

**SUSTAINABILITY OF THE ZAMBIAN MICROFINANCE
INDUSTRY: A CASE STUDY OF CREDIT MANAGEMENT
SERVICES**



**SUSTAINABILITY OF THE ZAMBIAN MICROFINANCE
INDUSTRY: A CASE STUDY OF CREDIT MANAGEMENT
SERVICES**

By

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**A Minithesis Submitted in Partial Fulfillment of the Requirements for
the Degree of Master of Arts at the Institute for Social Development,
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KEY WORDS/CONCEPTS

Sustainability

Microfinance

Microfinance Industry

Operational sustainability

Financial sustainability

Subsidy

Collateral

Donors

Best-practice

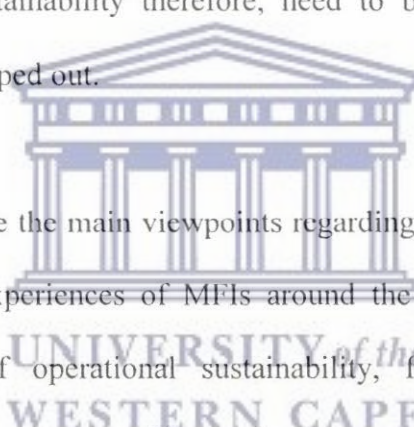
Poverty-reduction



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ABSTRACT

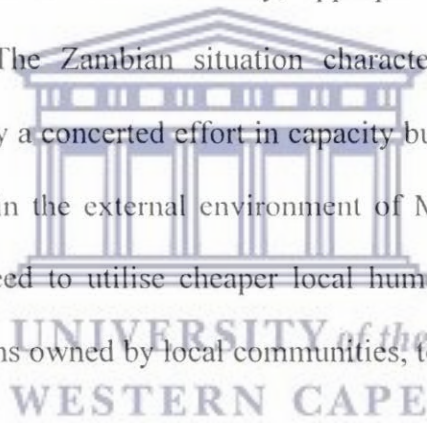
This thesis is both a qualitative and quantitative study, investigating the sustainability of Credit Management Services Limited (CMS) within the broader context of the Zambian microfinance industry. Microfinance is regarded as one of the tools for poverty reduction. As such, making microfinance available to many poor people is the purpose of microfinance. Over the years it has become clear that microfinance institutions have to operate efficiently and be self-sustainable in order to continue assisting the poor. However, in spite of the support and encouragement given for sustainability, evidence shows that there are few sustainable microfinance institutions in the world. The various factors impacting upon sustainability therefore, need to be examined and means of enhancing sustainability mapped out.



The study brought to the fore the main viewpoints regarding sustainability and how they have been influenced by experiences of MFIs around the world. The framework for discussion and analysis of operational sustainability, financial sustainability and operational efficiency is also set out. The study discusses the Zambian microfinance industry and shows how and why the industry has emerged and grown in the past decade. Some constraints are identified that need to be dealt with in order to enhance sustainability of the industry. The study of CMS reveals that the institution is not yet financially sustainable, but that its efficiency levels are steadily increasing as it has put in place mechanisms to recover costs, charge economic rates of interest and increase and maintain its client outreach. Indicators are that it is moving in the right direction with its

cost recovery, increasing client outreach and utilization of loans for on-lending as opposed to subsidies. This study therefore draws on the general experiences of the Credit Management Services in order to draw lessons for the Zambian industry. The study will argue the case that though sustainability is difficult to achieve, there are positive indicators in the Zambian industry that this is possible and that CMS could be considered as an example. This claim is verified against the experience on the ground of Credit Management Services.

The study concludes that building a sustainable microfinance industry anywhere is not the easiest task. Sustainability is possible but requires a lot of investment in capacity building and deliberate steps for cost efficiency, appropriate pricing policies and an increased client outreach. The Zambian situation characterised by even a younger industry, will require not only a concerted effort in capacity building, but much more, the need to counter constraints in the external environment of MFIs. Recommendations to stake holders include the need to utilise cheaper local human resources and invest in strengthening local institutions owned by local communities, to enhance the sustainability of microfinance initiatives.



DECLARATION

I declare that “*Sustainability of the Zambian Microfinance Industry: A Case Study of Credit Management Services*”, is my own work. None of the material contained in this thesis, other than that acknowledged to other authors, has been previously submitted for an academic award in this or any other institution.

Signature.....

Veronica N. Phiri

July 2002



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Last but not least, To many colleagues and friends who supported, encouraged and prayed with me both at home and in South Africa during the time of writing this thesis.

Veronica Nanyangwe-Phiri



DEDICATION

**Dedicated to my husband, Moses Phiri and my children Wezi, Zewelani,
Tiwonge and Ntiusya.**



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LIST OF ACRONYMS

ACEP	Agence de Credit pour l' Enterprise Privee'
ADOPEM	Asociacion' Dominicano para el Desarrollo de la Mujer
AFC	Agricultural Finance Company
AMIZ	Association for Microfinance Institutions of Zambia
ARMS	Africa Region Microcredit Summit
Banco Sol	Banco Solidario
BKD	Badan Kredit Desa
BRK	Banking Raya Karkara
CGAP	Consultative Group to Assist the Poorest
CorpoSol	Corporacio'n de Accion Solidaria
COZ	Credit Organisation of Zambia
CUSA	Credit Unions and Savings Association
DFID	Department for International Development
FAO	Food and Agricultural Organisation
FINCA	Fundacio'n Integral Campesina
FRA	Food Reserve Agency
IMF	International Monetary Fund
K-REP	Kenya Rural Enterprise Programme
MBT	MicroBankers' trust
MCDSS	Ministry of community Development and Social Services
MFI	Microfinance Institution
MIS	Management Information Systems
NGO	Non Governmental Organisations
SAP	Structural Adjustment programme
SEP	Small Enterprise Promotion
SDI	Subsidy Dependency Index
SIDA	Swedish International Development Agency
SIDO	Small Industries Development Organisation

UNDP	United Nations Development Programme
USAID	United States Agency for International Development
VIS	Village Industry Services
ZCF	Zambia Co operative Federation




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CHAPTER ONE

INTRODUCTION

This research report comprises a case study on the sustainability of a Zambian microfinance institution, Credit Management Services limited (CMS). The study sets out to analyse the sustainability of CMS in the broader context of the microfinance industry in Zambia and draws conclusions and recommendations for stakeholders. This introductory chapter of the thesis presents the overview, the rationale of the study and states the research problem. The aims and objectives of the study, and structure of the thesis are also discussed.

1.0 Overview



The task of building sustainable microfinance institutions¹ (MFIs) is an enormous one, because there are large numbers of poor entrepreneurs resulting in a high demand for financial services. Sustainability, in the context of microfinance institutions is widely accepted to be synonymous with financial viability and is regarded as necessary for an institution to increase its outreach to the poor. Ledgerwood (1999) points out that there are about 500 million economically active poor people in the world operating micro enterprises and small businesses, but most of them do not have access to adequate

¹ The term microfinance institution normally refers to non-Governmental Organisations (NGOs) and/or private institutions providing financial services to poor entrepreneurs or low-income households.

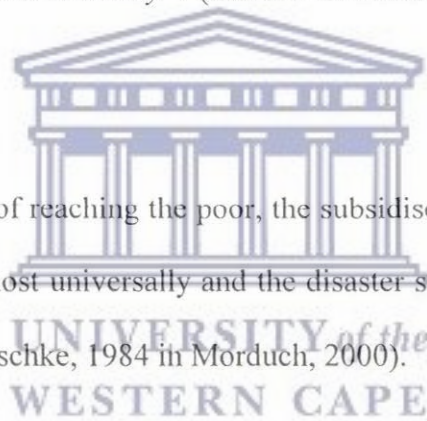
financial services. In fact it is estimated that Microfinance² only serves 16 million out of the total number of 500 million (CGAP FocusNote No. 20, May 2001). In view of the fact that credit provision has an important role to play in poverty reduction, the need to develop and sustain the MFIs cannot be over emphasised. As a result, all stakeholders are paying a lot of attention to sustainability issues.

International literature shows that past efforts using subsidized and directed credit seem to have left a legacy of failed and unsustainable programmes that perpetually depended on donor and government funding. These early credit programmes constituted the subsidizing of bank loans to poor households in order to overcome the reluctance of banks to lend to collateral poor households. The loans were subsidised by the state and/or donors in order to make them affordable to low income households. Because the mission of the programmes was social, interest rates were also kept below market clearing levels (Morduch, 2000). Morduch further points out that default rates in these programmes were high because the loans were uncollateralised and some borrowers saw no need to pay back government money. The losses due to non-payment were borne by the governments. Since banks were having problems recovering loans and were still subsidised by governments, they were not motivated to mobilise savings as an alternative source of finance for on lending (Ibid.). As a result, some banks ran out of money and closed the programmes altogether. One thus finds that these programmes, either ran out of money or they drained government coffers.

² Microfinance refers to financial services, which are provided to low-income households and/or poor entrepreneurs. These services include credit, savings and insurance. Some institutions will also provide non-financial services like training, group formation and counselling in order to build the capacity of their clients.

Another negative consequence of government supported loan programmes was that they ended up mostly subsidising the well off and those with political connections (Morduch 2000). In the end, the poor did not benefit as much from government supported programmes.

“Overall, the weaknesses of past efforts to reach small farmers and other priority groups have been in three main areas: lending institutions have not been financially viable and became quickly decapitalised; funds have not reached the intended target group; some programmes have distorted the financial market and interfered with the evolution of finance for broad sectors of the economy”. (USAID Evaluation Highlights NO.49, June 1995, online).



And so, despite the promise of reaching the poor, the subsidised credit programmes of the past three decades failed almost universally and the disaster stories are well documented (Adams, Graham and Von Pischke, 1984 in Morduch, 2000).

Due to the low success rate of government and donor supported credit programmes, micro financing programmes and institutions came into being as a way of meeting the challenge of reaching poor clients in a more sustainable way. The new microfinance programmes set out to avoid the weaknesses of government programmes. These institutions however emerged after a lot of experimentation with product designs, and institutional structures. Morduch (2000) for example points out that “by employing

contractual innovations like group lending and by exploiting dynamic incentives, many programmes have achieved repayment rates above 95%". (Christen et al quoted in Morduch, 2000: 620). In the past two decades, microfinance institutions have concentrated on providing loans for microenterprise activities. These institutions exist in various legal forms: NGOs, credit unions, non-bank financial intermediaries, various types of companies and of late some very successful ones have evolved into registered commercial banks.

1.1 Rationale of the Study

There has been little research conducted in microfinance in Zambia. Interest in this area was minimal due to the small number of institutions until the mid-nineties. The few studies that have been conducted are mostly concerned with impact assessment. So far, to the best of my knowledge, no studies have been conducted in sustainability analysis although constraints faced by the industry have been alluded to in various studies and papers. Due to the ever-increasing number of microfinance institutions and heavy donor investment, research in sustainability has become imperative for the purpose of providing information both to the MFIs and to stakeholders. A lot of policies and standards have been formulated at international level by donors and other stakeholders to apply to a whole spectrum of institutions, regardless of where they are found. It is however becoming increasingly clear that regional and institutional characteristics need to be taken into consideration when microfinance policies and standards are made. This information can only be obtained by conducting research into institutions and populations

served by these institutions. This will not only provide empirical information that can be used by stakeholders, but will also contribute to a bottom up analysis of issues. Most of the time the programmes have been donor driven because there has been little relevant information from the field.

Literature shows that while initially the priority of microfinance was to provide financial services to the poor, there has been an additional need to create financially sustainable institutions with the capacity to continue servicing clients. It is assumed that the more financially sustainable the institution, the more poor people it will service. Morduch (2000) for example points out that by achieving financial sustainability and avoiding subsidies, microfinance institutions are expected to grow without the constraints imposed by donor budgets. In the process, these institutions are expected to serve more poor people than can be served by programmes fueled by subsidies. Literature shows that with regard to outreach, some clients reached by financially viable institutions are very small businesses that would not qualify for formal financial services. Some studies have in fact set out to test the premise that large numbers of poor people, including the very poor, can be reached with financial services through financially viable institutions. One such study is the USAID Evaluation Highlights 1995 (online). According to this study, “contrary to expectations, outreach to the very poor did not appear to limit profitability because even institutions serving very poor clients could be financially viable”. (USAID Evaluation Highlights 1995, online).

In addition to being efficient or sustainable, a microfinance institution that meets these goals stands better chances of attracting more financial investment. This is because it can build trust among its clients, donors, and partners.

There is a lot of encouragement being given for MFIs to move towards sustainability. Some donor organisations, the CGAP (Consultative Group to Assist the Poorest) in particular, have been instrumental in promoting best practices among MFIs for the purpose of making them sustainable (CGAP FocusNote No. 20, May 2001). The best practices are performance standards that are meant to propel the institutions towards sustainability. Best practice includes, substantial client outreach, setting of economic rates of interest and Operational efficiency. Literature seems to suggest that successful MFIs seem to have all of these factors in common. For example according to the USAID Evaluation Highlights (1995) study, the two keys to self-sufficiency are efficient operations and appropriate pricing policies (economic interest rates). Analysts also point out that there are external environmental factors impacting upon the sustainability of microfinance programmes. To this end Wenner and Chalmers (2001, online) assert that in the case of microfinance, analysis of sustainability will involve the examination of many variables including economic, regulatory, political and cultural.

In spite of the emphasis on sustainability, it is evident that there are not many institutions that have reached full financial sustainability. For example, the most careful and comprehensive recent survey shows that the programmes that target the poorest borrowers generate revenues sufficient to cover just 70% of their full costs (Micro Banking Bulletin,

1998 quoted in Morduch 2000). Further evidence also shows that there are not only few financially sustainable MFIs, but also that these were initially heavily subsidised before they became financially viable. One such institution is the Grameen bank, which has been widely used as a model of sustainability. Writing on the Grameen bank and sustainability, Shahidur, Khandker, Khalily and Khan (1995) point out that it is doubtful it could have generated enough revenue in the early years of its operation to cover costs. It is also unlikely that the rural poor would have been able to bear the full cost of Grameen bank services (Ibid.).

Literature seems to suggest that sustainability is a process that begins with operational sustainability then moves on to financial sustainability as the institution develops. This is in fact true of any business undertaking because some investment has to be made initially before the business breaks even and begins to recover its costs.

In view of this, it is imperative to conduct research on the sustainability of microfinance institutions in order to determine appropriate interventions and enable stakeholders to make informed decisions. This is even more important for the Zambian microfinance industry, which is relatively young and still needs to work at becoming sustainable.

1.2 Statement of the Research Problem

There are over 21 established microfinance institutions offering financial services in rural and peri-urban areas of Zambia (Mbulo, 2000). Microfinancing is a relatively new

industry in Zambia because most of the MFIs emerged only in the mid-nineties (See Appendix 1 table 5). In fact both the government of Zambia and the donor community recognise that institutions for the delivery of micro finance in Zambia are still in the formative stage and that capacity building is still required (Liato-Katundu and Nakalonga 1999). There is a concern therefore that microfinance intermediaries need to be making significant progress in expanding client reach and market penetration (Ibid.). By way of best practice, therefore these institutions need to offer loans at a cost that will ensure cost recovery within a reasonable period of time. The financial performance of MFIs inevitably includes, decreasing dependence on subsidies and increasing financial self-sufficiency.

For the Zambian MFIs therefore, there needs to be a deliberate move on the part of the institutions to operate efficiently by controlling and recovering costs as well as by way of charging economic rates of interest. Given that these institutions operate in the broader economic, political and social environment, sustainability analysis inevitably includes an examination of the external factors affecting the sustainability of these institutions.



