

REACHING THE HARD TO REACH:

Comparative Study of Member-Owned Financial Institutions in Remote Rural Areas

SYNTHESIS PAPER

Financial Services in Remote Rural Areas: Findings from Seven Member-Owned Institutions

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with Renée Chao-Béroff, Malcolm Harper and Nanci Lee

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**Reaching the Hard to Reach:
Comparative Study of Member-Owned Financial Institutions in Remote Rural Areas**

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Abbreviations

AGDF	Affinity Group for Development Finance
LPD	Lembaga Perkreditan Desas
MFI	Microfinance institution
MOI	Member-owned institution
MACS	Mutually Aided Cooperative Society
MC2s	Mutuelle Communautaire de Croissances
MIS	Monthly Income Scheme
NGO	Nongovernmental organization
PACS	Primary Agricultural Credit Society
SACCO	Savings and credit cooperative
SHG	Self-help group
VSLA	Village savings and loan association

Executive Summary

Interested in expanding financial services to remote-rural areas, the Ford Foundation Affinity Group for Development Finance commissioned a set of studies on member-owned financial institutions (MOIs). The studies include a literature review, seven case studies, and three thematic papers on key drivers of MOI outreach—internal governance, federations and linkages to external agents, and regulation and supervision.¹ This paper synthesizes the findings from the cases and the papers. Its purpose is to better understand what types of MOIs and MOI support structures might best serve remote-rural populations, particularly the poor. Because MOIs run the gamut from neighborhood self-help groups to national cooperative networks, this paper starts by presenting a simple typology of MOIs.

MOI Outreach

The seven case studies generated the following observations about MOI outreach.

Depth: The case studies suggest that the poor are largely rural and the rural are largely poor. The rural poor have vastly less access to financial services and the MOIs' geographic roots or social missions enable them to reach more and poorer rural markets than other types of institutions. The MOIs that reached the most sparsely-populated areas were large: one was a remote branch of a 23-branch mostly rural cooperative in Ecuador. The MOIs with the next most remote outreach were small unlinked village savings and loan associations (VSLAs) in Niger.

The groups serve a poorer clientele and more women than the other MOIs. This seems to be a function of their product terms and ability to serve exclusively the poor. Other MOIs' poverty outreach may be a function of working in more rural and poorer areas: although they serve poorer markets than other types of financial institutions, their members may still be somewhat better off than the overall population in their service areas.

Where MOIs serve primarily men, the gender imbalance has the same roots as that of other financial institutions: a focus on agriculture which is dominated by men, collateral requirements that women cannot meet, or social norms.

Breadth: Neither roots in local governance structures nor a history of social activism for members ensures high penetration. However, some MOIs serve nearly all households in their service areas. The promotion of groups can reach large numbers quickly.

Scope: Although groups provide the most limited services, they can determine their product terms, and payment schedules may accommodate personal emergencies. The largest product ranges were offered by the MOIs that were very large, linked or federated. At the same time, the small non-group MOI had a wide range of products, comparable with several larger MOIs. Transaction sizes—

¹ The case institutions are: the Bararanga Primary Agricultural Credit Societies and its linked self-help groups (SHGs) in West Bengal, India; SHGs federated into the Jeevan Mutually Aided Cooperative Society (MACS) in Andhra Pradesh, India; the Muntigung LPD in Indonesia; the village savings and loans associations (VSLAs) in Niger; the Mutuelle Communautaire de Croissances (MC2s) in Cameroon; the Mixtlan Savings and Credit Cooperative in Mexico; and the Jardín Azuayo Cooperative in Ecuador.

measured as percentages of per capita GNI—increased with the size of the MOI. Groups had much smaller sizes than larger MOIs.

Costs to Members: Because they are closer by, small MOIs often impose lower transaction costs on clients than other types of financial institutions. Many extend their services or hours to meet the demand of remote markets or emergency needs. Their interest rates and efficiency vary. Groups charge high rates but capture the interest themselves. Concerning the perceived risk of losses, members tend to trust local, friendlier staff, government-sponsored institutions, and institutions that are deeply engaged with or have a long history in the community. Groups are trusted more than other MOIs.

Worth to Members: Above all, members seem to care about proximity, loan size, and quick emergency access. They also care about the MOI's trustworthiness, interest rates, suitability of loan terms to members' desired use, and speed of access.

Length or Sustainability: Unlinked groups that periodically disburse all their funds seem to have much more potential for quick sustained remote-rural outreach than other groups, which may require ongoing support. MOIs that start dependent on external support may lack the drive to rid themselves of costly support and staffing patterns. Ties to traditional local authorities might strengthen governance, repayment and sustainability—but also might not. A federated MOI can serve remote-rural areas and still recover full costs.

Key Drivers of Outreach

Governance

External capital, returns and perceived ownership: Members are more likely to safeguard money that they perceive as their own rather than as external capital. While linking member-owned groups to financial institutions can expand rural outreach, it also can lessen members' sense of ownership and MOI performance. Members perceive themselves as owners when their money comes back to them in the form of ready access to their funds, reasonable returns, or profits used to benefit their families or community. So for example, group members felt less ownership when their savings were held in a second-tier MOI.

Member-ownership did not guarantee trust or patronage if services were not competitive or flexible enough. Member did feel a strong sense of ownership when the institution was both in the community and benefited the community socially. But a sense of ownership did not ensure that members held each other and the institution accountable.

Governance challenges and approaches for different types of MOIs: Small autonomous groups and larger MOIs seem to have the strongest forms of governance and accountability. Autonomous groups that regularly disburse their funds retain accountability in the hands of members. These small associations keep transactions simple and use witness-style governance, local norms for organizing and often oral bookkeeping. Complex external reporting requirements can threaten groups' ability to keep their own records or to supervise others to do so.

Large sophisticated networks or cooperatives are able to effectively combine internal controls with external regulation and supervision including audits. In part, they are able to do this because there is

a level of standardization across the system. Building large decentralized institutions is about determining how members naturally organize locally. The complexity of products affects the complexity of governance. More products or more sophisticated products require more complex systems and professionally-trained management that in turn, make member oversight more challenging.

Being local and networked proves quite challenging for governance. Where decisions were made by higher-tiers or management, member oversight became more difficult and members had a weaker sense of ownership. Two-tier MOIs have two overlapping governance systems, one at the group or association level and another at the second-tier level. Particularly where the second-tier collects savings from the groups, the financial intermediation role warrants strong oversight.

The MOIs that aimed to have one association per village or community faced a unique governance challenge. In grafting onto the local governance structure, they used social capital and local leadership in positive ways. However, relying on social controls by local leaders can reinforce local power structures. These village-based MOIs are particularly prone to elite domination. Other mechanisms may be required to hold this system in check.

Balancing standardization and control with flexibility and decentralization: While decentralization may be important for flexibility and tailoring to local needs, some level of standardization is essential to control risks. Larger MOIs with a more diverse product range and networked associations require a certain amount of standardization in order to permit adequate oversight and control.

As MOIs begin to accumulate rather than regularly disburse funds, their transactions become more complex and member oversight becomes more challenging. As the MOI becomes larger and more sophisticated, it needs mechanisms for keeping members engaged. The key is keeping some form of decentralization while ensuring enough standardization for control.

Federations and Linkages

The cases suggest the following lessons and guidelines:

- The value an MOI derives from its relationship to a second-tier or external institution rests in part on the origins of their relationship and the type of services it receives.
- Local, familiar management and ownership conflict with the benefits of being part of a more distant, large-scale, professionally-run institution. MOIs have to sacrifice some of the benefits of local control in order to obtain a broader range of services.
- Secondary-level MOIs should not be imposed on small local institutions unless the members will gain real advantages. Very poor people who live in remote areas have the least need for the kinds of sophisticated services that linkages or federations can provide, and are the least able to manage such linkages. NGOs should avoid promoting groups of groups in order to provide themselves with convenient delivery channels for other services.
- State-promoted entities are not usually the best basis for a mutually-beneficial and sustainable relationship with members.

- Without assistance, MOIs cannot select and manage relationship with linkage institutions.
- “Vertical” linkages, between primary level MOIs and secondary level institutions or other providers, can supply services that the primary level cannot supply itself. “Horizontal” linkages between primary MOIs that individually lack the necessary scale or competence to supply the services they need but that together may be able to do so, may be a necessary precursor to identifying and devolving “higher level” service providers.
- In many cases, private providers would be unlikely to provide the services better than federations or NGOs do. However, cooperatives are not necessarily always the best source of services for other cooperatives.
- Finally, it may be no coincidence that the most effective institution of the case institutions was large and self-contained. Linkages are not the solution to every problem.

Regulation and Supervision

Consensus is needed on core principles of regulation and supervision of MOIs in order for the MOI sector to move forward.

Which MOIs should be regulated and supervised? Small time-bound MOIs should not be regulated. Other small MOIs might be freed from regulation if they are linked with and overseen by a regulated financial intermediary. Alternatively, small and medium-sized MOIs might be required to form networks to which some supervisory functions could be delegated. The network might collect data and oversee high-level internal control of its member MOIs. The supervisory authorities would supervise the network and its capacity to provide credible on-site control and individual MOIs to check for compliance, randomly check reported data, and enforce prudential requirements. However, although supervising networks rather than individual MOIs would be more cost effective, it might curtail deep outreach by excluding small remote MOIs.

Not regulating young MOIs may enable them to innovate. Regulation should be triggered by an MOI putting more people, the sector, or the financial discipline in a geographic area at risk. It should be triggered by the nature of activities rather than legal status with requirements adjusted for rural MOIs.

Requiring “promoters”—NGOs, consulting firms, donors or government projects—to have a credible strategy for institutional and financial sustainability can help depositors and the sector by halting competition from subsidized schemes that undermine the strength of other financial institutions. It may however, burden supervisory authority.

What about a tiered approach? A tiered approach can avoid either overburdening less risky, remote rural MOIs or treating laxly or ineffectively large bank-like cooperatives. Increased risk might trigger greater reporting, auditing and capital adequacy requirements. Assessing the direct costs to an MOI of being regulated—from capital adequacy to provisioning, reporting, staffing, MIS, and controls—will help determine what size MOI can absorb such investment and operating costs.

Who should supervise? Regulation should be by one specialized supervision authority such as the Central Banks. This agency can propose whether licensing and supervision should be undertaken by a special unit or by the same inspectors that oversee banks. Splitting regulation and supervision between two entities creates confusion, distorts the markets and weakens the MOIs. Third-party supervision can be problematic. Refinanciers may have conflicts of interest, be too distant or may lack human resources. Audit firms or banks may be costly and illegal.

What to supervise? A good regulation is one that both parties understand and can implement: It should be simple yet strict on core principles and affordable so as to encourage rural outreach. Regulation should define core principles of **good governance** rather than detailed management rules, operational procedures, and products. In remote rural areas, mandating board qualifications will empower elites and lower community ownership. Where illiteracy is high, external auditors or private service providers could be used instead of a Supervisory Committee.

Allowing **solidarity mechanisms** to secure loans without requiring additional provisioning is essential for the sustainability of MOIs that seek to serve the poor and women, who may not have collateral. Not restricting **external credit** can damage MOIs, but restricting it too much can limit outreach, products, and sustainability. Allowing **non-financial activities** such as marketing, can put savings at risk. **Interest rate caps** can impede MOIs from covering their costs and the costs of higher level tiers or service providers whose services are essential. Regulation should provide **suitable graduation paths** for small rural MOIs: Transforming into a multi-tiered cooperative may not suit the local context, stimulate participation or strengthen governance as much as other options.

Costs of supervision: The costs can be managed by delegating certain functions to networks and combining on-site and off-site supervision. Donor support might still be needed initially to develop procedures, train inspectors, and obtain software. MOIs might be required to pay a small percentage of their annual surplus for supervision.

As a way forward, we join some key stakeholders in recommending:

- A Basel Accord-like process to develop international guidelines for MOI regulation as proposed by Cuevas and Fischer (2006).
- Or, more pragmatically, an international task force of experts, promoters, and practitioners to build consensus on good practice for MOIs operating in rural areas and to identify norms, standards, and related risks as a step towards appropriate regulation and supervision.
- Simultaneously, an analysis of how regulation and supervision frameworks affect MOI sustainability and rural outreach that can be used to raise government and central bank awareness.

Financial Services in Remote Rural Areas: Findings from Seven Member-Owned Institutions²

Microfinance has attracted great interest because of its potential to alleviate poverty or, at least, poverty's worst effects. To expand financial services to the poor, attention and funds have flowed primarily to non-governmental organizations, commercial institutions and public banks to the neglect of member-owned institutions (MOIs). Bucking this trend, the Ford Foundation Affinity Group for Development Finance (AGDF) commissioned a set of studies on MOIs, including seven case studies of remote-rural MOIs that display strong outreach. These cases resoundingly affirm Ford's assumption: If we want to expand financial services to the poor, MOIs merit attention.

For the countries in which the case institutions operate, the case studies suggest that the poor are largely rural and the rural are largely poor. The rural poor have vastly less access to financial services and many of the institutions positioned to serve the rural poor are member-owned.

- In Cameroon, 84% of the poor live in rural areas and 61% of the rural population is poor. The markets served by commercial banks are solely urban and those served by MFIs are largely semi-urban. In contrast, 75% of the country's MOIs are based in rural areas.
- Over 72% of Indians live in rural households (Census of India, 2001) nearly half of which lack access to banking services. Member-owned self-help groups (SHGs) provide financial services to an estimated half of all poor Indian households while member-owned agricultural credit societies have twice the number of branches as all the country's commercial banks, cooperative banks and microfinance institutions (MFIs) combined.
- In Niger, 80% to 90% of the population does not have access to financial services (IMF, 2007). The ratio of bank branches to potential clients in the capital is 1:33,700; elsewhere the ratio is 1:844,000. Member-owned village savings and loan associations (VSLAs) seem to serve nearly two-thirds the number of clients as all other MFIs combined.
- In Ecuador, 37% of the population lives in rural areas and 60% of the rural population is poor. Cooperatives account for over two-fifths of the microcredit market and their share of GDP is growing.
- In Mexico, nearly three-quarters of municipalities have no bank branch while over half of registered MOIs serve primarily rural areas.
- Despite the renowned outreach of the Bank Rakyat Indonesia (BRI), a survey by the bank itself found that almost two thirds of village households in Indonesia still do not have access to formal or semi-formal financial services. Unlike the BRI and BPDs, institutions with broad outreach that are not member-owned, the member-owned LPDs have a significant village-level presence throughout Bali.

This context calls us to look carefully at how and how well MOIs serve remote-rural populations and the factors that affect this performance.

² The authors gratefully acknowledge the unflagging and invaluable support of Nanci Lee and Derek Cameron.

