers or field agents during field visits who forcefully speak out when it occurs; and (v) preventing the provision of credit lines from governments or donors, which can increase vulnerability to elite capture.

Box 1: Common mistakes in supporting CBFOs

- **Making lines of credit directly available to CBFOs for on-lending to their clients.** IFAD's CPMs and PDTs may be put under pressure to provide quick access to external credit directly to CBFOs as a means to help them grow faster. This pressure must be resisted. Experience has shown that poorly designed access to external credit damages the CBFOs because it reduces the incentive of members to save, skews the emphasis of the institution towards borrowers rather than savers, leads to weakened credit analysis and leads to neglected loan recovery.
- **Providing external support to manage the CBFOs for their members.** CBFOs are intended to be community-owned and managed, and having external professionals undertake these tasks undermines their ownership and the sustainability of the CBFO. And yet, in the early stages, CBFOs do need help; therefore, support should take the form of mentoring and capacity-building. Some limited gaps may need to be externally filled where high-level professional expertise is not readily available.
- **Making the CBFOs supply-driven.** The CBFOs must not be pressured to absorb large amounts of technical assistance and support that they cannot realistically absorb just so that donors' disbursement requirements are met.

Source: (Rosenberg 2009)

Are CBFOs likely to be sustainable? Rural financial services must be sustainable for the long term, which is particularly important in the case of CBFOs since they are based on the mobilization of members' savings and the worst possible outcome is for members to lose their money. Thus, if there is a possibility that CBFOs will not become sustainable, resulting in the loss of depositors' money, the project should not go forward. The satisfaction of the preconditions, as well as attention to KPIs, should help determine whether the institution is likely to be sustainable.

Box 2: Characteristics of a sustainable CBFO

- Mobilizes sufficient savings to provide a good range of loans to its members
- Operates in a sustainable manner
- Pays near market rates of interest
- Follows best practices in management and governance
- Has a well-written constitution and sound rules and regulations
- Shows strong commitment by members to the success of the CBFO as witnessed by good attendance at meetings, low to no loan defaults, and effective management and governance
- Provides controls against elite capture
- Uses an external auditor for annual financial statements
- Remunerates its management.

Is there social cohesion? The targeted client base should have a common denominator or interest that enables them to coalesce into an operating group. Cohesion can be lacking in transient societies, where greater emphasis is placed on individualism than on acting collectively.

Are members participants and owners? In addition to being able to manage and save, members must also be prepared to take great interest in the CBFO's operations and attend all of its meetings. Without a strong level of support, CBFOs will not be sustainable.

Can the CBFO manage its own financial affairs? Most decentralized financial institutions are self-governing; thus, operational decisions and record keeping are executed by the members themselves. It is, therefore, crucial that the local culture allows for a relatively democratic approach to the election of CBFO officers, who are prepared to act in the best interests of the membership at large, and the group is able to maintain its own books and records so that all funds are accounted for. This requires that at least a few members have a minimum degree of literacy and numeracy, as well as the capacity and willingness to manage and record financial transactions.

Is there a qualified technical service provider (TSP)? The provision of technical assistance is critical for the CBFO to become sustainable within the life of the project and remain so thereafter. TSPs must be available at the field level where the project will be operating. The TSP should provide initial training and ongoing assistance and oversight. If this cannot be arranged, the project should not go ahead.

Scaling up

Monitoring in order to successfully support CBFOs

CBFOs should not be exempt from monitoring and evaluation, regardless of their size and informal status. A monitoring and evaluation system with clear KPIs needs to be built into the proposed project at the outset of the design, which enables continuous collection and analysis of data from a large number of small groups. Important points of attention for this monitoring system for CBFOs are discussed in Annex I. For additional information on KPIs, please refer to IFAD's *How To Do: Key Performance Indicators and Performance-based Agreements*: http://www.ifad.org/knotes.

Second-tier organizations

When proposing to support small, scattered CBFOs, consider working jointly with an existing second-tier organization. Working with a second-tier organization can provide economies of scale and scope, and can be advantageous for the CBFOs and IFAD in both ongoing operations and long-term sustainability of CBFOs.

It can take 5 to 10 years for a CBFO to become sustainable (IFAD 2010). Therefore, the strategy must include efforts that ensure that CBFOs continue to prosper after the project support ends. This phasing-out strategy will require either having CBFOs that are strong enough to stand alone, with the benefit that members will continue to operate them alone, or transferring support and oversight responsibilities to a successor organization. However, there are genuine concerns about the ability of CBFOs to function effectively over the long term without external support in key areas, such as auditing and performance monitoring. These functions can be provided by a support organization, networks or federations of CBFOs.