1.3 Research Focus

Due to time and other limitations discussed in the third chapter, this study focuses on one Zambian microfinance institution, Credit management Services Limited (CMS). The sustainability of CMS will be analysed within the framework of sustainability set out in the literature i.e., in terms of operational efficiency, charging of economic rates of

interest and the level of client outreach. The national setting for microfinance will also be analysed in terms of the constraints to sustainability. The study will reflect the characteristics of the institution, its clientele and the types of services it offers. The study will also analyse efficiency and sustainability levels of the institution.

1.4 Aim and Objectives of the Study

The primary aim of this study is to ascertain the sustainability of Credit Management Services Limited (CMS) within the broader context of the Zambian microfinance industry. This will be accomplished by examining CMS as an example of a microfinance institution in Zambia. The study will also discuss constraints that impact upon sustainability of microfinance institutions in Zambia and assess whether these pose a serious threat to the industry. Specific objectives of this study are:

To examine the outreach levels of CMS and hindrances to client outreach.

To establish whether CMS charges economic rates of interest and administrative charges that will enable it to recover costs.

To determine the efficiency and sustainability levels of Credit Management Services (CMS).

To examine the constraints that impinge on the sustainability of MFIs in Zambia.

To draw conclusions and make recommendations for stakeholders in microfinance.

1.5 Research Methodology

The study used two research designs to collect data from the field namely: a questionnaire, which was used to collect information from the case study institution and a focus group discussion. The two designs were used in order to crosscheck data and to deal with possible gaps in information collected from the field. Primary data was collected through the use of a questionnaire, which was used to collect data from Credit Management Services. The focus group discussion was conducted with the board of the Association for Microfinance Institutions of Zambia (AMIZ) to get a more representative view on the constraints affecting the sustainability of the industry as a whole.

A literature survey of secondary data was conducted in order to provide a theoretical and analytical framework for the study. The literature survey also provides experiences and performance of microfinance institutions globally. In addition, financial and operational records of Credit management Services were examined in order to provide information relating to specific efficiency and sustainability levels of the institution.

1.6 Structure of the Thesis

The thesis comprises of the following six chapters:

Chapter One- Introduction

This chapter describes the basis of the current study. It presents the motivation for the study, statement of the research problem and its aims, the objectives and the research methodology.

Chapter Two-The Sustainability Debate

This is based on the review of literature and highlights current views on the subject of sustainability and how they are informed. It also presents the framework for analysis of sustainability and factors determining sustainability. It also to some extent critiques some studies which analyse sustainability.

Chapter Three- Research Design and Methodology

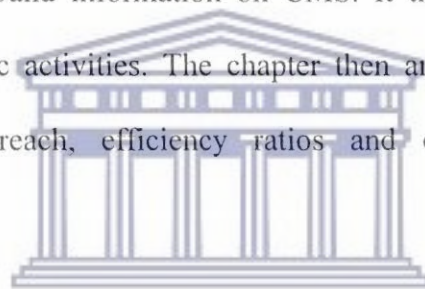
This chapter presents and explains in some detail the methodology used in the research and the kinds of data collected by the research instruments. It also presents sampling procedures and criteria as well as limitations of the study.

Chapter 4 - Growth of Microfinance Institutions in Zambia and Constraints on Sustainability

This chapter discusses the evolution of microfinance in Zambia and the experiences of microfinance institutions. It also sets out the types of MFIs, the services they provide and the main constraints affecting the industry.

Chapter Five- Presentation and Discussion of Results

This chapter presents and analyses results from data collected from Credit Management Services. It presents background information on CMS. It then discusses target group characteristics, and economic activities. The chapter then analyses and interprets data with regard to client outreach, efficiency ratios and operational and financial sustainability.



Chapter Six- Summary, Conclusions and Recommendations

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This chapter draws conclusions from the main findings in the research and makes recommendations to stakeholders in microfinance.

CHAPTER TWO

THE SUSTAINABILITY DEBATE

2.0 Introduction

This chapter of the thesis puts the study topic in context and discusses sustainability and its related concepts in the context of microfinancing. In order to appreciate the issue of sustainability, this chapter begins by highlighting the purpose of microfinance as perceived globally. This is followed by a definition of sustainability and the two levels of sustainability namely, operational and financial sustainability. This discussion includes discussions on how the sustainability levels are calculated. This chapter further looks at the current sustainability debate and how experiences and performance of microfinance institutions influence viewpoints. The two viewpoints in the debate are those of the ‘sustainability’ camp and the ‘poverty’ camp although a section on other viewpoints is also presented. The last section of this chapter will discuss determinants of sustainability by way of looking at factors that bear upon the sustainability of microfinance institutions or programmes. It takes into consideration internal factors i.e., outreach levels, operational efficiency and interest rates (pricing policies). External factors refer to those in the external environment of the MFIs. The chapter ends with a conclusion.

2.1 The Purpose of Microfinance

The central purpose of microfinance is to provide large numbers of poor people, including the very poor and women with quality financial services, thereby reducing poverty. To this end, the microcredit summit of Feb 1997 held in Washington DC pledged itself to reach 100 million of the world's poorest families, especially the women of those families with credit for self-employment and other financial and business services by the year 2005 (Microcredit Summit, 1997, online).

The core themes of the summit included: reaching the poorest and empowering women; building financially self-sufficient institutions; and ensuring a positive, measurable impact on the lives of the clients and their families. Building financially sustainable MFIs is considered one of the critical components in the whole process of poverty reduction. To underline the importance attached to this theme, the Africa Region Microcredit Summit held in Harare in October 2000 had the theme, "Working towards institutional financial self-sufficiency while maintaining a commitment to serving the poorest families". Hence all stakeholders and partners in microfinance share more or less the same basic goal and that is, to provide microfinance services to large numbers of the poor in a sustainable way.

More than just aspects of scale or large numbers, reaching the poor has aspects of reaching the very poor (normally referred to as depth of outreach), as well as meeting client needs (appropriateness of the services).

2.2 What is Sustainability?

Sustainability encompasses several concepts and has been defined in different ways, depending on the discipline or development activity. In general terms however, sustainability means continuity, the ability to survive or be self-sustaining, with minimum or little outside support. According to Edgcomb and Cawley (1993), it refers to the continuation of activities after the project ends, often implies self-financing and suggests that the flow of benefits will continue on the basis of the impetus and resources of local institutions. The term sustainability is also used synonymously with self-sufficiency.

The concept “Program sustainability” means “the ability of a programme to continuously carry out activities and services in pursuit of its objectives...” (Shahidur, Khandker, Khalily, Khan. 1995:36). This definition of sustainability does not seem to imply financial sustainability per-se. But sustainability in this case is achieved so long as the institution continues to carry out its activities regardless of its source of funding. This is not the current understanding of institutional sustainability as far as MFIs are concerned.

In the case of microfinance institutions or programmes, sustainability nowadays implies the ability of an institution or programme to sustain its own existence from its own revenue. Although currently sustainability is taken to be synonymous with the financial viability of an institution, it also important to note that within microfinance circles, still

others assert that it goes beyond the issue of financial viability. According to Chua and Llanto (1996:7) for example,

“it is the ability of the organisation to grow and adapt to changes. It is the ability to ensure the continuity of its services, to expand and to adjust to changing circumstances. The issue of sustainability has to do with good leadership, organisation and strategic management”.

Having established the definition of sustainability in the context of microfinance, the next section defines and explains in detail the levels of sustainability.

2.3 Levels of Sustainability (self-sufficiency)

There are essentially two levels of sustainability namely, operational self-sufficiency and financial self-sufficiency. Financial self-sufficiency is synonymous with financial viability, which inevitably implies that the institution operates on business principles and makes a profit. (A fully subsidized institution depends entirely on grants and generates little or no revenue. An MFI operating at this level is like any other donor funded development program). Until they are fully self-sufficient all MFI receive or need some form of subsidy in order to carry out their operations.

2.3.1 Operational Self-sufficiency


Operational sustainability is the ability of an institution to cover its operational costs from its own sources. According to Edgcomb and Cawley (1993), Operational self-sufficiency is achieved when internally generated income (from interest and fees) is equal to or greater than the expenses of operating a credit program. This would mean that salaries and administrative expenses are covered out of the institution's revenues. At this level the MFI will still need to be partially subsidized. "Some institutions define operational self sufficiency as the ability to generate enough revenue to cover the MFIs operating costs, financing costs and the provision for Loan losses". (Ledgerwood, 1999:217). Some MFIs exclude financing costs because they fund their loans from grants or collect savings and do not need to borrow money for onlending. As MFIs move towards financial viability, some of them are able to access capital from commercial banks and thus incur financing costs. In this definition, financing costs does not include the cost of the original capital. Nevertheless, all MFIs incur operating expenses and the cost of making provision for loan losses. Ledgerwood (1999) presents two formulas for calculating operational self – sufficiency:

$$(i) \text{ Operational self-sufficiency} = \frac{\text{Operating Income}}{\text{Operating Expenses} + \text{financing costs} + \text{provision for loan losses}}$$

$$(ii) \text{ Operational Self Sufficiency} = \frac{\text{Operating Income}}{\text{Operating expenses} + \text{Provision for loan losses}}$$

The second formula is preferable in the Zambian situation for example because currently, most institutions do not borrow money from commercial banks and do not therefore incur financing costs. Ledgerwood (1999) however points out that regardless of which formula is used, if an MFI does not reach operational efficiency, eventually its loan fund capital (equity) will be reduced by losses leading to decapitalisation. This could lead to closure of an institution unless additional grants are sourced, costs are reduced or interest rates are raised. This means that such institutions are not operationally sustainable.

2.3.2 Financial Sustainability or Viability



According to Ledgerwood (1999), financial sustainability (full self-sufficiency) means that an institution or programme is able to cover both the costs of operation, financial resources and financial costs from its profits. This entails that an institution operates on business principles and is therefore able to break-even and make a profit. Financial sustainability therefore indicates whether or not enough revenue has been earned to cover both direct costs, (including financing costs, provision for loan losses, and operating expenses) and indirect costs, including the adjusted cost of capital.¹

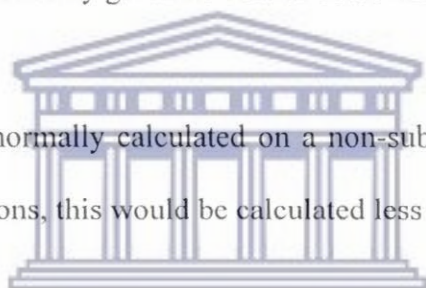
¹ The adjusted cost of capital is considered to be the cost of maintaining the value of the loan fund capital relative to inflation and the cost of accessing commercial rate liabilities rather than concessional loans. (Ledgerwood. 1999: 217).

The financial self- sufficiency ratio is calculated as follows:

$$\text{Financial self-sufficiency} = \frac{\text{Operating Income}}{\text{Operating expenses} + \text{financing costs} + \text{provision for losses} + \text{cost of capital}}$$

The above calculations will translate into a percentage or ratio used to indicate the level of sustainability. Financial sustainability is reached, when the ratio is 100% or more. Unless this level is reached, the provision of financial services will continue to some extent to rely on subsidies. This calculation can also help to determine whether the programme requires financial subsidy given its cost of borrowing and how much.²

Financial self-sufficiency is normally calculated on a non-subsidized basis. This means that for donor funded institutions, this would be calculated less the amount of the subsidy.



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2.4 The Subsidy Dependence Index

Financial sustainability is ultimately determined by the extent to which an institution will continue to rely on grants or subsidies for its continued operation. A subsidy is money paid especially by the state or donors to help support organisations or to help reduce the costs of producing goods so that their prices can be kept low (Oxford Advanced Learner's Dictionary, Fifth Edition. 1995). With regard to MFIs, subsidies include:

² This criterion does not however capture the possibility that a programme that may not be viable now may still be financially viable over time. Analysis of sustainability would therefore require further examination

donated equity, concessional loans from donors and central banks, and exemption from reserve requirements.

The subsidy dependence index (SDI) is expressed as a ratio that indicates the percentage increase required in the onlending interest rate to completely eliminate all subsidies required in a given year (Ledgerwood, 1999). It is computed by dividing the total annual subsidy received by the average annual interest income. An SDI of 100% indicates that the interest rate will have to be doubled in order to eliminate the subsidy. A 0% subsidy would indicate that an MFI has achieved financial sustainability. The subsidy dependency index is useful in compiling the total subsidy required by an MFI over time. It also enables analysts to compare the subsidy dependence of MFIs providing similar services to similar clientele.

2.5 The Sustainability Debate



“The development of microfinance institutions over the last two decades has lent broad credence to the idea that microfinance is a major stimulus for development in the countries of the south, and a powerful instrument for combating poverty”. (Chao-Beroff, 1995, online). Based on this assumption, many microfinance programmes have been designed and implemented in developing countries targeting poor populations. Inevitably, results have been varied in terms of experiences and performance of the MFIs. Experiences and performance of lending institutions have been studied, and lessons

drawn from these have been used to determine general development policies with regard to microfinance almost universally.

Broadly speaking in microfinance, there is an evident split between those in the ‘sustainability’ camp advocating for financial sustainability as a means to poverty reduction, and those in the ‘poverty’ camp advocating for the prioritizing of social considerations ahead of sustainability. Each camp has its own premise for their standpoint, which is now discussed below.

2.5.1 The ‘Sustainability’ Camp

Those in the sustainability camp hold that microfinancing institutions have to be viable and work towards full financial sustainability otherwise they will not be able to service the poor they seek to serve. This viewpoint emphasizes that reaching the poor and sustainability are two sides of the same coin, and that you cannot have one without the other. Sustainability serves outreach and vice versa. A conclusion is therefore made that “Only by achieving a high degree of sustainability have microfinance programs gained access to the funding they need overtime to serve significant numbers of their poverty level clients”. (Rhyne, 1998:7). The focus of many in the sustainability camp is therefore more on the scale of outreach (large numbers) rather than depth of outreach (reaching the poorest). Rhyne (1998) also points out that many in the sustainability camp are more interested in opening access to the full spectrum of the poor who lack financial services. There is therefore a preference for mixed programs, which can become large and

sustainable to small programs exclusively focusing on the poor. It is expected that in due course such large sustainable programmes will service even more of the poorest than the focussed ones, which are likely to become unsustainable anyway.

The sustainability camp maintains that any future that continues dependence on donors and governments is a future in which few microfinance clients will be served (Ibid.). They maintain that donors and governments are prone to fatigue and may not subsidise microfinance indefinitely. As such they see the private sector as the future home of microfinance because it is able to mobilise and access commercial rate capital which is available all the time, as opposed to subsidies. It is perceived that, “Only the private sector has plenty of resources and will stick with a money making activity even if it is not in fashion”. (Rhyne, 1998:2).



Donor organizations have been particularly concerned about sustainability issues because of the heavy investment in microfinance. In particular, the Consultative Group to Assist the Poorest (CGAP), has been instrumental in supporting and promoting best practices. The CGAP is a donor consortium currently made up of about 27 donor organisations and is funded by the World Bank. Member organisations include: the United States Agency for International Development (USAID), the World Bank, the Department for International Development (DFID), Swedish International Development Agency (SIDA) and The United nations Development Programme (UNDP). The formation of the CGAP is indicative of the Bank’s interest in sponsoring microcredit programs to address poverty.

The objectives of CGAP are twofold, namely, increasing financial sustainability of MFIs and deepening their poverty focus (CGAP FocusNote No. 20, May 2001). The CGAP has been instrumental in promoting best practices among MFIs for the purpose of making them sustainable.

“The goal of breaking even, and thereby being able to liberate themselves from grant funding within a reasonable period of time, has been set for microfinance programmes and this very rapidly became the fundamental orientation of microfinance ‘best practice’”. (Chao-Beroff, 1999, online).


