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ORGANIZATION AND MANAGEMENT OF CREDIT SCHEMES FOR THE POOR AT GRASSROOTS LEVEL IN AFRICA

By

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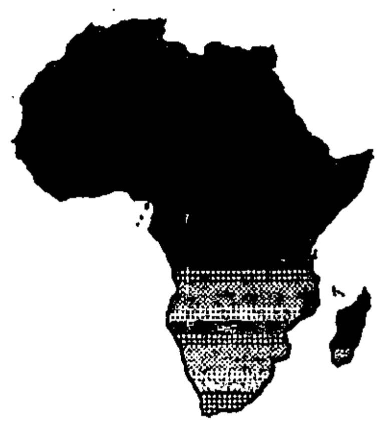

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ORGANIZATION AND MANAGEMENT OF CREDIT SCHEMES AT THE GRASSROOTS LEVEL FOR PARTICIPATORY RURAL DEVELOPMENT PROGRAMMES IN AFRICA

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CHAPTER I

INTRODUCTION

A. Background

Many African countries have suffered repeated setbacks in their efforts to promote sustained economic development. Since the mid 1970's they have experienced a seemingly endless series of economic shocks, emanating largely from a decline in world prices of primary commodites. In the light of the mounting debt problem it is unlikely that attempts to maintain economic growth through external financing and imports will succeed. Corrections in economic policies are inevitable, and many countries have already taken the initiative with the adoption of structural adjustment programme for economic recovery.

In this situation, African countries must rely largely on their own resources and potentials to further their development. The mobilization of local resources and their efficient utilization through a strategy of "bottom-up development" has become the central problem and challenge. Self-sustaining economic and social development requires a renewed emphasis on and re-inforcement of labour intensive traditional economic sectors. This applies especially to agriculture and small enterprises, the integrative elements of rural development. Only a strategy that proceeds from the rural economic base can ultimately secure the supply of foodstuffs, ensure that basic needs will be met over the long term, and prevent further impoverishment of the rural population.

The key factors in this context must be the initiatives of the inhabitants of rural areas, their organizations and their institutions. The contributions of the rural population - in the form of labour and monetary inputs - must replace the overused practice of "spoon feeding" with loans from government and external agencies, which has stifled grass-roots initiative and induced a "charity recipient mentality."

For the advancement of their own initiative and for the utilization and expansion of their resources and potentials, the small-scale farmers and entreprenurs in the rural population - including their self-help groups - must be provided with the basic pre-requisites, for economic independence and flexibility. In addition, a rural financial infra-structure must be created that is suited to the needs of the rural poor and to the local situation. This infrasturcture must: (i) mobilize the financial resources in the rural areas and channel these funds for the provision of credit to the enterprises in the various sectors of the rural economy, such as: agriculture, food processing, handicrafts, transportation, etc., (ii) contribute to the creation and expansion of local financial and product markets, to an increase in demand and employment and to an improvement in the supply of goods available in the local area; (iii) provide owners of mobilized funds with additional income in the form of interest earnings; and (iv) link savings with the supply of credit and make both subject to the social control of savers and borrowers.

Financial institutions that perform these functions and whose programmes focus on the poor target groups, private businesses, self-help groups and self-help organizations struggling for economic survival provide a basic pre-requisite, and thus a crucial instrument, for the necessary bottom-up development.

B. Scope for New Approach to Rural Credit

Like many other institutions in Africa, banking institutions in many countries are primarily urban-oriented and geared towards the needs of the economically fortunate class. Their structure, character and mode of operation are not easily amendable to providing efficient services in the rural areas, not to speak of the rural poor. As the inadequacy of the present banking system in catering for the credit needs of the rural sector was becoming transparent, more branches were opened in the rural areas under government coercion and/or persuasion. But this has not improved the situation. Rural branches especially of commercial banks, have turned out to be instruments to siphon off deposits from the rural areas to the urban areas. The banking community have tried to adapt their services to the needs of the rural people by introducing special credit programmes and schemes. These, have also remained to be token efforts without any substantive change in the basic mode of operation. Rural disadvantaged groups, like small-scale farmers (men and women), craftsmen, women engaged in small businesses remain totally outside the orbit of the banking system, although they constitute the largest segment of the society, and they are the ones who are desperately in need of credit for mere physical survival.

The basic reason for the poor being poor is that they have to operate from a very narrow economic base, and very little economic manouverability. Their economic base consists of only physical labour and may be a small plot of land. A great transformation in their economic base would have taken place if they could only add some financial resource to support their physical resource. For instance, if the small farmer does not borrow from the trader or moneylender to purchase inputs or to meet his/her consumption needs, he/she can sell his/her produce at a fair price and perhaps double his/her income. Similarly if a petty-trader or petty-producer who has to borrow at an exorbitant rate from a moneylender could have borrowed from a formal financial institution at the commerical rate he/she could earn a much higher return on his/her investment. In each of the examples cited, under the existing circumstances, there is no chance for the poor to improve their economic base and thereby improve their income because the existing system makes it absolutely sure that their income is kept perpetually at a low level that nothing can ever be saved or invested to let the economic base expand.

The poor are not unproductive. They could be among the most the productive segment of the rural population. But unfortunately, fruits of their labour are usurped by the better off segments of the population through economic, social and political manipulations. All these

manipulations find their strength in their control over financial resources. If the control over the financial resources could be loosened, the poor can, at the very least, begin to enjoy some fruits of their labour, begin to expand their economic base, live their lives with dignity and look forward to build better lives for themselves and contribute more to rural development.

Reaching the poor with income-generating credit programmes is not an impossible task as is sometimes imagined. This paper attempts to make out a case and provide a model (credit scheme) that the poor can be effectively reached if the credit programmes are designed exclusively for them, implemented through specialized delivery mechanism (involving group participation) with specialized trained people, designed by people who know what they are doing and for whom and implemented within a national policy framework which is supportive of participatory rural development.

C. Objectives

The rural poor who are desparately in need of credit generally remain outside the orbit of conventional banking systems. The paper aims at designing an action-oriented participatory scheme which will bring the rural poor within a viable banking network. If financial resources could be made available to the rural poor on terms and conditions both appropriate and reasonable to them, these millions of small people with their millions of small pursuits could add up to create rural development projects.

More specifically the objectives of the credit scheme will be as follows:

i) To extend banking facilities to the poor men and women in the rural areas;

ii) To create self-employment income-generating opportunities for the un - and under - utilized labour resources;

iii) To bring such disadvantaged people within the fold of some organized format, which they could not only understand and operate but also find in it socio-political strength through mutual support; and

iv) To reverse the age-old vicious circle of "low income, low savings, low investment, low income" into an expanding system of "low income, credit, investment, more income, more credit, more investment"; and

v) To help release the poor from the grips of money-lenders and traders.

D. Structure and Coverage

The structure of the paper is as follows: By way of a background, Chapter II contains a brief description of the role of formal financial institutions in the supply of credit and deposit facilities to the rural poor. The constraints hindering access of the rural poor to formal credit are systematically analyzed in Chapter III in order to formulate a conceptual orientation for the organization of a grass-roots level credit scheme. Group promotion, formation and development for the active participation of the rural people in savings, credit and other supportive services is taken up in Chapter IV. Chapter V deals with the successive stages in the organization of credit scheme at the grass-roots level for participatory rural development. A summary of conclusions and recommendations is presented in Chapter VI.

CHAPTER II

FORMAL FINANCIAL INSTITUTIONS AND THE SUPPLY OF CREDIT TO RURAL POOR

A. Introduction

Like all organizations formal financial institutions want to survive economically. Some have the additional objective of catering for their clients' needs and supporting them, while others may simply take their customers' demand into account in order to increase their profits. The essential question for both groups is this: Can they be viable in a remote rural setting? Can they cover their costs and maintain their liquidity and capital? Are they forced to be overly restrictive and to avoid lending to small farmers and businessmen and women?

The problem and practices of formal financial institutions which can be observed in Africa, as in many other developing countries, may be a consequence of real internal and external constraints 1/ which they face, but they may also be a consequence of insufficient knowledge about their customers, inadequate organizational forms and unsuitable lending and follow-up procedures. Some positive examples from the formal sector - but especially the experience of the informal sector - show that this potential can be increased. This would most likely imply simple organizational forms, cost-effective procedures and a differentiated structure of financial institutions should be developed and used.

1/ Constraints such as: high administrative costs in granting small loans, negative real interest rates are fully discussed in Chapter III.

The main policy issue is whether and how formal financial institutions can be strengthened or created and supported in a way which enable them to serve the rural poor and still survive. Training of bankers and of customers will be an essential part of any such effort. A financial sector policy for the development of the rural areas requires knowledge about the three factors listed above. The chart on the next page depicts the linkages between the formal financial institutions and the rural poor on which the discussions in the succeeding sections of this chapter are based.

B. The Target Population and Target Groups

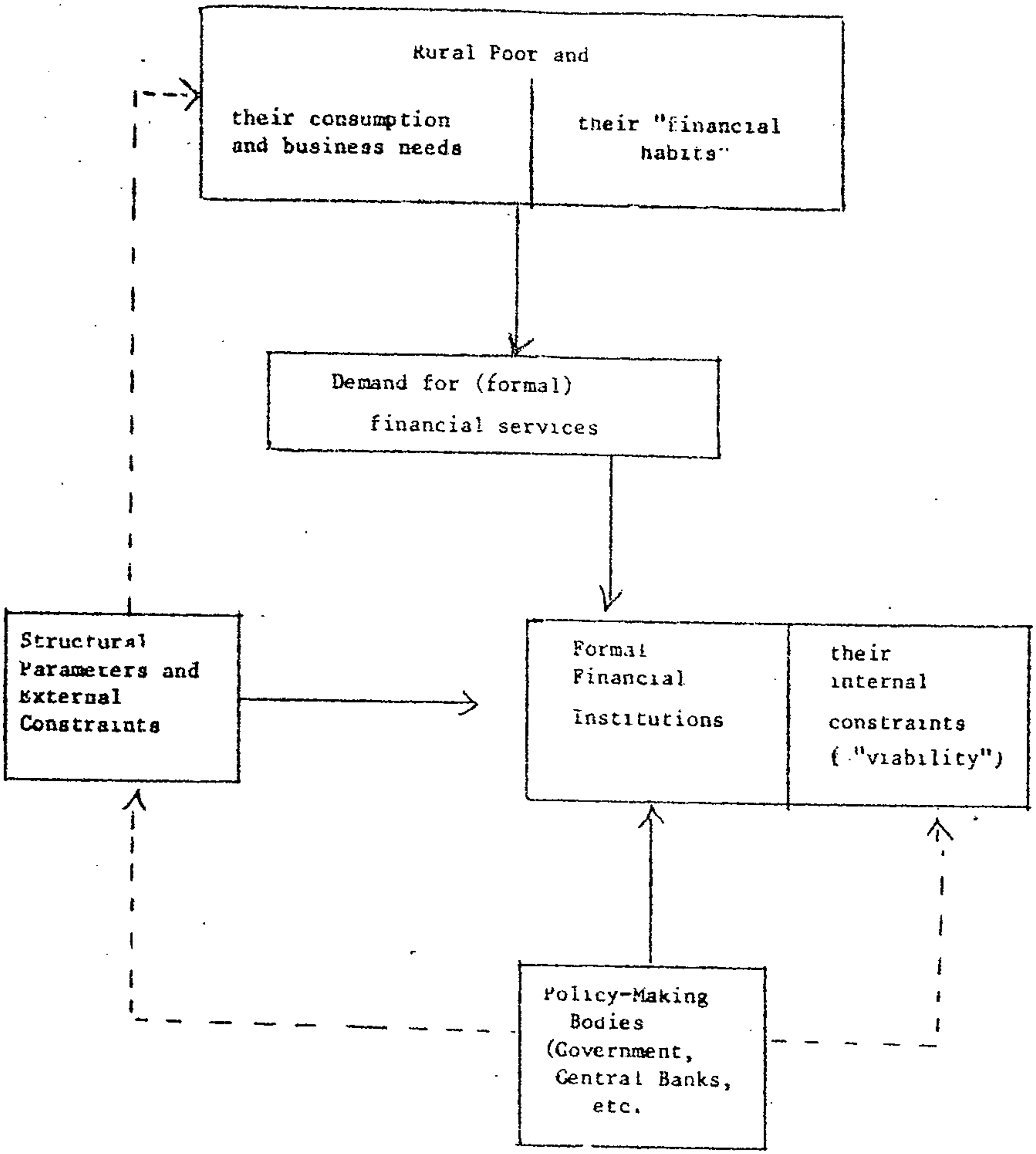
The primary objective of the promotion and organization of grass-roots level credit schemes in the context of participatory rural development is to improve the living conditions of the rural poor in Africa through income-generating activities. Who the specific members of the target population are is a question of definition to be determined according to the prevailing socio-economic conditions in each country. 1/ The target population can be broken down into sub-groups, so-called target groups, which are homogenous with respect to such factors as type of activity, savings capacity or economic situation. The target groups in the promotion of rural credit are, for example, owners of small farms (men and women), fishermen, proprietors of small-scale enterprises involved in raising livestock, handicrafts, retail trade, and the agro-processing industries in the rural areas, and the employees of such enterprises. Differentiating the rural poor according to target groups is important for the success of a rural credit scheme because the various groups have different demands for financial services and differing financial potentials.

The primary objective, namely, the improvement in the living conditions of the target population through the provision of institutional rural credit, must be broken down into more concrete intermediate or secondary objectives. Specific promotion measures can be directed towards these intermediate objectives. A first intermediate objective with direct effect on the target groups is the development of accessible financial institutions. Accessibility in this context refers to the types of "products" or services, the business policies and, last but not the least, the location of the financial institutions. In those rural areas where there are no financial institutions, this secondary objective consists in establishing them. In areas where rural financial institutions already exist, the secondary objective is to motivate them to respond to the needs of the poorer segments of the population. A second intermediate objective which is directly related to the target groups is to strengthen the efficiency, stability and autonomy of those pre-existing and newly established financial institutions which are oriented towards the target groups.