Purpose, Conceptual Framework and Structure

To shed more light on MOI outreach, the Ford Foundation AGDF commissioned several pieces: A review of the literature on member-owned financial institutions, seven case studies, three thematic papers that derive insights from the cases, and this final synthesis report (See Appendix B for a summary of the findings from the literature review). This report analyzes and generates findings from the case studies and thematic papers, and places them in the context of observations and debates highlighted in the literature review. Our purpose is to understand the potential outreach of different types of MOIs and how we might help MOIs achieve this potential. We use the cases to better understand what types of MOIs and support structures might best serve remote-rural populations and in particular the poor.

As in the other Ford MOI studies, we frame our findings using Schreiner's (1998) aspects of outreach, three drivers of outreach, and a simple typology of MOIs. We define the aspects of outreach as follows:

Depth, the value we attach to the net gain of a given client. For example, we value more highly benefits to people who live in more rural areas; **Breadth**, simply the number of people served or, where an MOI is bounded geographically or in some other way, its penetration rate;

Length, the time frame of supply which encompasses both financial and institutional sustainability;³

Scope, the range of services provided and the variations within them;

Worth, the value members derive from participating in the MOI which hinges in part on the fit between the MOI's services and member demand; and

Cost to members such as the sum of financial costs, transaction costs, and potential losses due to fraud, theft or mismanagement.

The literature on MOIs focuses on three key drivers of outreach: internal governance including structures, bylaws and local oversight; participation in federations and linkages to external agents such as donors, suppliers, and NGOs; and regulation and supervision.⁴

These aspects and drivers help us organize our findings. At the same time, MOIs run the gamut from neighborhood self-help groups (SHGs) to village-owned institutions and national cooperative networks. Their outreach and governance vary widely. Being able to think about how different types of MOIs behave and perform can help us make sense of what we learn and more effectively support their remote-rural outreach. Therefore, we define a typology of MOIs.

³ Financial sustainability is the ability to cover financial, operating and loan loss provision expenses with operating income after adjusting for inflation, the market cost of capital and subsidies. Institutional sustainability is the capacity and will of the governing body, members and staff to provide ongoing services.

⁴ For purposes of this study, the terms *federations* and *networks* (and *federating* and *networking*) are used interchangeably. For the sake of consistency, we shall use the terms federate and federation except in regards to specific named institutions that are commonly called a network, for example, the MC2s network.

First, we distinguish types of MOIs by their size, that is, whether an MOI is small enough for its members to assess each other's debt capacity, follow up on delinquency, and monitor operations - in other words, whether or not "peer monitoring" can be effective. Of the MOIs that are too large for peer monitoring to be effective, some are large enough to afford internal controls and attract government supervision that can compensate for the lack of peer monitoring while others occupy a more challenging middle ground. Second, we recognize that the operations of a small MOI that disburses its funds periodically are significantly simpler and more transparent than one that accumulates its funds continuously. This may affect whether external support and oversight is needed. These distinctions lead us to the following typology:

Small MOIs that are time-bound: These are groups in which all members participate in all decision-making and periodically disburse all their funds. These groups tend to have a handful to several hundred members: peer monitoring is effective;

Small MOIs that accumulate funds: These might be groups in which all members participate in all decision-making. Alternatively these might be democratic MOIs, in which members elect representatives to govern, and these volunteers or paid staff manage day-to-day decisions. In both cases, these MOIs are small enough for peer monitoring to be effective: their maximum size will vary by context but would not exceed a few hundred members;

Medium-sized MOIs: With several hundred to several thousand members, these MOIs are governed by elected representatives and rely largely on paid staff. MOIs of this size face a particular challenge: though too big for peer monitoring to work, they are too small to afford or attract some of the controls that replace it, for example, professional auditors, more skilled staff, and government supervision (Wanjau, 2007). At the same time, local roots may provide them with some community oversight;

Large MOIs: These MOIs rely completely on professional management and are governed by elected representatives. However, their larger size enables them to cover the costs of skilled staff and attract direct or delegated supervision from the government. These MOIs do not benefit from peer monitoring or community oversight, in fact may look more like banks than like community-owned institutions. They have from several thousand to, in some cooperative banks, over one million members.

With this framework in mind, we introduce our case studies, looking first at their outreach and then at three factors that drive it.

Part I: Outreach of the Case Study Institutions

To better understand the potential outreach of MOIs, the research team studied different types of MOIs from different regions. We wanted relatively transparent MOIs with strong remote-rural outreach, which were near or completely financially sustainable. We also wanted institutions whose experience could be useful to other institutions. We chose the following MOIs:

Bararanga Primary Agricultural Credit Society and its linked SHGs, West Bengal. In West Bengal, India, the linkage between self-help groups and Primary Agricultural Credit Societies (PACS) is particularly interesting because the regulation allows SHGs to be members of PACS, which represent 69% of the rural financial branch infrastructure (NABARD, 2007);

SHGs Federated into the Jeevan Mutually Aided Cooperative Society (MACS), Andhra Pradesh. In the tribal belt of the Andhra Pradesh, India, the Jeevan MACS SHG federation is largely comprised of and governed by lower-caste women. It operates under the new APMACS legislation that enables SHG federations to free themselves of the Indian Cooperative Act;

Muntigunung LPD, Bali. The Muntigunung LPD is one of a set of village-based financial institutions in Bali, Indonesia that are governed by traditional village councils. The LPD actively serves 24% of the village's 1020 residents, which is located in a relatively poor area 45 km from any other financial institution;

Village Savings and Loans Associations (VSLAs), Niger. The oldest and largest of CARE's thirteen VSLA programs in Africa, the Niger program serves about 130,000 women with a simple savings and lending methodology. The case study looks at this simple but evolving type of MOI in a region with a population density of 10-25 persons per km²;

Mutuelle Communautaire de Croissances (MC2s), Cameroon. These two MC2s, Njinikom and Bambalang, operate 65 km and 85 km respectively from the provincial capital in an area populated by 107 persons per km². With 3,512 members, many in informal groups, these MC2s rely on a bank and NGO linkage for financial and management support;

Mixtlan Savings and Credit Cooperative (SACCO), Mexico. A 47-year old rural SACCO with 3,452 members and a 90% penetration rate, Mixtlan is one of just a few rural members of a large, highly-rated urban-rural federation. Mixtlan's federation membership enables it to offer a range of services including remittance and bill-paying services;

Jardín Azuayo Savings and Loan Cooperative, Ecuador. Jardín Azuayo is a sustainable, decentralized cooperative that serves 80,378 members with twenty of its twenty-three offices in rural areas. This case examines five profitable rural offices with 29,260 members, one in an area with a population density of six persons per km².

Appendix C describes the cases in more detail. As Table 1 indicates, they include small time-bound and accumulating MOIs⁵, and medium-sized and large MOIs. Two come from Africa, three from Asia, and two from Latin America.

Table 1: MOI Typology: Where the Case Studies Fit

Small MOIs		Large MOIs	
Time-bound groups	Accumulating-fund groups & other MOIs	Medium-sized MOIs	Large MOIs
<ul style="list-style-type: none"> ▪ time-bound VSLAs (unnetworked) 	<ul style="list-style-type: none"> ▪ accumulating VSLAs (networked) ▪ Muntigunung LPD 	<ul style="list-style-type: none"> ▪ Bamb. & Njin. MC2s ▪ Jeevan MACS 	<ul style="list-style-type: none"> ▪ Bararanga PACS ▪ Jardín Azuayo Coop. ▪ Mixtlan Coop.

Depth of Outreach

Remote-Rural Outreach

Case institutions compared to other types of institutions: Studies of financial landscapes reveal that even where markets are considered saturated, microfinance is often primarily urban and peri-urban. The Ford case studies suggest that MOIs tend to reach more and poorer rural markets than other types of financial institutions. In each case, at least one of the primary MOIs was serving a rural area that other types of institutions were not. In some cases, this was dramatic. For the two study areas served by VSLAs in Niger, the closest microfinance institution or cooperative was 45 and 160 kilometers (km) away, respectively.

Some of the MOIs serve more remote-rural areas because their roots or charters define for them a rural domain. For example, the LPDs of Bali are village-based institutions and serve more remote areas than either the famed Bank Rakyat Indonesia (BRI) or the well-known BPDs that rarely serve villages. The case study LPD is located in a poor remote settlement and uses a single room donated by a local charity as the office for its three staff.

MOIs also are driven to more remote areas than other financial institutions by their social missions.⁶ In discussing their deliberate outreach to more rural areas, managers from the MACS and the PACS talked about the higher cost and effort involved. The commitment to reach these areas is also evident in the extension efforts of the MC2s and Mixtlan. The latter uses a mobile collector to serve a remote locality 137 km from its nearest branch. Half of that locality's 760 residents are members, which gives them the weekly opportunity to save, take a loan or pay their utility bills. Although the MOIs that make these efforts aim to be financially sustainable, their social missions drive them to go the costly extra mile.

Different types of MOIs: The MOI literature suggests that small MOIs achieve more remote outreach than larger ones. In this context, our findings contain a surprise. Using population density as a proxy for remoteness, the case institutions that reach the most remote area with population

⁵ Because each villager is automatically a member, the LPD officially has 1,020 members, placing it squarely in the category of medium-sized. However, counting members with some active financial stake in the MOI seems more accurate. With 240 borrowers and savers, the LPD looks and acts more like a small MOI.

⁶ Although many MFIs also have a social mission, they tend not to be tethered to rural areas and the industry's push to attain sustainability quickly tends to focus them on urban and peri-urban areas.

densities of just six people per square kilometer (km²), are not small. Rather, both are large and one is a decentralized branch of Jardín Azuayo, the largest MOI in our study with over 80,000 members.

Although 20 of Jardín Azuayo's 23 branches are rural, the Limón branch is more so than the others. The other remote branches we studied are located in areas with a much higher population density, from 60 to 678 people per km². Nevertheless, like all the Jardín Azuayo branches, Limón operates profitably. It has a delinquency rate of just 0.2% and a low operational cost ratio of 1.3%. However, its total portfolio and average loan size, US\$2,993, is larger than that of nearly two-thirds of the cooperative's other branches. As a percentage of per capita GNI—68%, its average loan size is much higher than most of our other case studies.

Less surprising, the case institution that achieved the next most remote outreach was the VSLAs, small accumulating-fund groups that historically were not systematically linked to another financial institution. The remote outreach of the VSLAs is not an anomaly: All those studied serve areas with a population density of 10 to 25 people per km², areas that rely primarily on subsistence farming, that have no electricity, cell phone or land line communication, and where residents must use a motorcycle to get to public transport. In comparison, the MC2s in nearly-neighbouring Cameroon serve rural areas that are five to ten times more densely populated.

Poverty Outreach

In all the cases, MOIs are reaching poorer people, or a higher proportion of their clientele are poor than are with other types of financial institutions. This is true even where the other institutions are serving the same geographic area. To some extent, MOIs' deep poverty outreach is a function of where they work. However, member-owned groups may reach poorer people than the other MOIs and financial institutions reach because of how they work.

Even where other types of financial institutions are present, the case MOIs often serve a poorer clientele. For example, according to the Government of India, PACS serve a significantly poorer population than rural or commercial banks. Although loan size is not a perfect proxy, it is striking that 35% of the loans of the regional rural banks are for US\$2,400 or more as compared to just 10% of the PACS' loans. Similarly, using average loan size and average outstanding savings balances as proxies, the LPD shows far greater depth of outreach than other rural financial institutions like the BRI units and BPDs.

However, even though MOIs typically serve a poorer population than other financial institutions, they do not necessarily serve a relatively poor population within their service area. The experience of the Mixtlan cooperative seems to be typical of remote rural MOIs that are managed by elected representatives. Mixtlan has high poverty outreach because it works in remote rural areas that are relatively poor. Although the poverty rate in Mexico is 52%, the poverty rate in the Mixtlan cooperative service area is higher, 76%. But, the poverty rate among Mixtlan cooperative members is just 62%. In other words, the cooperative is serving a *lower* percentage of the poor than is present in its service area but, because its service area is relatively poor, it is serving a higher percentage of the poor than is present in Mexico's overall population.

In fact, remote outreach and local governance and ownership do not assure that the poorer segments in the service area will be reached. Where elected representatives govern, quite the opposite may be true. For example, Muntigunung customary law dictates that all LPD loans be fully

collateralized, a requirement that excludes many of the poor as well as the extreme poor. Product terms—in particular, a US\$200 loan cap—also screen out the wealthy.

Member-owned groups may reach poorer people. For example, the SHGs linked to the PACS serve a poorer population than the rest of the PACS and the population at large. In 70% of the SHGs studied, 20% to 50% of the members were extremely poor in comparison to only 10% to 15% of the overall village population. In other words, unlike the Mixtlan cooperative, these SHGs serve a greater portion of the poor than is present in the local population.

The SHGs serve a poorer clientele in part due to the terms of their products. The SHG loans are smaller than the PACS' other loans and unlike the latter, do not require collateral, can be used for consumption, and are paid back with small regular payments rather than one large lump sum. Furthermore, the small size of the SHGs allows them to be more flexible regarding the timing of payments which can be very important for the extreme poor. Finally, the groups can be comprised of only the extreme poor who can then save smaller amounts than other groups. These poor-friendly features are shared by the VSLAs and other member-owned groups.

Groups appear as not client-responsive and have fallen out of favour in some microfinance quarters. The case studies highlight how unfortunate this is for the poor, the women and the remote-rural markets. Groups enable the MOIs to include women and the very poor who cannot provide collateral and cannot meet the share or savings requirements used to secure individual loans. The outreach through groups is significant, in several cases accounting for more than half of those served.

Gender Outreach

Our cases provide some insights into outreach to women.

- Where men handle agriculture-related household finance, institutions that primarily make agricultural loans—like the Bararanga PACS—may serve primarily men.
- Where men traditionally hold land titles or property for the household, women may not qualify for loans that require collateral—such as the LPD and MC2 loans.
- The focus on men may be a social norm. After the PACS began to serve groups of women, more women began to join as individuals members. Seeing women SHGs join the PACS encouraged them to become members as well. The PACS itself may also have been stimulated by its loans to women's SHGs to include women in its standard operations. The MC2s have consciously tried to break down the cultural barriers to serving women. Groups of primarily women now represent half of the people they serve.

Groups include a greater proportion of women than the other MOIs. In contrast to the others, the groups neither require collateral nor represent the entire community and its social mores. Furthermore, the groups may suit women's needs because they are close by and their payment requirements may be more flexible. In all three cases that involve group-based services—the MACS, PACS and VSLAs—groups serve primarily or only women.