‘Best Practice’ normally refers to performance standards that microfinance institutions are expected to observe and adopt if they are to be sustainable and attract funding. “The term ‘best practice’ hence owes its origin to the World Bank and evokes the notion of optimal practices applicable anywhere”. (Parhusip and Seibel, 1999, online). Ranking high on the list of best practices are:

- Substantial client outreach,
- Charging of economic rates of interest and
- Operational efficiency.

To determine ‘best practice’, the best and high performing institutions have been studied. This has been done with a view to avoiding bad, unsustainable practices and encouraging donors and governments to invest in institutions and programs that show the promise of

sustainability and thereby alleviating the most poverty, so to speak. As in most sectors, donors who will also give conditions for providing support largely determine policies and standards in microfinance. Institutions are therefore obliged to observe 'best practice' in order to conform to global standards and attract support.

Some of the Best Practices have been adopted from successful banks like the Grameen Bank. For example a study of the Grameen Bank commissioned by the World Bank set out to examine the potential for expanding the Grameen bank in Bangladesh and replicating it elsewhere. The findings of the study were expected to have significant implications for development policy in general as well as for World Bank operations. (Shahidur, Khandker, Khalily, Khan. 1995).



The USAID's Center for Development Information examined 11 successful micro enterprise finance programmes for the purpose of identifying best practices. Only two programs out of the 11 examined were from Africa namely the Kenya Rural Enterprise Programme (K-REP), and the Agence de Credit pour l' 'Enterprise Privee'(ACEP) of Senegal. (See Appendix I table I for a full list of institutions studied). The ages of institutions studied varied from 3 years (BRK Niger) to 40+ (BKD Indonesia) and client outreach covers both rural and urban areas (See appendix 1, table 1). This particular study set out to test the premise that large numbers of poor people, including the very poor, can be reached with financial services through financially viable institutions. According to this study, contrary to expectations, outreach to the very poor did not appear to limit

profitability because even institutions serving very poor clients could be financially viable (USAID Evaluation Highlights, 1995, online).

Ten of the eleven institutions examined were operationally efficient and reached large numbers of people with financial services while five of the institutions were financially sustainable and yielded returns comparable to other financial institutions. The study concluded that the conventional thinking that microfinance cannot be sustainable is quite wrong and that “Microfinance institutions can and indeed need to be self sustaining if they are to achieve their outreach potential-providing rapid growth in access to financial services by poor people”. (Ibid.)

With regard to depth of outreach, study results show that clients reached by these institutions are very small businesses that would not qualify for formal financial services. The very poor were reached by all except one of these institutions. Moreover, these institutions reach large numbers of women because women tend to go for smaller loan sizes. Several of the institutions have achieved major coverage on a national level. For example, the Grameen bank’s market outreach covers almost half the villages in Bangladesh reaching 1.8 million poor clients. The BRI Unit Desa in Indonesia has more than 2 million borrowers and 12 million savers while some programmes have expanded very rapidly in terms of outreach with rates ranging from 25% to 100% per year (Ibid.). The rapid growth in client outreach was associated with the ability to maintain financial viability.

In this study, indicators of strong client demand were growth in the number of borrowers, the loan portfolio and savings deposits. Clients were also willing to pay interest rates above the rate of inflation and repay loans on a timely basis (evidenced in low delinquency rates). Some very large programmes have amongst the smallest loan sizes. Mixed programmes that serve a range of clients (not just those of a given loan size) have successfully reached very poor clients. A conclusion is also made that it is scale and not exclusive focus that determines whether significant outreach to the poor will occur (Ibid.).


According to the USAID Evaluation Highlights (1995) study, the two keys to self-sufficiency are efficient operations and appropriate pricing policies. The study concludes that viability is not the direct result of context, culture, or target groups. This apparently is in direct contrast to a claim made by Wenner and Chalmers (2001) who point out that, “examining why a certain industry has flourished more in one region than the other always involves analysing many variables. In the case of microfinance, the explanatory factors range from economic to regulatory to political and cultural”. (Wenner and Chalmers online, 2001). I tend to agree with the latter view because it takes into consideration that MFIs operate in varying contexts. Hence it is more reasonable to expect that a whole range of variables will impact upon sustainability.

Morduch (2000) commenting on the effect of successful program points out that these successes have bred false generalisations such as “ Subsidization, inefficiency, and limited scale necessarily go hand in hand....government involvement means trouble.

Effective savings mobilization is incompatible with subsidised credit". (Morduch 2000:620). These ideas are however not necessarily consistent with logic or experience.

2.5.2 The 'Poverty' Camp

Those in the poverty camp are of the view that micro enterprise finance helps poor people and therefore is a desirable development activity but that it cannot be financially viable (USAID Evaluation Highlights, 1995, online). Currently the view is that sustainability is necessary but it must not be pursued at the expense of reaching the poor. This thinking emanates from what is currently happening on the ground with regard to institutional sustainability.



Morduch (2000) points out that in spite of being aware of best practices, nearly all programs remain substantially subsidized, especially those with social objectives. The most recent surveys show that NGO programs targeting the poorest borrowers generate revenues to cover just 70% of their full costs (Morduch 2000 quoting the Micro banking bulletin 1998). According to Morduch, most programs are not moving towards financial sustainability quickly because micro finance best practice is not so easy to implement on the ground. This supports an earlier observation by Edgcomb and Cawley (1993) that a number of programmes have approached and reached the operational self-sufficiency level, yet only a few have attained the financial self-sufficiency level because of the need to have a very high volume of clients and a highly market oriented approach.

Most of the lessons from this camp have been drawn from institutions delivering credit in disadvantaged areas particularly in Sub-Saharan Africa. A study conducted in 1999 on 'constraints associated with developing sustainable rural financing systems in disadvantaged rural areas in Africa' highlights challenges specifically associated with providing credit in rural Africa Chao-Beroff (1999, online) points out that it is difficult for MFIs to break even in Sub-Saharan Africa because of high transaction costs. Transaction costs tend to be high because of a combination of the following factors:

- Managing large numbers of small loans which need substantial costs to issue and monitor in any context.
- The dispersion of the population (low density, long distances between villages, poor state of roads) which leads to more travel time and costs.
- High wages as compared to the ratios for the same positions in Asia from which the model draws its inspiration.
- High costs of a centralized system.



According to Chao-Beroff (1999) an increase in revenue can only be achieved in two main ways, which are also subject to severe limitations in disadvantaged areas. An increase in interest rates or an increase in the volume of loans. (An alternative may also be a decrease in salaries paid which tends to have legal implications most organisations would rather avoid). An increase in interest rates could lead to competition with other subsidised programs and the possibility of a programme pricing itself out of the market. An increase in the volume of loans requires expansion into new areas thereby increasing

costs for the institution. In fact this is a universal concern and was also an issue for the Africa Region Microcredit Summit (ARMS) held in Harare in October 2000. The Challenge faced is how to maintain financial viability while expanding outreach to the poor. The summit observed that at a practical level this is possible but very difficult, to the extent that there are going to be very few of such sustainable financial institutions working with the poor (Final Report of the Africa Region Microcredit Summit. May 2001).

This study pointed out that previous financial projections showed that the network as a whole would obtain the break-even point only by 2004/2005, or some 15 years after the start up of the projects, and only after a significant expansion into new areas (Chao-Beroff, 1999, online). On the other hand Chao-Beroff (1999) points out that it was just such significant expansions that gave rise to the crises in the first place. An awareness of the structural difficulties associated with breaking-even came with the first major crises, which were reflected in the field by a disturbing level of delinquency, cases of fraud, and sometimes also by localized Union conflicts (Ibid.). Institutions cited the following as causes of the crises:

- Pressure from donors to increase volume of operations so as to break even quickly.
- Pressure to attain national coverage and the establishment of operations in specific zones by donors and the state, as well as the difficulty of resisting markets.

- Saturation of markets with certain products leading to a drop in selling prices and difficulties in repaying loans.
- Emergence of strong competition (some institutions had zero or very minimum rates of interest so clients shunned institutions with higher rates).
- Political interference particularly during election times.

These institutions as a result of their experiences are now entering a phase of reviewing the choices made and are searching for new solutions. Donors also need to rethink.

In comparison to the Asian context where MFIs are most sustainable, the scenario is quite different. According to the World Bank, Asia has the highest microfinance activities and fastest growing institutions compared to Latin America and Africa (Mutalima, 2000 quoting World Bank, 1996:29). Asia's high performance is attributed to the enabling macroeconomic and regulatory environment, and a notably higher population density. Speaking of Cambodia for example, the rural areas are not isolated in the geographical sense of the term, and the average population density is 156 people per square km as compared to 15 in Guinea and Burkina Faso in Africa (Chao-Beroff, 1999, online). Consequently the distances between villages are such that it is possible to go from one village level institution to another in less than half a day. A study of the Grameen Bank points out that its success has partly been dependent on its low percentage of defaulters (Shahidur, Khandker, Khalily, Khan. 1995). " Analysis of branch data for overdue loans suggests that local development indicators such as roads, electrification and education infrastructure and branch characteristics such as age and manager's incentives influence

loan repayment performance”. (Ibid:36). The study concluded that bad loans are therefore not an erratic behavior of certain borrowers, they are also dependent on both demand and supply side factors determining the volume of lending.

2.5.3 Omissions in Sustainability Studies

There are, however, some important omissions in the studies conducted to determine best practice, and it is that they have not critically analysed and compared client characteristics that can impact on sustainability. Morduch (2001) points out that client characteristics differ from region to region. He observes that some clients are traders making a high rate of return on investments, others have to invest in longer-term investments like livestock farming, agricultural processing and handicrafts. High costs of borrowing for the later group of clients will put financial services out of their reach. This is because they will be required to pay back the loan before they earn adequate returns on investments. Because of this scenario, those in the sustainability camp would argue that clients who are unable to pay high interest rates are destitute and need social programs like health and education.

According to Morduch (2000:618), “confronting the schism between rhetoric and action- and between financially minded donors and socially minded programs will first of all require that both donors and practitioners pay greater attention to who is being served”. There is a need to analyse client characteristics by occupation, loan use, and income level. The call to best practice can only be convincing if the financially viable institutions

are serving clients with profiles similar to those of socially minded institutions. There is also a great need to make cross-country comparisons of other local situations such as population densities and cultures. Many studies that have been used as a basis for determining best practice have not included client profiles and other comparisons. The studies do not provide comparable and reliable evidence like incomes, occupations and loan sizes of clients and of comparable non-participants. Morduch (2000) points out that there is only one study that provided this information conducted by Hulme and Mosley (1996). This concern for lack of empirical data on client profiles is confirmed by Rhyne (1998:8): “ we still know very little about the poverty level of clients in various microfinance programs, and we still rely on loan size as the only readily available proxy for client poverty level”.

In my view, if comparisons between sustainable and unsustainable institutions are made without comparing client statistics, the comparisons are not fair.



2.5.4 Other Viewpoints

The above two view-points are not the only ones. There are still other analysts who assert that microfinance does not necessarily serve the poor. It is indicated that “Although microfinance can reduce poverty, the benefits are directly related to the level of poverty so that they disproportionately accrue to the middle poor in society while the poorest receive little benefit”. (Hulme and Mosley (1996) quoted in Bonti-Ankomah and Chamba 2000:8). Hulme and Mosley (1996) further argue that microfinance on its own may not

be an effective tool in reducing poverty, and may particularly be inappropriate for the poorest in society (Ibid). This view is even partly supported by empirical evidence (put forward by the sustainability camp) which shows that the most sustainable programmes are those serving a mixed range of clients as opposed to those targeting the poorest. For example, according to Rhyne (1998), the focus of many in the sustainability camp is more on the scale of outreach (large numbers) rather than depth of outreach (reaching the poorest). In my view, the only difference is that the sustainability camp argues that mixed programs ultimately serve the poorest because they are sustainable.

2.6 Determinants of Sustainability

The above debate raises a question as to what really determines institutional sustainability. Evidently, there are various factors determining sustainability. Generally, since sustainability is synonymous with the profitability or viability of any given institution, various factors will impact upon it. According to USAID Evaluation Highlights (1995), factors include: 1. Volume of business (scale of client outreach), 2. Pricing policies, which is dependent on the ability of the institutions to operate on business principles. This is basically the ability of the institution to charge interest rates that recover costs. 3. Efficient operations evidenced in keeping all costs low (an expensive structure eats into profits).

2.6.1 Scale of Outreach

The higher the scale of outreach the higher the revenue reached depending on the size of loans. An MFI needs to have a certain pre-determined number of clients to enable it to reach economies of scale and break even. A failure to scale up will result in high costs and eventual loss in revenue.

2.6.2 Interest rates

Given that the scale of outreach is significant, the most critical of the above three factors is setting of economic rates of interest. The above USAID study of the 11 institutions revealed that the most viable institutions differed from the less viable in their willingness to set interest rates at levels that would fully cover costs. The less viable held down interest rates and remained subsidy dependent. For example Corposol (Colombia) a financially viable program charged an effective real rate of interest of 52 percent per annum while K-REP (Kenya) charged negative 9 percent which was the lowest rate of the sample (See table 2. Appendix 1). If a programme charges uneconomic rates, it inevitably subsidises interest rates. A prioritisation of social above sustainability goals would imply that the poor cannot pay economic rates of interest. An increase in interest rates may not lead to decreased demand of the financial product unless of course there was competition in which case clients opt for the cheaper loans, given that a significant number of factors remain equal.

2.6.3. Efficiency of Operations

With regard to maintaining efficiency³ of operations, it follows logically that the lower the costs of an institution, the more profitable it will be. For example, in the above study, programmes like FINCA, BKDs and Grameen that used local personell to staff their operations were more profitable. Others like ADOPEM, K-REP and BRK (Niger) with significantly higher salaries had less cost advantage (USAID Evaluation Highlights No. 49. June 1995 online. 11/09/01).

Efficiency is normally measured in terms of ratios, which measure the cost of providing services in form of loans to generate revenue. These are referred to as operating costs and should include neither financing costs nor loan loss provisions (Ledgerwood, 1999). MFIs that provide savings have higher operating costs than those offering savings only. This is so because additional operating costs are incurred to collect savings deposits. So the comparisons should not be made between MFIs offering different services unless a kind of leveling off is made.

Two key factors tend to influence the level of activity and hence operating costs and efficiency, i.e., turnover of the loan portfolio and the average loan size (Bartel, McCord, and Bell, 1995 quoted in Ledgerwood, 1999). The efficiency of operations can therefore be analysed by looking at operating costs as a percentage of portfolio outstanding and at

³ Efficiency is defined as the ability to maximize output per unit of input. Operational indicators would include the ratio of staff to clients, staff to loan amounts, and costs per unit of output such as number and amount of loans released. (Chua and Llanto 1996:6)

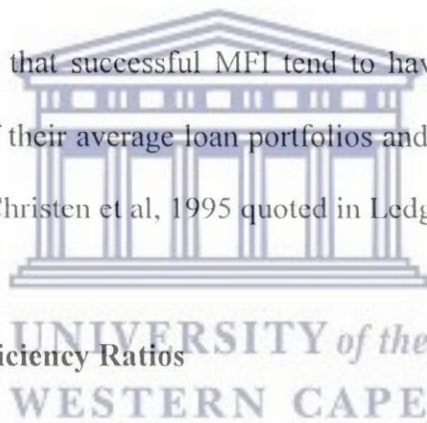
the costs associated with lending on per unit of currency basis or per loan basis (Ledgerwood, 1999).

2.6.4 Operating Cost ratio

This provides an indication of the efficiency of the lending operations. This is affected by increasing or decreasing operational costs relative to the average portfolio.

$$\text{Operating Cost Ratio} = \frac{\text{Operating Costs}}{\text{Average Portfolio Outstanding}}$$

An observation is also made that successful MFI tend to have operating cost ratios of between 13 and 21 percent of their average loan portfolios and between 5 and 16 percent of their average total assets (Christen et al, 1995 quoted in Ledgerwood, 1999).