1/ Some of the criteria that can be applied in identifying the target population are the size of the farm holding or the income - asset of the rural household.

FIGURE 1

FORMAL FINANCIAL INSTITUTIONS AND THE RURAL POOR



The expansion of the rural financial infrastructure should lead to the creation of self-perpetuating local income flows: the savings of all the groups of the rural population must be mobilized so that they can be lent out in the area as credit and lead to increases in local income and the creation of more savings. The autonomy and institutional stability of the financial institutions, which are necessary if the interests of the target group are to be served, can only be secured via such a circuit: if financial institutions mobilize savings themselves, they no longer have to depend on state subsidies or external financing, and if they provide needed services, they can remain viable in the long-term. The long-term access to such autonomous, efficient and stable financial institutions benefits the target group directly and can also lead to increase in the income of these groups.

This secondary objective, namely of creating and strengthening financial institutions for the target groups, requires that such institutions pursue the following specific tasks: a) the target groups must be trained in how to handle money and credit and learn how to contact the financial institutions; b) investment opportunities must be opened up for savings which already exist so that savers may realize interest; c) income-generating and, possibly, job creating investments, which the target groups previously could not finance, should be made possible; and d) savings and credit opportunities are to be provided for self-help projects. (See Figure 2 for the hierarchy of objectives in the organization of credit scheme for the rural poor).

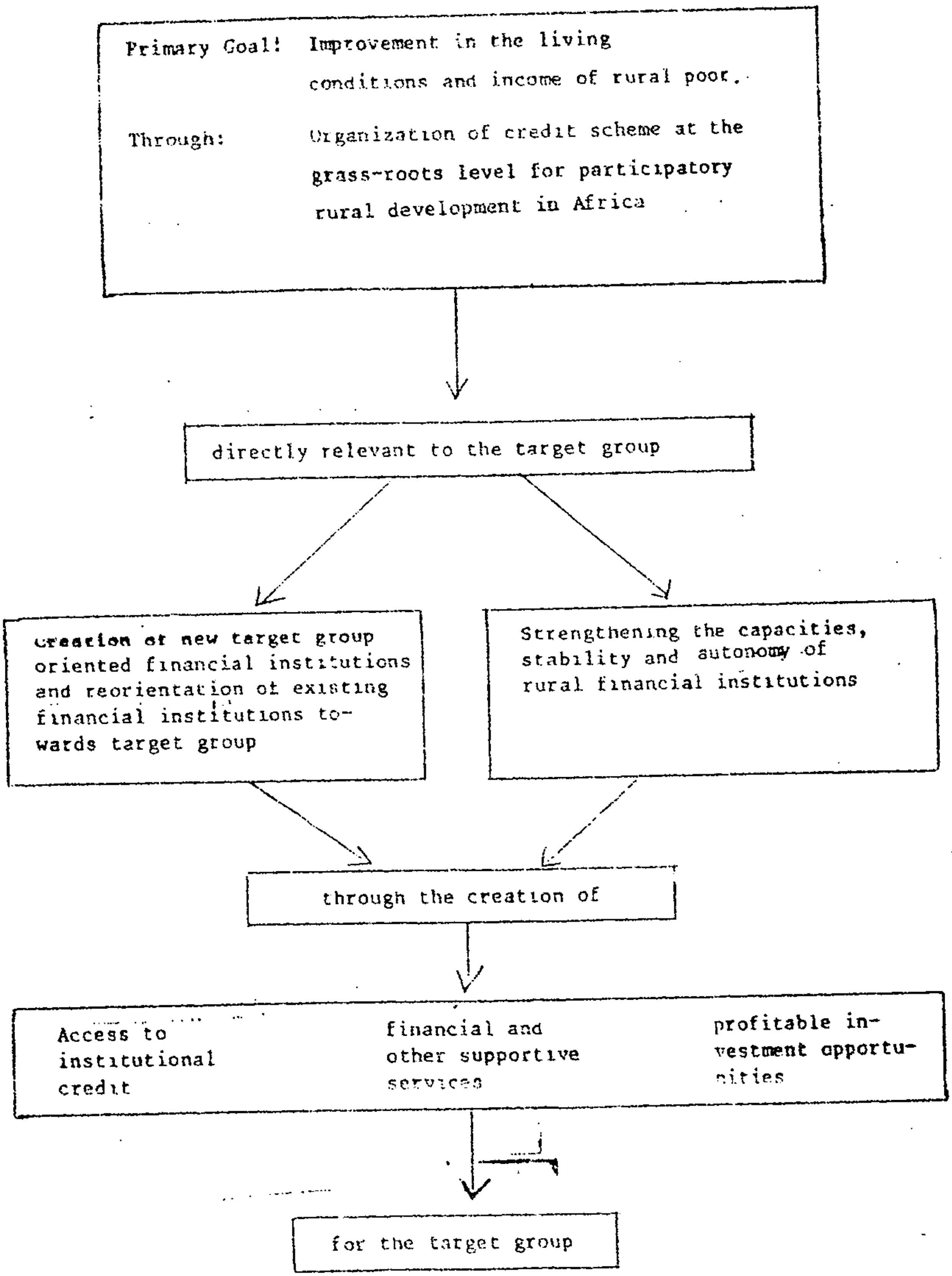
C. The Needs and Demand of Target Groups

It is not easy to get a clear picture of the need or demand which target groups in the disadvantaged segments of the rural population have with respect of the services of financial institutions. They cannot be found by observing actual demand since this is merely a reflection of the existing insufficient supply. More in-depth analyses, based on questionnaires and case studies of households and enterprises, do exist and offer interesting results. It is questionable, however, whether these results can be generalized. Therefore, general statements on the need for financial services can only be made with great reservation. Need depends in each case on the level of development in the respective country and in the respective region or province, on the forms of production in the agricultural and the non-agricultural sectors, on the extent of market integration, and on numerous other factors. The following discussion is not only important for an understanding of the rural financial system, but also for the planning and organizing grassroots level credit schemes for rural development.

The credit needs of the poorer rural target groups must be seen in relaton to the saving needs. Thus, there is often a need for short-term credit; because most assets are not liquid. The demand for liquidity is especially pronounced among small-farmers and small-scale enterprises. Short-term credit before a harvest or to cover operating costs are often urgently needed and would have direct positive effects on income

FIGURE 2

GOALS AND OBJECTIVES OF GRASSROOTS LEVEL CREDIT SCHEME



In the course of the development of an enterprise and of increased market orientation or of changes in its products and forms of production, an increase in the demand for long-term loans can be expected. There is already a considerable need for long-term loans in some areas of agriculture e.g. for perennial crops (cocoa, coffee, oil palm and coconut production), for the construction of irrigation works, or for long-term soil improvement projects. An increase in the need for long-term credit involving larger sums can only be expected at a higher level of development, for example, the need for credit to purchase machinery as farm size increases. Promotion via technical assistance and training could reveal potential innovations and investment possibilities and thus re-direct demand for short-term loans towards a greater demand for long-term loans. This applies to all sectors of the rural economy. At present, however, the main credit needs of rural craftsmen and small retailers are presumably of a short-term type and would serve to finance production and inventory.

The quantification of credit demand according to the conditions discussed above is not even possible within a given country. If financial institutions were prepared to offer attractive saving opportunities to the target groups, this would in itself reduce the demand for "liquidity loans". Seasonal loans for short-term finance in case of emergency or for social purposes and for non-productive acquisitions/purchases would become less of a problem if savings were readily accessible. Improved opportunities for capital accumulation via savings would also serve as a substitute for at least part of the demand for investment loans.

What are the other desired characteristics of rural credit in addition to the amount and the term? Of central importance in this context are the desired conditions and availability. Many studies in this area show that the interest rate of a loan is not considered to be very important by the rural poor. Demand is largely inelastic with respect to the interest rate. This is because interest costs are relatively low for small loans, compared to fees and other charges and the opportunity costs involved in applying for a loan and getting it approved.

Lending institutions should have a local presence and be reasonbly able to reach. In addition, they should - and could - operate more in accordance with the target groups' needs and their situation with respect to credit securities. They should try to restrict their requirements in terms of collateral, and instead regard the character of a borrower and his/her capacity to earn income as the relevant credit securities. Thus, the demand for rural credit is not in accordance with what the formal financial institutions usually provide. The target groups need and demand fast, non-bureaucratic application procedures for loans, prompt provision of funds, and flexible repayment.

Credit and investment counselling could also serve the needs of the target group, complementary services for the procurement of inputs and marketing are not normally activities of financial institutions. If other institutions do not provide such services, however, financial

institutions could better serve the target groups by performing these functions themselves. By linking these services with financial services, the costs and risks of credit business could be reduced.

D. The Financial Products in the Formal Sector

The following section discusses briefly what "financial products" are offered and supplied by the financial institutions in Africa. The emphasis is not on describing the products; rather, an attempt is made to determine why the offers are not attractive to the rural poor.

i) The Supply of Deposit Facilities

Deposit facilities are important for two reasons: The deposits are important for the banks because they constitute funds which can be lent out; for the customer they constitute a service which can be very valuable. The service can either consist of "genuine savings" in the sense of accumulating capital for some length of time and earning interest on it. Or, it can consist of the possibility to hold money for a short time, with the bank account serving more or less as a substitute for the private cash box, purse or a tin can. This is not genuine saving, but rather an elementary form of cash management.

The spectrum of deposit facilities offered by most banks is incomplete. Neither the banks nor, in fact, any other financial institutions operating in the rural areas offer savings opportunities which could protect savers from inflation and "reward" them adequately for giving up liquidity. As one learns from the informal market, rural people like saving schemes which oblige them to make small but regular payments. Such schemes are not offered by the banks. They could easily be introduced.

ii) The Supply of Credit Facilities

Credit facilities provided by banks in rural areas can be sub-divided into four types: overdraft facilities, short-term loans, medium - and long-term loans, and group loans. The major share of rural lending takes the form of overdarfts. They are granted invariably to traders and wealthy farmers and business people who are, in most case, rural - as well as urban-based. The overdraft facilities are for those customers who have current accounts. Current accounts and overdaraft facilities are rarely accessible to small holders, petty traders, rural craftsmen and micro-enterprises. They have to apply for loans if they want credit from a bank, even if they have a regular, recurrent demand and have established a good credit record. Almost all loans granted in rural areas are short-term loans not exceeding one year's time to maturity. Medium - and long -term loans are virtually not available.

The world of loans, or, in other words of credit to small people in the rural areas is completely different from the world of overdraft or credit to the modern urban-oriented business. The "small" rural people feel that they are treated unfairly and much worse than the wealthier clients. This is what happens in fact and it undermines the confidence in the banks as well as the morale and readiness to repay small loans.

The ambiguous behaviour of banks vis-a-vis small borrowers has other devastating consequences for repayment behaviour. If a borrower refuses to repay instalments with the argument that he has paid interest for the entire year, he invariably gets away with it without any difficulty. The lesson for him and all his neighbours is that it does not really matter what repayment terms have been agreed upon with the bank.

The same feature of ambiguity can be found in many other aspects of the lending policy. Loan contracts very often contain a clause specifying the deployment of the borrowed money; but compliance with this clause is very often not monitored. Credit securities present another example: they are required, but as a rule are not used by the banks in the case of default. Why are convenants and securities requested by the banks? They are means of sorting out some potential borrowers, a non-price rationing device. In addition such a requirement increases the margin of discretion which the bank or branch manager can exercise, and this gives him a strong position to request or at least expect bribes. The majority of the rural people look through these practices.

The full cost of a loans also varies between borrowers and between banks. In addition to the cost component of interest and fees of between 40% and 70% one has to add transport costs, cost of paper work, the salary of a hired labourer who replaces the farmer during the many days he has to be off to visit the bank (which may be many kilometers away) and cost of entertaining project officer. All these items easily add up to more than 100% effective cost of credit. This is prohibitive in many cases, and it should be mentioned that less than half of these costs constitute revenue for the bank. The low demand for loans, the huge repayment problems and the general reservations of the poor rural people towards the banks testify to the deficiency of the formal-sector supply of credit to the proverbial "small man/woman".

CHAPTER III

IDENTIFICATION OF CONSTRAINTS IN CREDIT DELIVERY TO THE RURAL POOR

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The credit business of financial institutions oriented to the target group (rural poor) must observe three sets of requirements.

i) The types of loans and, if possible, their volume and terms, should correspond to the needs of the borrowers, otherwise they would do more harm than good, or will not be accepted by the intended clients;

ii) The extension of credit should be profitable for the lending institution whereby the precise definition of profitability may vary according to the type of institution - in order to help cover operating costs and thus provide for long-term availability of credit; and

iii) If it is supported directly or indirectly, the extension of credit should lead to the desired development effects for the target groups, for rural areas and for the whole economy.

In order to meet these requirements, four problems must be solved in the planning, design and implementation phases of a credit scheme, especially if the scheme is directed towards the rural poor at the grass-roots level who would otherwise not have access to formal financial institutions. These are:

a) the access problem: how can a financial institution reach the target groups (rural poor) and how can it activate their demand for credit? Or, seen from the opposite perspective, how can the rural poor gain access to credit?

b) the utilization problem: how can an efficient utilization of the funds be attained?

c) the repayment problem: how can repayment, and thus the continued existence of the credit funds be ensured?

d) the cost problem: how can a financial institution reduce its costs and risks so that its existence and autonomy are not endangered?

a) The access problem

In many formal financial institutions, the access problem is one which the institutions create themselves. There are institutions which create such barriers through their external appearance as such, the choice and design of bank offices, the behaviour of their employees, and the prescribed minimum sums of deposits and loans. Extremely complicated credit application processes and formal requirements for bankability, such as registration of the business which is seeking credit. These requirements limit the access to banks in many parts of Africa.