Serving Other Disadvantaged Groups

Where socio-economic lines are sharply drawn, serving disadvantaged groups apparently must be a conscious decision. The MACS' roots are in activism on behalf of disadvantaged groups known as

the Scheduled Castes or Scheduled Tribes. It has developed leadership almost solely by members of these groups and in the process leaving the traditional elites with less power and say.

Breadth of Outreach

Table 2 provides data on the case institutions' size, growth and penetration rate. Growth rates give us a context for the other data—a low number means little in a new institution but a lot in an older one. Penetration rates are important because the number of clients served by a single MOI may be inherently limited for groups and other MOIs that serve a geographically limited domain.

Table 2: Breadth of Outreach of Case Study Institutions

	Members / total population	Indicators of growth *	Absolute numbers
VSLAs	9% - 32%	Focus on more intensive services seems to have slowed growth.	5 – 20 per group @ 132,000 in 2006
Muntigunung LPD	100% (automatic) Borrowers: 24%; Savers: 12%		249 borrowers; 88 savers 1020 (inclusive of and limited to entire village)
Jeevan MACS	3%	SHGs in all of India: from 0 to 40 million in 15 years	1020 members including 91 SHGs
Bararanga PACS	98%		1382 members including 85 SHGs; All India: 135 million in 1 of 6 villages
Bambalang & Njinikom MC2s	8%: Bambalang 4%: Njinikom		1194: Njinikom 1288: Bambalang (limited to kingdom)
Mixtlan	90%		3452 members
Jardin Azuayo	18% - 35% (100% of households)	2003 – 6: Savers doubled; Borrowers: up 50%	80,378 (29,260 in 5 offices studied)

* For MOIs that reach large numbers through replication rather than growth—groups and geographically limited MOIs—this figure refers to the entire system rather than an individual MOI.

Although results from this sample of just seven MOIs cannot be seen as representative, the penetration rates do contain some surprises:

- The absolute numbers of SHGs and VSLAs confirm that the replication of groups has the potential to reach very large numbers very quickly: The outreach of the Nigerien VSLAs neared two-thirds of that of Niger's entire microfinance sector. However, the Nigerien VSLAs' penetration rate now is 9% to 32%—in an area devoid of institutional finance.;
- Neither of the MOIs that are rooted in local governance structures—the LPD nor the MC2s—has a high penetration rate. The MC2 rates are just 8% and 4%. Although all villagers are automatically members of the LPD, only an estimated 24% have a financial stake in it, as either a borrower or saver;
- The MOI with a powerful history of successful social activism on behalf of its disadvantaged members—the Jeevan MACS—has a penetration rate of just 3%; and
- The three largest case institutions—the Bararanga PACS with its linked SHGS and the Mixtlan and Jardin Azuayo cooperatives—exhibit the highest penetration rates. In terms of households served, their penetration rates may near 100%.

Our examination of the scope, worth and costs of these MOIs should shed light on these variations in penetration.

Net Value to the Member

The value to members of their MOI is a function of the scope of its services, the value to members of these services and of their membership, and the costs of these services and of membership. We look first at the scope and cost of services, which are easier to nail down, and then consider overall worth to members.

Table 3 summarizes the product offerings of the case MOIs while Table 4 notes their relative costs. The tables support the following observations:

Product Range

- Groups, VSLAs and SHGs, provide the most limited services, a very short-term loan and illiquid savings with the same terms for the entire group. However, small groups dictate the terms of their products—from interest rates to loan sizes and lengths. Furthermore, payment schedules can be bent to accommodate personal emergencies.
- The one small non-group-based MOI offers a wider product range: An individual loan, regular savings, and a time deposit. However, its collateral requirements may exclude the poor.
- The largest MOI—Jardín Azuayo with 80,000 members—offers a much wider range of products than any of the other MOIs including various loans, long and short-term savings, remittances and mobile-phone banking.
- One of the medium-sized and one of the large MOIs offer only regular savings, individual loans, and group loans. The other medium-sized MOI, the MC2s, benefits from external technical and liquidity support and offers a fuller range of products. The other large MOI, the Mixtlan cooperative, is a part of a federation and also offers a range of loan and savings products including a remittance service.

Table 3: Product Offerings of Case Study Institutions

	Loan Products	Savings Products	Other Products
Small MOI: time-bound groups			
VSLA	<ul style="list-style-type: none"> ▪ US\$2–21 (.2–2.5% per capita GNI) ▪ Monthly payment ▪ 1-3 months: can be rescheduled <p>Network:</p> <ul style="list-style-type: none"> ▪ US\$21-105 (2.5% to 13% per capita GNI per member) 	<ul style="list-style-type: none"> ▪ Set deposits: US\$.05 - .40 (< .01% to .5% per capita GNI) ▪ Illiquid ▪ Group decides amount, frequency, interest, term ▪ High interest return <p>Network:</p> <ul style="list-style-type: none"> ▪ US\$1–5 per 2 weeks (per group - < .1% per capita GNI) 	<p>Network:</p> <ul style="list-style-type: none"> ▪ Training ▪ Cereal banks
Small MOI: accumulating fund			
LPD	<ul style="list-style-type: none"> ▪ Flexible or fixed payment ▪ 100% collateralized ▪ No min. up to US\$200 (5% per capita GNI) 	<ul style="list-style-type: none"> ▪ Savings account: min. US\$.45 (<.1% per capita GNI) ▪ Time deposit: min. US\$45 (1% per capita GNI) 	
Medium-sized MOIs			
MACS	<ul style="list-style-type: none"> ▪ Individual ▪ Group ▪ 15 months ▪ Monthly installments ▪ Avg. balance: US\$5912 (156% per capita GNI) 	<ul style="list-style-type: none"> ▪ Voluntary ▪ Avg. balance US\$38 (1% per capita GNI) 	
MC2	<ul style="list-style-type: none"> ▪ Individual: collateralized ▪ Group: no collateral ▪ Match local cash flows ▪ Many types: social, income-generating, construction, education, health ▪ Minimum: US\$ 100 (4% per capita GNI) ▪ 4 to 24 months 	<ul style="list-style-type: none"> ▪ Minimum: US\$2 (.1% per capita GNI) ▪ Pays some interest ▪ Savings accounts ▪ Current accounts 	<ul style="list-style-type: none"> ▪ Insurance ▪ Travelers' checks ▪ Training in loan use
Large MOIs			
PACS	<ul style="list-style-type: none"> ▪ Individual: collateralized, only for agriculture, 1-year, balloon payment ▪ Group: no collateral ▪ Min. loan: US\$ 50 (1.3% pc GNI) 	<ul style="list-style-type: none"> ▪ Groups: illiquid with small set deposits but groups decide their own terms ▪ Min. deposit: US .44 (.01% per capita GNI) 	
Mixtlan	<ul style="list-style-type: none"> ▪ US\$27 to 3x savings (.2% /capita GNI) ▪ Monthly repayments ▪ Up to 18 months ▪ Many: ordinary, confidence, emergency, automatic 	<ul style="list-style-type: none"> ▪ Minimum: US\$73 (.6% per capita GNI) ▪ Term: pays interest ▪ Current ▪ Youth 	<ul style="list-style-type: none"> ▪ Remittances ▪ Utility & tax payments ▪ Loan insurance ▪ Government targeted credit pass-through
Jardín Azuayo	<ul style="list-style-type: none"> ▪ Individual or group ▪ Minimum: < banks ▪ Maximum: > coop's ▪ Many types: working capital, emergency, health, education, housing ▪ Avg. size: US\$2993 (in study areas, 68% pc GNI) 	<ul style="list-style-type: none"> ▪ Passbook ▪ Term ▪ Avg. balance: US\$906 (in study areas, 20% pc GNI) 	<ul style="list-style-type: none"> ▪ Transfers: cellular, international, inter-bank ▪ Cellular: verify balance ▪ Bill & tax payments ▪ Loan endorsement ▪ Cooperative education ▪ Receive social security ▪ Death payment ▪ Loan insurance

Transaction Sizes

- In terms of per capita GNI, the VSLAs and the PACS provide the smallest transaction sizes by a factor of ten to sixty times or more.
- For the one large MOI, Jardín Azuayo, the average loan size in terms of per capita GNI is over five times the maximum loan size available from the VSLA network (and over 26 times the maximum loan size available from the VSLA group).
- Similarly, in terms of per capita GNI, the minimum deposit size for the large MOI, Mixtlan, is sixty times the minimum deposit size for the VSLA.

In other words, the better-managed more sustainable large MOIs offer products with transaction sizes that are significantly higher than those offered by the small MOIs, particularly the groups.

Table 4: Costs to Members of Case Study Institutions

	Financial Costs*	Transaction Costs	Perceived Risk of Losses
Small MOI: time-bound groups			
VSLA	<ul style="list-style-type: none"> ▪ High but no other options and interest goes to VSLA 	<ul style="list-style-type: none"> ▪ Very close. Alternatives are much more costly. ▪ Quick and easy ▪ Meetings take time 	<ul style="list-style-type: none"> ▪ Self-managed at VSLA level: trust is unclear
Small MOIs: accumulating-fund			
SHGs	<ul style="list-style-type: none"> ▪ Higher than others (PACS or banks) 	<ul style="list-style-type: none"> ▪ Convenient, timely ▪ Meetings take time 	<ul style="list-style-type: none"> ▪ Highly trusted: self-managed
LPD	<ul style="list-style-type: none"> ▪ Higher than others institutions 	<ul style="list-style-type: none"> ▪ Close by ▪ Manager available even when office is closed 	<ul style="list-style-type: none"> ▪ Trusted: very local, know management
Medium-sized MOIs			
MACS	<ul style="list-style-type: none"> ▪ Lower than SHGs ▪ More than others 	<ul style="list-style-type: none"> ▪ Slow loan disbursement 	<ul style="list-style-type: none"> ▪ Trust it more than banks but less than SHGs or government MACS
MC2s	<ul style="list-style-type: none"> ▪ Lower than local options ▪ Higher than bank rate 	<ul style="list-style-type: none"> ▪ Extension offices and mobile collectors ▪ Slow for emergencies 	<ul style="list-style-type: none"> ▪ May not be as well trusted as others: newer
Large MOIs			
PACS	<ul style="list-style-type: none"> ▪ Lower than SHGs ▪ Higher than others 	<ul style="list-style-type: none"> ▪ Close by: can come late in evening for a loan 	<ul style="list-style-type: none"> ▪ Trusted – know staff, government- backed but SHGs are trusted more
Mixtlan	<ul style="list-style-type: none"> ▪ Lower than all others 	<ul style="list-style-type: none"> ▪ Mobile collection 	<ul style="list-style-type: none"> ▪ Trusted: long history
Jardin Azuayo	<ul style="list-style-type: none"> ▪ Lower than others except state bank 	<ul style="list-style-type: none"> ▪ Timely and efficient 	<ul style="list-style-type: none"> ▪ Trusted: seen as part of & engaged with community

* All of the MOIs charge less than local moneylenders and more than relatives and family who tend not to charge.

Financial Costs

- Although the groups charge higher interest rates than the other MOIs, these interest rates are favoured over others' because the returns go back to the group.
- Three of the other MOIs—Jardín Azuayo, the Mixtlan cooperative, and the MC2s—charge lower rates of interest than other local non-member-owned institutions. The remaining MOIs charge more than the nearest competition.

Transaction Costs

- The case MOIs are at least as close by or closer to their markets than other types of institutions.
- Some MOIs, such as the PACS and the LPD, provide informal emergency service during evening hours, a great convenience for members in need.

- Some MOIs, such as Mixtlan and the MC2s, provide mobile collection or extension offices that greatly decrease members' transaction costs.
- Groups tend to be closer by and seem to be perceived as quicker in processing loans than other types of MOIs. However, the time it takes to meet can be a deterrent to joining.
- Some other MOIs, such as Jardín Azuayo, are seen as timely and efficient in processing transactions while others, such as the Jeevan MACS, are perceived as slow.

Trust: Perceived Risk of Losses

- Trust may emanate more from whether staff is local and familiar to members than from the actual quality of risk management. For example, residents seem to trust the Bararanga PACS—which is well-known but manages precariously with inadequate systems—more than more solidly-managed commercial banks that are farther away, less friendly, and more bureaucratic.
- Government involvement inspires trust as well. For example, some members prefer a new MACS over the Jeevan MACS because the former is closer by and is associated with the government even though the Jeevan MACS has a long, impressive history of supporting its members.
- Self-managed groups seem to be trusted more than other types of institutions. For example, the members trust their SHGs more than they trust the Bararanga PACS to which their SHG is linked.
- Size and roots outside the community does not necessarily impede trust. The largest MOI, Jardín Azuayo, is highly trusted because it is seen as deeply engaged with the community.
- The length of time an institution has been serving a community seems to matter as well. The Mixtlan cooperative seems to be trusted because of its long history with the community. In contrast, even the MC2 that has not experienced mismanagement seems not to be as trusted as other institutions because the MC2 is newer than these others.

Worth

In discussions with members about the value of MOI services, certain qualities—proximity, loan size, and quick access to funds in case of emergencies—seem to trump everything else. Others also came up over and over as important: trustworthiness of the MOI, interest rates, flexibility and suitability of loans to members' desired use, and speed of access.

Regarding proximity, an LPD member expresses a seemingly widely-held sentiment when he suggests that his loyalty to the LPD is less important than the interest rate on loans *if the better rate is available close by*. If a service is too distant, other considerations seem irrelevant.

Loan and minimum deposit amounts also seem to be determining: SHG and VSLA members seek out the PACS and VSLA networks for loans that are larger than their groups can provide despite that these loans are more expensive, less conveniently located, slower, and require depositing savings in an illiquid account in a less-trusted institution. Conversely, for many group members, other institutions are not an option, despite their more varied and flexible services, because their minimum deposit amounts and loan sizes are not feasible.

For two of the four MOIs with less penetration, members see the inability to meet emergency needs as a major shortcoming. Conversely, in one of the institutions with the highest penetration,

members identify access to an emergency loan and the flexibility to use loans for consumption as key desirable qualities. More generally, flexible loan use, suitability of products, and speed of access to a loan all emerge over and over as key factors in the worth of the MOI to its members.

Perhaps because the risk of losses *is* a risk rather than a certainty, trust—which is closely tied to local, familiar staff—and loyalty seem to be important but less determining. Members seem ready to abandon even an institution with which they have a long, trusting history for one that will provide them with a better interest rate. Even SHG members, when offered the prospect of a moneylender loan at the same rate as their SHG loan, explain their preference for the SHG loan in terms that are financial, “the interest returns to us,” rather than in terms of loyalty.