Types of second-tier organizations

Second-tier organizations (networks, associations, unions, federations and apexes[1]) can provide a range of services to the CBFOs. Another type of second-tier organization is an apex organization; linkages among CBFOs to form a second-tier organization can be horizontal or vertical:

Box 3: An example of a second-tier organization in Ethiopia: Keleta Savings and Credit Cooperative (SACCO) Union

Keleta SACCO Union was formed in 2005 with seven primary Rural Savings and Credit Cooperatives (RUSACCOs), which had 112 individual members. As of February 2012, the Union had a membership base of 17 primary RUSACCOs, with individual membership standing at 5,083. Keleta SACCO Union is mainly led by women and its members come together to pool resources to form a safety net. In forming the Union, the women had hoped to improve their livelihoods. They were inspired by Self Help Africa and IFAD.

[1] Apexes provide funding facilities to their members and affiliates. They are the subject of a separate technical note.

- **Horizontal linkages** (networks) are formed between primary CBFOs that individually lack the necessary scale or competence to supply the services they need but together may be able to do so. Forming a horizontal linkage may be a necessary precursor to identifying and developing a second-tier organization.

- **Vertical linkage** (federations, unions, associations) are formed between primary-level CBFOs and second-tier organizations (or other providers such as NGOs), which are used to supply services that cannot be provided by the CBFOs.

In case a second-tier organization has limited resources in terms of management, governance and funding, it should primarily focus on information dissemination. As it strengthens its internal capacities and financial position over the course of time, this role can be expanded to include other services, such as political lobbying, brokering services from external suppliers, undertaking performance monitoring and establishing benchmarks. If the second-tier organization and its participating CBFOs are relatively sophisticated, the organization can provide services in training and capacity-building, and offer consulting services to CBFO members. In an extremely sophisticated operating environment, they can broker access to funds from third parties and undertake self-regulatory activities (Gross and Bruntrup 2003).

Advantages of working with second-tier organizations

Economies of scale: Second-tier organizations reduce the per unit costs of technical assistance because support can be channelled to a wide range of small CBFOs that cannot be supported individually. These organizations encourage the development of the meso level since affiliated services will emerge to work in a relatively large market that does not exist with unaffiliated CBFOs. In addition, they enhance the possibility of linking to the formal financial sector.

Economies of scope: Second-tier organization provide access to training and technical assistance on best practices in microfinance and a platform to introduce standardized operating procedures that comply with best practices. They also create a mechanism for building a network with other CBFOs and institutions involved in rural finance, which can lobby government and donors regarding the needs of small rural CBFOs and their clients, including support with the distribution of training courses and materials.

Disadvantages of working with second-tier organizations

Losing local identity: CBFOs may have to sacrifice some of the benefits of local identity and control in order to obtain a broader range of services. For example, the value of having local, familiar ownership can conflict with the benefits of being part of a more distant, large-scale, professionally run institution. Second-tier institutions should not be imposed on small local institutions unless the members will gain real advantages.

Being both local and networked can prove quite challenging for governance. Two-tier CBFOs have two overlapping governance systems, one at the local level and another at the second-tier level. The financial intermediation role warrants strong oversight, in particular, where the second-tier collects savings from the groups. Where decisions were made by second-tiers or management, member oversight becomes more difficult and members have a weaker sense of ownership.

Box 4: An example of second-tier organization in the United Republic of Tanzania: Dunduliza Savings and Credit Cooperative (SACCO) network

Dunduliza network is a company that is 100 per cent owned by 50 SACCOS in seven regions. Their objective is "to establish and service financially and operationally sustainable SACCOS that provide members with secure and adapted financial services; and access from Dunduliza network the best practices based on technical, financial and professional services". Seventy-five per cent of the SACCOS in the network are rural. The SACCOs sign a Memorandum of Understanding (MOU) and use adapted and standardized operations developed by the network. The network develops business plans for each SACCO and provides ongoing technical support.

Dunduliza is supported financially by Financial Sector Deepening Trust and receives technical support from Development International Desjardins of Canada.

Design and implementation of a second-tier organization

CBFOs typically need assistance in selecting appropriate second-tier organizations and managing the relationship. In many cases, federations or NGOs can deliver services that are equal to that of private providers.

Second-tier organizations offer various services but their ability to deliver will depend on their level of sophistication. It is, therefore, important for the CPM and the PDT to carefully match the designated tasks with the ability of the second-tier organization to carry them out. Selecting a strong organization is key to the success of the intervention.