Financial institutions that are close to the target groups, some cooperatives and especially informal financial institutions (e.g. credit unions) do not have these kinds of barriers to access. Their familiarity with the target groups of small farmers, share-croppers, women groups, rural craftsmen and even with the landless and their living conditions and problems, makes them accessible to these target groups and even enables them to activate their credit demand. There are examples in other developing countries of credit schemes and financial institutions which actually go to the target groups instead of waiting for them to cross the threshold of the bank.1/

1/ The best known example of this sort is the Grameen(Rural) Bank of Bangladesh. Other examples in Africa are: Rural Banks in Ghana, the Zimbabwian Credit Club Scheme and the Sahelian model "Triple A's." See the annexed case studies.

The problem of access to the target groups - and of their access to credit - are thus to a great extent determined by the type of financial institution and its policy. Even financial institutions which are oriented to the target groups, however, are confronted with practical problems related to the access to the target groups. These problems must be solved on a case-by-case basis. Economic and legal parameters often determine which solutions are possible. Is it permissible to demand such high interest rates that small loans, unsecured loans, and loans in remote areas can also be carried by the financial institutions? How can the language barrier and the widespread problem of illiteracy among the target groups be overcome?

Inaccessibility for the target group often results from a credit scheme design that is not tailored to their needs. If the credit offered is not tailored to the needs of clients with respect to duration, terms of repayment, disbursement terms, required securities and the provision of supplementary services (in particular extension and marketing services), potential borrowers will not apply for loans and/or financial institutions will deny these clients credit because they consider them to be too great a credit risk. This type of access barrier is harder to avoid, since it is not even clear at the conceptual level how loans can be tailored to suit the needs of such borrowers. Thus, for instance, the question is still open - and, of course, can only be answered on a case-by-case basis - whether the most urgent financial need in rural areas is for long-term investment credits or for short-term working capital or crop loans, and whether rural poor only need credit or a package including, for example, a loan, technical assistance, and organizational and marketing assistance. Financial institutions oriented to the rural poor, however, should use all opportunities to systematically expose the actual needs and latent demand e.g. through the use of pilot projects. Even if all the needs are known, not all financial institutions will be capable of providing credit of the desired term and with the needed extension, because they often lack the necessary financial resources, personnel and the required know-how.

Relatively high interest rates are not an important factor in restricting access. Empirical studies in a number of countries have shown that credit demand is not very interest-elastic. This implies that loans which require much technical assistance and supervision, and even somewhat risky and costly loans, can be extended. Higher rates of interest would allow less stringent requirements for loan securities, which are the decisive barrier for many small rural enterprises.

b) <u>The Utilization Problem</u>

The utilization problem results from the fact that borrowers do not always utilize funds in ways which promote rural development e.g. by creating jobs, stimulating production, or improving the local supply of goods and services needed by the target groups. In general, it is difficult to judge which utilization is beneficial for the rural economy as a whole, particularly in view of the fact that for small

enterprises the schematic distinction between "unproductive" consumption and "productive" investments is often inadequate. The other aspect of the utiliztion problem is that loans are not always used for income-generating activities e.g. because borrowers are poorly informed. Formal financial institutions are interested in economic activities which increase the ability of the borrower to repay the loan. Many financial institutions as well as public policy agencies thus have an intense interest in working towards a good and meaningful utilization of loaned funds. It has been difficult, however, to realize this interest in practice. Specifications on use, reduced interest rates for certain projects and extension of loans in kind and many other methods for the control of utilization have been attempted in the past and have frequently failed to attain the desired results. In many cases it is impossible to check whether specifications on use have been observed and even if the borrower completes the project for which the loan was granted it is still difficult to determine what was actually financed with the loans.

In conjunction with interest rate subsidies, specifications on loan use also have negative social implications, since the wealthier borrowers will more likely to able to produce that type of project which is eligible for subsidized loans. The fungibility of money, that is, the fact that it is impossible to determine which piece of currency is used for which specific purpose generally makes specifications on loan use ineffective.

Granting loans in kind instead of cash can also provide a means for controlling the use of loan funds, especially if repayment is also made in kind or is integrated in supporting the sale of the harvest. The problem with loans in kind, however, is that they cannot be adapted to the individual situation of the borrower and his enterprise as well as cash loans can. They are not flexible enough and, therefore, often not tailored to the needs of the target group.

A rational and promising method for controlling utilization requires that the whole enterprise (all expected net revenues) and the household (needs and ability to repay) of the borrower be taken into consideration and provided with assistance. Through technical, managerial and marketing assistance, and through the provision of complementary inputs, such as: fertilizers for agricultural enterprises - either by the financial institution itself or by other institutions - a financial institution can ensure that a revenue - increasing use of funds is planned,and that this plan is put into action. This requires, of course, that the plan be realistic; it is difficult and costly for financial institutions to work out such plans with borrowers. If costs or insufficient capacities make such comprehensive promotion impossible, it is advisable to place more importance on the character of the borrower than on his/her project. An astute, honest and experienced borrower will take care to ensure that his/her use of funds is at least profitable for his/her own enterprise and household.

c) The Repayment Problem

The viability of a credit scheme and a financial institution, and in some cases even the security of the depositors and the prospects of future borrowers for receiving credit, depend on the solution of the repayment problem. The consistent observance of disciplined repayment is also necessary in order to avoid a misallocation of scarce funds and to protect borrowers from imprudent decisions.

A good credit extension policy is the first and most important determinant of repayment; this includes the selection of trustworthy borrowers, a design of the volume and the terms of loans which is adapted to the situation of each enterprise, and the assistance of borrowers in the utilization of funds. A financial institution must make clear from the start that it requires repayment; it must admonish negligent debtors and, if necessary, initiate massive debt collection measures. Re-scheduling and prolongation of loans and similar measures only come to question if it is neither directly nor indirectly the debtors fault that he is not in a position to make interest and principal payments. In general, however, the requirement of conventional material credit securities such as: land charges and mortgages has an undesirable, socially discriminatory effect. It discriminates against the poorer segments of the population that cannot provide such securities. Only in exceptional cases do the rural poor possess easily transferable and easily manageable securities such as gold jewelry. In general, however, if financial institutions do not want to exclude the broad segments of the rural population from their credit supply, they must be willing to accept substitutes for conventional securities. These substitutes are primarily personal guarantees provided by individuals or groups. Collective liability and group loans are discussed in more detail in chapter IV. In a broad sense, however, the revenue potential of the financed project, which ultimately determines the ability to repay a loan, is the best form of security.

In very traditional societies, the extension of credit can be integrated into rigid social structures and common law if these structures support repayment and if common law permits the securing of credit. Thus, it may sometimes be advantageous to conduct credit negotiations in public (on the village square). The individual borrower is then prevented from making a fanciful description of his/her situation, is reminded of his/her obligation by his/her peers, and in some cases is restrained from endangering the honour of his/her village. A similar effect can be obtained by involving dignitaries, such as: village chiefs and elders or the pastor in the credit extension process. Their recommendation of a borrower creates for them a certain moral obligation to make sure that the loan is actually repaid.

The interest in maintaining a long-term financial or economic relationship can also serve as a substitute for conventional credit securities, since it creates a strong incentive for the borrower to fulfil his/her credit obligations. Informal financial institutions, traders, money lenders have more diverse and better opportunities for

protecting themselves against bad loans than formal financial institutions do: their proximity to the borrowers allows for more intensive control, they can make use of social pressure, and they can react flexibly when loans are not repaid. The options available to formal institutions are indeed more limited, but they can learn from the experience of the informal lenders and attempt to apply a more "liberal" security.

d) The cost problem

There are limitations in the area of target-group-oriented banking services which are due to cost considerations. The extension of credit to target groups requiring merely small loans, a great deal of assistance and supervision, and who often cannot provide conventional securities involves a considerable cost problem. Administrative costs as well as the risk of bad loans are usually high and must be limited or as the case may be, borne. 1/

Financial institutions that are oriented towards target groups cannot cover their costs and risks with the usual banking margins. Even when costs and risks are held within strict limits, interest margins of 10% to 20% are often insufficient for small borrower credit schemes. It is in the interest of the target groups of such schemes that they carry the cost of the scheme rather than forgo the loans or have to rely on traders and money-lenders. Unfortunately, traditional prejudices and interest rate ceilings often hinder credit schemes oriented towards target groups.

Most financial institutions, however, can adjust the effective interest earned on small loans to their higher effective costs through the use of fees which are independent of the amount of the loan. Cost-reducing improvements in a financial institution can, after all provide a broader scope of target-group-oriented services. The standardization of loans in "packages", the extension of group loans, the employment of inexpensive local personnel ("bank workers") and the use of simple financial techniques offer opportunities for limiting costs.

e) Obstacles associated with credit Delivery

In addition to the problems discussed above, there are other obstacles associated with credit delivery to the rural poor. Firstly, there are those that have to do with the internal operations of formal financial institutions and the existing credit policies. Secondly, there are those related to the rural poor. The third class of obstacles are basically external and socio-economic in nature.

1/ Administrative costs may be as high as 10% to 25% of the total loan portfolio depending on the financial institution's overhead costs and volume of operations.

i) Obstacles Associated with Credit Polices and Operations of Formal Financial Institutions:

The existing financial system (mainly concentrated in urban centers) is basically unsuitable for the needs of the African rural sector which is dominated by numerous highly dispersed peasant farmers. The banking system on the other hand is dominated by institutions whose lending preference is for large-scale enterprises in the commercial, industrial and agricultural sectors with minimal predictable risks. Thus in spite of efforts by some governments, through incentives and occasional coercion, it has been difficult to transform the present financial system to suit the needs of the rural poor. As already discussed, the various agricultural and rural credit schemes have been characterized by the problem of loan defaults which has not inspired the active involvement of banks on voluntary bais, not even with the introduction of small borrower credit guarantee and crop insurance schemes in some countries.

There is also the procedural problem, especially with regard to the powers to approve loans, which in some institutions is usually over-centralized. Loan applications have to be vetted by many officers before the facility is approved. Needless saying that the practice of over-centralization of lending authority has contributed to restrict the flow of credit to the rural areas. Loan applications take too long to process because most banks have not recruited or trained enough specialized staff to handle the growing volume of requests from the rural areas.

ii) Obstacles Related to the Rural Poor

Some of the problems of rural credit are farmer-induced. One of the most serious in this regard is the 'national-cake' mentality, whereby some of the farmers feel that they were under no obligation to repay loans from financial institutions. Another problem of the rural poor has been that of illiteracy. Lending to this kind of group requires special arrangements since their illiteracy means that even rudimentary records needed for monitoring the banks' operations, cannot be maintained. Even the operation of a bank account on the basis of which a lending relationship develops assumes some modest level of literacy which a typical rural borrower may not have; this could obstruct lending. When they are relatively poor they may find it impossible to provide a suitable and acceptable security to banks whose security requirements are often stringent.

Even where a farmer has an asset such as land, it usually takes an unduly long time to verify ownership title through obtaining a certificate of occupancy. Some farmers are also known to have encountered difficulties in meeting preliminary expenditures involved in seeking bank credit. Such expenditures often include feasibility study, land valuation and the like. These expenditures could run into sizable sum of money which if the potential borrower cannot find, credit will be restricted or delayed.

iii) Obstacles associated with Socio-economic environment

Several aspects of the African socio-economic environment have also contributed to the inadequate flow of institutional credit to the rural poor. Some of these environmental issues are directly or indirectly linked with government policies. For instance, where farm inputs, such as: fertilizers are not available, provision of credit for their acquisition will be valueless. Similarly, where rural infra-structures on which certain rural economic activities depend are non-existent, credit for such activities would not generate the desired production and income. Factors such as inefficient marketing system, inadequate storage and processing facilities, inadequate agricultural pricing policies, inadequate extension, and problems of land acquisition have constituted obstacles to effective channelling of institutional credit to the rural poor. Moreover, such natural problems as inclement weather conditions (drought), and pest and disease infestations have contributed immensely to raising the riskiness of agricultural ventures in Africa thereby restraining formal financial institutions from granting agricultural loans to the rural poor. Many of the areas identified as growth centres and warranting the opening of bank branches or rural banks are often inaccessible by road or by rail and this also militates against the provision of banking facilities to the rural poor.

CHAPTER IV

GROUP FORMATION AT GRASSROOTS LEVEL FOR CREDIT SCHEME

A. Importance of Groups at Grass-roots level

Formation of groups is crucial for the success of a credit scheme for the rural poor. Individually a poor person feels exposed to all kinds of hazards. Membership of a group will give him/her a feeling of protection. Individually a person tends to be erratic, uncertain in his behaviour; but group membership smoothens his behaviour pattern, makes him more reliable.

Peer pressure will keep the group members in line with the broad objectives of the credit scheme. A sense of inter-group or intra-group competition will help everyone to be an achiever. It is very difficult to keep track of individual borrower; but if he is a member of a group, it is much less difficult. Group pressure on individual members also ensures that borrowers fulfil their repayment obligations.

Gradually group members will find themselves in a collective income-generating activity which is beyond the management capacity of each individual member of the group, such as collective ownership of farming equipment or small processing plants.

B. Group Formation

Savings and credit can be a good starting point for group formation. There is a great incentive to form a group if the rural poor see that it is the only way to have access to institutional credit. By restricting the size of the group to a small number, the concentration of power in a single person (the group leader) in the group can be reduced. In a smaller group (say, five) each member has a better access to information and to the leader than it would be the case in a larger group.