2.6.5 Other Operational Efficiency Ratios

Ledgerwood (1999) also puts forward the following efficiency ratios that are used to further analyse operating efficiency:

1. Salaries and Benefits to Average portfolio Outstanding

Successful MFIs have salaries and benefits running between 4 percent and 16 percent of average portfolio outstanding (Christen ET al, 1995 quoted in Ledgerwood, 1999). When

making comparisons though, there is a need to consider the credit methodology, density of population, and the salary levels in a particular country.

Salaries and benefits to Average portfolio outstanding = Salaries and benefits/ Average portfolio outstanding.

2. Cost per Unit of Currency Lent

This reflects the impact of the turnover of the loan portfolio on operating costs. Again the lower the ratio, the higher the efficiency. A consideration needs to be made with regard to the term of the loans. Short-term loans will reflect lower costs than long-term loans of the same portfolio disbursed.

Cost per Unit of Currency lent = Operating costs for the period/ Total amount disbursed in the period.



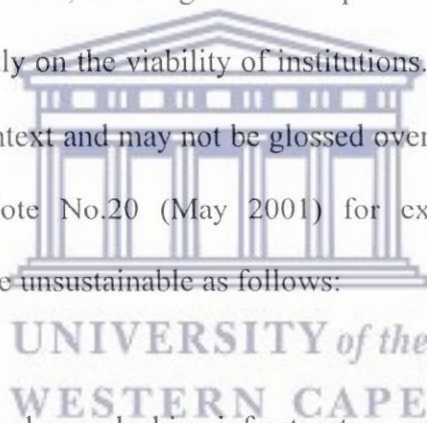
3. Cost Per Loan Made

This ratio provides an indication of the cost of providing loans based on the number of loans made. This is expressed as:

Cost per loan = Operating costs for the period/ Total number of loans made in the period.

A lot of care however needs to be taken when making these calculations. As Ledgerwood (1999) points out, “It is difficult to compare efficiency ratios among MFIs because the average loan size and loan term are so significant in these calculations”. (Ledgerwood, 1999:214). For example, relatively larger loans will result in lower costs per unit of currency lent or cost per loan made ratios than smaller loans. In addition, lending to groups is relatively cheaper than lending to individuals. Inevitably, lending models also have an impact. As a result the ratios are deemed to be more beneficial for internal financial management than for comparison purposes.

The above are the factors directly influencing financial sustainability, ‘other things being equal’. However, in the real world, all things are not equal and a lot of factors come to bear either directly or indirectly on the viability of institutions. Some of these factors are very real as in the African context and may not be glossed over. Extremes are however to be avoided. CGAP FocusNote No.20 (May 2001) for example summarises some conditions where credit will be unsustainable as follows:



- In severely disadvantaged rural areas lacking infrastructure, services and or access to markets.
- A population so dispersed that it is too costly to reach clients on a regular basis.
- Dependence on a single economic activity such as a single agricultural crop.
- Reliance on barter as opposed to cash transactions.
- A population with a high degree of mobility or instability.
- Likelihood of future crises such as civil disorder, natural disasters and hyperinflation.

- Lack of social cohesion that can undermine the use of non-collateral credit methodologies like group lending.
- A legal/regulatory framework that constitutes a barrier to microfinance activities.

Thus factors affecting efficiency will include both direct and indirect influences. Although these may be widely debated, there is empirical evidence to show they impact sustainability. (As shown in the studies alluded to in the above poverty/sustainability debate).

2.7 Conclusion

Fundamentally, the ‘sustainability camp’ and the ‘poverty camp’ seem to differ on whether or not to subsidise the MFIs and the length of time they should be subsidized. The ‘sustainability camp’ pushes for financial sustainability almost regardless of who is being served while the poverty camp advances the social mission of reaching the poorest as a priority. But it is also evident that MFIs need subsidies in order to develop into institutions that are capable of delivering credit on a sustainable basis. Literature shows that there are few financially sustainable microfinance institutions in the world and that even the best of these have reached financial sustainability after substantial subsidisation. The main reason for this is that best practice is not easily translated into practice on the ground because of the varying conditions under which MFIs operate.

Concluding from literature on experience around the world, the delivery of credit to a broad spectrum of poor clients is more sustainable than that directed at the poorest. Serving poor clients implies higher costs and risks for lenders because small loans are more expensive to administer and yield relatively lower returns on investment for the MFIs. Microfinance therefore does not necessarily serve the poorest and is not always the most appropriate tool for poverty alleviation. In fact other programmes may be more appropriate as long as in the end they will contribute towards enabling the poor have access to or build an asset base to enable them engage in productive economic activities. Alternatively stakeholders have to make a choice between focussing on the not so poor areas and obtain significant results that become apparent quickly or, to invest in remote areas where the cost will be much higher and the results will be seen only after a longer period of time. (Chao-Beroff, 1999, online).



Clearly, to me, sustainability is affected by both internal and environmental factors. I agree with analysts who point out that it partly depends on both the supply side and the demand side factors determining the volume of lending. While efficient operations and appropriate pricing policies are critical, one may not ignore for example, geographical and socio-economic contexts in which some programmes operate. On this point I disagree with those in the sustainability camp who make a conclusion that sustainability is not a direct result of context, culture or target groups. I am of the opinion that individual cases of MFIs should be analysed and treated as such, because programmes operate in areas of varied cultural, economic and geographical characteristics. Therefore consideration needs to be given to these regional differences.

The biggest challenge that remains is to draw appropriate lessons from the mistakes of the past as well as the successes of the high performing MFIs. It seems the most important lesson to be learned from past failures is the need for operational efficiency and appropriate pricing policies. The lessons provided seem to me to point to the fact that after all is said and done, the path to follow is that of moving towards financial sustainability. This should however be done with minimum pressure from donors and governments in order to allow for local adaptations of best practices as well as varying time periods for reaching sustainability.



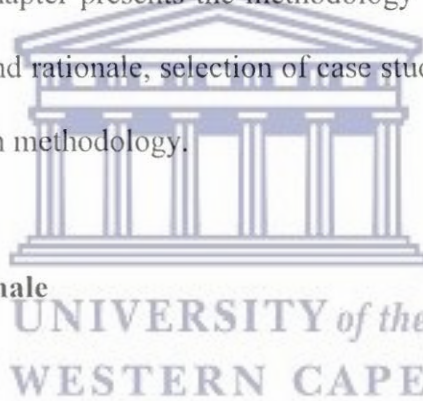
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CHAPTER THREE

RESEARCH DESIGN AND METHODOLOGY

3.0 Introduction

The previous chapter presented the sustainability debate, which highlighted the viewpoints on sustainability, how they are formed and how they affect the formulation of microfinance standards and best practice. A discussion of the concept of sustainability and factors determining sustainability was presented and the framework for analysis of sustainability set out. This chapter presents the methodology of the study. It focuses on the following: study design and rationale, selection of case study, data collection methods and limitations of the research methodology.



3.1 Study Design and Rationale

The study used two research designs namely: a questionnaire, which was used to collect information from the case study institution and a focus group discussion. The focus group discussion was conducted with board members of the Association of Microfinance Institutions of Zambia (AMIZ). This was done as a means of supplementing information and explaining some of the responses emanating from the case study through the questionnaire. A list showing the names of the board members and the institutions they represent is attached as appendix three (3).

3.2 Methodology

The nature of this study entailed the use of both primary and secondary sources of information. It also entailed the use of both qualitative and quantitative analysis of data.

3.2.1 Primary Data

Primary information was obtained through an interviewer-administered questionnaire (see Appendix 2). The other was the focus group discussion. The questionnaire allowed for a close examination of Credit Management services (CMS) and was used to elicit the following information:

- Nature of the organisation
- Services offered by the institution
- Characteristics of the clients and general target group baselines
- Client Outreach and hindrances to increased client outreach
- Interest rates and fees charged
- Operational efficiency
- Operational sustainability
- Financial sustainability ratios.



The focus group discussion with the board members was conducted in order to get an overall picture of the constraints affecting the sustainability of the industry. This was done as a means of supplementing and explaining some of the responses emanating from the institution via the questionnaire. The focus group discussion allowed for the participation of practitioners who are directly involved in managing microfinance institutions and could give an insider view point. Specific issues discussed were as follows:

- Constraints in obtaining scale of client outreach
- Interest rates and fees charged and determining factors
- Cost of Operations and what leads to high costs
- External constraints impinging on sustainability

3.2.2 Secondary Data



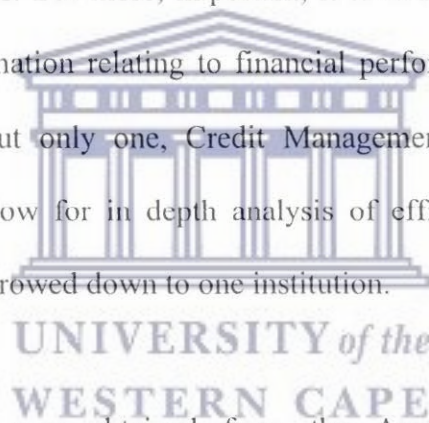
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This research uses secondary data from previous research, books and topical articles in journals and the institution's reports and documents. Collection of secondary data entailed an extensive survey of literature in order to appreciate the conceptual and theoretical framework of sustainability, the current debates and actual factors determining sustainability. Literature survey also provided data on the history and experience of microfinance in Zambia.

Quantitative analysis of data was used to calculate the operational and financial sustainability of CMS. Raw data was collected via audited financial statements for three consecutive years 1999, 2000, and 2001. Efficiency and sustainability ratios for the years 1999, 2000, and 2001 were calculated by me based on the audited financial reports to allow for analysis of trends (see Appendix 4).

3.3 Selection of Case Study Institution

The study initially set out to study four institutions with the highest client outreach. This was not possible due to time constraints because the study actually entailed spending a lot of time with the organisations. But more, important, it turned out that institutions were not willing to provide information relating to financial performance. Three institutions were eventually surveyed but only one, Credit Management Services (CMS) could provide financial data to allow for in depth analysis of efficiency and sustainability. Hence the study had to be narrowed down to one institution.

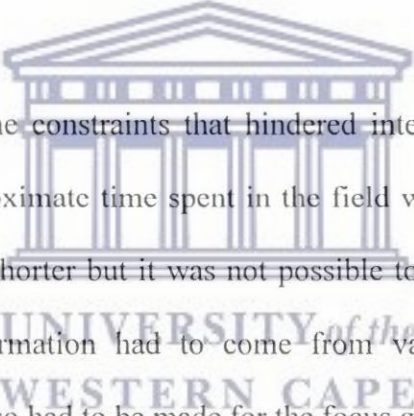


An MFI membership list was obtained from the Association of Microfinance organisations in Zambia. (Attached as appendix 1. Table 3). The List shows outreach activities of MFIs including the number of clients served as at Dec. 2001. Only organisation with a high client base needed to be chosen. This allows for analysis of sustainability because the institutions have a full cost structure and are already getting some revenue. This allows for calculation of efficiency ratios, operational sustainability and financial sustainability.

3.4 Testing of questionnaire

Although a test case was not planned for initially, the questionnaire had to be adjusted after the survey of the first institution. This helped to ensure clarity and relevance of questions. It was also at this stage that the focus group discussion was found to be relevant as a tool of data collection. Although the test institution could not provide data on financial performance, the questionnaire was reliable enough to collect the rest of the information needed.

3.5 Limitations of the Research Methods



The study was limited by time constraints that hindered interaction with the potential institutions in the field. Approximate time spent in the field was about two weeks. This time period could have been shorter but it was not possible to get all the information in one sitting because the information had to come from various sources within the organisation. Arrangements also had to be made for the focus group discussion

It was difficult to get all the data relevant to the research because apparently, some institutions have not developed their Management Information Systems (MIS) as to portray accurate data on loan performance, sustainability and efficiency ratios. This problem is also alluded to by Mbulo (2000) who points out that MIS for MFIs are not well developed hence the need for exposure to what well established MFIs are using. But

more important than this, there were transparency problems because the study also inevitably included what some institutions perceived as sensitive because determining sustainability levels indirectly involves discussing efficiency and cost effectiveness of operations. The problem of transparency in some MFI is also alluded to by Morduch (2001) as one of the problems affecting the sustainability of MFIs. In fact, this problem largely contributed to the narrowing down of the study to Credit Management Services (CMS), which was willing to provide all the information.



CHAPTER FOUR

GROWTH OF MICROFINANCE INSTITUTIONS IN ZAMBIA AND CONSTRAINTS AFFECTING THEIR SUSTAINABILITY

4.0 Introduction

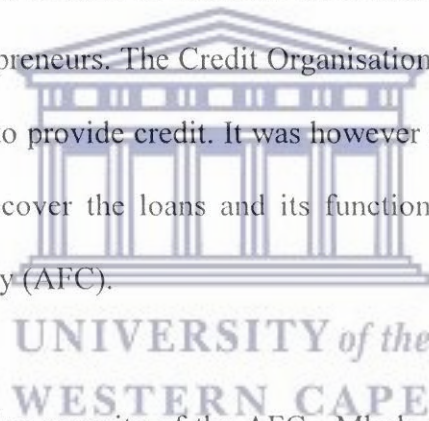
The preceding chapter presented the research design, data collection methods and the limitations of the research methods. This chapter presents the background of how the microfinance industry has emerged and grown in Zambia and discusses constraints impinging on sustainability of Zambian MFIs. Understanding the historical background of microfinance is important in this study because it gives the reader some appreciation of sustainability issues. The discussion therefore begins with the history of subsidised credit in Zambia and then looks at how microfinance as we know it today has emerged. Following this is a brief discussion of the institutional types as well as the services offered by the institutions. After this the constraints faced by the industry are discussed. The constraints are discussed both in terms of internal and external factors. Internal factors are those that can be directly controlled by the MFIs, while external factors are those that the MFIs have little or no control over. The discussion is largely based on various research reports and articles dealing with microfinance in Zambia and the focus group discussion held with the board members of the Association of Microfinance

Institutions of Zambia (AMIZ). The results of the focus group discussion as well as the names of the board members in attendance are attached as Appendix 3.

4.1 Background of Micro Credit

4.1.1 History of Micro Credit

Supervised and targeted microcredit in Zambia dates back to colonial times in the 1950's when the Colonial government provided credit to small-scale farmers through the Land Bank (Mbanacele 2000). After independence, during the mid-sixties, the new Zambian government started to set up a number of financial institutions to cater for the needs of small-scale farmers and entrepreneurs. The Credit Organisation (COZ) of Zambia was set up to replace the Land Bank to provide credit. It was however declared bankrupt because the government could not recover the loans and its functions were taken over by the Agricultural Finance Company (AFC).



On assessing the administrative capacity of the AFC, Mbulo (1990) observed that, “the AFC failed to reconcile social objectives and commercial objectives as it was expected to provide seasonal loans to small scale farmers as long as they were recommended by government agricultural extension officers”. (Mbulo quoted in Banda 1993:11). The Agricultural finance company was later merged with the Zambia Agricultural Development Limited (ZADL) which was formed to cater for commercial farmers. The company that emerged was called Lima bank. The Small Industries Organisation (SIDO),

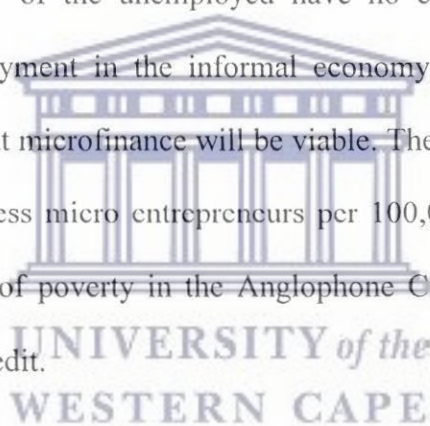
the Village Industries Services (VIS) and the Small Enterprises Promotion (SEP) were created to cater for the small and medium enterprise (SME) sectors (Mbanacele 2000). Other institutions set up were the credit Union and Savings Association (CUSA) and the Zambia Cooperative Federation (ZCF) which were basically member based. All these institutions were government supported and/or controlled.