Similarly, loyalty seems to be tied more to the effects of close community integration than to the institution itself: Members’ loyalty to Jardín Azuayo may result from its responsive products and ongoing community support. In contrast, members seem less loyal to the Jeevan MACS—that is perceived as slow, overpriced and untrustworthy—despite its roots in social activism on behalf of the disadvantaged groups from which its members come. Alternatively, its low penetration rate may be related to the fact that its activism was on behalf of just one segment of the market.

Finally, interest rates—often seen as marginally important to the poor—emerge as an important consideration if not an all-determining one. In six of the case studies, interest charges on loans emerge as a strong positive or negative factor in members’ assessment of worth.

Table 5 indicates relative market penetration alongside a rough assessment of how members view the case institutions on key determinants of worth. Institutions that seem to engage most households—at least 25% of the population—in their service areas are rated as high penetration, those that engage 8% or less of the population are rated as low, and the one that falls between is rated medium.⁷ The assessment of the determinants of worth are qualitative and rough: Institutions noted for their strength in an area are rated high, those noted for their weaknesses are rated as low, and the rest are rated as medium unless the case makes no reference to this area.

Table 5: Rough Assessment of Relative Penetration and Worth Factors in Case Institutions

	VSLAs	LPD	MACS	PACS with SHGs	MC2s	Mixtlan	Jardín Azuayo
Penetration	0	0	-	+	-	+	0/+
Relative proximity	+	+	-	+	+ / 0	+	+
Loan size	0	0	+	+	0	+	+
Emergency access	+	+	NC	+	-	+	+
Relatively trustworthy	+	+	0	+	0	+	+
Interest rates relative to similar products offered by others	+	0	-	0	+	+	+
Product flexibility / suitability	0	+	NC	+	+/-	+	+
Relative ease / speed of access	+	+	-	-	-	0	+

High: +, Medium: 0, Low: -, No comment: NC

The ratings support our anecdotal observations about what matters most. All three MOIs with high penetration rates are rated highly for proximity, emergency access and loan size. Although two of these rate medium or low for speed of access and interest rates, their penetration rates are still high.

⁷ Notably, these levels of penetration are high relative to penetration levels of institutions in more urban and peri-urban markets where there may be more competition.

All three also are rated highly for trustworthiness and product suitability. In contrast, of the four MOIs with medium or low penetration rates, two rate medium or low for loan size or emergency access (and two are not highly trusted.) Although members state that trust and loyalty matter less to them than other factors, it may come into play more than they acknowledge.

Length

Because the issues of sustainability vary so much, we look at each case separately.

VSLAs

With the cumulative number of Nigerien VSLAs reported at nearly 200,000 and the 2006 number at 132,000, the sustainability of Nigerien VSLAs seems to be lower than that of the VSLAs in Zanzibar. These comparisons over time and place suggest that time-bound, un-networked groups may be more sustainable than networked ones.

In recent years, CARE has promoted and supported the VSLAs with literate VSLA members as village agents instead of the CARE staff it used previously. Instituted to make the support system self-financing, CARE's use of village agents has shortcomings. Groups do not always pay the US\$.10 per agent visit expected of them. For all but the few groups in her own village, an agent may need to travel up to 10 km without compensation. Although the agents are expected to keep records for existing groups, whether the groups require and get this ongoing support is unclear. In any case, growth in the number of groups has slowed considerably. The institution of networks and village agents may have contributed to the decline in VSLAs.

MACS

In the case of the ASP MACS, on-going donor support has allowed for an unsustainably staff-intensive support structure at each tier. Heavily dependent on external credit, financial operating support, and in-kind management support, the Jeevan MACS is neither financially nor institutionally sustainable.

PACS

The PACS also is neither financially nor operationally sustainable and is managerially weak. Low-cost staff and member-owners have neither the education nor the motivation to manage the PACS soundly while decisions to grow or consolidate are taken by higher tiers and are not based on local realities. The PACS does not provide for loan losses and its loan recovery rate is just 82%. The MIS does not generate reports on loan repayments for SHG loans; basic internal controls are missing; and weak liquidity management threatens the entire system. Furthermore, the PACS lacks the autonomy and management capacity to undertake business planning.

LPD

The Muntigunung LPD is significantly more sustainable, financially and institutionally, than the other Asian case studies. Its 18% return on assets is due in part to its high interest rate, low operating expense ratio of 4.14%, and 100% repayment rate. The LPD has received a sound rating by the supervisory authority based on its capital adequacy, asset quality, management quality, liquidity and profitability. Furthermore, the LPD is required to contribute 5% of profits to cover the costs of external guidance and training that help ensure continued strong management.

Although fundamentally sound, the Muntigunung LPD faces a few risks. Its weak deposit mobilization and lack of access to other sources of liquidity limits its growth. While the LPD's perfect repayment record results from its roots in local governance and laws, this traditional authority might leave villagers less able to confront mismanagement and risk if it occurred. Finally, unlike some remote-rural LPDs, the Muntigunung LPD has a sound local manager—the local school teacher who also has a background in accounting. Its sound management hinges in part on continuing to attract this quality of manager.

MC2s

The MC2s are heavily subsidized from their inception and few have graduated from this subsidy. Up to 70% of initial capital comes from urban elites, low-cost loans are provided by Afriland Bank and other patrons, and ADAP, an NGO, provides ongoing technical assistance at a subsidy in audit, control, and monitoring. Although the financial sustainability of the Bambalang and Njimikom MC2s stands at 84% and 108% respectively, these figures do not include adjustments for inflation or technical support, or adequate loan loss provisions.

Particularly in the case of more remote MC2s, the MC2 promoters believe that ongoing subsidy is justified because it enables the MC2s to provide non-financial services, train members and expand access to institutional finance to areas that would otherwise not have it. Nevertheless, aspects of management and governance are weak, particularly in Bambalang as evidenced by a 22% high portfolio at risk and cases of insider lending and misappropriation. In theory, their ties to traditional governance in the kingdom reduce their risk of default. In fact, both MC2s are carrying loans from their start-up over five years ago: These represent 12% of assets in the case of Njimikom and 5% for Bambalang. Although credit management procedures are followed, accounting and administrative control gaps persist and member participation in meetings is low. The board and management lack many skills.

Mixtlan

In contrast, the Mixtlan cooperative receives no subsidies of any kind. Its level of operational sustainability is 94%, and this includes fees to the second-tier that completely cover the costs of the federation support that it receives. The cooperative has excess liquidity that it cannot invest profitably. Mixtlan serves a remote community 137 km from the head office with a weekly collector. The cooperative lowers the associated risk of fraud by deploying a collector who has many years of service to the cooperative and whose family is well-known.

Jardín Azuayo

In recent years, all the Jardín Azuayo offices have operated at a profit despite the fact that the cooperative has lowered its loan interest rates and fees. The cooperative is rated triple AAA by the Superintendency of Banking and Insurance. It tightly controls its operating costs, employing just three people—a coordinator, a loan officer and a teller—in each office and relying solely (and effectively) on word of mouth to attract clients. The cooperative depends on its local volunteer loan committees to assess loan applications. With all this, it maintains a maximum 30-day portfolio at risk of 5.2%, less in its more remote branches like the ones studied. Although new branches receive initial capital interest-free, thereafter they pay an internal transfer price of 8% that motivates them to mobilize deposits rather than rely on liquidity from other branches. The branches studied have excess liquidity even though they offer both individual and group loans.

In sum, though we cannot draw any definitive conclusions, the cases do suggest possibilities:

- Unlinked time-bound groups seem to have much more potential for quick sustained remote-rural outreach than other groups that may require ongoing support.
- Managing the costs of transport and time may be a key to promotion and support of VSLAs by village agents.
- MOIs that start dependent on external support may lack the drive to rid themselves of costly support and staffing patterns.
- Higher tiers that control and make key management decisions without reference to local realities can impede an MOI's sustainability.
- Ties to traditional local authorities might strengthen governance, repayment and therefore sustainability but also might not.
- A federated MOI might serve remote-rural areas and still recover full costs.

Part II: Drivers of Outreach

Governance⁸

Representing a range of governance models, the cases suggest certain features of good governance that apply across these models and other features that are unique to certain ones:

1. In all cases, members' trust and sense of ownership, key factors in strong governance, were strongly linked to savings and the returns the MOI provides
2. Different MOI models were marked by different governance approaches and challenges:
 - a. In autonomous groups, simplified processes enabled members to “bear witness”
 - b. In groups that were networked and linked, governance was more challenging
 - c. Governance was also more challenging in community-based models grafted onto local governance structures
 - d. In larger MOIs, decentralization allowed members to “watchdog”
3. Tension exists in MOIs between member oversight and the need for standardization for control

Members feel greater ownership when the capital belongs to them and when they perceive that their money comes back to them.

Members are more likely to safeguard their own money than external capital such as donated or government funds. This affects both governance and performance. The size of member-generated capital relative to other capital seemed to be an important factor in members' sense of ownership. Members' perception of ownership, however, proved as important as their actual capital stake in the organization. In some cases, even if they were technically members and their savings were being used, they did not perceive this to be the case and did not feel a strong sense of ownership.

Subsidy is often justified as necessary to serve remote areas but a high level of subsidy gives members an impression that they need not pay back. Linkage programs present strong potential to expand rural outreach. The trade-off is that these groups are likely to comprise a small percentage of the overall client base, which can lower perceptions of ownership and performance.

Perceived returns on capital could take the form of ready access to their funds, high or reasonable returns, or the use of profits to benefit their families or community. For example, VSLA and SHG members felt less connection to their savings held in their second-tier relationships, in part because they did not perceive the returns to be very high. While they associated some level of member-ownership with the second-tier, they would not hesitate to go looking for a better deal if one existed.

Consistently, members stated that member-ownership in and of itself did not guarantee their trust or patronage. Ownership was not a value for members in its own right if services were not competitive or flexible enough. Members also felt a strong sense of ownership when the institution was both in the community and benefited the community socially. Both Ecuador and Cameroon had strong policies related to investing excess liquidity in the local community rather than siphoning it to higher tiers or investing in urban areas.

⁸ This section of the paper is abstracted from Lee, (2007).

Although a sense of ownership is important for patronage and member loyalty, it does not ensure that members hold each other and the institution accountable.

Different MOI models used different approaches to governance

The cases include a spectrum of governance models including:

- a. Autonomous groups
- b. Groups or associations that were linked to other financial institutions or networked amongst themselves
- c. Community-based models that grafted onto local governance structures
- d. Larger representative MOIs such as cooperatives

The two extremes on the spectrum, small autonomous groups and larger MOIs, seem to have the strongest forms of governance and accountability. Autonomous groups that regularly disburse their funds keep accountability in the hands of members. Each group is its own financial intermediary accountable to a small group of members. The more sophisticated networks or cooperatives, like Mixtlan, MC2s and Jardin Azuayo, are able to effectively combine internal controls with external regulation and supervision including audits. In part, they are able to do this because there is a level of standardization across the system. Their architecture is like that of the spider plant: There is some level of member organization and autonomy at the base tier but, for control purposes, these tiers need to be consistent with the broader system.

The other two models have control challenges as they operate in that murky area between simple, informal norms and more complex institutional rules. This includes newly-networked VSLAs, linked SHGs, federated SHGs and village-based systems such as LPDs that are loosely linked or monitored.

The complexity of products affects the complexity of governance. More products or more sophisticated products (MC2s, Cameroon; Mixtlan, Mexico; Jardin Azuayo, Ecuador) require more complex systems and professionally-trained management that in turn make member oversight more challenging. Governance may be stronger in MOIs with more sophisticated members who are able to oversee these more sophisticated staff and systems.

In autonomous groups, simplified processes were used so that members could “bear witness”: Members expressed a stronger sense of ownership at the group or association level than at the federation level and a greater ability to influence products and access. In these MOIs, members were responsible both for management and governance of the MOI and accountability rested on keeping process simple.

Time-bound associations, like traditional rotating savings and credit associations, keep transactions simple and use witness-style governance, local norms for organizing and often oral bookkeeping and norms. Norms may also be effective if they are written as long as they exist, members are aware of them and they are implemented. In general, governance may be better served by relying on simple oral systems that are transparent rather than by making traditional systems more complex.

Groups or associations that were linked to other financial institutions or networked amongst themselves: Where decisions were made by higher-tiers or management, member oversight became more difficult and members had a weaker sense of ownership. These cases showed that being local and linked proves quite challenging for governance.

Two-tier MOIs have two overlapping governance systems, one at the group or association level and another at the second-tier level. Particularly where the second-tier collects savings from the groups, the financial intermediation role warrants strong oversight. Largely self-regulated systems or weakly supervised systems, as in the case of the federated SHGs and the cooperative societies with groups as members, do not prove adequate.

Linkages and networks can affect governance differently. For example, some linkages in India allow groups to maintain a certain amount of governance and ownership at the group level, keeping group-level transactions relatively simple. In contrast, the leaders of networked groups or associations must handle complex liquidity arrangements and financial management. Increasingly, SHGs in India are expected to provide more and clearer reporting through NABARD. There is even discussion of double-entry accounting for SHGs. The increased complexity threatens groups' ability to keep their own records or to supervise others to do so.

Community-based models that are grafted onto local governance structures: In rural areas, community-based models, those that attempt to have a financial institution for each village, are particularly affected by power structures. Hired staff members are more likely to be men from outside the area. Financial institutions that use the local governance system may be dominated by local male leaders. These power structures are reinforced by socio-cultural structures that may be exacerbated by policies, as in Bali, where loans are secured by land, which most women do not own.

In all cases, members were willing to participate less in decision-making in order to improve services either because they trusted their leadership or because they doubted their own capacities. Decision-making by representatives or management was fine if members trusted the MOI, even if it did not serve them well.

We use the term social capital positively to refer to the organizing of groups and mutual support that community members show one another. But we have overlooked crucial elements of social capital—above all, social control—that may conflict with good corporate governance. In both the Indonesia and Cameroon cases, governance is tied to the traditions of the local council, village elites and elders. In Cameroon, the boards of elders plays an important role in the MC2s, helping ensure member repayment in part by employing social sanctions. In Indonesia, the customary council is the actual owner of the LPD and failure to comply with oral customary law can result in excommunication or the inability to be buried in the community. While this may seem harsh, it is accepted and respected by community members and in fact, effectively controls credit risk.

The village-based MOIs are particularly prone to elite domination as they are grafted onto the local governance and power structure. At best, we can use corporate governance to complement this domination but, especially in remote areas, replace or challenging traditional systems is unlikely. Other forms of accountability may be required as well.

Larger MOIs such as cooperatives: In larger MOIs where representatives of the members oversee paid managers such that members can no longer witness, members were able to watchdog. In the cases, decentralized governance structures provided important alternatives to annual general meetings. For example, the Jardín Azuayo cooperative, where the average rural office size exceeds 3,000 members, provides remote members with frequent opportunities to meet in smaller, more manageable fora.