Groups should form by themselves, rather than being formed by politicians,cooperative agents, extension worker or a bank official. Group solidarity will be stronger if the group came into being through their own efforts and negotiations. By their own right groups are independent organizations. At the initial stages they may not be sure of themselves, but gradually they will discover their strength and start asserting it.

A number of factors need to be considered in group formation. These include: economic situation and interest of members, the size and the homogenuity of members. In the formation of groups encouragement should be given to members with similar economic background and social needs in order to make the group stable and to avoid conflicts in the choice of activities to be undertaken. The number in the group should be small so as not to lose cohesion. The groups should have well defined objectives and sense of purpose. The rules and regulations for the group should be made simple, clear and well understood by members.

For the self-reliance of the group, and reduction of their dependence on the banks, a strong savings mobilization programme is essential. Not because this allows the group from taking loans from the banks, but because existence of a common fund gives them experience in money management which is important for any joint enterprise. This common fund also enables them to undertake larger projects collectively.

Credit schemes for the poor should not be designed only for a handful of people. It should start with small groups of people to gain experience, and gradually expand to cover more and more people. Contrary to popular belief, credit schemes for the poor only require very small amounts in the initial stages. Based on the initial success of the scheme, the volume of loan disbursements can be increased over time. For, granting loans is the business of the banks. If they stop advancing credit they would be out of business. As long as dispensing credit to the poor is a profitable business, there is no reason why the banks should stop extending them credit. The banks' interests would be better served by granting more credit, not less.

There is no reason why credit should be made available to the "privileged" poor at the expense of the non-poor segments of the society. The poor should be competing for credit with the farmers,

traders, exporters and industralists on equal footing. That is, in order for the poor to compete with others the poor must also be given all the facilities and privileges enjoyed by the non-poor: special import duties, access to inputs, infrastructural facilities etc.

Another related issue is how to release the poor from the grips of the money-lenders so that they could enjoy the full benefits of their labour. Combatting moneylending by only mobilizing group savings will be possible, but it will be a very difficult and an uphill task. A simple way to immobilize the money lenders is to bring in institutional credit to the rural areas. Both of them are in credit business and should compete out the other for greater efficiency.

C. Group Savings

In theoretical discussions savers (lenders) and borrowers are usually considered as two separate groups of people. Savers deposit their savings in the banks and the borrowers go to the banks and borrow the savings of others at a price. Not much consideration is given to the fact that a saver himself/herself can also be an investor (borrower). For the poor this is the most usual case. His investment can be calibrated in very small steps; any small savings can be ploughted back into investment at any time.

The multiplier effect of investment can be vividly demonstrated in a credit scheme for the poor through continuous expansion of the economic base of the poor as his/her income rises with additional investment through borrowing. Vicious cycle of "low income - low savings - low investment - low income" can be broken by injecting credit in the cycle; " credit-more income - more savings - more investment - more income".

Group savings in a rural bank will serve a wide range of purposes other than the immediate investment:

i) It will impose a discipline on a group member in developing a savings habit which is not there.

ii) Savings will enhance self-confidence. Being a no-saver all his/her life an individual in a group will find it a great source of enccouragement to become a habitual saver.

iii) Savings will cover against normal business risks, seasonal variations in income, natural calamities like drought, pests and diseases. Members of the group can undertake riskier decisions because they can find some cushion in the savings.

iv) Group savings of the poor can demonstrate the strength in the largeness of their number. Even if each poor person saves a very small amount each week regularly, it will add up to an unbeliveable large amount in no time because they are so numerous. That their

number is such a great source of strength to themselves and to the nation will be demonstrated in a sharp manner in a simple savings scheme.

D. Group Organization, Extension and Credit

Many of the problems discussed in chapters II and III can partly be mitigated if there is an efficient extension service. The field level extension worker will (a) advise farmers on farm planning and management; (b) assist farmers in securing credit, (c) advise them on the use of inputs; and (d) promote farmers' group organizations for marketing.

Given the low density of extension workers in many African countries, it is very unlikely that they can handle both credit activities and offer agricultural advice. It is therefore necessary to ensure that the number of adequately trained extension staff is substantially increased and that they are not overburdened by credit handling. One means of accomplishing this is by phasing out individual credit and promoting group credit. Credit groups have the following impact on extension and credit.

i) The existence of a group gives extension worker the chance to use group meetings for extension advice, demonstration of techniques and the dissemination of messages;

ii) Since extension workers may delegate part of their administrative duties to the group, they save time previously required for individual visits to fill in credit application forms, etc.;

iii) A common problem between extension and credit is the tendency to concentrate extension advice on credit farmers in comparison to other farmers purchasing their inputs with cash. Groups may help to shorten the extension time required for credit farmers and thus save time for advice to other non-credit farmers.

iv) There is a growing tendency among extension staff to convert groups into multi-purpose institutions which could be used, on the local level, to organize regular discussions and mutual assistance in problem situations.

Apart from better and cheaper access to credit, credit groups can considerably reduce the administrative costs of credit and extension time spent on loan follow-up and recovery. Unlike cooperative, which typically have several hundred members, credit groups have limited membership and rely on unpaid management. This keeps lending costs low.

The organization of members in their groups and centres will serve a number of purposes. Firstly, it will give individuals a measure of personal security and confidence to take risks and launch new initiatives. Secondly, groups and centres will be the main vehicles for members' participation in the activities of grass-roots level savings and credit schemes. Thirdly, as noted before, the groups and centres will act as source of pressure on the individual to fulfil his/her obligations towards the Bank and to encourage him/her to discard undesirable traditional attitudes and to oppose anti-social but entrenched customs and practices. Fourthly, groups and centres wll provide the necessary organizational support for the launching of a variety of economic, social and cultural activities. A sense of healthy rivalry and competition among them will spur each to a higher level of performance. Fifthly, the formation of groups will enable the rural poor to transform their individual weaknesses into collective strength and thus exert pressure against local centres of power.

Extension Sevices

A related issue which is often not fully conceived in organizing credit schemes at the grassroots level is the method of out reaching and dissemination of information to the rural people. Credit schemes for the rural poor do not usually achieve the desired impact, unless they are packaged with training, education, technology, marketing and transportation facilities. The provision of all these require an extension service for the beneficiaries. The chances of making relevant impact on the development of the rural people depends on the ability to reach them and being able to modify their actions and behaviour. Outreach is also necessary because rural projects operate in a socio-cultural environment where most rural people are illiterate and shy to come out to seek out opportunities. Therefore getting information on income-generating activities to reach them can go a long way towards stimulating business practices among them.

Conventional extension systems need to be organized through regular training programmes and provision of appropriate incentives to the staff so that they can play a useful role in participatory group credit schemes. To be able to play the role, the extension workers should exhibit the following qualities.

i) The extension worker must be able to recognize problems, to define them in simple terms and solve them. He/she should seek information and assistance from the appropriate sources for those problems which are not within his/her competence. He should never leave problems unsolved. As he is working with adults who have learnt to live their lives and have a wider range of experience, he should act as a facilitator in problem solving, discuss the various solutions with the group and pull solutions that meet the acceptance of the group. Entrepreneurship development calls for analytical mind being able to analyse problems from various points of view and provide solutions that can bring change and success. The extension worker must always keep up with new experiences so as to be able to widen his/her scope of solutions.

ii) To pass on knowledge and help the group the extension worker should be a good communicator. He/she must be able to communicate at the level of the group, using words and symbols that create mutual understanding. Extension service is a way of providing technical assistance that creates active outreach to the target groups in order to acquaint them with the needed information. This means meeting the people at their setting. To do this, the field approach becomes an invaluable means for reaching the grassroots rural poor. Therefore one element critical to the effectiveness of providing extension services and follow-up is the planning of field work. The extension worker must therefore be a good planner and be able to come up with easily managed plans of actions.

iii) An extension worker is a leader in guiding and providing assistance towards promotion and achievement of group and individual's interest. His leadership powers must cover the handling of issues, the effective use of the group's ability which will be felt on the ultimate achievement of the group's goals and objectives. Generally the extension worker must have an outlook that aims at satisfying the group's needs and work performance. He will therefore have to work harmoniously with the groups so as to gain their confidence and cooperation. This general characteristic enhances the extension worker's effectiveness in putting across his knowledge.

CHAPTER V

ORGANIZATION OF PARTICIPATORY CREDIT SCHEME AT GRASSROOTS LEVEL

1. A. Introduction

As has been discussed in previous chapters, a large proportion of the rural population in many African countries have no access to institutional credit. These disadvantaged rural people, most of whom are below poverty level consist of small-scale farmers including female headed households, part-time farmers and the landless. If credit is provided to them, they may not only improve their farming practices and generate more income, but would also engage in other non-farm income-generating activities on a self-employment basis. In fact, in some countries, they do depend more on off-farm activities than on-farm activities. Their identification with smallholders has given them no benefit even from the special credit schemes designed for smallholders and small enterprise development. Hence they are in need of a proper identity and a separate credit scheme that would identify their peculiar problems, cater to their needs, expand their opportunities and accordingly provide financial and other assistance - extension, training, marketing etc. The poor should be identified as poor and not as small, marginal or below subsistence farmers. Once "the

poor" are identified with "small farmers", all attention for rural development goes to the development of agriculture rather than the development of the poor.

In all cases a baseline survey of the socio-economic characteristics of the target population has to be conducted to assess whether a viable target group exists in the respective country and whether existing financial institutions could be used or a new one could be created for the purpose of implementing the credit scheme. It is generally agreed that specific target groups exist in some African countries and that these groups need institutional credit to enlarge and strengthen their economic base.

B. Target Group Definition

The rural poor, consisting both men and women will constitute the target group for the proposed grassroots level credit scheme for participatory rural development. While the poor may be defined or classified in several ways it would be necessary for each country to be precise in the choice and definition of an appropriate criterion for defining the poor in order to avoid confusion in identifying persons who need immediate attention. One such method is to use the income-asset criterion and/or the size of a farm holding. This, would of course differ according to the socio-economic conditions in each country.

The target group has no access to formal sources of credit. They remain outside the orbit of the existing banking or credit system, although they constitute the largest segment of the rural society and they are the ones who are desperately in need of credit, not only for their bare survival but also for their productive survival. They have physical strength and survival skill but they may not have sufficient land and rainfall to work all the year round and to grow enough crop or rear enough livestock to maintain them throughout the year. They cannot use their skills in farming, fishing or other activities as they have no access to credit.

In operating the grassroots level credit scheme preference should be given to those who are at the bottom. Preference may also be given to women in the target group as they are usually found more disciplined, hardworking, serious in their task and at the same time more concerned about household welfare. They are, in fact, a main segment of the rural labour force but virtually without support. The female-headed households headed by unmarried, divorced, abandoned or widowed women are the most vulnerable having to maintain the family as well as having to provide the family income. They suffer the greatest poverty. If the survival skill of the poor is combined with credit, it creates a lot of self-employment opportunities for the poor for their continued and productive survival. If credit can be rightly delivered and served, it can make a profound impact on the life of the poor in terms of significant improvements in their output, income, survival and savings.

C. Demand for Credit

As already discussed in Chapter II, there is an evident demand for credit for income-generating activities by the rural poor, although adequate data do not exist on the basis of which the demand for such credit might be quantified. There are a number of activities apart from farming for which the target group would require institutional credit. These include food processing, trading, baking, sewing, brick-making etc. Once credit is made available to the poor they would be able to increase their income and would have more demand for food and non-food items. With higher demand for these items, activities related to producing, processing and trading of these would also increase. This would not only benefit them in terms of more employment opportunities and income, but also the rural economy in terms of more employment, output and income.

2. Grassroots Level Credit Scheme for Participatory Rural Development

A. Objective and Rationale

The objective of the Grassroots level credit scheme for participatory Rural Development, to be designated as the Participatory Rural Development Fund (PRDF), would be to extend banking facilities for lending and savings to the rural poor (men and women) without collateral. Its primary aim would be to organize the poor through the credit scheme so that they could undertake income-generating activities of their own choice. It would bring them into an organizational format so that they could understand and operate it for their own benefit. It would also expose them to innovative and rural developmental opportunities so that they could strive for a better life, with respect also to education, nutrition, sanitation, health care, family planning, etc.

The rationale of the credit scheme rests on the fact that the rural poor, being land poor in particular, and resource poor in general, do not have adequate opportunities of employment and income. In many cases, the land that they cultivate does not keep them fully engaged all the year round. It only partially meets their food requirements. Some work for others, as and when they get the chance, often in seasonal work. Others have non-farming skills as well which they use to earn income. However, the scope for the utilization of their labour and skills in land and non-land based activities is limited because they have no access to financial resources. Provided that the poor can be organized to gain access to financial resources which provide command over other resources for example, farm inputs, they can create their own employment opportunities and maintain a better living. The proposed credit scheme would therefore aim to create facilities for the poor and to enable their access to institutional credit under certain

arrangements and thus to demonstrate that, where properly organized, they are able to receive and pay back credit and can in the process create self-employment as a means of earning, spending and saving more. The scheme would aim at developing an organization among the rural poor which would ultimately become a viable, self-sustaining concern, and replicable in other areas.