Like other subsidised credit interventions worldwide these organisations failed due to liquidity and sustainability problems. Amongst the problems faced by these institutions were: poor loan recoveries resulting from a poor credit culture, inadequate government funding, political interference and poor marketing policies for agricultural produce.

4.1.2 Emergence and Growth of Microfinance Institutions

The Structural Adjustment Programme introduced in 1991 through the World Bank led to privatisation of state owned industries. A lot of state-owned industries including the lending institutions, collapsed due to insolvency problems. The collapse of industries led to a high rate of unemployment and consequently high poverty levels. As a means of contributing to poverty reduction, the private sector and Non Governmental Organisations (NGOs) have intervened and sought ways of providing microfinance to the ever-growing informal sector. Thus, the vacuum created by the collapse of government supported lending institutions is being filled.

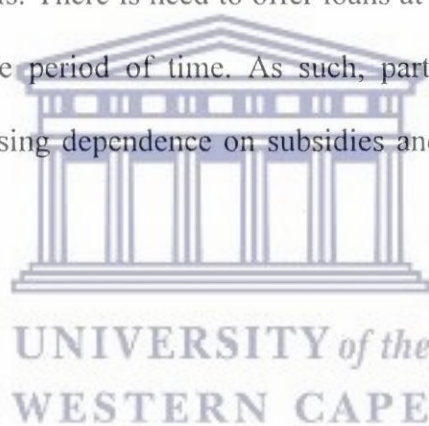
According to Mbulo (2000) there is considerable evidence that the demand for microcredit is unmet in Zambia due to the fact that there are a lot of poor families whose household expenditure depends entirely on income generated from microenterprises. As a consequence, the number of MFIs is increasing. This assertion is supported by broader literature on the relationship between poverty levels and level of microfinance activities. For example, in explaining why microfinance seems to have thrived more in Latin America than the Anglophone Caribbean, Wenner and Chalmers online (2001) observe that, “Microfinance tends to thrive in countries with high rates of unemployment/underemployment, high rates of poverty, and high degrees of inequality in access to basic services and government transfer programs”. In such circumstances, the authors point out that many of the unemployed have no choice but to pursue self-employment or wage employment in the informal economy. The larger the informal sector the more likely it is that microfinance will be viable. They further point out that the Anglophone Caribbean has less micro entrepreneurs per 100,000 inhabitants than Latin America. The lesser degree of poverty in the Anglophone Caribbean does not create a sense of urgency to access credit.



Since 1992, a number of institutions have sprung up in order to provide credit to the poor. Microfinancing is thus a relatively new industry in Zambia. (Dates of formation of MFIs in Zambia are tabled in Appendix 1 table five). Nakalonga and Liato-Katundu (1999) observe that both the government of Zambia and the donor community recognise that institutions for the delivery of micro finance in Zambia are still in the formative stage and that capacity building is still required. Examples of capacities needing to be built include:

a sound governing structure; competent and stable local staff; a strong business plan for expansion and sustainability as well as the development and usage of accurate Management Information Systems (MIS). The need to develop a mission and a vision is also critical for creating a sense of purpose, ownership and accountability by both the organisations and their clients.

In Zambia, the government and donors are also concerned that microfinance should be targeted at the poor. The donor community is therefore also interested in microfinance intermediaries making significant progress in expanding client reach and market penetration (Nakalonga and Liato-Katundu 1999). Donors are also interested in the financial performance of MFIs. There is need to offer loans at a cost that will ensure cost recovery within a reasonable period of time. As such, part of the required financial performance includes decreasing dependence on subsidies and increasing financial self-sufficiency.



4.2. Types of MFIs

There are over 21 established microfinance institutions offering financial services in rural and peri-urban areas of Zambia (Mbulo. 2000). The industry of practicing MFIs is composed of Local private organisations in the form of companies, international and local NGOs, Co-operatives, Associations and projects. The companies are registered under the Companies Act and offer their services for profit and are usually wholly Zambian owned. The NGOs are a mix of local and international NGOs mostly operating

as non-profit making organisations. The Co-operatives and Associations are member-based organisations like the Women's Finance Co-operative of Zambia Limited. Some selected government institutions like the Credit and Savings Bank of Zambia and the National Trust Fund for the Disabled (NTFD) also offer microfinance services. A list showing outreach of major MFIs includes types of MFIs in Zambia and is attached as Appendix 1 Table 3.

Institutions giving support to the sector include the Micro bankers' Trust (MBT), and the Association of Microfinance institutions in Zambia AMIZ. The Micro Bankers' Trust is the biggest microcredit wholesaling institution providing wholesale credit to MFIs. The MBT was initially established to implement the 'Micro Credit Delivery for the Empowerment of the Poor'. This programme was largely supported by the European Union and the Ministry of Community Development and Social Services (MCDSS). Apart from providing wholesale credit, the MBT also provides capacity building in form of business planning and development of MIS to client organisations. As at June 2000, the MBT also started lending directly to groups. AMIZ was formed in 1998 to provide services to its member organisations. Objectives of the Association include strengthening of lateral learning among its members; support of best practices and innovative techniques; information dissemination and sharing; establishment of a national defaulters' register; advocacy and lobbying. The aim of the association is basically to improve the Zambian financial sector providing services to poor entrepreneurs.

4.3 Services Provided by MFIs

Most MFIs use the group lending methodology adapted from the Grameen Bank model, although the systems differ from one microfinance institution to another (Mbulo 2000). Services offered by the MFIs include credit, training and savings mobilisation. The savings are mostly collected as a guarantee against default by group members. They are compulsory as opposed to voluntary. These moneys are given back to group members if there is no default. They are not available as capital for on-lending because in essence they do not belong to the institutions and legally, the MFIs are not allowed to take savings per se from the public. This is a disadvantage because it limits capital for on-lending to donor funds and for companies, to shareholders equity only. The practice of compulsory savings is however expected to cultivate a culture of saving in the clients.

The size of loans differ but range from a low of K50,000 (US\$ 12.50) for a first loan to a maximum of K2.5 million (US\$ 625) for a subsequent loan (Ibid.)



4.4 Constraints Affecting Sustainability of MFIs


The focus group discussion looked at constraining factors in terms of constraints in achieving the scale of outreach. Broader literature on the experience of microfinance in Zambia discusses these constraints in terms of their general impact on sustainability.

These factors are not discussed in any order of priority because for the most part, institutions are affected at different levels.

4.4.1 Inadequate Funding.

According to the results of the focus group discussion, some MFIs cannot get adequate capital needed in order to scale up their operations. Considerable amounts of money are needed for on-lending and institutional development. Inadequate funding cripples scaling up and ultimately sustainability. That is why some institutions either fold up or maintain a small clientele.

4.4.2 Institutional Capacity

The logo of the University of the Western Cape, featuring a classical building facade with columns and a pediment, with the text 'UNIVERSITY of the WESTERN CAPE' overlaid in a light blue color.

Institutional development is the process by which the capacity to be self-sustainable is introduced or strengthened in an institution or organization (Edgcomb and Cawley 1993). Most MFIs have inadequate institutional capacity in terms of experienced staff and board members. As earlier pointed out, microfinance institutions are relatively young and still need to develop their capacity to deliver their services in an efficient manner. MFIs combine both for profit and social motives and need staff, managers and boards that are appropriately trained to manage MFIs. This means that a balance in skills needs to be created. Mbulo (2000) points out that most managers and staff come with considerable experience from NGOs specialised in charitable programmes, while most boards of directors either have experience in non-profit or for-profit organisations. Therefore, there

is a great need for exposure, training and reorienting of staff and MFI boards to equip them for managing MFIs efficiently and effectively. It also takes time for staff to reach productivity because of the need for training and re-orientation. So some considerable investments need to be made to build capacity in the organisation to deliver credit and scale up.

This view is supported by the results of the focus group discussion that there is inadequate qualified staff to manage the institutions. This is sometimes worsened by the problem of high staff turn over which has affected some institutions, due to low remuneration and inadequate incentives especially among field staff.

Another capacity needing to be developed is that of Management Information Systems (MIS). Most MFIs do not have well-developed MIS. As a result data is not captured accurately and on time. This means that reports and information required for decision making is not produced in good time. This is also supported by Mbulo (2000) who points out that there is still a need for exposure to MIS being used by well-established MFIs.

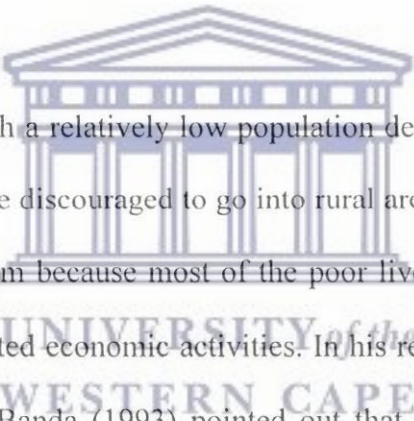


If MFIs are to deliver credit in a sustainable way they have to invest in the above mentioned aspects of institutional development.

4.4.3 Poor Infrastructure

This refers to a whole range of infrastructure required by MFIs and their clients i.e., roads, various types of communication, post offices, banks. High operational costs are incurred due to poor and inadequate infrastructure especially in rural locations. This is especially a constraint to those organisations trying to reach a rural clientele, as they have to invest highly in overcoming problems posed by poor infrastructure. In fact, most institutions tend to operate in the provincial towns to avoid incurring higher costs of operation. This problem was pointed out in the focus group discussion

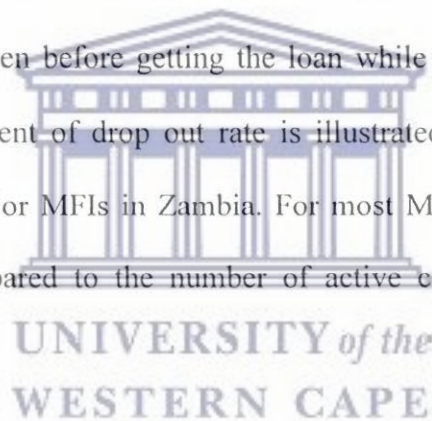
4.4.4 A Scattered Rural Population



Zambia is a large country with a relatively low population density especially in the rural areas. Most MFIs are therefore discouraged to go into rural areas because of the high cost of operation. This is a problem because most of the poor live in rural areas and require credit for agriculture and related economic activities. In his review of literature on credit interventions in rural areas, Banda (1993) pointed out that agricultural credit tends to marginalise the small-scale producers and that there is a need to uplift the subsistence producer with emphasis on the poorer, the weaker and those who are remote. This problem will continue to persist until development of rural infrastructure is made a priority by the government.

4.4.5 High Dropout Rates

Dropouts are clients who leave the programme for various reasons. One of the reasons has to do with default. Defaulting clients cease to be active after three months and inevitably drop out. Another cause of dropouts is the group lending methodology, which is tailor made to suit MFIs with inadequate consideration to client needs. Making an observation on this, Likulunga and Simonda (2001) point out that “it would appear that for a number of institutions, there is no adequate research and ground work done in order to design products and services actually demanded by clients”. (Likulunga and Simonda 2001:8). An example given is that of weekly repayments instituted by MFIs that are not suited for manufacturing businesses which need more than a week to get returns. Some clients therefore drop out even before getting the loan while other potential clients are kept out altogether. The extent of drop out rate is illustrated in Appendix 1 Table. 3 showing the outreach of major MFIs in Zambia. For most MFIs, the number of clients since the MFI started compared to the number of active clients now shows quite a significant drop.



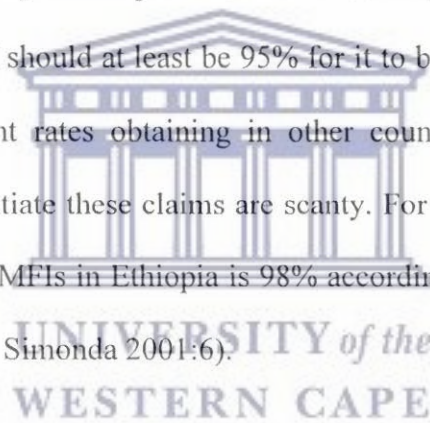
4.4.6 A Poor Credit Culture

Poor credit culture basically refers to the attitudes both people and institutions have developed towards credit overtime. This is also referred to as a ‘poor credit discipline.’ It is a culture of poor loan repayment, which seems to affect quite a good number of institutions. It dates back to the post independence era and is referred to in the above

discussion on the history of microcredit during which the government created microfinance institutions. “The general perception was that this was a way of compensating the people for having supported the independence struggle and therefore these loans were not to be paid back”. (Likulunga and Simonda 2001:4). This problem is also alluded to in the focus group discussion.

A schedule of repayment rates is attached for selected institutions for the year 2000 as appendix 1 Table 4. This includes various institution types including those providing consumption loans.

Likulunga and Simonda (2001) further point out that according to MFIs best practice, the recovery rate of a given MFI should at least be 95% for it to be sustainable. According to these authors, the repayment rates obtaining in other countries are higher than this, although statistics to substantiate these claims are scanty. For example, the authors point out that the average rate for MFIs in Ethiopia is 98% according to a review conducted in March 2000. (Likulunga and Simonda 2001:6).

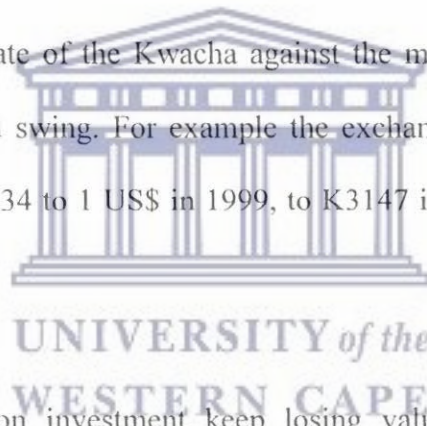


4.4.7 Macroeconomic Environment

This section considers the impact of the macro economic environment on the sustainability of microfinance institutions. The ability of Zambian small and micro entrepreneurs to benefit from microfinance depends on favourable trade policies. The current trade policy allows for unrestricted importation of goods into the country without

consideration of the impact on local manufacturing. Manufacturing is especially affected due to high taxes on imported raw materials and low taxes on imported goods. This exposes local industries to unfair competition. It has become expensive for local manufacturers to produce goods; while at the same time, imported goods have become cheaper. Thus, liberalisation has inevitably led to the closure of domestic industries. The current macro-economic environment is therefore hostile to the development of micro enterprise especially for small industries that cannot compete with imports.

The inflation rate is also quite high leading to low returns on any form of investment. The macro economic indicators pose a threat to sustainability of MFIs. The inflation rate as at December 1999 stood at 20.6% and at 30% in the year 2000 and 19.6% in 2001(See table 5.1 below). The exchange rate of the Kwacha against the major convertible currencies has always taken an upward swing. For example the exchange rate yearly average has steadily increased from K2,434 to 1 US\$ in 1999, to K3147 in 2000 and K3617 in 2001 (See table 5.1 below).