The literature finds a number of factors important for governance to be effective: Size of group; homogeneity of group and population density (Van Bastelear (2000) in Lee, (2007)). The cases seemed to echo these findings. Size and a certain amount of homogeneity did matter.

Building decentralized institutions is about determining how members naturally organize locally. For example, Jardín Azuayo created a governance structure that paralleled the management structure of the overall cooperative. Neighbourhood and parish councils meet regularly and feed into loan and audit committees at the local office level as well as provide representation for the general assembly. This type of solution relies on smaller bodies that are more accessible geographically and linguistically.

Frequency of both meetings and reporting can also increase accountability, as in the case of the Bambalang MC2 where members dealt with a case of mismanagement by calling an extraordinary meeting of the General Assembly and enacted sanctions.

Tension between member oversight and standardization for control

While decentralization may be important for flexibility and tailoring to local needs, some level of standardization is essential for control of risks and for safety. The type of control an MOI requires depends on the level of sophistication of its products and systems. Larger MOIs with a more diverse product range and networked associations require a certain amount of standardization in order to permit adequate oversight and control. Controls are also important to be credit-worthy for a linkage, to be able to be regulated, or to be rated by an external agency. At the same time, rural remote areas demand a certain amount of flexibility at the local level, for example, the freedom to accept traditional forms of collateral. This is the core tension in finding the right mechanisms and structure for governance: Control versus flexibility.

The first threshold for internal control is accumulation of funds. When earnings are not distributed, associations start to accumulate their internal fund and must handle varied payments and disbursements. This requires more sophisticated internal control mechanisms.

Conclusions

All members expressed more trust and ownership where they perceived that the MOI was their institution using their money. They were more likely to save and increase their savings provided that the MOI provided the necessary flexibility and competitiveness in terms of returns. These returns could be non-financial such as community or social investments.

The lesson for good governance design seems to be, keep it simple or ramp it up. Going back to the metaphor of the spider plant, MOIs need to be very clear as to how the system as a whole is being governed as well as its parts. In some cases, the MOI networks or federations competed with their member associations for liquidity.

Both the simple and the complex MOIs were able to design strong mechanisms for governance. Associations that remain informal or semi-formal with only minor supports to make the traditional schemes more effective can use distribution of savings and capital, simple processes and member witnessing.

Linkages may not present too many governance challenges provided the gains from the linkage outweigh the costs in terms of lost liquidity, flexibility and oversight. Networking, however,

becomes more challenging if the second-tier plays a financial intermediation role. With two overlapping governance structures, the system can become too sophisticated for members to provide adequate oversight yet may not be standardized enough for external regulation.

Those MOI models that aimed to have one association per village or community faced a unique governance challenge. In grafting onto the local governance structure, they used social capital and local leadership in positive ways. However, relying on social controls by local leaders can reinforce local power structures. Other mechanisms may be required to hold this system in check.

The key triggers to more complex forms of governance are accumulation and aggregation. As MOIs begin to accumulate, their transactions become more complex and member oversight becomes more challenging. As the MOI becomes larger and more sophisticated, creative mechanisms for keeping members engaged are required such as decentralized fora and training. The key is keeping some form of decentralization while ensuring enough standardization for control. The success of the larger systems requires information systems and internal control that facilitates external even prudential supervision.

Either the governance system must be simplified so that members can manage it or the system must be standardized so that external regulation and supervision can complement internal controls.

Not surprisingly with something as complex and human as good governance, there cannot so much be a list of features as a careful balancing of precarious tensions: Legal structure and perceived ownership; principal and agent; local and institutional rules; flexibility and control.

Linkages⁹

Federations require much of their member MOIs: Time to participate in management, money in the form of fees, and risk capital that often earns no interest and may be difficult to withdraw. They might also demand loyalty. Member MOIs may have to use their services even if alternative suppliers may be preferable. Furthermore, federations may fail more frequently than other businesses. Nevertheless, many of the case study MOIs chose to join a federation, in some cases because they had no alternative means to obtain needed inputs. Our purpose is to analyze the costs and benefits to them of federating or using linkages to obtain needed services.

The value an MOI derives from its relationship to a second-tier or external institution rests in part on the origins of their relationship and the type of services it receives. These might be savings or credit, assistance in promoting or strengthening its capacity, supervision to ensure its financial security, or help in “empowering” itself or its members.

After we look at each case, we shall attempt to judge the success of the linkage by answering ten questions about it.

1. Does it help the MOI to be financially viable?
2. Does it help the MOI to offer more, or better quality, services?

⁹ This section of the paper is abstracted from Harper, (2007).

3. Does it help the MOI, or others which may start, to achieve broader outreach, to reach more people?
4. Does it help MOIs to achieve deeper outreach, to reach poorer people?
5. Does it improve the MOI's governance?
6. Are there alternative and preferable suppliers, or could existing institutions be reformed so that they could be better sources of services for the primary MOI?
7. If a secondary institution serves as a sort of "middleman" between clients and service providers, is the cost justified by the additional level of services?
8. Are the authorities able to adequately supervise the secondary institution?
9. The weaker members of any group are usually those who benefit the least from membership, and groups are always attractive targets for political 'hijacking'. Enforced loyalty to a group can be a form of disempowerment and marginalization for the poor. In this case, do the poorest people benefit as much as the group leaders and the better off?
10. Secondary MOIs have to be promoted, their members and staff capacity have to be built, and the cost of this process, as well as the cost of continuing operation, often has to be subsidized. If the case involves a secondary MOI, is it likely to depend on subsidy for its initiation and continuation?

Not all the questions can be answered definitively, but it is vital that such questions be asked, particularly by members of MOIs and those who promote these kinds of linkages. We hope that our answers will encourage all parties to look critically and objectively at such linkages, rather than to promote them for their own sake.

The Cases and How They Stand Up to Our Questions

Self-Help Groups and PACS, West Bengal

The SHGs in Purulia, West Bengal are linked to the local PACS. Promoted by the PACS or by the local cadre of the Communist party, the SHGs use the PACS primarily as a source of loans. In a quasi-monopolistic position, the PACS service is far from perfect. It restricts the SHGs' access to their savings, its interest rates are high, deposits are uninsured, and the PACS may be insufficiently liquid to provide the SHGs with the funds they require. However, the PACS staff is accessible and local, and they understand the community.

Not genuinely cooperatives, the PACS were established by the government as a delivery channel for cheap credit. This weakens their financial position, and means that they have traditionally been seen as sources of 'soft' money from government, rather than as community-based financial intermediaries. Furthermore, SHGs make up only a small proportion of the PACS membership, and their members are not even permitted to contribute time to its management.

MACS, Mehbubnagar, Andhra Pradesh

The Jeevan MACS evolved out of a long-standing social movement against caste and gender discrimination. The multi-tier federations are not a product of the individual members' or SHGs' own initiative. They have been promoted by the State Government and international agencies such as the UNDP and World Bank. The linkages between SHGs and MACS have had positive results: On their own, the SHGs could not have achieved such social empowerment, with "untouchable"

women holding most offices in large, highly-visible institutions. This happened only with the support of the MACS.

The MACS may fail to compete with the commercial banks because their services are neither high-quality nor cheap. The MACS savings facilities are inflexible, and are seen as a route to loans rather than as services in their own right. The banks offer lower-cost loans and more secure and flexible savings. As the SHG members become more sophisticated, they may realize that social empowerment and ownership come at a heavy cost. Many groups already borrow from banks. Eventually, this may reduce members' willingness to give their time to the governance of their MACS and to pay its higher interest rates, and the linkages may be fatally weakened.

VSLAs, Niger in comparison to Zanzibar

CARE has promoted VSLAs in thirteen African countries including Niger and Zanzibar. Zanzibar provides a good test of unlinked and unfederated VSLAs, since CARE promoted sixty VSLAs there in the year 2001, and then left. By 2006, one hundred new VSLAs had been formed in Zanzibar, and only one of the original sixty had broken up, with most of its members forming a new group (Anyango, et al, 2007). The member dropout rate had been 3% per year, much lower than the 10% rate from Indian SHGs (Sinha, et al., 2008) and member savings grew at an annual rate of 53%. Trainers of the original groups had set up an institution to promote new groups, charging members a fee rather than taking any subsidy from CARE or any other donor.

In Niger, CARE has recently taken a different route. Historically, the Niger groups were time-bound—they regularly disbursed their savings and re-formed—and were not networked or linked to a financial institution. They reportedly thrived without ongoing support, reaching a cumulative total of up to 200,000 women with groups spontaneously catalyzing and training new groups. In recent years, CARE changed its Niger model. In response to some VSLAs' expressed need for larger loans, CARE has helped VSLAs form federations to intermediate between VSLAs with excess loan demand and those with surpluses, to access loans from MFIs or cooperatives, and to serve as channels through which CARE helps communities build and operate cereal banks.

The VSLA federations pose some clear disadvantages. The member VSLAs have to capitalize the federation with an entry fee, must deposit savings with the federation, and must pay interest on loans from their federation, which reduces their own revenues and loanable funds. Furthermore, because managing the federations requires written records and paid staff, the federations are not as transparent as the VSLAs by themselves. Furthermore, the VSLAs' regular 'cashing out', which served as an effective internal control, has had to be abandoned because the federations are too formalized to close down every 12 months. The federations must register, and in theory, are subject to the West African PARMEC law. Whether such supervision would benefit the VSLAs is not clear, but the high survival rate of the VSLAs in Zanzibar contrasts dramatically with the apparent decline in VSLA numbers in Niger, albeit over a longer period.

The VSLA members do not need the federations, and they are unlikely to be able to manage or genuinely 'own' them. As a means to increase loanable funds, the federations may be ineffective or unnecessary. The two federations described in the case study have lent out just 28% and 32% of their member VSLAs deposits. Furthermore, one VSLA found the external loan that it accessed through its federation too costly to be worthwhile and chose not to borrow a second time. Remote VSLAs may simply not be able to use commercially priced-loans and the federations need for literacy and professional staff will distance them from their members. Living in an area that is

famine-prone, members appreciate the cereal banks that CARE provides through the federations. However, some of the VSLAs became over-indebted and folded. Furthermore, the federations require substantial ongoing funding and management support from CARE. They tend to perpetuate dependence on CARE and technical elites rather than member control.

Mixtlan, Mexico

The Mixtlan SACCO is a long-established local MOI which has benefited from its recent membership in UNISAP, a strong state-wide federation with forty member MOIs. Mixtlan joined UNISAP in 2002, in response to the national financial crisis that weakened people's confidence in financial institutions. Partly in response to this linkage, Mixtlan has grown rapidly ever since.

Mixtlan is the most remote of UNISAP's member MOIs, 80% of which are urban. The strength and volume of its urban members appear to enable UNISAP to offer a wide range of services, at prices that Mixtlan would not have been able to access on its own. Although Mixtlan does not need UNISAP's financial intermediation service, UNISAP enables Mixtlan to offer an extremely low-cost remittance service and a utility bill payment facility. UNISAP also provides Mixtlan with training and capacity building, particularly through the provision of information technology, which also provides UNISAP with routine information to monitor the MOIs' performance. UNISAP gives Mixtlan members confidence that their money is secure. UNISAP monitors the performance of its member MOIs regularly, and through their membership they are automatically protected and supervised by UNISAP's membership in BANSEFI, a government-supported tertiary-level institution that provides overall supervision and temporary liquidity.

UNISAP does not demand loyalty from its members. Mixtlan is free to use other suppliers, although none are likely to match UNISAP's services and prices in the remote areas where Mixtlan operates. UNISAP's services are cross-subsidized by its urban members, and Mixtlan pays a total service fee of under \$10,000.

There is, however, one serious threat. UNISAP finds it costly to deal with small MOIs and has suggested that Mixtlan merge with a larger, neighbouring institution. The proposal is strongly resisted by Mixtlan's management and membership, who highly value Mixtlan local staff and knowledge. The members fear, almost certainly correctly, that they would lose the individual service they value if the office was subsumed within a larger merged entity. Some form of merger is nearly inevitable or UNISAP will not be able to continue its present level of service to Mixtlan, because it has to compete for its larger urban MOIs' business with commercial banks and other alternative suppliers. Only time will tell whether Mixtlan and its members will continue to benefit from UNISAP's services in the same way as they do now.

MC2s, Cameroon

The MC2s in Cameroon were established and continue to be heavily supported by Afriland First Bank, a privately owned institution. Afriland provides cross-subsidized funds at lower cost than the MC2s could obtain elsewhere, and facilitated ongoing tax concessions and supervision by the West African Central Bank. The high level of direct subsidy, up to 10% of assets, fosters continued financial dependence. The linkage to Afriland First Bank may not always be beneficial to the MC2: one of those studied, the Bambalang MC2, appears to be borrowing unnecessarily. ADAP, an NGO, provides ongoing capacity building services.

Afriland and the NGO will assist the MC2s to form their own second-tier support institution which will assume the bank and NGO support functions. How the MC2s will manage without a direct linkage to the Bank remains to be seen.

LPD, Indonesia

The Muntigunung LPD is owned by the traditional village council, which is nominally controlled by the assembly of all the villagers but is effectively directed by 21 families with inherited positions in the village hierarchy. Established by government to serve smaller rural villages and poorer villagers, the LPD is not federated or closely linked to any one institution, although it is regulated by the regional development bank and its sister institution the PLDPK. Both these government institutions play a major part in governing the LPDs, determining their staffing, interest rates, loan conditions and the disposition of any surplus. Like the Indian PACS, the LPDs are nearly government-controlled entities. The PLDPK provides limited training and capacity building to help enable the LPDs to conform to regulations.

Although its members have a strong sense of ownership over the LPD, they have asked the government whether it could be converted into a cooperative and linked to the local cooperative union. The union and the government turned down the request, believing that such a link would reduce the sense of local ownership, and would hurt the union financially. The members have resisted a government proposal that the LPDs be merged and transformed into for-profit non-bank finance institutions. They feel that the change would destroy the LPD's local character.

Jardín Azuayo, Ecuador

The Jardín Azuayo Savings and Loan Cooperative is the only case that is neither federated nor closely linked other than for normal commercial transactions. With 20 of its 23 offices in remote rural areas, Jardín Azuayo does not cross-subsidize its rural operations with urban ones. Instead, it successfully combines the advantages of decentralized, self-managed, and independent local entities with the strengths of centralized policy direction, services, and treasury management. Frequent visits by directors and employees to other offices and institutions encourage learning and foster a sense of belonging to the same entity in spite of the offices' widely scattered locations. Jardín Azuayo has a strong social mandate and operates an active education program that includes links and scholarships to a local university.