B. General Description

The proposed credit scheme to be eventually managed by the rural people has been conceived in a series of overlapping phases; the first would be to create a basic establishment and initiate PRDF in a few (not exceeding three) selected locations in each participating country which can be effectively supervised and monitored. On the basis of that experience and given satisfactory performance, it would then be replicated at other locations in the second and subsequent overlapping phases. To ensure its autonomy and freedom from political and government interference, management of the scheme should be vested largely outside the government structure. It should, however, operate under the aegis of inter-ministerial and inter-agency committee including Non-Governmental Organizations (NGOs) engaged in rural development and representatives of the beneficiaries. The Committee which will comprise of representatives from the Ministries of Economic Planning, Finance, Agriculture, Rural Development, Education, Health, the Central Bank, other financial institutions, Labour and Social Welfare and representatives of the target group (rural poor) would be responsible for the overall conduct and performance of the scheme in relation to the established objectives. Initially, there would be a small Management Unit headed by the Scheme Administrator (SA) and support staff and at each of the few selected locations there will be PRDF Branch Units with a contingent of staff and support facilities. There will be a training and induction programme for that staff, who at each unit would implement specific lending procedures applicable to target group lending.

The specific components of the scheme would be:

(a) Establishment of inter-ministerial and inter-agency steering committee;

(b) Establishment of a small management unit;

(c) Conduct of preparatory surveys to identify the locations of the branch units;

(d) Establishment of two or three pilot branch units in Phase I and more units in subsequent phases;

(e) Conduct of a staff training programme including overseas training for senior level staff and local training for middle and junior level staff and beneficiaries (the target groups);

(f) Establishment of an initial capital and provision of incremental funding for a Revolving credit fund for the poor (Participatory Rural Development Fund);

(g) Provision of technical assistance in support of the scheme and to assist in its evaluation; and

(h) Monitoring and Evaluation

The Scheme in its first phase covering the establishment and operation of two or three branch units, should run for at least five years, before the second phase commences.

C. Detailed Features

i) Establishment of a Management Unit

The Management Unit would comprise a Scheme Administrator (SA), an accounts assistant, secretary and service staff (messenger and driver), and representatives of the beneficiaries. It should be located in rented premises, in the first phase, in the vicinity of the two or three branch units to be established, then moving to a more central position as more branches are established in other parts of the country. The SA should be appointed at the start of the scheme and will be responsible for its establishment and operation in consultation with the beneficiaries.

ii) Preparatory Surveys

Before the commencement of the scheme a baseline survey should be undertaken in order to identify the location of the branch areas and socio-economic characteristics of the target population. The basic guidelines in selecting the survey areas should be the density of population, the arable land per capita, good communication systems and presence of a market place, commercial bank or a branch of any other financial institution. Once the areas are selected, general information and data will be collected on socio-economic characteristics of the target population, such as: age, family size, education, resources, employment opportunities, skill, assets and liabilities, and occupation, etc. The survey work should be carried out with the assistance of the staff to be recruited with the ultimate view that they would be subsequently absorbed by the scheme on a fixed term contract. Their involvement in the survey would increase their knowledge of the area and build up their experience and rapport with the target group. In conducting the baseline survey and in preparing the survey report, assistance should be sought from universities and/or other local organizations suitable for the purpose such as the centre for social studies.

iii) Branch Units

Each branch unit should be staffed with a branch manager, a book-keeper or sub-accountant, bank workers, typist and messenger/guard. The unit should be in rented premises situated at a central location with access to banking facilities and rural market. The bank workers should live in villages within range of the branch unit. Each bank worker will be expected to operate a number of groups to be determined by the SA. Each target group will comprise five members, either male or female. The group members will also engage in linked schemes for group saving and risk insurance, and through their group membership, would be able to manage the credit scheme and engage progressively in rural development activities in their own interest (chapter IV refers)

iv) Training and Staff Development

Due to the innovative nature of the credit scheme, it will be necessary for the SA and the first two or three branch managers to be recruited to be initially sent to other African and developing countries which have developed successful credit schemes for the rural people for familiarization and to participate in the induction courses that have been organized there. These officers will form the core staff of Phase 1 of the scheme and will play a key role in the establishment and implementation of the required training programme.

v) Credit Fund

The Government, the central Bank and other interested commercial banks should contribute to the initial capital fund for starting off the scheme. This should be supplemented by funds from external resources to meet the incremental credit needs of the loan beneficiaries. The detailed arrangements would be determined by the recipient government and the external donor or lending agency.

vi) Financing

It is proposed that Phase 1 should be financed from grant resources, recognizing the innovative nature of the scheme and the need for financing flexibility in its establishment. In the second phase, which will be contingent on the satisfactory performnace of the first phase, financing should be under the terms of a project loan.

It is proposed that financing of the first phase be arranged under the terms of a subsidiary financing agreement between the Government and the Participatory Rural Development Fund (PRDF). Those funds, derived from the grant resources, are proposed to be passed on to PRDF on grant terms, as the establishment cost of the scheme. This should be conditional to agreement on specific procedures within a time frame for the transfer of operating costs to the PRDF budget. Those costs would then be covered through

operating profits derived from the spread of interest charges. Until that time interest repayment would be allowed to accumulate in the PRDF credit account, but subsequently the funding position should be carefully reviewed to ascertain right on-lending terms to PRDF that would both reflect reasonable operating margins and preserve the value of the fund. At the outset, the charges to the scheme beneficiaries would be at the nominal rates to the smallholder sector. Grant funds will be deposited in a special account specifically for the scheme to be established in the central bank of the country and held in US dollars under the joint signatories of the Scheme Administrator, another signatory to be designated by the Government, and a representative of the beneficiaries.

3. Organization and Management

A. Central Organization

Although the Government will take the initiative for introducing the grassroots level credit scheme for participatory rural development, it is proposed that it will be preferable that the scheme is operated, as far as possible, independently of the government bureaucracy. It should be started with the intention that it will become financially self-sustaining as soon as possible. One option will be the creation of a company with a stratified shareholding, involving the government, the central bank, commercial banks and the beneficiary participants. While such a company will operate as a private entity, nevertheless government would preserve an interest through the medium of a financing agreement between the government and the management entity.

The Central Management Unit, will comprise the Scheme Administrator, Accounts Assistant, Secretary, service staff and a representative of the beneficiaries. It will report to a central inter-ministerial/inter-agency committee which would consider its annual audit and management reports and three-monthly progress reports. The central committee would comprise representatives of each interested ministry as well as of the Fund Management and elected members from among the beneficiaries themselves, (whether or not this committee would constitute a Board of Directors or a separate supervisory/advisory committee constituted with reference to the subsidiary financing agreement is a matter to be decided by each government).

The commitment, skill and leadership qualities of the Scheme Administrator and his freedom of initiative in setting up and managing the scheme are vital ingredients for success. It is proposed that the SA should be identified and appointed through consultations between the concerned Government officials and senior officials of the central and commercial banks. Until the management entity is fully established, he would be engaged on a

consultancy basis to set in train necessary procurement and establishment procedures and would then be given the opportunity to visit African and other developing countries for familiarization and training tour. On return he would commence the task of recruitment of the key PRDF staff, including branch managers and bank workers. The managers, accounting assistants and male bank workers would be nationally recruited but the female bank workers would be recruited locally from the areas in which they will work. Once that is achieved, an experienced internationally recruited consultant may visit the country for one month to assist in staff induction and training process, establishing also the procedures for the conduct of the necessary preparatory surveys and supervising the commencement of that work in collaboration with inputs from appropriate local institutions.

Once the scheme becomes fully operational the central unit will be responsible for disbursement of funds to the respective branch accounts, training, administration, maintenance of central accounts, development and maintenance of an effective management information system. It would continuously monitor the progress of the scheme and produce quarterly and annual progress reports.

B. Branch Units

Compatible with maintaining staff incentives and enthusiasm the branch units should be run on a least cost basis, since ultimately the cost effectiveness of the scheme would depend on the effectiveness of the branch units in building up their level of business without high overheads. Besides the monetary rewards, the satisfaction of working for a close-knit, expanding and purposeful new organization, should add greatly to the incentives of staff recruits. The branch manager, book-keeper and the four bank workers would be based at the Branch Unit. Books on lending accounts, savings accounts and risk fund accounts would be kept at the branch and regularly reported to the central unit where consolidated accounts would be maintained by the scheme's accountants. Each branch would operate on the basis of its own annual plan and budget which would be submitted for approval by the central unit. The system of accounting would be set up by the central unit.

A branch unit would be expected to reach a targeted number of the target population living in adjacent villages of the branch location. The target number of group members for each branch will be determined by the SA in consultation with the branch manager and bank workers. This would of course depend on the socio-economic conditions, population densities and existing infra-structural facilities in each country. For example, each bank worker could service about 50 groups of target people. Each group would consist of five male or female members. To get a loan, a potential borrower would have to form a group with four others who are like-minded and have a similar economic and social status as himself/herself.

In a village several groups may be formed. Male and female members could form separate groups of their own. Each group would have its own "chairman" or "chair person", and "secretary" elected by the group members. Each group must hold weekly meetings. Several groups (5-10 groups for instance) in a village will be federated into a "centre". The group chairmen/persons in a centre would elect a "Centre-Chief" and a "deputy Centre-Chief" from amongst themselves. The centre would find a convenient day and time to hold its weekly meetings where members of all the groups belonging to the centre would attend, deposit savings and transact banking and other business. The "Centre-Chief" would conduct the meeting and the Bank worker would be present to collect savings, loan repayments and make loan disbursements. In this case, bank officials/employees would go the target population in the village rather than people coming to the bank office for their business.

Once a group is formed it should be kept under observation for at least one month to see whether the group members are conforming to the discipline of the scheme. In the first week of the formation of the group, the members would have to attend daily meetings at a place and time to be decided by the members. Thereafter the meetings will be held once a week. The bank worker will be present at the meetings to explain the scheme's rules and procedures, to teach them how to complete the documentation, and to collect savings at a rate to be determined by the SA for all areas. In the meeting, obligations of the members will be repeated to them time and again to ensure that they are thoroughly understood. At the end of the one-month observation period, if the group is found qualified, it would be recognized as eligible for credit and further collaboration.

Banks want to ensure repayment of loans, and one such assurance is the legal entity of the group. It is therefore important that the groups formed under the credit scheme should have a legal identity on which obligations become binding. This legal identity, creates a sense of obligation on the group which has the responsibility to fulfil this obligation. The legislation of groups also helps in overcoming the stiff collateral requirements of some banks. The most common method of legislation is through registering the group as a cooperative; but cooperatives need to examine their requirements to make it easier and shorter for groups to be registered and become fully operational.

C. Credit Fund Organization and Lending Operations

The Central Management Unit of the scheme would maintain and operate the credit scheme fund, including the credit fund. It would operate the fund as per the decision of the Board of Directors/control Committee. It would approve the loan proposals processed under specified arrangements and disburse loans through the branch office for all types of income-generating activities. It would prepare and issue guidelines for credit operation and reporting by branches. It would collect, consolidate and circulate

overall statements of financial operations made by the branches. It would monitor and supervise the credit scheme.

Lending Procedure

The lending procedure of the grass-roots level credit scheme would be as follows:

a) The loan proposal stating loan purpose and amount would be made by the group member himself/herself;

b) No collateral would be required to apply for or obtain a loan;

c) Initially, two members of the group (selected among themselves) will be granted loans and others will be asked to monitor their performance for four to six weeks. Other members shall be warned that if the first pair of loanees fail to make their regular repayments, the remaining members would forfeit the loan benefit. This would put loanees under "peer pressure" to honour their repayment obligations. Once the first two loans are seen to being repaid, the next two borrowers can apply, and subsequently the fifth member as well. The chair person and secretary will be among the last to get loans. The first two would again qualify for a loan when they have repaid their previous loans and the process would continue with the other group members.

d) Each loan request would be considered and approved within the group and would need to be scrutinized and forwarded by the bank worker. Discussions will be conducted publicly so that exaggeration, misinformation, wilful suppression of facts can be minimized.

e) The Branch Manager, after scrutinizing and assessing individual loan proposals would prepare a consolidated list of applicants and the amount of loans and would forward this to the scheme' administration;

f) The Scheme Administrator would finally scrutinize the proposal, approve the loans and disburse the loans through the branch manager and his staff;

g) Loan utilization would be strictly supervised by the group members; the centre chief and the bank workers.

h) As far as feasible, all loans shall normally be repaid in 50 weekly instalments of equal amounts (2 per cent of the principal amount), with interest being repaid in the last two weeks of the year in two equal succeeding instalments, at a rate equivalent to the prevailing commercial rate. At the same time the borrower will pay an amount equal to 25 per cent of his interest liability into an

"emergency fund" (para...below). If a loan is paid off earlier, interest will be paid only for the loan period. Loans will be expected to be utilized within one week in activities which generate immediate cash flow. Suitable adjustments will be made if the cash flow is delayed or is received in lumps but in all cases a token weekly payment will be insisted upon for reasons of discipline. All property/materials purchased with the loan will be regarded as bank property until the loan is repaid in full;

i) The branch office would maintain accounts (scheme current accounts and scheme short-term deposit accounts) with a nearby branch of a commercial bank or post office savings bank, would keep all funds there and submit statements of accounts to the central unit, showing loan disbursement, repayments, savings and risk fund deposits and interest accounts; and

j) The Branch would also maintain accounts of a "Group Fund" and the "Emergency Fund" that would be developed in the process by the contribution of the group members (para...).

The Group Fund (GF)

The Group Fund (GF) will be an important component of the credit scheme. The group fund will be explained to group members as being their own "mini-bank" to protect them from going to money-lenders when they need immediate cash for such purposes as medical care, school fees of their children, meeting maintenance expenses for themselves and making quick supplementary investments. Every group member will make a single small deposit each week (as may be determined by the SA) as personal savings with the scheme. Over and above, when a group member receives a loan, an obligatory deduction will be made from him at the rate of five per cent of loan amount. This and the weekly personal savings together will constitute the GF. The GF money will be deposited into an account to be known as the Group Fund Savings Account.