In this case MFI returns on investment keep losing value and could lead to de-capitalisation unless the MFI increases interest rates charged on loans. The clients' return on investments are also reduced because although they are able to charge higher prices, the money progressively loses value. The high interest rates make it expensive and difficult for them to repay the loans. This is also confirmed by Mbulo (2000) who points out that:

“The high interest rates make borrowing very expensive and in most cases, borrowers do not graduate but continue to borrow after every loan indicating that they have not earned sufficient returns to enable them graduate from microcredit to formal financial institutions”.(Mbulo, 2000:7)

Table 4.1 Zambia: Inflation, Exchange rates, Real GDP 1999-2001

	1999	2000	2001
Inflation %	20.6%	30.0%	19.6
Ex. Rate to 1US \$	2434	3147	3619
Real GDP %	2.0	3.5	-

Source: SADC, *Regional Economic Review, 2000* and Bank of Zambia, *Statistics Fortnightly, 2002*.




4.4.8 Political intervention

Political intervention is also said to have contributed to the poor credit discipline and even up to now this is prevalent especially during election time. This view is also presented from results of the focus group discussion and supported by Likulunga and Simonda (2001) who point out in their research that political intervention has included the following: some political leaders encourage loanees in their constituencies not to pay back as a way of buying votes; some politicians give directives to government supported institutions to give loans to people of their choice, regardless of whether they are

creditworthy or not; and still, some political leaders borrow from institutions and do not pay back. For example “it is public knowledge that about 90% of the agents who borrowed from the Food Reserve Agency (FRA) and have not paid back are politicians”. (Likulunga and Simonda, 2001:10). The poor credit culture is inevitably worsened by all the constraints discussed above.

But in addition to this negative intervention, another problem identified during the focus group discussion is the lack of ‘political will’. In this case politicians lack the will to implement policy in general. So even if a lot of good policies are formulated they are not translated into action. This of course is of no benefit to the industry.

4.4.9 The Regulatory/legal Framework



MFIs in Zambia are required by law to register either under the Societies Act or under the Companies Act. They are required to also register with the Bank of Zambia under the Banking and Financial Services Act. The existing regulatory framework on MFIs is inadequate and inappropriate for MFIs (Ibid.). The current regulatory framework offers limited options for MFIs in that it basically caters for commercial banks with a very high start up capital requirement for example. MFIs are also unable to take savings deposits from the public and this limits the expansion especially of those with little access to donor funding. As a result AMIZ in conjunction with the Bank of Zambia has been working out a legal framework appropriate for MFIs. This new framework has however yet to be implemented.

The legal process prosecuting defaulters is also deemed unfavourable to MFIs because it is long and time consuming. According to Likulunga and Simonda (2001), because of this, many defaulting clients are not motivated to pay back. In addition, defaulting under such circumstances works to the advantage of the client because they buy time to clear their loans and the amount outstanding will be worth much less because of inflation.

Currently, legal redress is also expensive for MFIs in that what may be eventually recovered is much less than the amount spent on the legal process itself. MFIs have been pressing for the establishment of a small claims court, which can allow for quicker disposal of default cases.

4.5 Conclusion



The Zambian microfinance industry has been termed as young and developing. In its relatively short history, it has faced a number of constraints that pose a threat to the industry. The constraints identified are real and alluded to in various literature and in the focus group discussion. Due to the ever-growing size of the informal sector, the number of microfinance institutions has however continued to grow in spite of the constraints. The survival or sustainability of the MFIs will nevertheless, depend a great deal on their internal capacity to mobilise funds for scaling up, generate enough revenue to cover their operating costs, as well as adapt their systems to suit their clients. The constraints in the external environment require various stakeholders in the industry to work through. Since

microfinance plays an important role in poverty reduction and employment creation, there are already efforts within the industry to bring together various stakeholders. This is evidenced by the existence of the Association for Microfinance Institutions of Zambia (AMIZ) and the Micro Bankers Trust (MBT) whose objectives center around the building capacity of MFIs and lobbying for a more conducive environment for microfinance. There is also a lot of research in Microfinance whose results are being utilised evidenced by the number of workshops to discuss the findings and the way forward. The constraints are therefore real, but not totally insurmountable especially with a lot of collaboration between MFIs and other stakeholders in the area of poverty reduction.



CHAPTER 5

DATA PRESENTATION AND ANALYSIS-CREDIT MANAGEMENT SERVICES (CMS)

5.0. INTRODUCTION

The previous chapter discussed how microfinance institutions have emerged and grown in Zambia. It set out the various constraints experienced by the industry as a whole and how these have affected the sustainability of the MFIs in general. Given this context, this chapter zeroes in on Credit Management Services Limited (CMS) and seeks to analyse its operational efficiency and sustainability. The chapter begins by presenting a brief background of the institution and discusses the findings of the field survey in terms of client and target group characteristic. Then the findings on the lending methodology, outreach and interest rates are presented. The question of how staffing policies, the training of credit officers and management information systems can enhance the capacity of the organisation to deliver credit and increase its outreach is discussed. In one of the key sections of this chapter, the operational efficiency, operational and financial sustainability ratios of the organisation are presented and analysed. The analysis is based on information based on the audited financial reports obtained from Credit management Services for the years 1999, 2000 and 2001(Appendix 4 shows the calculations of

efficiency and sustainability ratios). The data is interpreted given the question whether Credit Management Services Ltd. is sustainable and finally some conclusions are drawn.

5.1 BACKGROUND OF CREDIT MANAGEMENT SERVICES

Credit Management Services started in 1992 as a limited company. Initially it managed credit funds on behalf of the European Union for a large-scale agricultural crop marketing loan fund. It became a full-fledged MFI in 1997 when it started lending on its own account. In effect, the institution has been operational for about 5 years. It started off by borrowing loan funds from The Micro Bankers' Trust (MBT) at subsidized rates of interest. The company has also been funded by USAID, and FAO.

The company is registered with the Bank of Zambia as a non-deposit taking financial Institution under the Banking and Financial Services Act of 1994.

5.1.1 Mission and Objectives

The mission of the institution is “to improve the access by the poor to financial services and credit to enable them improve their standard of living”. (CMS Progress Report 2000)

Their objectives include:

To promote savings and credit as a tool of social and economic change.

To educate clients in enterprise development and sustainable economic growth and generation of new employment activities.

To assist clients develop self-confidence, self-discipline, concern for others and also create social pressure.

To create a fully commercial and sustainable company.

5.1.2 Geographical Coverage

CMS covers five out of the 10 provinces in Zambia namely: Eastern, Southern, Lusaka, Central and Copperbelt provinces. Thus it has both urban and rural coverage although it has a significantly higher proportion of clients in the rural areas. The spread of clients is 90% rural and 10% urban. This in itself is of great significance for sustainability because Zambia is a large country with poorly developed infrastructure.



5.1.3 Staffing of CMS

The company has a decentralised structure with a skeleton staff at the Head Office. The Head office staff are as follows: Director, General Manager, Chief Accountant, a computer advisor and a driver. Regional staff are as follows:

Three (3) Regional Managers

One (1) Regional Accountant

Twenty five (25) Credit Officers

Three (3) Regional Receptionists/Cashiers

Three (3) Credit Co-ordinators

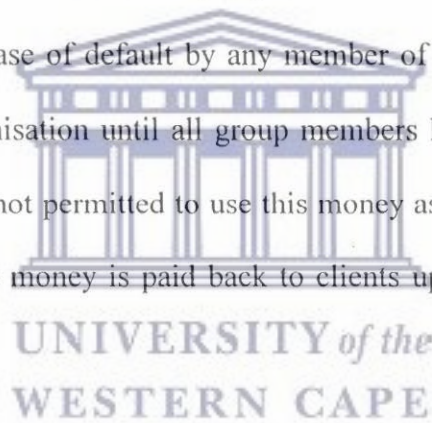
Six (6) computer Operators

Two (2) Drivers

Three (3) Cleaners

5.1.4 Lending Methodology

CMS uses the solidarity group lending methodology. Clients come together in groups of 20-25 and guarantee each other's loans. They pay 25% of the loan amount before the loan is granted as guarantee in case of default by any member of the group. The guaranteed amount is kept by the organisation until all group members have paid back their loans. Legally, the organisation is not permitted to use this money as a source of capital for on-lending. The loan guarantee money is paid back to clients upon full repayment of their loans.



All Clients have to undergo orientation and training in the credit methodology for about five weeks before the loans are disbursed. The training is conducted by credit officers and evaluated by regional managers. The training is to ensure that the methodology is understood and the groups are well consolidated before any moneys are disbursed.

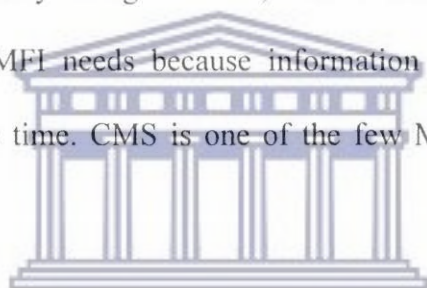
5.1.5 Credit Officer Training

In house training is conducted for credit officers. Some of the topics covered include:

Client selection, disbursement and monitoring, record keeping, loan methodology, prevention of default, risk management, time management and work planning. After this classroom training, they are attached to branches for a four-month period of orientation before they are allowed to handle clients.

5.1.6 Management Information Systems (MIS)

The company uses specifically designed MIS, which combines loan tracking and accounting. This is suited MFI needs because information is produced promptly for decision making at any give time. CMS is one of the few MFIs in the country with a developed MIS.



5.2. DATA PRESENTATION

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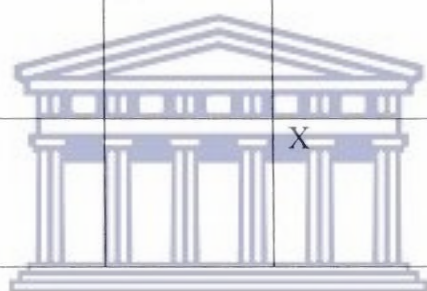
5.2.1 Services Offered

CMS offers credit, training and savings services as shown in table 5.1 below. The company plans to introduce life and medical insurance. This is because most clients tend to fall back on their working capital in case of illness or death in their families. The organisation is planning to introduce life insurance in case of death of a client before the

loan is fully repaid. A considerable amount of default is attributed to use of working capital on urgent family problems. It is expected that introduction of life and health insurance will improve loan repayment. The clients will contribute to the insurance scheme and be paid upon the death or sickness of a member or their immediate family.

Table 5.1 Services Offered /Planned

	Credit	Forced Savings	Training	Life Insurance	Medical Insurance
Services Offered	X	X	X		
Planned Services				X	X



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5.2.2 Target Group Characteristics

The target group of CMS is small business operators, small-scale manufacturers, and small livestock traders. The company targets both men and women who are credit worthy. The percentage of clients that are female is estimated to be 66% while the percentage of male clients is 44%. These groups of people would be those who have little or no access to financial services from commercial banks. According to the company,

these are middle and lower income groups in urban centers, peri-urban and rural areas. The company covers a range of literacy levels, i.e. literate, semi-literate and illiterate. Currently 90% of its clientele is in the rural while 10% is in the peri-urban areas. The target group of the organisation is a broad range of the poor and not necessarily the poorest.

5.2.3 Economic Activities of Clients

Economic activities of clients are trading, manufacturing (bricks, furniture, clothing), crop marketing and agriculture. The majority of the clients are in small business especially trading. Most agricultural loans are now given for non-seasonal agricultural activities such as vegetable growing and poultry. The company is now deliberately reducing the number of agricultural loans because of the risk associated with seasonal farming. In the past years a number of clients have failed to pay back loans due to poor harvest resulting from drought conditions.

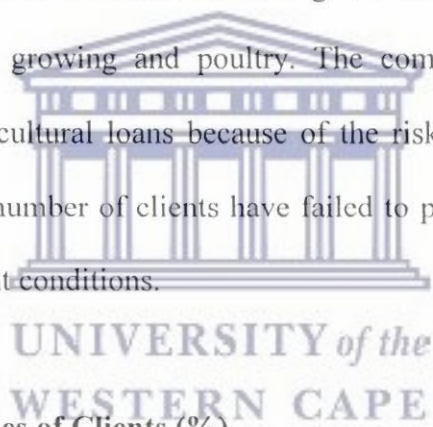


Table 5.2 Economic Activities of Clients (%)

Trading	Manufactur ing	Service	Agriculture	Other	Total
70	12	10	5	3	100%

5.2.4 Client Outreach

According to data obtained from AMIZ, the number of active clients for the year 2000 was 12,100. The total number of clients who have received loans since the program started are 35,600 (See Appendix 1. Table 3). CMS records show that the drop out rates as follows: Drop out rate 1999=3%, 2000=3%, 2001=5%. The dropouts are those who leave the programme for various reasons including default, and conditions imposed by the group lending methodology. Such conditions include frequent weekly repayment of loans and guarantee conditions. According to this institution, the main hindrance to increased client outreach is the default rate. This is alluded to in the focus group discussion as a high drop out rate due to default. When clients default, they automatically drop out of the programme.



5.2.5 Interest Rate and other charges

The organisation currently charges average compounded interest rates of 100% per annum. The rate was 120% in 1999, 100% for 2000 and 2001. Since the average loan period is about four to nine months the organisation normally calculates interest on a monthly basis. To provide an incentive to good clients, the interest rate is reduced for consecutive loans. The average interest rates per month are as follows: first cycle 10%; second cycle 8%; third and subsequent loans 7.5% per month. Credit Management Services calculates the interest rate to cover operational costs as well as inflation.

In addition, an administrative fee equivalent of US\$1.40 per client is charged. This fee is meant to cover the cost of administering the loan to the client. A training fee of 5% of the loan amount is charged per client to cover training related expenses.

Table 5.3 Annual Interest rates and other charges

	1999	2000	2001
Interest	120%	100%	100%
Training Fees	5%	5%	5 %
Admin Fees	US\$1.40	US\$1.40	US\$1.40

Average loan sizes are as follows;

1st loan US\$ 70

2nd loan US\$ 140

3rd loan US\$ 210

maximum US\$ 700



5.2.6 Efficiency Ratios

As reflected in the table below, the operating cost ratio has been decreasing in the past three years. This ratio stood at 118% in 1999, 97% in 2000 and 89% in 2001. The ratio of operating costs to average portfolio outstanding is however above the average cost ratio

for successful MFIs that is estimated to vary between 13-21% (Christen et al, 1995 quoted in Ledgerwood, 1999). However the consistent decrease in the ratio is a positive indicator of increasing efficiency. The high ratio is attributed to the cost of hiring field staff due to expansion of the operations of the organization. The table also indicates that the number of clients per Credit Officer increased in the period 1999 to 2000, but remained stable in 2001. An observation is also made that successful MFIs tend to have operating cost ratios of between 13 and 21 percent of their average loan portfolios and between 5 and 16 percent of their average total assets. However consideration is also given to the fact that this institution has been in existence for a comparatively shorter time than the sustainable institutions.

Successful MFIs have salaries and benefits running between 4 percent and 16 percent of average portfolio outstanding (Christen ET al, 1995 quoted in Ledgerwood, 1999). Credit management with levels of 65%, 53% and 41% in three consecutive years would fall far outside the 'successful' range. On the other hand, the trend in the three years indicates that there is an improvement in this efficiency ratio. In the absence of critical comparisons like credit methodology, and population density (Christen et al, 1995 quoted in Ledgerwood, 1999), however it would be premature to conclude that it is inefficient. This high percentage (as in the above discussion of the operational cost ratios) is attributed to salary costs due to expansion. On the whole there is a positive trend in CMS because the decrease in ratios is an indication of cost recovery as the organization expands.