A strong second-tier organization should include, but not be limited to, the following characteristics:

- The organization is legally registered.
- There is a critical mass of member CBFOs who are oriented towards achieving sustainability.
- Members must share a strong common concern.
- There is acceptance by the local government that the organization speaks on behalf of the CBFO sector.
- The organization has access to long-term financing either by membership fees, a long-term strategic donor or both.
- Management of the organization must not be subject to elite capture by the more powerful members.

Additional resources

Links to other How To Do documents

- How To Do: Key Performance Indicators and Performance-based Agreements

Standardized templates, formats, other models and tools

- Key Performance Indicators for Community-based Financial Organizations (CBFOs) (see Annex I)

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Annex I: Key performance indicators for community-based financial organizations (CBFOs)[2]

Both microfinance institutions (MFIs) and credit unions have shown improved financial and management performance as a result of having and utilizing performance standards (Hirschland, Jazayeri and Lee 2008); similarly, CBFOs should not be exempt from monitoring and evaluation, no matter how small or informal they may be. Although the level of formality will dictate the level and type of monitoring, a solid monitoring and evaluation (M&E) system needs to be built into the proposed project at the outset of the design, which enables the continuous collection and analysis of data from a large number of small groups. Setting up an effective system includes the following steps (scaled to the size of the institution).[3]

Step 1. Introduce a standardized accounting system adapted to the type of CBFO being supported

As a base for good financial management and administration of any CBFO, the following should be in place:

- adequate accounting and adequate policies and procedures manuals
- written portfolio management policies
- adequate asset/liability management
- appropriate cash and liquidity management.

Step 2. Establish a set of key performance indicators (KPIs)

Setting the KPIs should depend on the type of CBFO and the objectives of the support (e.g. outreach to a particular target group; sustainability for safeguarding savings). Starting with a baseline survey, a management information system (MIS) should be developed that tracks KPIs on outreach and organizational performance. Given the importance of local ownership for a CBFO, members' own indicators (financial and/or pictorial) should be balanced alongside the indicator requests from donors or governments (Dhan 2003 in Hirschland, Jazayeri and Lee 2008).

Implementation of KPIs depends on the CBFO's level of formality. More formal CBFOs require analysis of the individual performance, just as with MFIs, while with informal CBFOs, it is more prudent to analyse and manage performance at an aggregate level or to select random samples. Frequency is also dependent on the model; more formal CBFOs should report more frequently (ideally quarterly); informal CBFOs can report less frequently, usually based on the length of the cycle and the average terms of the loans.

Step 3. Build in technical support to a supervising entity

A supervising entity may already be working with the CBFOs in a support capacity and it should be able to collect and analyse information. This role could be assumed by one or more of the following:

- field agents/loan officers: collecting KPIs at the CBFO level to then be consolidated at a regional or district level, if necessary, before being forwarded to the project management unit (PMU) level for project-wide consolidation
- linked formal institution: where the CBFO is linked with a more formal institution such as a bank.

[2] Refer to IFAD's How To Note on Key Performance Indicators for additional information.
[3] Ideas adapted from Vogel 2002; Ritchie 2007; Hirschland, Jazayeri and Lee 2008; IFAD 2010; and Rosenberg 2009.

- second-tier organization: provided that they have the clear mandate, capacity and funds to collect and analyse performance indicators. Compliance could be better enforced if this organization is also offering other services needed by the CBFO, such as liquidity support.
- regulator: for more formal CBFOs, such as credit unions or savings and credit cooperatives (SACCOs) where a regulation law exists in the country. Compliance could be incentivized by offering additional needs-based support to the CBFOs which voluntarily submit their data.[4]
- government: even for unregulated CBFOs, the government can still encourage the diffusion of simple performance indicators.

More formalized CBFOs, such as credit unions and SACCOs, with sophisticated operations and reporting capacity should be treated similarly to MFIs. Some credit unions and cooperatives already report on the Microfinance Information Exchange (MIX) and/or use the internationally recognized PEARLS monitoring system of the World Council of Credit Unions (WOCCU). For smaller CBFOs (e.g. funds managed by members of the community), record keeping can be more limited and performed manually, although key areas of performance can and should still be tracked. International efforts are currently working on encouraging standardized performance monitoring of more decentralized CBFOs, most notably the SEEP Network and the nascent reporting system and data platform Savings Groups Information Exchange (SAVIX).