The Group Fund will in fact function as a savings bank for the group members within the umbrella and framework of the scheme. The group members will be able to borrow from this fund as and when they like on both individual and group basis for investment as well as consumption purposes. The fund will be jointly operated by Group Chairman and the Secretary. The terms and conditions of the group fund loan, including the rate of interest, will, however, be determined by the group members. (To preserve the fund, a rule should be made that not more than 50 per cent of the Group Fund can be lent out at any one time).

Emergency Funds

Besides the Group Fund, the scheme will also maintain a fund, to be known as the "Emergency Fund". This will basically be an insurance fund for insurance against default caused by death, disability and other accidents. The fund can also be used to undertake activities which will improve the health, education, skill and investment opportunities of the group members. Each borrower will pay to this fund an amount equal to 25 per cent of the amount charged by the scheme as interest on its loan. The Government, banks and other agencies interested in building rural development fund for the poor could also contribute to this fund.

4. Organization and Implementation of Training Programme

The successful operation of the credit scheme would depend on the training programmes to be organized for both the bank staff and members of the target groups. To acquire the motivational and organizational skill to bring the scheme to the rural poor and to organize them under it, a thorough understanding of the training methodology and procedure, of other African and developing countries which have successfully operated credit schemes for rural people would be necessary. For this, the Scheme Administrator (SA) would have to go through an extensive dialogue and exposure programme in those countries and he would have to be sufficiently acquainted with the training approach and content developed and followed for training managers and bank workers. For this purpose he and his first two branch managers, would be required to participate in training and to visit rural banks in those countries. He would, in turn, develop appropriate training courses for his country with the help of local training institutes and technical assistance if necessary so that the scheme staff may be locally trained.

Once the branch managers and other staff members are selected, they should be, after sufficient briefing on their assignment, sent to prospective branch areas where they would collect data on market and socio-economic conditions of the area, meet members of the target group, gather information of their living condition and occupation and prepare a few case histories. This will give them the understanding of social and economic milieu and constraints within which they will have to work in their respective areas. Then they would be trained on the organization of groups, rendering banking and other services to the target group members, maintaining accounts and preparing financial and other reports. This would require at least four months of intensive training both at the village and classroom level to be able to undertake their assignment at the branch level. Besides this induction training, the staff should also be given in-service training at regular intervals in order to keep them up-to-date and raise their standards of performance.

Before eligible borrowers are granted loans they should go through an intensive training programme lasting between one and two weeks dealing with the philosophy of the Credit Scheme and its rules and

procedures. The group members have to pass a "test" before they are granted recognition and hence eligibility for loans. During this "test" members must satisfy the bank staff of their integrity and seriousness and understanding of the principles and procedures of the scheme for delivery and recovery of loans.

5. Monitoring, Reporting and Evaluation

For the successful operation and future expansion of the credit scheme, it will be necessary to establish an effective monitoring system and undertake internal and external evaluation. Each Branch Manager will submit a monthly narrative report to the SA for information and necessary action. The report will contain information on progress in group formation, loan disbursements, loan repayments, loan discipline, overdue loans, the group and emergency fund situations, group and centre activities, group and centre discipline, activities and problems of the branch and discipline of the staff, etc. He will also prepare and submit an annual plan of his branch for the next year including a balance sheet of the estimated expenditure and income of the branch.

The SA will be responsible for monitoring of the branch units and regular reporting to the chairman of the Inter-Ministerial and Inter-Agency Steering and Control Committee. Based on the branch reports, he will prepare and circulate a consolidated monthly report which will contain statistical information on the number of group members, numbers of centres, number of borrowers, number of villages covered, amount of disbursement from loan fund and emergency funds etc. The SA will also prepare and circulate an annual report highlighting the scheme activities, income and expenditures. He will hold review meeting with his staff at the branch level and organize workshops with the group members at the village level. He should also take initiative for the external evaluation of the scheme at the end of the second year and the fifth year at which points the introduction of Phase 2 and future replication of the scheme in other areas will be respectively determined. One of the existing research institutions in the country which has been involved with the evaluation of small farmer credit schemes and/or integrated Rural Development Projects would undertake the evaluations possibly in close collaboraton with the appropriate University Faculty (such as the Rural Economics Department). Annexes I to IV provide monitoring and evaluation activities that need to be undertaken.

6. Strategies for Achieving Viability and Sustainability

Does the cost structure of banks providing rural credit prohibit profitable operations? There are a series of options with which the average bank can achieve viability, i.e. cover its operating costs with the surplus of average return over average capital costs. First of all, because of the low elasticity of demand for credit in the rural areas, it should be possible for banks to increase the average return on loans so much that the break-even point is reached. The survival of banks is more important to the rural people than the interest rate.

Secondly, it seems possible to lower the required or cost-covering margin. One way to achieve this is by means of a simple reduction of staff costs and other administrative costs. There is a considerable potential for economizing on costs, as can be judged from, among other things the fact that the ratio of staff costs and administrative costs to loans vary so much between banks. The other way to reduce the required margin would be an expansion of operations in order to spread the overhead costs over a larger volume of business. Economies of scale can, however, only be realized if variable costs are lower than variable returns. Also, some administrative costs are not fixed, but would instead grow with business. Another strategy would be to reduce the liquid funds which do not earn interest and/or increase the share of "cheap" current deposits. This change of the asset and liability structure would increase the gross margin and thus permit profitability. However, this strategy might increase the risk of insolvency.

Every strategy of reducing costs in order to achieve cost-covering returns by varying only one parameter is difficult or even infeasible. However, a "mixed strategy" is much easier. For example, reducing liquid funds, lowering overhead costs and increasing the scope of operations would be sufficient to eliminate the loss of many banks providing rural credit, and also appears realistic. With such a strategy, the continued supply of financial services to the rural people could be achieved. Finally a combined strategy of raising the effective interest rate and reducing average costs is even more realistic. Although the sensitive issue of repayment has not been touched on, the above considerations lead to the conclusion that successful banking in terms of operational efficiency is possible in rural areas.

CHAPTER VI

CONCLUSIONS AND RECOMMENDATIONS

A. Conclusions:

Rural development is a process aimed at redistribution of opportunities; willing participation by the rural poor in its institutional environment in which the rural poor have the security of expectation regarding fair returns on the products of their labour. In the short-run, programmes and projects aimed at meeting the basic needs of the target groups may have significance; in the long-run, they are no substitute for an organization for creating an optimum institutional framework in which the poor can have access to scarce resources, such as, formal credit and actively participate in the rural development process.

As has been highlighted in the paper, the rural poor (including women) who constitute the largest segment of the population in many African countries are outside the orbit of the conventional banking system. Channelling credit by the formal financial institutions directly to the rural poor has met with very limited success. The best alternative would be to organize the scattered disadvantaged people in purposive viable groups which an organized institutional credit scheme can support. The paper has noted that the central focus of a viable participatory rural development strategy needs to be shifted from attempts to meet the credit needs of "individuals" to that of organizing the rural poor into purposive income-generating viable groups and creating institutional infrastructure to lend support to these groups. The distinct advantages of such as approach were noted as. (i) it minimises the difficulties of the institutional credit system in reaching the poor in terms of operational costs and efficiency; (ii) it makes it easier to supervise and monitor the use of credit; and (iii) it ensures discipline among illiterate borrowers through group activity and group lending.

The paper also attempted to identify the existing constraints and disincentives needing urgent corrective action with a view to ensuring the participation of the rural poor in the people's organizations and utlimately in the rural development process. Although the financial system has a very crucial role to play in accelerating the rural development process, it was, however, noted that there were limits beyond which the financial system by itself was unable to influence the process. This is because the constraints needing remedial action are partly external to the financial system. It is recommended that the national government and the financial institutions would have to play a more dynamic role in future within their respective jurisdictions and undertake simultaneous coordinated efforts on issues needing joint action.

B. Recommendations:

The purpose of this paper is to provide guidelines to Africa Governments and Central Banks (AG/CB) which these entities can use as a building block for organizing credit schemes at the grassroots level for participatory rural development in Africa. This purpose determines the nature of the recommendations that follow, which are meant to be both policy - and action - oriented and comprise what AG/CB should consider and which steps they should take. The roles of AG/CB should be restricted to the following: (i) political and morale leadership, (ii) setting structural parameters as well as design and implementation of economic and credit policies in this area; (iii) taking selected important initiatives. The following recomemendations are addressed to AG/CB in these capacities.

1. Recommendations for Political Leadership

Whatever specific measures AG/CB may undertake in order to increase access of the rural poor the formal credit, the political leaders should be aware of the present situation in the rural areas which can be summarised in ten points:

-The present rural financial system, and in particular the formal banking system, do not fulfil their social and economic functions in a way which could be considered satisfactory, they do not sufficiently contribute to rural development;

-Their contribution to rural development can, however, be enhanced through the adoption of appropriate business policies. Even though the necessary institutional infrastructure is inadequate in many countries, the potential exists to make rural credit a successful business activity.

-However, in order to exploit this potential, a fundamental reorientation in the minds and behaviour of bank directors, managers and personnel concerned with rural credit is required: they have to start actively seeking their business instead of waiting for it, and they have to be open-minded towards their customers and their needs, attitudes and behavioural pattern. In this specific sense it is absolutely essential that the social orientation of bank workers handling rural credit be strengthened through appropriate training programmes;

-The most pressing need to the rural population is for safe, convenient, financially attractive and liquid savings facilities. The provision of such facilities is a basic service to the customers and should not be viewed only as a way of obtaining credit from the banks;

-Credit has to be granted on the basis of solid economic evaluations and under clear and easily understandable conditions. Post-disbursement services, such as extension, market counselling, financial management, monitoring etc. are indispensable. In no way should credit appear to be a form of subsidy or welfare payment. If this reorientation takes place, repayment problems can be avoided for the most part;

-There is a vast largely untapped "information resources" which could provide the necessary information about customers' needs and behavioural patterns - namely, the customers themselves. Bankers must go to the people, look at the farms, small businesses and talk to them either individually or in their groups. This resource has, as yet, not been fully exploited.

-There is also the tremendous potential, which is not currently being exploited to a sufficient degree, to reduce both costs and repayment problems: a variety of different kinds of linkages between the formal banking sector and the informal groups and non-financial institutions such as: Non-Governmental Organizations (NGOs) should be investigated and established. The informal groups and other organizations can, for instance, help to identify qualified borrowers and encourage them to repay loans;

-Administrative costs of bank branches in the rural areas can be reduced, among other things, by expanding the scope of their activities: Likewise, the costs of clients obtaining bank services must and can be reduced. However, this does not apply to the interest cost component of loans.

-One essential prerequisite for achieving more than the current limited level of success in the operations of formal banks is a general attitude of strict fairness towards rural customers on the part of bankers. If such an attitude of impartiality is adopted - and put into practice - the banks would have taken a major step towards establsihing a good reputation for themselves and their current and potential customers.

-The other essential prerequisite is the financial soundness of the respective financial institution. The rural people cannot - and should not - be induced to deposit their savings with financially weak institutions. Depositor protection is an objective of the highest priority; and AG/CB have to contribute to its achievement.

If AG/CB want to induce their banking community to improve its performance in the rural areas, they must know precisely what they expect the bankers to do, and these expectations have to be realistic. This leads to:

Recommendation 1: Whatever specific programmes AG/CB may decide on, they should make the above ten points one of the foundations of their policy.

Recommendation 2: AG/CB should make it clear that they accept the basic view of rural financial institutions and their role in the rural development process which is reflected in the above ten points and should set themselves the political task of propagating this "rural banking philosophy" in the banking community, in political arena, in the rural community and the society at large.

2. Recommendations for Policy Measures.

The following set of six recommendations is more operational in nature. They rest on the premise that AG/CB are basically only in a position to determine the rules according to which the players in the field can and must adjust their activities. Recommendations 3 to 5 are addressed to AG/CB in their capacity as law-making and law enforcing entities.

Recommendation 3: Enact and enforce strict prudential regulations for rural banking activities. Such regulations would put banks in rural areas under pressure to conduct their business in a sound manner and to "struggle for survival". Regulations should be such that banks have no alternative other than to behave in the interest of the customers or to suffer being driven out of the market. Strong pressure to avoid losses will, in the final analysis, motivate bankers to become much more oriented towards the profit potential inherent in an imaginative and open-minded approach to the specific aspects of rural finance.

Recommendation 4: Permit more competition in the rural financial market, and create and encourage a spirit of competition. Competition is a good means of safe-guarding the interests of clients and inducing the bankers to be more efficient and more market-oriented than they are now. A realistic margin between interest revenue and interest costs to the banks could be an incentive for new competitors to enter the market, this should be encouraged. Weak banks must have the opportunity to leave the market. AG/CB should make this possible in a way which will not hurt depositors. The problem of who bears the cost, i.e. pays the depositors has to be faced.

Recommendation 5: The legal system, including law enforcement, should be reviewed and possibly modified in such a way that it becomes easier to provide sound, innovative rural banking services to the rural poor especially women. The banks' insistence on collaterals, the need for credit to women to be co-signed by their husbands, laws denying women ownership of land should be reviewed and abolished. The opportunities for banks to force unwilling borrowers to repay their loans should be strengthened, they are currently not effective enough. The possibility for banks to operate input procurement subsidiaries and to open branches in the rural areas should be investigated, and if need be, encouraged. This would increase the physical presence of banking facilities in the rural areas.

Recommendation 6: As the predominant interest of rural people is to have attractive savings opportunities, AG/CB in their capacity as fiscal and monetary authorities should do all they can in an effort to raise the effective real interest rate on savings - deposits to a positive level. This would help very much to expand the scope of rural banking activities. It has to be realized that banks operating in rural areas would then need opportunities to invest their surplus funds at positive real interest rates as well. No one should be concerned that higher deposit rate would also mean higher interest for other credit customers. The typical rural borrowers would not have to suffer, they might instead benefit from the fact that higher interest rates would crowd out those borrowers who do not have a genuine demand for credit, but are only "seeking rents". The banks should also benefit from the positive selection effect created by higher rates.