Table 5.4 Efficiency Ratios

Efficiency Ratio	Ratio	1998	1999	2000	2001
Operating Costs as % of Average portfolio outstanding	Operating costs/Average portfolio outstanding	98%	118%	97%	89%
Salaries as % of Average Portfolio Outstanding	Salaries/Average portfolio outstanding	44%	65%	53%	41%
Cost Per Unit of Currency Lent	Operating costs/Total amount disbursed	-	58%	87%	87%
Cost Per Loan Made(Kwacha)	Operating costs/Total number of loans made	-	183,000	171,000	379,500
Number of active borrowers per Credit Officer (CO)	Average No. active borrowers/Average no. COs	-	103	154	154

Source: Adapted from Appendix 4.

5.2.7 Operational and Financial Sustainability

The data indicates that the institution is neither operationally nor financially self-sufficient. According to the calculations I made based on audited financial statements for the years 1999, 2000 and 2001, the ratio for operational and financial sustainability has been going down by margins indicated in the above table. This trend can be explained by the increase in the cost of operation which (as indicated in Appendix 4) is going up. Income for the organisation has been increasing while the costs of operating have also been increasing (see Appendix 4). The operational costs have however increased at a faster pace. As explained above, this is due to the expansion in the operations of the organisation. This scenario is also alluded to in Chapter 2 with regard to concerns raised at the Africa Region Microcredit Summit (ARMS) by the practicing MFIs. The concern is that an increase in the volume of loans requires expansion into new areas thereby increasing costs for the institution. The challenge faced is how to maintain financial viability while expanding outreach to the poor. The summit observed that at a practical level this is possible, but very difficult, to the extent that there are going to be very few of such sustainable financial institutions working with the poor (Final Report of the Africa Region Microcredit Summit, May 2001).

Prior to 1999 the company only paid management fees as opposed to salaries. In 1999, the institution put in place a staff structure with a salary package of more than double of the management fees (See Appendix 4). The wage bill has been increasing in consecutive years. Further calculations in fact show that the percentage increase in the salary bill has

been reducing in consecutive years as follows: 158 % in 1999, 67% in 2000 and 37% in 2001. This indicates that the situation is in fact stabilising. This also explains why the number of active borrowers per Credit Officer has increased by 50% from 1999 to 2000, but remained the same in 2001. This shows that the increase in clients has not been accompanied by a corresponding increase in Credit Officers. Consequently, the organisation has been able to increase the number of clients without necessarily increasing staff. According to this Company, because of the solidarity group methodology and peer pressure, the individual members of the group do most of the monitoring, thereby reducing the load for the Credit Officers.

Operations for the organisation are decentralised. This means that most staff are located where the clients are, leaving a skeleton at the headquarters. This reduces the cost of travel and allows for close monitoring of clients. One of the problems of breaking even is associated with an expensive centralised system as pointed out by Chao-Beroff (1999) and discussed in chapter 2. Other reasons given for high transaction costs in Sub-Saharan Africa are poor infrastructure, a dispersed population and high wages as compared to the Asian context (Chao-Beroff 1999 online). The rest of the costs, i.e., the cost per unit of currency lent and cost per loan made have also increased in the period under review. These basically increase with increasing operational costs as in this case.

Table 5.5 Operational and Financial Self-sufficiency (%)

Year	Operational Self- sufficiency	Financial Self- sufficiency
1998	110	105
1999	73	61
2000	77	70
2001	57	54

Source: Adapted from Appendix 4.



5.3 Is CMS Ltd. Moving Towards Sustainability?

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On the outset, the institution is neither operationally nor financially sustainable as tabled above. But because of the fact that the organisation has only been in the field for a relatively short period, one may look at the trend and practices in the organisation and speak of whether the institution is showing positive trends and make deductions from there. This question needs to be answered in relation to direct factors determining sustainability, i.e., level of outreach, interest rates and other charges, as well as the efficiency of operations. The indirect factors are discussed in chapter 5 and these apply to

the industry as a whole. But of special relevance to this organisation is the fact that 90% of its operations are in the rural areas, where infrastructure is relatively poor and travelling distances longer.

5.3.1 Outreach

First of all, its outreach in 2000 was the highest among the Zambian MFIs for which data is provided. (See Appendix 1 Table 3). According to CMS, there has since been a decrease from this number to 6,000 because of non-repayment of agricultural loans occasioned by a drought period. The company has now stopped giving agricultural loans for seasonal crops. This company now focuses more on the scale of outreach rather than depth of outreach. This is demonstrated by its shift to a wide range of clients who are mostly traders and small manufacturers and can be described as 'mixed'. CMS has focussed more on clients with year round activities as opposed to survivalist and seasonal economic activities. This kind of outreach is comparable to that discussed in chapter two under the subheading 'the sustainability camp'. Organisations that move towards financial sustainability faster are those targeting a mixed range of clients rather than the poorest. The organisation has put in place some measures to retain its clients and improve the repayment rate. For example it does not charge training fees for subsequent loans. The interest rate is also reduced for clients who repay loans on time. The current rate of repayment is indicated at 74% per annum although the planned rate is 92%. The organisation has further plans for the expansion of its client base and improved repayment rates as follows:

31st March 2001 6000 clients and 92% on time repayments

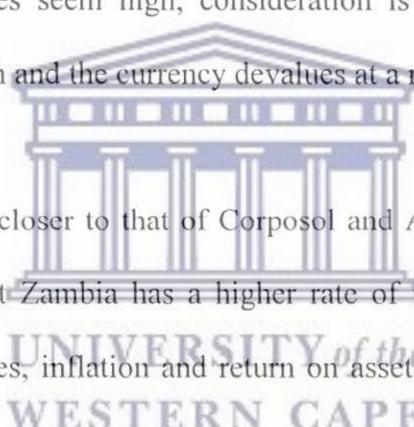
31st March 2002 9,000 clients and 93% on time repayments

31st March 2003 12,000 clients and 94% on time repayments

Source: Credit Management Progress Report 2000

5.3.2 Interest rate and Other Charges

The organisation makes deliberate attempts to recover its costs by charging economic interest rates. CMS also charges its clients for any training done as well as administrative charges. Although the figures seem high, consideration is given to the fact that the inflation rate is relatively high and the currency devalues at a relatively fast pace.



The interest rate of CMS is closer to that of Corposol and ADOPEM of 71% and 72% respectively, considering that Zambia has a higher rate of inflation. (See Appendix 1. Table 2 showing interest rates, inflation and return on assets). Corposol has the second highest inflation rate of the eleven institutions studied which at 19% per annum is relatively close to that of Zambia at an average of 23% per annum (See Table 4.1 in Chapter 4). K-rep with a high rate of inflation of 47% charged only 38% and made the lowest return on investments (See Appendix 1. Table 2). Corposol makes the second highest return on investment. There is therefore a high correlation between the interest charged and return on investment. So far CMS seems to be going in the right direction with regard to charging economic rates of interest.

5.4. CONCLUSION

Although CMS is not yet operationally or financially sustainable, evidence shows that the trend in its efficiency rates are getting progressively better. The operational costs are high initially. This is because the institution has had to put in place a comprehensive staff structure and expand into new areas in order to allow for future growth in its client base. In the first few years, the organisation has been investing in institutional development, which as indicated in literature, is a pre-requisite for the sustainability of any MFI. This in fact is typical of the formative years even of the most sustainable institutions like the Grameen Bank. Shahidur, Khander, Khalily and Khan (1995) in speaking of the sustainability and subsidies with regard to the Grameen Bank point out that, despite the fact that group pressure promotes proper loan use and high loan recovery, it is doubtful that the Grameen Bank could have generated sufficient revenue in the early years of its operation to support these costs. In the case of Credit Management Services however, findings indicate that the costs of running the institution have already started to stabilise, thereby indicating cost efficiency.

Credit Management Services from the onset has included financial sustainability as one of its objectives and is deliberately working towards achieving this. Although the mission of the organisation is to make financial services available to the poor, it has a selection process that over the years ensures that only those operating viable and relatively risk free businesses are recruited. In addition it ensures that its clients are developed to the extent

that they are able to manage their businesses. There are also indications that the organisation has set in motion mechanisms to recover costs and reduce dropouts thereby increasing its client outreach. Another good indicator for sustainability is that there is no significant increase in its operation costs over the past three years although the number of clients has been increasing. The relatively higher cost ratios in my view are not an indicator of inefficiency in this case, given the number of years in operation as well as the organisation's rural orientation.

CMS gets subsidized loan capital for on-lending as opposed to donated equity as in the case of many other institutions locally and internationally. The interest rates are set with a view of recovering costs as well as cover the rate of inflation. As discussed above, CMS Ltd. also happens to have similar practices to the financially viable institutions referred to in Chapter 2 except that it is relatively young as a microfinance institution.



CHAPTER SIX

SUMMARY, CONCLUSION AND RECOMMENDATIONS

The thesis aimed at analysing the sustainability of Credit Management Services limited (CMS) within the context of the Zambian microfinance industry. The research discussed the sustainability debate, the emergence of MFIs in Zambia and the constraints faced by the Zambian microfinance industry as a whole. The research then discussed and analysed the efficiency and sustainability of CMS as a case study of the Zambian industry. This concluding chapter of the thesis will summarise and discuss salient findings of this research in both the literature survey and the empirical findings. It will then discuss how the findings of this research have relevance for the microfinance industry in Zambia. Recommendations for further research and for stakeholders are also made.

6.1 Summary and Conclusions



Findings of this research show that there are few financially sustainable microfinance institutions in the world and that even the best of these have reached financial sustainability after substantial subsidisation. It is also evident that most microfinance programmes have failed not because they have been subsidized, but because they have been inefficient and their costs of operation have been too high resulting in their closing down due to insolvency. MFIs therefore need to operate more efficiently and recover costs in order to be sustainable. The facts on the ground however point to the fact that for

some programmes, increasing outreach will entail increasing costs thereby compromising sustainability. This is a paradox also discussed at the Africa Region Microcredit summit and alluded to in other literature.

Findings also indicate that some microfinance programmes have failed because lending methodologies have been inappropriate. Coupled with this is the fact that some programmes have operated in unsuitable geographical locations because of donor and government pressure to extend services to the poorest. This partly suggests why it has taken longer for some institutions to be sustainable than others. A lot of experimentation has therefore had to take place for institutions to arrive at methodologies and systems appropriate for their clients. This requires time, flexibility and financial investment in capacity building. Hence MFIs must be given an opportunity to grow into stable institutions because only then can they scale up and become sustainable.

Concluding from literature on experience around the world, the delivery of credit to a broad spectrum of poor clients is more sustainable than that directed at the poorest. This is because serving poor clients implies higher costs and risks for lenders. Small loans are more expensive to administer and yield relatively lower returns on investment for the MFIs. In Sub-Saharan Africa, which includes Zambia, most clients in this group are found in rural locations where the costs of operating are relatively high. As a result, some institutions have preferred to serve a mixed range of clients rather than target the poorest.


Lessons also point to the fact that microfinance is not always the most appropriate intervention in alleviating poverty. Where it is not appropriate or sustainable, stakeholders need to invest in other interventions that will provide an enabling environment for micro enterprise to flourish. Notably investments in both social and physical infrastructure need to be made. This will create an enabling environment for rural enterprise to survive and consequently contribute to sustainability of MFIs.

Credit delivery mechanisms seem to have been evolving because of unsatisfactory results in terms of impact and sustainability of institutions. And so, there has been a continued bid to increase impact by way of creating more appropriate institutions for credit delivery. The trend has been from subsidised bank loans, to subsidised socially oriented institutions, then to creation of financially viable institutions. As a result of this another conclusion that can be drawn is that microfinance as a poverty intervention strategy has shifting paradigms just as any other development intervention.



Findings show that Credit Management Services is not yet operationally or financially sustainable, but analysis of the trends of efficiency shows that this is improving by the year. If this trend can be maintained, the institution is on its way to financial viability. The high operational costs are attributed to high investment in capacity building to enable the institution to expand into new areas and allow for growth in its client base. This in itself is a pre-requisite for the sustainability of any MFI. Findings indicate that the costs of running the institution have already started to stabilise, thereby indicating some measure of cost recovery.

CMS operating in the Zambian context, is beginning to embrace best practice like charging economic rates of interest and increasing client outreach. Credit Management Services has a high client outreach compared to other institutions in Zambia. In addition to this, it has also streamlined its selection process for clients as well as the kind of activities to support. This is an indicator that the organisation is working at maintaining and expanding its client base. Findings also indicate that CMS, with regard to pricing policies has practices similar to financially viable institutions in other regions of the world. The fact that the other organisations have received substantial subsidies while CMS uses borrowed capital for on lending is a good indicator that the possibility of eventually becoming financially viable exists.



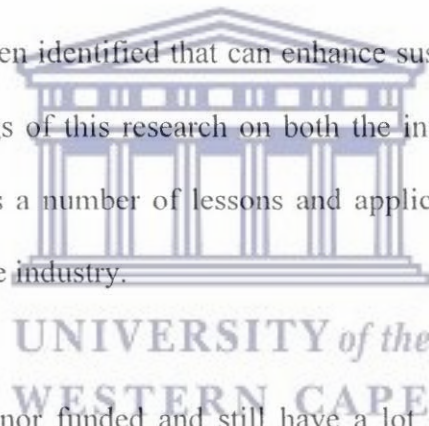
Credit Management Services has 90% of its clients in rural areas meaning that the cost of operating is relatively high compared to its urban counterparts. The implication of this is that it might delay the financial viability of the institution. CMS has however decentralised its operations in a bid to be near its clients and cut operational costs. These are efforts that contribute to cost efficiency and increasing revenue.

The organisation also displays a greater measure of transparency as compared to the other Zambian institutions. This makes it possible for the organisation to get input into its operations and make necessary adjustments.

- CMS though not financially sustainable can serve as a model for microfinance ‘best practices’ for the rest of the Zambian MFIs.

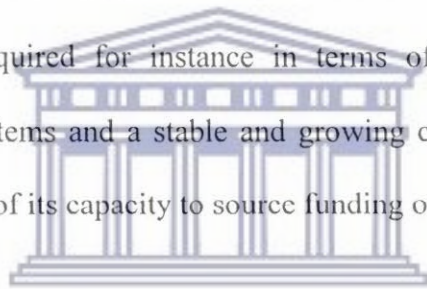
6.2 Relevance of Findings for the Zambian Microfinance Industry

Findings of this research indicate that building a sustainable microfinance industry in Zambia will not be easy. First of all, the Zambian microfinance industry is young and developing. Secondly, in its relatively short history, a number of constraints ranging from internal ones like institutional capacity and inadequate funding, to those in the external environment like macroeconomic policies and political intervention have been identified. These constraints need to be addressed in order to enhance sustainability of the industry. A number of factors have been identified that can enhance sustainability or work against it. In the light of the findings of this research on both the international scene and from Credit Management Services a number of lessons and applications are therefore drawn for the Zambian microfinance industry.



Most Zambian MFIs are donor funded and still have a lot of social considerations to make. The result is that they do not charge economic rates of interest because they are deemed exorbitant for poor clients. However for a country like Zambia with a currency that loses value at a fast rate, it is important that interest rates be set high enough to recover operational costs as well as the inflation. As shown in the broader literature and CMS in particular, only those institutions that set their interest rates high enough are able to move towards efficiency and ultimately, sustainability.

One of the biggest hindrances to client outreach by *Zambian MFIs* is the lack of funding for operations and expansion. The main problem is that most MFIs have been depending on donor funding for their operations and lack the capacity to source other funding. One way of resolving this is to change their legal status, for example, to register as limited companies. This will allow for sourcing of funds other than subsidies. This has in fact been done by CMS. One of the biggest assets of CMS is that it has been able to borrow funds for on lending from various donors. The survival of *Zambian MFIs* will therefore depend a great deal on their internal capacity to mobilise funds for scaling up and generate enough revenue to cover their operating costs. Findings of the literature reviewed on the *Zambian MFIs* indicate that some initial investment in building the capacity of the MFIs is required for instance in terms of a stable staff structure, management information systems and a stable and growing client base. CMS has been able to invest in this because of its capacity to source funding other than grants.