Financially, Jardín Azuayo is remarkably self-contained. Its 5:2 balance of savers to borrowers is healthy, as is its balance of loans to savings and liquidity. Modestly profitable, Jardín Azuayo appears to have struck the right balance between local autonomy and centralized professional management, without having to rely heavily on any other institutions.

Conclusions

Table 6 summarizes the impact of linkages or networks in each case. The conclusions are expressed either as a clearly positive 'yes' or a negative 'no', or as a '?', suggesting that the case study does not give enough information to answer the question, or as 'n/a', when the question does not apply. These answers are simplified, and some readers may disagree with some of them.

Table 6: Impact of Linkages

	SHGs to PACS, Purulia, West Bengal, India	SHGs to MACS Andhra Pradesh, India	VSLA Niger to CARE-promoted 'network'	Muntigunung LPD Indonesia 'links' to govt devt bank and reg. agency	Mixtlan Mexico to UNISAP	MC2s Cameroon (previous links to Bank and NGO)	Jardín Azuayo Ecuador
Does the linkage improve -							
viability?	Yes	No	No	Yes	Yes	Yes	n/a
depth?	Yes	Yes	No	No	Yes	Yes	n/a
breadth?	Yes	Yes	No	No	Yes	Yes	n/a
services?	Yes	No	?	No	Yes	Yes	n/a
governance?	?	Yes	No	Yes	?	Yes	n/a
Is the secondary MOI -							
the best source?	Yes	Yes	Yes	No	Yes	Yes	n/a
worth its cost?	Yes	?	No	?	Yes	Yes	n/a
secure and well-supervised?	No	No	No	Yes	Yes	?	n/a
empowering for the weakest?	No	Yes	No	No	?	Yes	n/a
independent of subsidy?	No	No	No	No	Yes	?	n/a

The cases do not provide enough evidence to accept or reject linkages in general or of any particular type. Nevertheless, the following lessons and guidelines can tentatively be drawn:

- Local familiar management and ‘ownership’ conflicts with the benefits of being part of a more distant large-scale, professionally-run institution. If the members of Mixtlan in Mexico and the Muntigunung LPD in Bali become more prosperous, they will almost certainly have to sacrifice some of the benefits of local control in order to obtain the broader range of services they will need.
- The VSLA case demonstrates, however, that secondary level MOIs should not be imposed on small local institutions unless the members will gain real advantages. Very poor people who live in remote areas have the least need for the kinds of sophisticated services that linkages or federations can provide, and are the least able to manage such linkages. As with SHGs in India, NGOs or others should avoid promoting groups of groups in order to provide themselves with convenient delivery channels.
- The Indian PACS and the Balinese LPDs were promoted by government as a means of bringing subsidized financial services to poor people in remote areas. State-promoted entities are not usually the best basis for a mutually-beneficial and sustainable relationship with members. MOIs that are linked to state-controlled entities may fare better with arms-length commercial relationships with banks and other service providers.
- Ideally, linkages should be initiated by primary level MOIs from “below”, when their members realize that they need services that their MOIs cannot provide. This rarely happens. It was only partly the case for the SHGs in Mehubnagar and the Mixtlan cooperative in Mexico and in the other cases, the process was purely ‘top-down’. Without assistance, MOIs cannot select and manage relationships with linkage institutions.
- ‘Vertical’ linkages, between primary level MOIs and secondary level institutions or other providers, can supply services that the primary level cannot supply itself. ‘Horizontal’ linkages, between primary MOIs that individually lack the necessary scale or competence to supply the

services they need but that together may be able to do so, may be a necessary precursor to identifying and evolving ‘higher level’ service providers.

Would the case institutions have been able to obtain the same services from purely private providers? Probably not. A private bank would be unlikely to cross-subsidize a remote and small-scale customer such as the Mixtlan SACCO, and the remote areas of Mehbubnagar or Purulia have no other financial service providers. Nevertheless, it might be more effective if Afriland First Bank did not try to off-load its responsibilities for serving its MC2s on to a new second-tier MOI, or if CARE did not try to build VSLA networks. Cooperatives are not necessarily always the best source of services for other cooperatives.

Finally, it may be no coincidence that the most effective institution of our seven examples appears to be Jardín Azuayo, which is self-contained and needs no close or permanent linkages beyond those that are normal for any institution. ‘Outsourcing’ specialized tasks rather than performing them ‘in-house’ may be fashionable for business, but MOIs in remote areas may be an exception. Linkages are not the solution to every problem.

Regulation and Supervision¹⁰

To date, the regulation and supervision of MOIs has largely not been effective. For the sector to move forward, a process to build consensus on core principles is crucial. The following questions demand answers:

- What types of MOIs should be regulated? Or what MOIs activities should be regulated?
- Are tiered licensing standards appropriate or should standards be uniform? If tiers are appropriate, how should they be defined and what should be required of each?
- What entity should supervise? Is delegated supervision or self-regulation acceptable and if so, under what conditions? Under what conditions might it be appropriate for different authorities to supervise different classes of MOIs?
- What are the costs of regulation and supervision? How should they be covered?

The case studies represent a variety of legal and regulatory frameworks. Some key features of these are analyzed below to assess how conducive or detrimental they are to the outreach and the governance of these MOIs. We then consolidate what they tell us about our key questions.

Regulation and Supervision of the Case Institutions

SHG-PACS linkages under the APMACS Act

Under the 1995 Andhra Pradesh Mutually Aided Cooperative Society (APMACS) Act, “clusters” or federations of SHG groups can transform into regulated cooperatives with a higher level of autonomy. To do so, they must give up government subsidy, be subject to stricter regulation, and all the SHG members must become individual members of the new cooperatives, legally known as Mutually Aided Cooperative Societies (MACS). As of mid-1998, 1,150 cooperatives were regulated under the APMACS Act and another 729 were choosing to convert, demonstrating how regulation can allow for graduation.

¹⁰ This section of the paper is abstracted from Chao-Béroff, (2007).

With over 120,000 PACS, the breadth of outreach that could be achieved by linking PACS with SHGs is huge. Even though SHGs are still only a small part of their business, these linkages have already expanded the PACS' focus from primarily male producers to include more women, groups and remote villages. Due to the PACS' weak management and compliance with prudential norms, however, the Registrar of Cooperatives does not encourage them to expand their deposit taking.

For small remote SHGs, a model of self regulation is envisioned: The apex is to supervise and guide cluster MACS that, in turn, must rate their member SHGs. Numerous realities make this model difficult: Weak management, ineffective on-site supervision, lax standards; and the high cost of on-site supervision and training staff. Furthermore, in the absence of strong operational controls, apex institutions, even as refinanciers, may not be able to strongly regulate and supervise their lower tiers.

LPD in Indonesia

By a 2002 decree of the Bali Provincial Government, 'LPD' refers to a financial business entity that can be owned and managed by any 'village', a community unit governed by traditional law. The principal refinance agency, the BPD together with the training and technical support arm of the provincial government, the PLPDK, supervise the LPDs based on standards that are the same for all LPDs, regardless of their size. LPDs are mandated to set aside 5% of profits to cover guidance and training costs.

A clear graduation path and supervisory support for LPDs have yet to be defined. Although they do seek external funding, LPDs have generally resisted transformation into a more institutional form including cooperatives. Because some LPDs are as big as a small bank, supervising them under banking laws could make sense. At the same time, the start up capital of US\$5,000 and other banking law could distract them from serving remote areas.

Jardín Azuayo Cooperative in Ecuador

De facto, Ecuador has a dual system of supervision for its savings and credit cooperatives. The Superintendency of Banking and Insurance (SBS) supervises all regulated financial entities including 37 savings and loan cooperatives, including Jardín Azuayo, with assets exceeding US\$10 million or equity of at least US\$788,682, and 34 other banks and financial institutions. Without a specific law governing them, the more than 400 savings and loan cooperatives that are not regulated report to the National Office for Cooperatives (DINACCOP) of the Ministry of Social Welfare. A cooperative moving from DINACCOP to SBS control must bear costs related to staffing and committee requirements, auditing, reporting, and acquisition of equipment and software. SBS requirements are much stricter and, in some cases, inappropriate.

The lack of understanding among SBS, DINACCOOP and the cooperatives themselves has led to delays in creating appropriate legislation for the presently unregulated savings and loan cooperatives. To support its unregulated members, the Rural Finance Network developed a financial monitoring system based on internationally-recognized benchmarks and a system of self-regulation.

Mixtlan Cooperative in Mexico

In Mexico, the National Commission of Bank and Values authorizes, regulates, supervises and audits federations while the National Bank of Financial Services, BANSEFI, operates like a central financing facility and promotes the member-owned financial sector. BANSEFI helps institutions comply with legislation and regulation but does not directly supervise.

The 2001 Law of Popular Saving and Credit has given MOI members an increased sense of security and has stimulated membership growth. By requiring cooperatives to be part of a federation, the new law encourages scale, viability and formalization. However, it risks excluding small MOIs that are serving communities in remote rural outreach. The law allows MOIs to transform into one of two legal forms: Popular financial associations or savings and loan cooperatives. To promote and regulate the former, the law proposes auxiliary supervision. To be approved and endorsed by the government, MOIs must fulfil certain requirements such as meeting an assets-to-deposits ratio.

While the law's strict professional standards help ensure the safety of deposits, it contains more flexible aspects that are crucial for remote MOIs. For example, the law does not require greater provisioning for uncollateralized solidarity loans.

VSLAs in Niger

In Niger and seven other countries of the West African Monetary Union, mutualist and cooperative institutions that provide financial services to their members are governed by the PARMEC law and are required to obtain a license prior to starting business. The PARMEC regulations are the same for very small, decentralized MOIs in remote rural areas as for large federations. The law does not cover informal associations such as the VSLAs although VSLAs are eligible to apply for recognition. To be recognized under PARMEC, they will have to agree to use a standardized chart of accounts and format for financial statements, and to meet certain prudential and non-prudential regulations, norms and financial standards. Then, to retain this status, after five years, they will have to submit a proposed performance and business plan that shows their level of self sufficiency and strategy for sustainability.

The VSLA networks are not regulated under PARMEC law but they are registered. Although the Ministry of Community Development should support and supervise them, in practice, CARE supports them so they can regulate themselves. The VSLAs' interest rate to members is much higher than the legal effective interest rate ceiling of 27% per annum. If the VSLAs were to be regulated, under current law, this could be problematic. On the other hand, the protection that external regulation and supervision provides could help the VSLA networks as they aim to increase savings transactions, provide larger loans, and secure external funds from commercial banks or MFIs.

MC2s in Cameroon

A 2003 Central Africa banking law requires MFIs to qualify for one of three licenses based on the markets they serve (see Table 7). The COBAC law innovates by regulating according to financial activities rather than legal status leaving MOIs free to choose their legal form such as associations, cooperative societies, or share companies. Reporting requirements vary with the size of assets: Smaller institutions must submit an audit by a qualified accountant; larger ones must have their financial statements certified by an external audit firm. MFIs of the first category are encouraged to operate sustainably and to avoid dependency on subsidies and donations. They must provision to cover the portfolio at risk and have a minimum infrastructure—a secured office with safe and appropriate safety procedures. Finally, all institutions are required to be part of a network with a headquarters that centralizes liquidity and provides support services.

The law is expected to inspire more confidence in rural savers and reduce the incidence of deliberate mismanagement and bankruptcies. At the same time, it could inhibit the development of small rural MOIs that cannot afford the registration, capital adequacy and staffing requirements.

Table 7: License Options under 2003 Central African Banking Law

Category	Characteristics	Requirements	Institutions
1	<ul style="list-style-type: none"> ▪ Credit & savings mobilization ▪ Members only 	<ul style="list-style-type: none"> ▪ Minimum capital adequacy; reserves of 20% of returns. 	<ul style="list-style-type: none"> ▪ Village banks, CVECAs, Credit Unions in CamCULL network, MC2s. ▪ 65% of the sector, 85% of the volume of activities
2	<ul style="list-style-type: none"> ▪ Credit & savings mobilization ▪ Members & non-members 	<ul style="list-style-type: none"> ▪ US\$100,000 guarantee to be held in a bank. 	<ul style="list-style-type: none"> ▪ Independent MFIs. ▪ 30% of the sector, 10% of the volume of activities
3	<ul style="list-style-type: none"> ▪ Credit only ▪ General public 	<ul style="list-style-type: none"> ▪ US\$50,000 guarantee to be held in a bank. 	<ul style="list-style-type: none"> ▪ Projects, credit institutions. ▪ @ 5% of the sectors

Lessons

The cases provide numerous insights into our core questions.

Which MOIs should be regulated and supervised?

The West African experience demonstrates how easy it is to underestimate effective supervisory requirements and how un-enforced regulation can be worse than no regulation at all. Regulating and supervising large numbers of small remote-rural MOIs may not be feasible in terms of costs and human resources even though the depositors in these MOIs, disproportionately poor, may particularly merit protection. The cases suggest some ways to handle this dilemma.

Small decentralized associations such as SHGs or VSLAs may be the only service providers to many rural poor. Regulators may consider a size under which they need not be regulated provided that they are linked with and perhaps overseen by a regulated financial intermediary, a bank or a SACCO. Having deposit mobilization trigger regulation may not be relevant for remote-rural MOIs that serve only their members, especially where they are the only organizations offering these services.

In both the Central and West African regions, recent regulation holds “promoters”—NGOs, consulting firms, donors or governmental projects—accountable for performance. Promoters must be licensed and have a credible strategy for sustainability including an institutional and business model and an exit strategy that addresses systemic risk. Although this approach may seem too stringent for small action research operations, especially for a supervisory authority with insufficient resources, it does help secure depositors and the sector by halting competition from subsidized schemes that undermine the strength of other financial institutions.

What about a Tiered Approach?

Regulation and supervision that is uniform for all type MOIs—as is the case in India and Indonesia—are highly likely to run one of two risks. Either it may overburden less-risky, remote, rural MOIs that may have no qualified staff or more likely, it will treat laxly or ineffectively large bank-like cooperatives that often are weakly-governed. Some considerations for tiered regulation emerged from the cases.

- In Central and West Africa, microfinance regulation is now based on activities rather than on legal status, with requirements adjusted for rural MOIs. In Central Africa, regulation is tiered according to whether clients are members, whether voluntary savings services are provided, and the size of assets. Increased risk triggers greater reporting, auditing and capital adequacy requirements. The larger MOIs more likely to function as small banks must provide a guarantee fund to prove solvency. In the Central African regulation, minimum capital requirements are very accessible for MOIs and are higher for institutions dealing with both members and non

members. The larger institutions are easier to supervise as they are based in cities and major towns.