At all levels, these statistics should be treated as an active management tool rather than just passively collected. The objective of collecting and monitoring indicators is to move the CBFOs towards better financial discipline and to encourage improved outreach and governance. KPIs should be analysed on a trend basis and feedback should be provided to the various implementing levels to help improve overall performance. These consolidated results, in addition to analysis, should be regularly provided to the project manager and CPM, depending on the length of the cycle and the level of aggregation of the reporting.

The table below provides an overview of suggested KPIs for all CBFOs. Even at the most informal level, it is crucial to track at least two outreach indicators and one performance indicator such as repayment. Repayment rates are a critical indicator of risk since they describe the safety of members' savings and, thus, the sustainability of the institution. Poor repayment performance may indicate that an institution does not promote a savings culture or is subject to elite capture. If the programme is supporting a large number of highly decentralized, informal groups, it is enough to analyse a random sample (Rosenberg 2009).

4 This is similar to the system for Indian MFIs.

Overview of suggested KPIs applicable to CBFOs

Indicator	Definition/calculation	What it measures
Outreach: To indicate the size, which can also have sustainability implications, and if the target group is being reached		
Outreach: *Breadth*		
Average number of members per group	Total number of members /total number of groups	
Women members (%)	Registered women/total number of members	Whether the institution is reaching enough women
Outreach: *Depth (client poverty level)*		
Average savings per member mobilized to date	Value of savings outstanding/number of active members	Level of confidence in CBFO
Average outstanding loan size	Value of loans outstanding/number of loans outstanding	Indicates changing debt capacity of members
Total value of gross loan portfolio	Total outstanding principal of all outstanding loans (includes all loans current and non-current; excludes non-microfinance loans, interest receivable and loans that have been written off)	Shows the total value of loans made by the CBFO at a certain time, which can be compared with the total estimated time demand for microcredit in the market
Performance		
Risk: *Repayment*		
Portfolio at risk (PAR) > 30 days	Outstanding balance of all loans with a payment later than 30 days/gross loan portfolio x 100 Value of outstanding loans that have an instalment past due by more 30 days, as a percentage of the value of the entire portfolio of all outstanding loans Include the outstanding value of all renegotiated loans, including rescheduled and refinanced loans, because they have higher than normal risk, especially if a payment is missed after renegotiation	PAR is the best way of depicting the risk of a CBFO's loan portfolio The lower the percentage, the healthier, less risky the loan portfolio and the safer the members' savings Any CBFO that is capable of collecting the "Outreach: *Depth"* indicators as per above should be able to report on PAR Note: For groups linked with formal financial institutions, PAR might show a better result for timely repayment of the loan to the formal financial institution but at the same time a poor result for timely repayment of internal CBFO funds from members to the CBFO (Ritchie 2007)
Optionally: Loans at risk (LAR) > 30 days	(Number of all loans with a payment over 30 days late/ total number of outstanding loans) x 100	The lower the percentage, the healthier, less risky the loan portfolio While PAR is the best indicator for understanding portfolio risk, some small or fledgling CBFOs – particularly small community-based time-bound savings groups and small community-based accumulating savings groups – do not have loan tracking systems that are sophisticated enough to calculate PAR but they should be able to calculate LAR, a simpler indicator that counts the number of loans instead of their amounts If the repayment rate is roughly the same for

Indicator	Definition/calculation	What it measures
		large loans and small loans, LAR will not be much different than PAR.
Sustainability		
Operational self-sufficiency (only for CBFOs that are not time-bound and are accumulating)	Financial revenue from the income statement divided by financial expense + loan loss provision expense + operating expense from the income statement	Overall performance and sustainability How well a CBFO covers its costs with its operating revenue and how reliant it is on donor funds The smaller the loans the CBFO makes and the higher their relative cost (i.e. more rural outreach), the lower this ratio

Note: Indicators for credit unions under the PEARLS system are split into five categories as follows: Protection (adequate loan loss protection and protection of assets); Effective Financial Structure (to determine growth potential and overall financial strength); Asset Quality (e.g. non-productive or non-earning assets); Rates of Return and Costs; Liquidity; Signs of Growth.

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Indonesia - National Program for Community Empowerment (PNPM)

International Fund for Agricultural Development
Via Paolo di Dono, 44 - 00142 Rome, Italy
Tel: +39 06 54591 - Fax: +39 06 5043463
E-mail: ifad@ifad.org
www.ifad.org
www.ruralpovertyportal.org
ifad-un.blogspot.com
www.facebook.com/ifad
instagram.com/ifadnews
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