Recommendation 7: As owners and promoters of rural banking facilities, AG/CB should see and actively support the "social component" of the training of the bank personnel, managers and directors. Professional bankers' knowledge is, of course, very important: However, this is currently not as lacking in the rural financial institutions as an openness to the socio-cultural milieu, a genuine understanding of the customers' habits and ways of thinking, and the ability to operate in and with the so-called informal or un-official sector. Rural bankers should not be less professional, but they must also be taught to be more 'popular' at the same time. Concrete measures should be taken to spread awareness among the personnel of banks operating in rural areas that a stronger social orientation, greater efficiency and more viability are possible, necessary and, indeed, expected of them by the government. A campaign aimed at achieving a new level of awareness should also be designed that officials of ministries and NGOs concerned with participatory rural development could also be addressed.

Recommendation 8: AG/CB should clarify the roles of the different bodies promoting, supporting and supervising rural development. The roles of the different organizations have to be spelled out clearly, the organizations have to be endowed with sufficient resources, and unnecessary conflicts as well as waste of resources have to be avoided. A separation of the promotional function from the supervisory function is advisable. Both functions should be organized with a stronger regional decentralization than at present. The present allocation of personnel and other resources should not be a binding constraint. Both effective support and strict supervision of rural credit schemes are vital for their proper functioning and should be given more weight than administrative obstacles.

A SUGGESTED LIST OF MONITORING AND EVALUATION REPORTS

1. Report on Baseline Survey of Target Group and Control Group
2. Quarterly Monitoring Reports on Physical and Financial Implementation
3. On-going Evaluation Reports on Credit Scheme Components
4. Mid-term Evaluation Report
5. Ex-post Evaluation Report

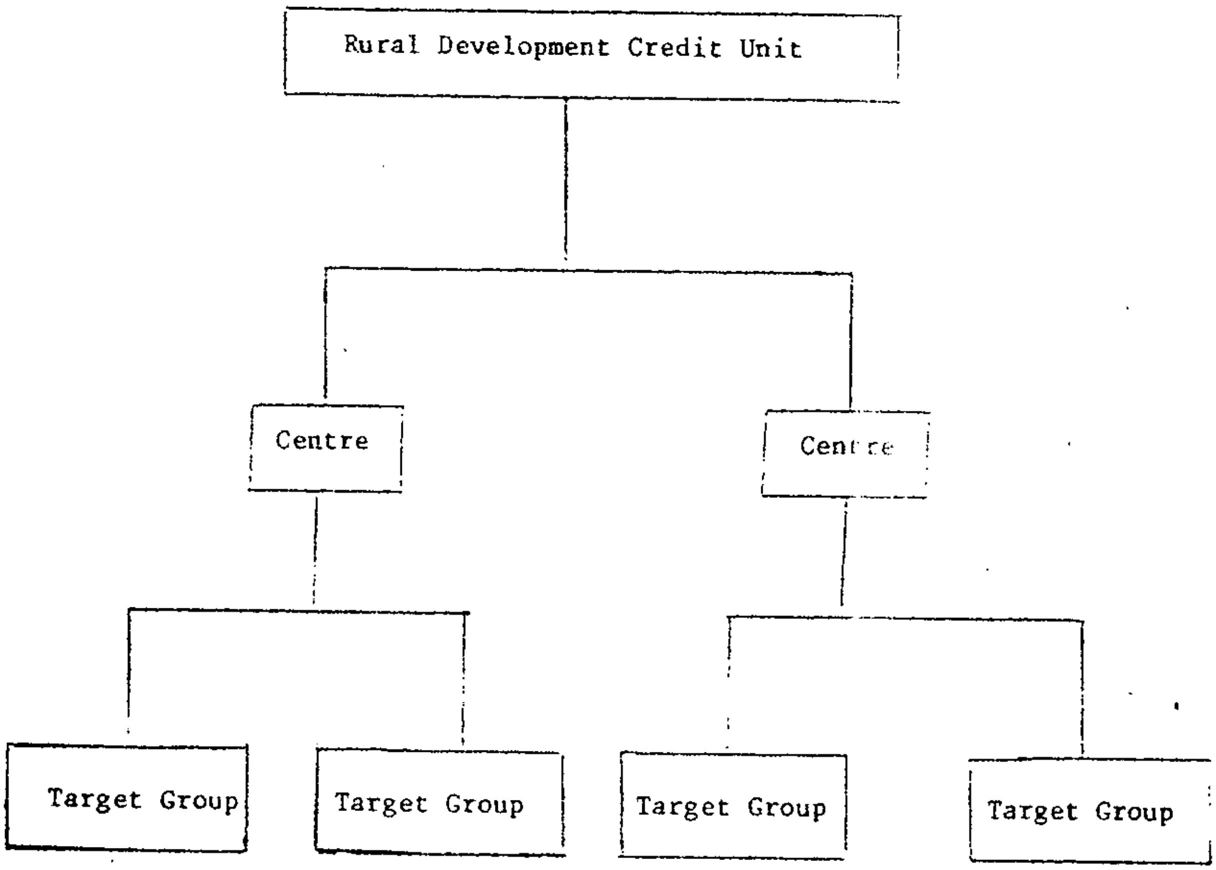
MONITORING AND EVALUATION ACTIVITIES

Activities	Responsible Agency
1. Baseline Survey of Target Group and Control Group	Outside Agency
2. Monitoring of Project (Physical and Financial) Implementation	Central Management Unit
3. On-going Evaluation of Selected Groups (Male and Female)	Central Management Unit
4. Selected Case History of Individual Borrowers (Male and Female)	Central Management Unit
5. Mid-Term Survey of Target Group and Control Group	Outside Agency
6. Project-end Survey of Target Group and Control Group	Outside Agency

ANNEX III

GRASSROOTS LEVEL CREDIT SCHEME

PROPOSED ORGANOGRAM



ANNEX IV

MANPOWER REQUIREMENTS FOR MONITORING AND EVALUATION

Type

Economist

Agricultural Economist

Credit Specialist

Rural Sociologist

Statistician

Research Assistant

Data Analyst

Programmer

Consultancy

Mass Communication

Investment

Training

Insurance

CASE STUDY 1

RURAL BANKING IN GHANA

INTRODUCTION

Credit facilities for the rural people in Ghana have remained grossly inadequate for many years in spite of various governmental and other measures designed to improve the position. For example, the peasant farmers (men and women) who form about 80 per cent of the rural population continue to depend on local money lenders for their credit needs and the rate of interest charged is such that the farmer is left with little or no return on his efforts. The small farmer has thus remained poor and cannot afford any decent living. Neither can he/she afford to expand his/her output by adopting modern cultural methods in agricultural production as these require substantial capital outlay far beyond his means.

In an attempt to alleviate the hardships of these farmers, farmers' co-operatives and other associations were in the past formed with a view to providing credit to farmers. Unfortunately these measures did not achieve any appreciable success in providing dependable and adequate source of credit for the peasant farmers. With a view to ensuring that adeqaute resources were channelled into agriculture the Agricultural Development Bank was established in 1965 with the aim of reaching the small farmers. Even though the bank is playing a creditable role in agricultural financing, it has so far succeeded in reaching only a small fraction of the country's peasant farmers. The nature and dimensions of rural credit in Ghana are such that with all goodwill of the Agricultural Development Bank, it simply does not have the financial and human resources to cope with them.

The commercial banks which mobilize nearly all the available savings in the country devote less the 10 per cent of their total loans to agriculture and almost all of this is taken up by relatively large commercial farmers, with very little remaining for the small farmer. The indications are that the banks will not change their pattern of lending in the foreseeable future, mainly because they have found their present operations sufficiently profitable, without getting involved in rural lending which requires more work and involves higher risks. The cost of administering and supervising a large nuember of small loans can hardly appeal to a commercial bank.

There are a number of branches of the major commercial banks in various parts of the country but as has already been noted, these branches are mainly mobilizing savings and not lending much to the rural people. Two main reasons account for this situation. The first is that a prospective borrower of a commercial bank needs to be a current account customer of that bank to be able to borrow. In other words, the relationship between the

customer and the bank must first be established. As a greater number of the peasant farmers do not operate such banking accounts they have no access to institutional credit. The second reason is that the collateral generally available to the peasant farmers which may be a rural dwelling house or a farm is unattractive to be considered by a commercial bank as satisfactory for purposes of granting a loan. As a consequence, the bulk of the savings which are mobilized by the commercial banks in the rural areas are not invested in those areas but are transferred to the urban centres and cities for profitable investment in trading and other sectors. This re-inforces the tendency towards over-concentration of savings in a few commercial banks and a consequent over-liquidity of such banks at a time when credit is not available for the peasant farmer.

It was in the light of the foregoing facts, that the Central Bank of Ghana decided to explore alternative means to ensure that local savings in the rural areas were utilized for the needs of the rural community. In this regard, the Bank of Ghana (BOG) conducted a study into the rural credit system in Ghana in 1970. The study revealed a noticeable gap in the banking system with insufficient funds flowing through the system to the large number of small rural borrowers which needed credit most. In view of this, the study recommended the establishment of rural banks.

RURAL BANKS IN GHANA

A rural bank is like any of the banks in the country. The only difference is that it is a unit bank, i.e. without branches, which mobilizes savings and lends to the people in the locality. The rural banks are private banks organized in the rural communities for specializing in the extension of credit to small peasant farmers and other small-scale rural entrepreneurs. The bank belongs to the people in the locality and its management, control and general operations is vested in the people. It has no headquarters.

BENEFITS OF RURAL BANKS TO THE RURAL ECONOMY

The establishment of the rural banking system is expected to produce the following benefits to the country's economy generally and more particularly to the rural economy.

1. The emergence of a credit system especially designed to meet the credit needs of small farmers and other rural entrepreneurs who constitute a great majority of the country's population, and the gradual elimination of the usurious money lender from the rural scene;

2. A more effective and realistic approach to the credit problems of small farmers since every rural bank would be managed and operated by residents of the locality who are familiar with its people so

that serious mistakes in selecting or identifying borrowers and making credit to them will thus be minimized or eliminated. The rural banks are in a better position to judge borrowers on their ability to repay and thus minimise or eliminate altogether the need for collateral;

3. More private funds would be available for agricultural credit in the form of private capital in rural banks as well as savings mobilized by these banks from private individuals;

4. Subscribers to the shares of a Rural Bank (RB) are inhabitants of the locality in which the bank is located although they need not be permanently resident in that locality. This is to ensure that the inhabitants are involved and identified with the development of the rural community.

CAPITALIZATION

Rural Banks (RBs) are organized in the form of joint stock companies. In 1981 the authorized capital was C 1 million 1/, while the minimum paid up capital was C 250,000 of which 50 per cent was made up of ordinary shares of C 1 per share, and 50 per cent in the form of redeemable preference shares taken up by the Central Bank of Ghana (BOG). The ordinary shares, which carry voting rights, are subscribed by the indigenous people. The entire preference shares are held by BOG until such time that these shares are sold to the inhabitants of the locality in which the RB is situated.

OWNERSHIP

To ownership of RB is spread as widely as possible to the inhabitants of the locality through subscription to its equity capital and by limiting individual's subscription to a maximum of C 10,000. Since it is envisaged that the RB would eventually be fully owned by the local people, BOG has over the years been gradually divesting itself of its preferred stocks by converting them to ordinary shares which are sold to the local people.

MANAGEMENT AND ADMINISTRATION

Subject to the supervisory machinery of BOG, the management of a RB is left entirely in the hands of the ordinary shareholders who are residents of the area in which the bank is located. The corporate powers of a RB are vested in the shareholders and the Board of Directors. The share-holders have the power to: i) elect, remove, increase or decrease the number of

1/ The exchange rate in 1981 was C 2.75 = 1 US $

directors; ii) increase or reduce the capital stock; iii) amend the articles of incorporation; iv) adopt, amend or repeal by-laws; and v) sell the corporate assets and authorise the dissolution and liquidation of the RB, in a manner provided for by law.

BOARD OF DIRECTORS

The Board of Directors, who are elected from the share-holders entitled to vote, exercise the ordinary corporate powers of a RB, conduct its business, hold and control its property. Questions of policy, management, and lawful appropriation of funds to advance corporate interests are within the discretion of the Board of Directors. It is the responsibility of the Board to conduct and manage the business affairs of the RB economically and efficiently.

Membership to the Board of Directors during the first year is by nomination from among the share-holders. At the end of the first year, all board members step down but are eligible for re-election at the Annual General Meeting. At subsequent Annual General Meetings, a third of the Board of Directors step down every year (or may be asked by the chairman/person to step down). But such members are also eligible for re-election and may contest with new nominees. Any newly elected board member(s) must be cleared by BOG whose decision on the issue is final. Ideally BOG identifies areas or localities where RBs may be set up. However, the BOG only considers applications from groups of persons, associations or Credit Unions who wish to establish RB in their locality.

ORGANIZATIONAL SET-UP

By its very nature, a RB must be a rather small unit. The organizational set-up of such a bank is therefore as simple as possible to ensure that it is inexpensive and reasonably easier to manage. Apart from the Board of Directors, the Management staff is made up of: Manager/secretary, Accountant/Assistant Accountant, Project Officer, Clerk/Typist and a messenger.

In order to ensure that only public spirited persons in the community offer to serve on the boards of RBs and also with a view to minimizing the operating costs of RBs, the directors' sitting allowances are kept as low as possible or as the Board may deem reasonable depending upon the Bank's resources. Initially the salaries of the management staff are also moderate and no attempt is made to match these with those paid by other commercial and development banks. But with time, if the resources of the bank permit, the Board could decide to adjust the remunerations so as to retain efficient staff.