- Assessing the direct costs to an MOI of being regulated—from capital adequacy to provisioning, reporting, staffing, MIS, and controls—will help determine what size MOI can absorb such investment and operating costs.
- Small MOIs that are less risky to the sector or for which supervision would not be cost-effective, might be required to form networks that are large enough to allow economies of scale, professional management, and financial solidarity to mitigate risks. Supervision could then concentrate on the network and its capacity to report and produce credible on-site control. In both the Mexico and Ecuador cases, regulation requires or encourages small or medium size MOIs to federate. Federations are more cost effective to supervise than many individual MOIs, especially if these MOIs operate in rural areas.

There are strong arguments for and against this approach. On the one hand, federations that recover their costs and realize economies of scale can help their member MOIs sustain growth while maintaining sound management and portfolio quality. This strategy may avoid massive losses due to fraud or defaults. The Rural Finance Network in Ecuador, UNISAP federation in Mexico, and MACS Act in Andhra Pradesh enhance sustainability and growth and help MOIs become regulated and integrated into the financial sector. On the other hand, regulation that requires MOIs to federate can curtail deep outreach by excluding small MOIs that are serving communities in remote rural areas. Several of the case MOIs resist federating because they fear that they will lose local control.

Who Should Supervise?

Having one financially specialized agency equitably regulate and supervise all institutions, independently of their legal status, is sound and consistent. This agency can propose whether licensing and supervision should be undertaken by a special unit or by the same inspectors that oversee banks.

Usually, the appropriate supervisory entity is the Central Bank or Banking Commission. In both Ecuador and Mexico, these supervisory entities have the appropriate skills to supervise financial institutions. That the Indian and Indonesian supervisory bodies for MOIs are non-financial authorities is problematic: Instead of protecting the MOIs they oversee, their weak and inappropriate standards, guidance and supervision puts these MOIs at risk. Where new laws shift supervisory responsibilities from the government's cooperative arm to its banking one, dual systems of control and supervision may coexist as they do in Mexico. This can be detrimental to sound MOI development.

Supervision by third parties may be problematic. Supervision by refinancing banks rarely works well. In the cases of the BPD in Indonesia, BANSEFI in Mexico, and the First Afriland Bank and MC2s in Cameroon, entrusting refinanciers with some aspects of supervision proved ineffective due to conflicts of interest, distance or scarce human resources. On the other hand, delegating external oversight to private audit firms or banks may be costly and illegal.

Supervisory authorities could delegate certain functions to networks and supervise networks instead of directly supervising each small remote-rural MOI. Distinct from self-regulation, delegated supervision has proven effective and cost-effective, especially in vast sparsely-populated regions. Networks might collect data and oversee high-level internal control, leaving the supervisory

authorities to concentrate on supervising for compliance, randomly check reported data, and enforce prudential requirements.

What to Supervise?

Governance: Though MOI risk is concentrated in the area of governance, regulation should avoid defining too-detailed management rules, operational procedures, methodologies and products. Providing core principles of good governance is more appropriate. Furthermore, in remote rural areas, mandating qualifications for the board will concentrate power in the hands of elites and will lower community ownership, as in the case of the LPD. In areas with a high level of illiteracy, a supervisory committee could be replaced by external auditors and/or private service providers appointed to this end.

Solidarity guarantees: Allowing solidarity mechanisms to secure loans without requiring additional provisioning is essential for the sustainability and growth of MOIs and for refinancing banks. In Mexico, the possibility of using solidarity as collateral, without having to provision highly for unsecured loans, is an important innovation to enable outreach to the poor and women.

External credit: Not restricting external credit can damage MOIs, but restricting it too much can limit outreach, products, and sustainability.

Non-financial activities: The West African BCEAO law limits MOI's investment in activities other than savings and credit. For rural MOIs, this probably makes good sense. Members frequently ask MOIs to market crops: This can put savings at risk and requires other skills than those involved in managing saving and loan activities.

Interest rate caps: Setting interest rate caps can reduce the ability of MOIs, especially remote rural ones, to be self-sustaining. MOIs must be able to charge enough to cover these costs and the costs of higher level tiers or service providers since these linkages are essential.

Costs of Supervision and Ways of Covering Them

- The costs to supervisory authorities can be kept manageable by delegating certain functions to networks, combining on-site and off-site supervision effectively, and involving external audit firms. However, donor support might be needed initially to develop procedures, train inspectors, and obtain software.
- In Indonesia, the requirement that 5% of an LPD's annual surplus be set aside to pay for guidance and supervision may be a promising approach to cost recovery.

Conclusions and Way Forward for Regulation and Supervision of MOIs

The cases provide some important lessons on how regulation and supervision affects MOIs' outreach and capacity to serve remote rural populations:

- The study has not identified any legal and regulatory environment that has been clearly hostile to MOIs. Perhaps by avoiding being regulated at an early stage, all the case MOIs have been able to emerge and grow without much constraint. In fact, their size and visibility is leading some to consider more formalization and some authorities to want more accountability and transparency.
- Initiatives and innovation at the grassroots is not threatened by the regulatory environment. As MOIs grow and put more people, the sector, or the financial discipline in a certain geographic area at risk, regulation should be considered.

- Given the limited capacity and resources of most specialized supervisory authorities, small time-bound MOIs should not be regulated. Small to medium-sized MOIs that are governed by representatives of the general membership and that operate in sparsely-populated rural areas should be encouraged to join networks or federations to which some supervisory functions could be delegated.
- Regulation needs to provide suitable paths for the graduation of small remote rural MOIs. The cases of the SHGs, VSLAs and MC2s suggest that a change in paradigm may be needed. The perceived path of graduation is almost always transformation into traditional multi-tiered cooperatives, even though other innovative options may suit the local context better and may stimulate greater participation and stronger governance.
- New laws typically designate specialized supervision authorities such as Central Banks and recognize the nature of activities rather than legal status as the trigger for regulation.
- Splitting supervision between a Cooperative Registrar and a Banking Superintendency creates confusion, distorts the markets and ultimately weakens the MOIs.
- A good regulation is one that both parties understand and can implement. It can be simple yet strict on core principles, tiered and affordable so as to encourage rural outreach.

As a way forward, we join some key stakeholders in recommending:

- A Basel Accord-like process to develop international guidelines for MOI regulation as proposed by Cuevas and Fischer (2006).
- Or, more pragmatically, an international task force of experts, promoters, and practitioners to build consensus on good practice for MOIs operating in rural areas and to identify norms, standards, and related risks as a step towards appropriate regulation and supervision.
- Simultaneously, an in-depth analysis of regulation and supervision frameworks, and their impact on MOI sustainability and rural outreach. This will provide data to ground an advocacy campaign and raise government and central bank awareness. This analysis could involve national associations like Ecuador's Rural Finance Network.

Conclusion

So, taken together, what do our case studies tell us about MOIs and remote-rural outreach? Do MOIs add value in and of themselves? What are the keys to strengthening their outreach? The answers to these questions differ according to the type of MOI and the market we aim to serve.

Small groups that provide very simple services and regularly disburse all their funds achieved the greatest outreach to poor remote-rural markets and can provide quick, large-scale and sustainable outreach—if they are left to themselves. For these MOIs, regulation and supervision, networks and linkages can hobble outreach and do not seem to add value. The services of “cash-out groups” may be well-suited to poor remote-rural areas and may be the best services that these areas can command.

In all types of small MOIs—groups and those governed by elected representatives—member ownership can be a strong positive force. For MOIs with a few hundred members or fewer, member ownership helps assure that members are overseeing management and seems to push the MOI to provide more responsive services than its limited management capacity would suggest is possible. Although larger MOIs may serve remote-rural areas that are better-off, the small MOIs seem uniquely positioned to serve remote rural areas that are poor. At the same time, in MOIs governed by elected representatives, governance is often strengthened by the involvement of local elites and traditional structures, often to the detriment of the poor in these areas.

In small MOIs, linkages and networking can pose challenging tradeoffs. External support can enable the MOI to provide more complex services or a broader range of services, but these linkages also can significantly weaken members’ sense of ownership and oversight. External capital and donor subsidy too can loosen the perceptions of ownership that lead to strong governance. With these MOIs, regulation and supervision, operational subsidy and linkages should be designed with utmost consideration to issues of ownership and governance: Tinkering can threaten the access of remote-rural markets to financial services.

For MOIs that are larger, oversight by members seems to be much weaker and governance by elected representatives often diverges from the interest of the whole. Networks may further weaken governance and oversight. This is particularly challenging for medium-sized MOIs that are too small to command direct effective government supervision and skilled management. These weaknesses can be exacerbated by a MOI’s roots: Where a MOI is born dependent on a donor or government agency, it may lack the drive to become sustainable. Their social missions may drive medium-sized and large MOIs to extend services to more remote areas but their services often are less responsive to member demand than those of smaller MOIs.

For other than small MOIs, bigger may be better. Of the five medium-sized and large MOIs in our study, the one with the greatest remote outreach, broadest product range, and greatest penetration rate is the largest, a 23-branch, primarily rural financial cooperative—a cooperative that is big enough to provide skilled management without resorting to a network or linkage.

When MOIs exceed the small size that allows for effective peer monitoring, finding ways to supervise is essential. Requiring tight federations in which the federation focuses on technical support and oversight and itself is supervised may be a key to strengthening governance.

However, while oversight and supervision is crucial for all but small MOIs, networks often are costly, add little value and diffuse member control. Networks seem to be stronger if they are not polluted by donor funds, government support or external capital. Enforcing simple transparent reporting systems can be helpful as can a focus on providing solely financial services. Finally, finding ways to enforce standardization and controls, while decentralizing operations enough to engage local members in oversight, is another key to strengthening governance and oversight.

Once a MOI surpasses the size that peer monitoring is effective, governance is a challenge: Often the lack of incentives for strong oversight is magnified by the lack of strong management skills. Finding simple, appropriate ways to supervise these institutions, while providing simple, appropriate systems and technical support, is crucial to strengthening these MOIs' remote-rural outreach. This is important because, strong or not, MOIs continue to fill a void, serving remote-rural and poor markets that otherwise are untouched.

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Appendix A:
Outreach Statistics for Case Institutions, Groups, or Networks (2006)

	2 MC2s	25 MMDs	1 MACS 68 groups	1 PACS 85 groups	1 LPD	Mixtlan	Jardin Azuayo (1 branch)
Depth							
Avg. savings balance as % of PC GNI	96%	2%	5.72%	12%	24%	15%	35%
Avg. loan balance as a % of PC GNI	163%	1%	21.6%	22.09%	13.35%	35%	90%
Population density (persons per sq. km.)	107	10-25	190	405	400	6	6 to 60
No. of service providers in service area ³	1 to 7	2	7	2	2	11	14
% of clients who are female	28.4%	100%	100%	85%	25%	49.4%	36%
Length							
Operational self-sufficiency	136%	3%	113%	98%	200% (2005)	35.8%	104.3%
Financial self-sufficiency	NA	NA	95%	NA	195%	NA	100.6%
Portfolio at risk > 30 days	24%	Past due loans: 7%	Repay-ment rate: 96%	Repay- ment rate: 82%	Repay- ment: 90% (2005)	7.9%	4.81%
Total operating expenses / avg. total assets	13.8%	358%	7.9%	6.99%	4%	65.8%	4.35%
Average staff remuneration / PC GNI	1331%	NA	88%	30%	5.5%	66%	266%
Breadth							
Number of active borrowers	1726	@ 525 ¹	148	386	173	1386	21,320
Number of active savers	3488	535	59	782	65	3224	52,047
Cost							
Effective interest rate ⁴	13-25%	768% ⁵	135%	30%- 522% ⁵	36-42%	15%	58%
Worth							
Retention rate	99.2%	NA	95%	95%	100%	90.4%	100%
Other							
Net loans / total assets	37%	30%	72%	62%	76%	74%	63%

Notes: Except for the case of the LPDs, data is self-reported. PC GNI refers to per capita gross national income. NA indicates that data is not available

¹ Assumes 21 members per group

² Includes only voluntary deposits

³ Formal or semi-formal

⁴ Based on average loan size

⁵ Low value reflects compulsory savings only for current loan period. High values reflect estimated accumulated compulsory savings

Appendix B: Chief Findings from the Literature Review

Member-owned institutions (MOIs) can achieve impressive outreach. They often serve more rural markets than any other type of financial institution. They typically recover their costs. Through growth or replication, they can serve large numbers of clients. And though often limited in scope, their services may respond to client demand and cost clients less than their alternatives. Frequently MOIs are plagued by fraud and mismanagement. Their scale and continued existence is limited by their governance.

This study examines what outreach can be expected of different types of MOIs, key controllable factors that affect it, and how it might be expanded. We consider three drivers of outreach:

- internal governance,
- participation in federations or networks and linkages to private suppliers, NGOs and government; and
- regulation and supervision.

Our analysis is based on a review of the literature on MOIs and focuses on MOIs that provide primarily credit and savings services in Africa, Asia and Latin America. We are particularly interested in MOIs that serve markets unserved by other financial institutions.

Outreach

MOIs run the gamut, from small informal ROSCAs to huge cooperative banks. To clarify our analysis, we define a simple typology of MOIs and then assess their potential using Schreiner's (1998) six aspects of outreach - depth, breadth, length, scope, worth to clients, and cost to clients.

Depth: MOIs are often the only institutional provider of financial services in rural and remote areas. Because rural-remote areas tend to be poorer, MOIs that serve them often serve poorer markets than other financial institutions. At the same time, within the geographic areas they reach, MOIs may not serve the poorest market segments. Depth of outreach varies by type of MOI. Smaller MOIs may serve more remote and poorer areas than larger ones and small cooperative-type MOIs may be the most cost-effective means to serve remote areas. However, even large MOIs tend to reach poorer market segments than commercial banks. MOIs may also be better-suited than other types of financial institutions to serve conflict and post-conflict areas.

Breadth: In many regions, MOIs serve large numbers both in absolute terms and relative to other types of financial service providers. The stimulus to grow often comes from donors or providers of technical support rather than MOIs themselves. Breadth of outreach should be considered in relation to population density: MOIs can serve more sparsely-populated, poorer regions than other types of institutions precisely because they can be viable without achieving a large scale. The simplicity of group models enables them to be extended to large numbers of people quickly. Mergers can enable large-scale growth through economies of scale but may be more relevant in competitive markets than in remote-rural ones.

Length: Most MOIs of all types cover their operating costs from their inception. For most MOIs, the greatest threat to long-term outreach is weak governance and management capacity or inappropriately complex management systems. All but the simplest time-bound groups and the most

sophisticated large MOIs seem to require ongoing support. The costs of this support should be figured into any assessment of their sustainability. Though not normally covered by operating revenues, the per-member cost of promoting groups might compare favorably to the per-client cost of developing sophisticated MFIs – that also are not covered by operating revenues.

Net value: scope, worth and costs to members: In non-competitive markets, many large MOIs are not motivated to diversify their product offerings. However, some now offer remittance and ATM services and a variety of loan, savings and insurance products. Linkages to commercial institutions and federations, incentives from donors, and technical assistance can help MOIs broaden their scope. Small MOIs are limited by their management capacity and lack of liquidity, but their responsiveness to members can lead them to offer surprisingly well-adapted products. Non-financial services can strengthen their provision of financial services or can cost-effectively increase impact but also can increase costs, weaken governance, and limit the scope and innovation of their financial services. MOIs tend to impose lower transaction and financial costs on their members than other types of financial institutions. But the risk of losses may be higher.

Drivers of Outreach

Governance

In large MOIs, the power to make decisions is diffused among so many members that individuals rarely feel that they have much influence and therefore do not actively oversee their MOIs. Because this leaves the boards and management of large MOIs relatively free to pursue their own interests, many large rural MOIs are plagued by mismanagement. Four other factors can also weaken their governance: socio-cultural norms that inhibit members from holding their leaders accountable; a mismatch between member capacity and MOI management systems that leaves members unable to effectively monitor their leaders; the provision of non-financial services that can muddy the difficult job of overseeing financial services; and the absence of competition.

These challenges can be addressed by:

- Catalyzing member participation and strong oversight through participatory processes within the MOI that involve local leaders and governance structures and economic incentives;
- Enabling members to effectively monitor management by providing technical training and training in how to hold leaders accountable, outsourcing complex services, and implementing simple systems such as oral bookkeeping for groups; and
- Establishing bylaws or rules that legislate sound governance structures and practices and give members the means by which to hold their leaders accountable.

Second-Tier Institutions and Linkages

MOIs require many types of on-going support from liquidity exchange to technical support. They can obtain this support from the market, from a second-tier institution, or from an NGO or the government. How this support is procured and paid for is important for two reasons. First, this support must be sustainable if the MOIs that rely on them are to be sustained. Second, how an MOI procures these inputs can profoundly affect its governance.

Federations can provide their member MOIs with some or all of the support they require. However, federations can suffer from severe accountability and capacity issues such that they provide members with little value, cost them a lot, and undermine their governance. Federations might be

kept accountable to their MOIs by funding themselves from member service fees rather than interest revenues. In remote-rural areas, some decentralization seems crucial to assure strong governance (at the same time as centralization may be essential in competitive markets).

Many SHGs do not seem to be sustainable with bank linkages alone and alternatives, such as linkages to microfinance institutions, have not yet proven viable. Clusters of SHGs can strengthen and provide services to their members and can be sustainable. They require skilled members and do not provide substantial economies of scale.

Market forces alone are unlikely to extend financial services to remote areas: strategic subsidies are needed. Whether a moderate amount of external capital strengthens or weakens MOIs is fiercely debated. What is clear is that external credit that is subsidized hurts MOIs, their members' access to financial services, and the rural financial sector.

Regulation and Supervision

Developing effective regulation and supervision may be the single most important means to increase MOI outreach. Consensus on principles for MOI regulation and supervision is urgently needed (Cuevas & Fischer, 2006). We explore the key questions that demand resolution: What types of MOIs should be regulated? Are tiered licensing standards appropriate? If so, how should they be defined and what should be required of each tier? What entity should supervise? Under what conditions, if any, might delegated supervision or self-regulation be acceptable? Under what conditions might it be appropriate for different authorities to supervise different classes of MOIs? How should the costs of supervision be covered?

The biggest impediment to effective supervision may be its costs. A key to cost recovery and to effective supervision is “fit”: simple regulatory requirements that are appropriate to the size and complexity of the MOI (Jazayeri & Lee, 2006). Tiered regulations make this possible. For example, large open-membership MOIs might be subject to bank-like supervision, medium-sized and closed ones might simply be required to submit standard financial reports and an annual external audit without prudential supervision, and small MOIs, that can effectively monitor themselves, might not be supervised at all (Vogel, 2002).

MOI regulations should focus on governance, the greatest risk that MOIs face. We identify a set of regulations that can place a check on governance. Finally, we suggest some strategies for donors, governments and second-tier institutions and pose some questions for researchers that might help strengthen MOI outreach.

Appendix C: Methodology and Summary of Case Studies

Study Objective

To illustrate how varied member-owned models in different contexts have been able to achieve significant outreach in remote, rural areas.

Defining Member-owned

- Clients are both owners and users of the institution
- Member equity is tied to ownership and decision-making (shares; savings; rotating/internal capital)
- Member equity is a key source of funds
- Legal entity is based on member-owned (i.e. association)

In order to cut across models definition needs to account for a variety of forms of equity and decision-making. Even what legal entities are possible will vary from context to context.

Defining Remote

Unserved in its own market. This can be due to several factors:

- Geographical distance from nearest service or input provider
- Population density
- Socio-cultural aspects of access such as gender or ethnic background as in the case of lower castes in Asia or indigenous groups in Latin America

Study Methodology

The intention of the research is to help answer some questions about different types of member-owned institutions to determine what potential they have for depth, breadth, scope, length, worth and cost of remote outreach, using Schreiner's (1998) six aspects. In-depth institutional analysis of each MOI sample examines remote outreach and demand by remote members and member groups. The second level of analysis focuses on how remote outreach is influenced by three key drivers:

- Networking and linkages
- Governance and ownership
- Regulation and supervision

The perspective of analysis is from the lowest tier association, SACCO or set of groups and their members. Selection of case MOI(s) is based on the 20% most remote MOIs within their sample universe. Selection is based on remote members/groups that are representative and mostly strong. The sample universe would be the district, sub-region or cluster of MOIs according to second-tier organizations, political boundaries or regulatory areas. Depending on size of MOI and sample, range could be a number of self-help groups to one SACCO or village association.

Case-Selection Criteria

- Remote in terms of households is proxied by one or more of the following:
 - Location of access points (decentralized and centralized level if receiving different services at each point).
 - Distance of access points to local centre and nearest road (nature of road), availability of transportation.
 - Depth of outreach (varies by context but broadly a factor of population density and infrastructure, poverty level, and other indicators of social exclusion).
- Member-owned (not managed externally; members involved in decision-making)
- Strong breadth of outreach relative to the context
- Informative in terms of one or more of our key research questions (governance and member-participation; external resources; regulation and supervision; type of MOI)
- Not so unique or idiosyncratic that it does not have lessons that can be applied to other contexts
- Relatively financially viable
- MOI is transparent, information is readily available or fairly easily collected and staff is willing to collaborate in collecting information.

Schreiner, M. (1998). Aspects of outreach: A framework for the discussion of the social benefits of microfinance. *Journal of International Development*, 14(5), 591-603.

Cases Selected

1. PACS (Primary Agricultural Credit Society) with self-help groups as members, Andhra Pradesh, India [linkage between SHGs and cooperative]
2. Self-help group federation, India [federation of SHGs]
3. LPD (Lembaga Perkreditasi Desa), Indonesia [small village-based associations]
4. Village savings and loans associations, Niger [de-linked and networked groups]
5. Mutuelle Communautaire de Croissance (MC2s), Cameroon [federated and decentralized associations]
6. Jardín Azuayo, Ecuador [rural credit union with remote service points]
7. Mixtlan SACCO within UNISAP Federation, Mexico [urban-rural cooperative with some rural SACCOs]

Self-Help Group—Primary Agricultural Credit Societies Linkage, India

The self-help group (SHG) linkage model is the largest-scale and perhaps the best-known linkage model in microfinance. SHGs are informal thrift and credit groups of poor, mainly women that became recognized as bank clients under a pilot project of the rural apex bank NABARD in India in 1992. As of March 2007, there were more than 2.9 million SHGs linked to financial institutions (commercial banks, rural banks and cooperatives) representing over 40 million households. This case study examines the linkage between SHGs and cooperatives, specifically the Primary Agricultural Credit Societies (PACS) which accounts for 69% of the rural financial branch infrastructure (NABARD, 2007). West Bengal has had the highest percentage of SHG-PACS linkages in India and regulation there allows groups to be members of financial institutions rather than requiring groups to serve as conduits for individual members.

This case examines the Bararanga PACS in West Bengal linked with 85 SHGs and 1,382 members, all women. It is located within Purulia Manbazaar II a border block with a population density of 405 persons per km². This PACS was locally described as the most remote since more than 75% of the

SHGs live in the most remote areas of the block and over 80% are from a tribal group, otherwise largely excluded from finance.

SHGs Federated into Mutually Aided Cooperative Societies, India

SHG linkage models have been given much more attention than SHG federated models. This case examines an SHG federation in the Tribal Belt of Andhra Pradesh (AP). AP is the most concentrated state of SHG activity, so it is interesting to understand how inclusive it actually is of people living in remote areas. AP also passed a new law called the AP Mutually Aided Cooperative Societies Act to govern the new generation cooperatives (including SHG federations) to allow them to move from charitable status and forgo government subsidy to become regulated in a new act free of the challenges and bureaucracy of the Cooperative Act.

This case study examines ASP (Ankuram Sanghamam Poram), a federation of SHG federations with nearly 6,000 SHGs and 65,520 members at its base. This system grew out of a local Dalit (Dappu' Dalitbahujan) movement and trade union, and has deep roots in social activism. It is a three-tier system federated at the state and sub-district levels, with the apex serving as the system's wholesale financier and supervisor. Each sub-district MACS has an office as does the state level MACS, and in addition there is some minimal infrastructure for the district level teams. The infrastructure and staff are largely subsidized by the apex MACS, which, through a business planning process, is attempting to wean member MACS away from subsidies. However significant levels of grant support are still required in the system.

This case examines Jeevan MACS, a sub-district level MACS, one of 108 within the ASP federation. Jeevan MACS has 1020 members and 68 SHGs. The population density is 190 persons per km². The remote nature of this case is also more socio-cultural than geographical. The federation is largely comprised of lower-caste women who have taken on leadership at each tier. The case allows an interesting contrast to the PACS-SHG linkage model.

LPD, Indonesia

The LPDs (Lembaga Perkreditan Desas) are village-based financial institutions in Indonesia that have been encouraged by the provincial government. LPDs have grafted their governance and management onto local customary institutions as one way to ensure local ownership and accessibility. Basing the financial institution in each village has enabled LPDs to achieve broad and remote outreach through lowered costs and local ownership, as well as a high level of acceptance and trust among local people. Since LPDs are owned by the traditional council and managed in part with traditional laws, member accountability to the MOI is high.

LPDs were chosen because they have high penetration in Bali, Indonesia where over 90% of the households are members of one of more than 1,200 LPDs. Even islands have their remote contexts. In this case, the Muntigunung LPD is one of 156 LPDs in Karangasem Regency/District. Muntigunung was identified by local officials as the most remote and poorest settlement in the hills, with poor irrigation and poor access to drinking water and located at least 45 km from another financial source. The population density is 400 persons per km² and the population is largely dependent on agriculture, as it is distant from the flows of tourism. This LPD reaches out to 1,020 members (all households in the *desa adat*) with 249 borrowers and 88 savers.

Village Savings and Loans Associations, Niger

Niger is the oldest, largest and one of the most remote CARE programs for village savings and credit associations (VSLAs) in Africa. Similar programs with a similar though adapted methodology exist in thirteen other African countries. Through the methodology, CARE has encouraged the formation of village loan funds composed of members' savings, using a simple time-bound savings and lending methodology. CARE tries to limit external involvement to one year of training and follow-up. The number of members in Niger VSLAs is currently about 50,000. While some of these savings and credit associations are entirely self-managing and cash out at the end of their one- to three-month cycles, others have come to network and link to financial institutions including cooperatives. CARE is also using the networks as a springboard for non-financial activities such as cereal banks. For this case, 25 VSLAs were chosen in Tahoua Region including both networked and non-networked VSLAs. The population density in this area is between 10-25 persons per km².

MC2s, Cameroon

Mutual associations have a strong reputation in West Africa for their rural outreach. This case study examines two Mutuelle Communautaire de Croissances (MC2s) in Cameroon, part of a larger network covering 62,744 members through 64 MC2s. The two MC2s, Njinikom and Bambilang, are located in two rural localities in the Northwest province of Cameroon situated 65 km and 85 km respectively from Bamenda, the main city of the province. The population density in the area of study is 107 persons per km². The two MC2s have 3,512 members, more than half of the members found in the province. Overall the MC2 network has 62,744 members. They present a good contrast between a strong and weak MC2 in terms of governance and financial performance.

The case examines the MC2s' complex set of relationships including its own emerging apex structure, government subsidy, support from a promoting non-government organization and linkages with market suppliers. The MC2s offer a variety of savings and loan products, training and other non-financial services to both individuals and groups. Groups include 'tontines'—informal savings and loan groups affiliated with local agricultural and women's associations—that are common throughout Cameroon. Of particular interest for remote outreach is their use of migrant relatives as a key source of funds and other ways that they have managed to secure market linkages.

Mixtlan SACCO, Mexico

Large cooperatives or federations with economies of scale, an urban and rural presence and a stable asset-base may be one solution to the challenges of decentralized MOIs. In part, Mexico's policy and regulatory regime have encouraged consolidation and scale in both microfinance institutions and MOIs.

This case examines Mixtlan, a rural SACCO. It is part of UNISAP Federation, a large and highly-rated urban-rural federation. UNISAP has over 350,000 members in Mexico. Of those, 19,155 are rural. Mixtlan cooperative, with 3,452 members, covers over forty localities in the north mountain range of Jalisco State. Mixtlan works in a rural and remote area with a population density of six persons per km². The nearest input supplier is 257 km. away and remote collectors are used in some rural localities. Mixtlan is one of few rural cooperatives within UNISAP (Cooperative Federation), which is a largely urban federation (more than 70% of its members are in urban areas). Within the rural MOIs, Mixtlan showed one of the highest rates of local penetration, nearly 90%. The federation's scale has provided important efficiencies and the urban presence is crucial for market linkages including remittances, a highly demanded service for remote members.

Jardín Azuayo Cooperative, Ecuador

One way for larger cooperatives to reach rural and remote areas is to provide urban-based services that can provide liquidity balancing and cross-subsidize smaller, costlier service points. The Jardín Azuayo Cooperative case presented here runs contrary to this logic. It is a largely rural cooperative (80,378 members) with twenty of its twenty-three offices in rural areas.

This case examines five rural offices with 29,260 members in the south-east spanning three provinces. The population density averages 39 persons per km² across the offices. Jardín Azuayo uses a model of decentralized representative governance in each office complemented by member education to support member participation. This case also demonstrates a reversal in the trend of rural siphoning (taking savings from rural areas to finance urban lending) common in Ecuador and elsewhere. It is a self-financed cooperative that has successfully moved from a system of self-regulation to prudential supervision by the Superintendency of Banks and Insurance.