LENDING OPERATIONS

1. Rural banks conduct their businesses with special emphasis on the mobilization of savings, the granting of loans and advances under reasonable terms to small farmers, small merchants and small businesses in the rural areas. All these activities are conducted within the framework and limitations and in the manner provided for in the guidelines issued by BOG subject to the supervisory powers of BOG.

2. Rural banks grant credit subject to the following requirements: (a) the applicant must be eligible and, (b) the purpose of the loan must be within those allowed under the operations of RBs.

a) Eligibility: The following persons may borrow from a RB.

- in all cases the prospective borrower(s) should be a customer of the RB.

- a farmer, who may be an individual or a duly organized group, cultivating acres of land dedicated to agricultural production, of not more than 50 acres (20 hectares);

- associations or groups of small farmers, producers of livestock and poultry, fishermen, craftsmen/women and petty traders;

- an operator of a rural industry or enterprise whose capital investment in plant and machinery does not exceed C 100,000; and,

-a retail or wholesale merchant whose capital investment does not exceed C 100,000.

b) Kinds of loans. RBs grant the following kinds of loans: agricultural, industrial and commercial. Personal loans are also granted for such purposes as: health, children's education and subsistence, etc.

3) Securities

a) Loans are granted to groups provided the members of the group shall in the case of default be jointly and severally liable for the loan repayment;

b) A potential borrower could be eligible for a loan if there exists a reasonable credit balance in his/her account:

c) Where the condition under (b) above is not applicable, then a potential borrower must be known by the board of directors to be a hard working and honest member of the community who could take full advantage of the loan granted him for productive purposes; and,

d) A potential borrower, must, in addition, be able to produce two people also in good standing within the locality, who are prepared to stand as guarantors for the loan.

4. <u>Loan Disbursement and Recovery</u>: Except for agricultural loans, the period granted for industrial, commercial and other loans is determined on the merits in each case but does not usually exceed one calendar year. Renewals may be granted only when this would improve the repayment capacity of the borrower, and would in no way, prejudice the interest of the bank.

To enable RBs to mobilize savings at the early stages of their establishment, they are not allowed to lend during the first six months of their inception. This gives them the opportunity to learn more about their prospective customers and also design more realistic lending procedures.

To prevent diversion of loans to purposes other than those for which they are granted; the release in lump sums and in cash to borrowers is avoided as much as possible. For example, where a loan is obtained for the purpose of purchasing farm inputs or merchandise arrangements are made for the delivery of such materials to the borrower; and payment is effected by the bank either in cash or by cheque direct to the suppliers.

In order to induce effective utilization of agricultural loans, disbursements are not made in lump sums but rather in instalments to allow the borrower apply the loan effectively to the critical phases of the production cycle. In this connection, agricultural loans are disbursed in three or four instalments depending on the production cycle of the particular crop.

5. Credit ceilings:

a) To ensure that the bulk of the RBs' credit is chanelled to the priority sectors, more particularly agriculture, the following sectoral allocations are recommended.

Sector	Percentage of Total Advances 1/ Granted Each Year
Agriculture	50
Cottage Industry	20
Transport	20
Trading	10

1/ Total Advances cover all credit facilities under loans and overdrafts.

b) In order to channel the greatest percentage of RB loans to small borrowers the following size distribution is recommended:

Size of Loan	Percentage
Up to C 1000	60
C 1000 - C 5,000	30
Over C 5,000	10

c) To ensure that RBs do not face liquidity problems the following recommendation is made for term loans.

Type of Loan	Percentage
Short-term (up to 1 1/2 yrs)	70
Medium-term (1 1/2 to 5 yrs)	20
Long-term (5 yrs to 15 yrs)	10

6. Payment of Dividends

To enable the RBs to build up reserves, no dividends are paid for the first five years of inception. This is to enable the banks to plough back that their profits. However, share-bonuses are paid after clearance with BOG.

7. Monitoring and Supervision

To enable BOG to monitor and supervise the operations of RBs the submission of the following returns is mandatory.

Periodicity	Contents of Report
a) Weekly	Liquidity Reserve Requirement
b) Monthly	-Analysis of Loans and Advances - Statement of Assets and Liabilities -Statement of Income and Expenditure -Summary report on general operations of the bank
c) Quarterly	-Outstanding loans/overdrafts as at the end of the Quarter -Quarterly statistics and the report of the bank's operations in general

Failure to submit any of the above-mentioned reports is punishable by a penalty and/or suspension of the manager concerned. The Board of Directors also cause a budget to be prepared for each financial year which includes a breakdown of the estimated itemized expenses and income. This is also submitted to BOG.

8. Training

BOG also organizes regular training courses for staff of the RBs to ensure that they update their knowledge on current banking and rural development practices to become more efficient.

9. Growth of Rural Banks

The Rural Banking Scheme is one of the most radical innovative programmes designed by BOG to ensure availabilty of savings and credit facilities to the rural people. The concept of "Rural Banking" is catching on fast. The performance of RBs, to date, has been encouraging, both in terms of increase in the number of banks and growth in deposits as illustrated in the table below.

Table 1

SCHEDULE SHOWING INCREASE IN NUMBERS AND DEPOSITS OF RURAL BANKS

Year	No. of Banks	Deposits
		'000 cedis
1977	3	359
1980	11	17,030
1982	35	191,709
1988	119	3,600,000

Source: Bank of Ghana, Rural Banking Department, 1989

Building on the experience of rural banks in the last decade, several strategies have been adopted to expand their role and improve their efficiency in rural financing. These are summarized hereunder:

a) To increase the capital stock of the banks non-resident citizens from the locality in which rural banks are situated are also allowed to purchase shares. These include rich businessmen/women, city and urban traders, and public servants.

b) Directors of the banks campaign for customers for the banks through public lectures at local community meetings; and identifying groups and organizing them to deposit their savings with the bank.

c) Unlike their sister banks, rural banks do not work according to fixed time schedules. Managers live in the bank premises or in nearby houses. This makes it possible to arrange business hours to suit the daily pursuits of the local people most of whom are farmers. Deposits are accepted any time of the day, while withdrawals are allowed even at the week ends.

d) Agency services are established at prosperous towns or villages on the fringes of the operational area of the rural banks. These offices are run on selected days of the week by staff of the rural bank; the sole aim being to collect deposits from people who are unable to travel to the main offices of the rural banks to deposit their saving.

CASE STUDY 2

GRAMEEN (RURAL) BANK - BANGLADESH

INTRODUCTION

The usual beliefs that the rural poor are not capable of banking, that they cannot find something from which to earn an income, that they cannot save, that they will run out of ideas, that the rural power structure will make sure that an institutional credit project fails, that rural society will not allow women to borrow from the bank have all been demonstrated to be mere myths by the experience of the Grameen(Rural) Bank in Bangladesh.

The bank started as a pilot rural credit project launched in Jobra village in Bangladesh together with some neighbouring villages during 1976-1979. Then, with the sponsorship and support of the nationalized commercial banks, it was extended to several other districts. In September 1983 the project was transformed into a specialized financial institution called "Grameen (Rural) Bank" with an authorized capital of TK 100 million (US $ 3 million) with 40 per cent of the share capital paid by the government, 40 per cent by member loanees and 20 per cent by other banks.

OBJECTIVES

The objectives of the Grameen Bank are as follows:

- To extend banking facilities to poor men and women in the rural areas;

- To eliminate exploitation of the rural people by money lenders;

- To create self-employment opportunities for the vast un - and under - utilized labour resources;

- To bring such disadvantaged people within the fold of some organizational system, which they could not only understand and operate but also find in it socio-political and economic strength through mutual support; and,

- To reverse the age-old vicious circle of "low-income, low savings, low investment, low income" into an expanding system of "low income, credit, investment, more income, more credit and more investment.

OPERATIONS

The Grameen Bank lends only to the poor, demands no collateral but achieves an astonishing recovery rate of 98 per cent. In its evolution and functioning the Grameen Bank (GB) has pioneered a series of new approaches, mechanisms and procedures in granting loans to the poorest in rural Bangladesh.

Borrowers are landless men and women who must organize themselves into groups of five in order to receive loans for which no collateral is required. The group members should be like-minded and have similar economic and social backgrounds. Any person whose family owns less than 0.5 acre of cultivable land and whose family assets all put together does not exceed the market value of one acre of medium quality land in the area, is eligible to take loans from the bank for any income-generating activity. Close relatives cannot be members of the same group. Initially one member from a family can be a group member, with the others gradually joining other groups, male and female groups being formed separately. Credit is granted largely for non-agricultural activities.

Each group elects its own chairman and secretary and must hold regular weekly meetings. Several groups from the same area are federated into a centre that varies in size from three to six groups (with a maximum of eight groups). This enables more in-depth and personal discussions to take place. A "centre chief" and a "deputy centre chief" are elected from amongst the chairpersons of the various groups and it is their responsibility to conduct weekly meetings of the centre, recommend loan proposals, supervise loan activities and assist the bank workers in their day-to-day work.

Loan requests are first formulated and considered within the group. They are then scrutized and approved successively by the centre chief, bank workers, the programme officer and finally the branch and zonal managers. Before eligible borrowers are granted loans they go through an intensive training programme dealing with the philosophy of GB and its rules and procedures. The group members have to pass a "test" before they are granted recognition and hence eligibility for loans. During this "test", group members must satisfy the bank staff of their integrity, seriousness and understanding of the principles and procedures of the GB for granting of loans. After the GB is satisfied with the seriousness of the group, only two of its members are selected for loan sanctioning. Usually the chairperson and the secretary of the group are the last to receive loans.

Initially, two members of the group (selected among themselves) are granted loans and others are requested to monitor their performance for four to six weeks. Upon successful compliance with the bank's regulations, additional members become eligible for loans. Other members are warned that if the first pair of borrowers fail to make their regular repayments,

the remaining members might forfeit the loan benefit. This puts the loanees under "peer pressure" to repay their loans. Loans are advanced to both individuals and groups. Although there are a lot of informal interlocking responsibilities in loan distribution, the loanee alone is held responsible for his or her own loan. All loans are repaid, normally in 50 weekly equal instalments with interest at 16 per cent being paid in the last two weeks of the year.

All GB transactions with the group members are completed at the weekly meetings. This is to adhere to the principle of the GB, that the bank should to go the people rather than the rural people going to the bank. A bank worker attends the weekly meetings to collect instalments and receive Group Fund Account deposits. All loan proposals are discussed with the bank at the group meetings. Discussions are conducted publicly so that exaggeration, misinformation and wilful suppression of facts can be minimized.

The organization of members in their groups and centres serves a number of purposes. First, it gives individuals a measure of personal security and confidence to take risks and launch new initiatives. Secondly, groups and centres are the main vehicles for members' participation in the activities of the credit scheme. Thirdly, as noted before, the groups and centres act as sources of pressure on the individual to fulfil his/her obligations towards the bank and to encourage him/her to discard undesirable traditional attitudes and to oppose anti-social but entrenched customs and practises. Fourthly, the groups and centres provide the necessary organizational support for launching a variety of economic, social and cultural activities. A sense of healthy rivalry and competition among them spurs each to a higher level of performance. Fifthly, the formation of groups enables the rural poor to transform their individual weakness into collective strength and thus exert pressure against the local centres of power.

GROUP FUND ACCOUNT

Each group member deposits TK 1 per week as personal saving. This is accumulated in an account designated the Group Fund Account, which is operated by the group. When a group member receives a loan from the bank, an obligatory deduction is made over and above all other repayments, at a rate of five per cent of the total loan amount. This is known as the Group Tax. A member pays this "tax" for enjoying the financial services coming to him through the group and also to build up a reserve for the group itself.

The Group Tax collection is also deposited in the Group Fund Account. Individuals do not have any special claim to the proceeds of the Group Tax. It belongs to all the group members. Any group members can borrow from the Group Fund Account for any purpose, such as: investment or consumption, with the consent of the remaining members at terms and conditions decided by the

group. The Group Fund Account is explained to members as being their own "mini-bank" to protect them from going to money-lenders when they need immediate cash for sickness, to avoid starvation, to meet social demands, for meeting maintenance expenses for themselves and their capital equipment, even to make a quick supplementary investment. In other words, it is a safety net for when they fall on hard times.

EMERGENCY FUND

Besides the Group Fund Account, members created another fund called Emergency Fund. This is basically a fund for insurance against default, death, disability and other accidents. Each loanee pays to the Emergency Fund, an amount equivalent to 25 per cent of the amount charged as the Bank's interest on his/her loan. The Fund is used to provide life and accident insurance coverage to all group members, to repay bad debts, and undertake activities which will improve the health, skill, education and investment opportunities of the group members. The Government and other agencies interested in building up economic programmes for the landless could participate by contributing to this fund. This is also expected to ease the burden on the banking system in leading the programme from the initial phase to the next higher phase.

ACHIEVEMENTS

The rural credit project has come a long way since it was launched in 1976. In July 1986, the Government raised the paid-up share capital of the Grameen (Rural) Bank to TK 72 million (approximately US $ 2 million), out of which the government's share was reduced from 40 per cent (in 1983) to 25 per cent while borrowers subscribed share was increased from 40 per cent (in 1983) to 75 per cent, indicating a marked decrease on the dependence on Government funding.

As at December 1987, the Grameen Bank had 295 branches in five zones and 13 districts covering 230,000 borrowers in over 5,000 villages. It had disbursed, by December 1986, approximately TK 1,470 million and had a recovery rate close to 98 per cent with group members saving more than TK 140 million, of which about 83 per cent of the loans disbursed went to female members. The bank has not faced any opposition from any body in any of the areas that it operates. It has more than substantially changed the structure of conventioanl banking systems and its relation with the rural poor.