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MFIs need to avoid remote rural locations where microfinance is not feasible, due to low density of population, poor state of roads and other infrastructure. In some cases there might even be a demand for microfinance services, but this demand has to be adequate to cover the operational costs in order for microfinance to be feasible. Remote rural locations require more travel time and consequently higher costs of operating. Some *Zambian MFIs* operate in relatively remote locations and stakeholders need to reconsider whether microfinance is the best intervention.

Caution also needs to be exercised with regard to the type of economic activities to support. CMS lost almost half its client base because of their inability to pay back agricultural loans due to drought. Credit Management Services has had to stop giving agricultural loans because of the risks involved. Mono crop economic activities pose higher risks than that of mixed non-seasonal activities. MFIs need to avoid this because the chances of default are much higher. This can perpetuate a culture of non-repayment as clients eventually fail to take loans seriously.

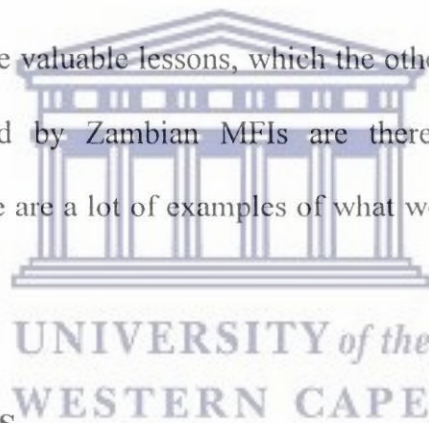
High wages contribute to high operational costs. For example in the case of CMS, findings show that this constitutes half of the operational costs. This has been the most expensive operational cost. MFIs need to work more at utilising local human resource for monitoring in order to cut down on this cost thereby increasing their operational efficiency. Linked to this is the need to cut down on expensive centralized staff structures. The implication of this is that Zambian MFIs do need to consider reducing on top-heavy structures and hire less expensive local staff as in the case of the Asian MFIs. Simple management structures and credit methodologies need to be developed in order to make it possible for the institutions to be financially viable without imposing costs that are too high on clients.

One of the problems of maintaining and attracting clients is the inappropriate application of the lending methodology. This is widely discussed in literature and seems to be a problem in general for Zambian institutions. The group lending methodology needs to be adapted according to local needs. Market research should ideally focus equally on both

client and MFI needs. This is important because the MFIs need to maintain their clients to be sustainable. Therefore a good balance needs to be struck between client needs and MFI needs in order for the MFIs to be sustainable.

Organisations also need a clear mission and objectives that deliberately include the need to create sustainable institutions. Most of the organisations have set good social objectives but have not articulated the need to create financially sustainable organisations. Setting the sustainability objective is important because it helps the organisations focus on working towards viability while serving the poor. This has been the case with CMS.

CMS therefore provides some valuable lessons, which the other Zambian MFIs can learn from. The constraints faced by Zambian MFIs are therefore real but not totally insurmountable because there are a lot of examples of what works and does not work for creating sustainable MFIs.



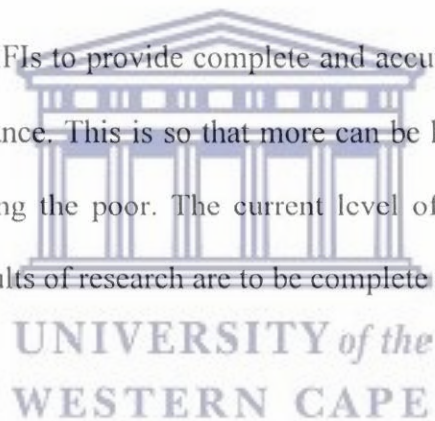
6.3 RECOMMENDATIONS

6.3.1 For Further Research

1. A serious concern pointed out in the literature is that there is inadequate empirical data on client poverty profiles and occupations served by various institutions. Researchers therefore need to look into a comparative study of the poverty levels

and other economic profiles of clients being serviced by institutions across Zambia. This will equip stakeholders and researchers with readily available information for making informed decision with regard to the type of investment to make in an organisation. This being an international concern will also make such research more attractive for funding.

2. There is a need to do sustainability analysis of a representative number of microfinance institutions in order to determine the extent to which the Zambian MFIs are sustainable. This will give stakeholders more empirical data as to the sustainability of the MFIs.
3. There is a need for MFIs to provide complete and accurate information especially on financial performance. This is so that more can be known about sustainability of programmes serving the poor. The current level of transparency needs to be improved upon if results of research are to be complete and valid.



6.3.2 For Stakeholders

1. Stakeholders need to be conscious of the fact that microfinance as a poverty reduction instrument is not always the appropriate intervention. There are circumstances that would undermine the financial sustainability of institutions and need to be avoided. Microfinance should ideally target poor entrepreneurs needing to build an asset base to operate enterprises and not the destitute.

2. Donors need to consider investing in and strengthening local institutions owned by local communities which have been there and have survived through time. This is because people will support and contribute more to what they own and already have a stake in. The best example is the utilization of the village bank model, which is being used in many parts of Africa.
3. Zambian Institutions need to look into mobilisation of voluntary savings from the local communities. This will serve as a potential source of loan capital instead of depending on grants for on lending. This will also reduce risk for the MFIs as the clients' deposits are controlled by the institutions. The introduction of deposit taking will also reduce the dropout rates because there will be more bonding between the clients and the organisations.



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APPENDIX 1.

Table 1. Age and Type of Selected Institutions

Name(country)	Age yrs	Type of Institution	Urban /rural
ACEP (Senegal)	8	NGO/credit union	Both
ADOPEM (DR)	12	NGO	Both
BancoSol (Bolivia)	7	Private Commercial Bank	Urban
BKD (Indonesia)	40+	Village-owned financial Institution	Rural
BRI Unit Desa System (Indonesia)	10	Division of Gov't commercial Bank	Both
BRK (Niger)	3	NGO	Rural
CorpoSol (Colombia)	6	NGO/finance company	Urban
FINCA (Costa Rica)	10	NGO	Rural
Grameen bank (Bangladesh)	18	Gov't/member-owned bank	Rural
K-REP (Kenya)	4	NGO	Both
LPD (Indonesia)	10	Village/government-owned bank	Both

Source: USAID Evaluation Highlights No. 49. June 1995. P4.

http://www.dec.org/pdf_docs/PNABS521.pdf 22/10/01

Table 2. Interest rates, Inflation, and return on Assets at Selected Institutions, 1993

Institution	Nominal effective rate Percentage	Estimated Current inflation, Percentage	Real effective rate, percentage	Return on average Assets, percentage
ACEP	20	6	14	0.1
ADOPEM	72	5	67	-0.8
BancoSol	55	9	46	1.0
BKD	55	10	46	3.2
BRI	34	10	25	1.8
BRK Niger	18	0	18	-11.5
CorpoSol	71	19	52	4.9
FINCA	32	9	23	-6.3
Grameen	20	8	12	-3.3
K-REP	38	47	-9	-18.5
LPD	36	10	27	7.4

Source: USAID Evaluation Highlights No. 49. June 1995. P5

http://www.dec.org/pdf_docs/PNABS521.pdf 22/10/01

TABLE 3: OUTREACH OF MAJOR MFIS (ZAMBIA)

Organisation	Type of Org	Number of clients since program started	Number of Active clients
1. Luena development Agency	NGO	530	254
2. Lutheran World Federation	NGO	13 groups of 10-35 people per group	11 groups
3. Women Finance Co-operative Zambia Ltd.	Co-operative	2300	700
4. Credit management Services Ltd	Company	35,600	12,100
5. PULSE Holdings Ltd.	Company	13,800	2365
6. Pride Zambia Ltd.	Company	8031	4341
7. ECLOF Zambia	NGO	2572	903
8. Zambezi Youth Organisation Ltd.	Company	802	631
9. CEBCA	NGO	8	8
10. Keepers Zambia Foundation	NGO	309	257
11. People's Participation Service	NGO	40 groups of 10-15 people per group	25 groups
12. National Savings and Credit Bank (Zambia) Ltd.	Company	8914	3092
13. CPG Castor Oil Zambia Ltd	Company	11 groups of 9-11 people per group	No active clients. Company concentrated on loan recoveries
14. Micro bankers' Trust	Trust/NGO	1668	1668
15. FINCA (Zambia) Ltd	Company	1433	1250
16. NDSTF	NGO	100	86
17. YSEI (YWCA)	NGO	232	200
Total		76,928	28,215

Source: AMIZ, June 2000. Unpublished.

Table 4: Recovery Rates for Selected MFIs and other Financial institutions

Name of Organisation	Recovery Rate%	Comments
Credit Management Services	70-75	Rate lowered due to poor recovery in agriculture
PULSE Zambia	60-70 95	Low rate for old product, high rate for new product
ECLOF (Zambia)	63-70	
FINCA (Zambia)	100	Just started operations
Women Finance Co-op Zambia	98	Rate improved 40-50% after some intervention
Lutheran World Federation	45-60	Trading (60-70%), Agric (50-70%). Manufacturing (45-50%)
Economic Expansion in Outlying Areas	45-85	45% on whole portfolio and 85% on dues
Zambia Co-operative Federation Finance Services	96-100	Rates obtaining before liquidation
Co-operative bank of Zambia	24	Rates obtaining before liquidation. To be revived
Zambia National Commercial bank	50-60	For agriculture and trading loans
National savings and Credit Bank	85-95	Microcredit only
Zambia National building Society	50-60	Recently improved to 85% after interventions
Pride Zambia	80	Chaisa (80%), Chachacha (94%), Ndola (100%)
Food Reserve Agency	10-20	

Source: Likulunga and Simonda (2000). Unpublished.

Table 5: The growth of MFIs in Zambia

Institutions	Date of Formation	Target Group
Pulse Holdings Limited	1994	Micro entrepreneurs in per-urban Lusaka compounds
Credit management Services	1992	Micro, small scale enterprises and small scale farmers
Country Services	1997	Small scale farmers and businesses
C.P.G Castor Oils Zambia	1996	Peasant farmers
Ecumenical Loan Fund (ECLOF)	1993	Women and youth groups, and church related groups
FINCA Zambia	2001	Self employed poor and Village Banks
Irish Aid	1996	Small scale entrepreneurs
Keepers (Z) Foundation	1997	Livestock farmers
Micro Bankers Trust (MBT)	1996	Microfinance institutions
Mukungwila Village Bank	1998	Rural poor
Peoples Participation Service (PPS)	1996	Rural microenterprises
Pride (Zambia)	2000	Small scale manufacturers
Progress Financing Ltd.	1998	Women and Youth
Women Finance Co-op	1995	Low income women entrepreneurs
Zambia Federation of Women in Business (ZFAWIB)	1998	Women entrepreneurs

Source: AMIZ, Unpublished papers, 2000.

APPENDIX 2.

QUESTIONNAIRE

The Institution/Funding

1. Age of institution (years)
2. Geographical location of clients:

- Rural
- Urban
- Both

3. What is your source of funding?

- Donor
- Savings
- fund raising
- share capital
- others (specify)



4. What is your legal status?

- Company limited by guarantee
- Company limited by shares
- NGO
- Co-op
- Other (specify)

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5. Do you have a business plan and if so, how many years are covered?

Services

1. What services does your organisation offer?

- Credit
- Savings
- Training/counselling
- Insurance
- Other (specify)

2. Do you plan to offer any other services apart from the above?

Yes

No

3. If yes, what type of services?

Voluntary savings

Life Insurance

Health Insurance

Other (specify)

4. Why would you offer the above services?

a.

b.

c.

Interest Rate

1. What fees do you charge?

Admin

Training

Insurance

2. What is your real rate of interest?.....

3. How do you determine your rate of interest?

a.

b.

c.

4. Do you have any competitors?

Yes.

No.

5. If so, what rates are they charging?

6. What is your rate of repayment?



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Client Characteristics

1. Type of business activities (% of clients).

- Trading
- Manufacturing
- Service
- Agriculture
- Other (specify)

2. Annual income categories/percentages

3. Loan use.

- Working capital
- Initial capital
- Other (specify)



General target group baselines

1. Type of economic activities (% of population).

- Trading
- Manufacturing
- Processing
- Agriculture
- other (specify)

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Client Outreach

1. Number of active clients.

2. Planned client outreach for the period

- 1999
- 2000
- 2001

3. Reasons for short fall of clients:

- Drop outs
- Not enough eligible clients
- Not enough funding
- Other (specify)

4. Drop out rate

- 1999
- 2000
- 2001

5. Loan sizes

6. What would you consider as the main hindrances to increased client out reach?

- a
- b
- c
- d



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Efficiency Ratios

Efficiency Ratio	Ratio	1999	2000	2001
Operating Costs as % of Average portfolio outstanding	Operating costs/ Average portfolio outstanding			
Salaries as % of Average Portfolio Outstanding	Salaries and benefits/Average portfolio outstanding			
Cost Per Unit of Currency Lent	Operating costs/ Total amount disbursed			
Cost Per Loan Made	Operating costs/ Total number of loans made			
Number of active borrowers per credit officer	Average number of active borrowers/Average number of credit officers			

Operational Self-sufficiency-

Year	Operating income	Operating Expenses	Financing costs	Provision for Loan losses	Operational Self-sufficiency
1999					
2000					
2001					

Financial Sustainability

Year	Operating income	Operating Expenses	Financing costs	Provision for Loan losses	Cost of capital
1999					
2000					
2001					



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APPENDIX 3.

FOCUS GROUP DISCUSSION

A focus group discussion was held with the board of the Association of microfinance Institutions in Zambia on the 27th February 2001. The Discussion focussed on constraints to sustainability of microfinance institutions. The main focus was on constraints to achieving scale of outreach and external factors. The discussion also looked at the question of whether the MFIs are charging economic interest rates and whether the cost of operation was under control.

At this meeting the aim and background of the research was given and also the purpose for requesting that meeting. This was to verify some assumptions and information collected from the selected institution.



Present at this meeting were the following board members representing some key MFIs:

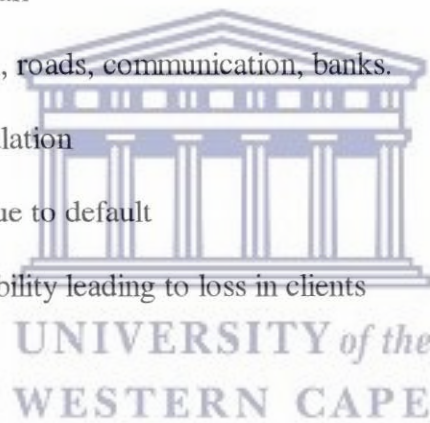
1. Mr. Abraham Ndofor FINCA
2. Mr. Micheal Mbulo PULSE
3. Mr. Derek Molver CMS
4. Ms. Mary Nandazi MBT
5. Mrs. Maluba H. Wakung'uma ECLOF
6. Mr. Paul Mayanja PRIDE

7. Mr. Webby Mate AMIZ

Constraints in Achieving Scale of Outreach

These were tabled as follows and they are not discussed in any order of priority because for the most part, institutions are affected at different levels.

- inadequate funding
- inadequate qualified staff
- poor infrastructure i.e., roads, communication, banks.
- A scattered rural population
- A high dropout rate due to default
- A high population mobility leading to loss in clients
- A poor credit culture
- Political interference



Interest Rates/Fees

Most institutions do not calculate to cover costs due to the social nature of their objectives. Some pointed out that they calculate interest rate to recover costs over time although the time period was not given. Some reasons given for not charging economic rates is that consideration is give to enterprises which take a while to become viable especially those in agriculture.

Cost of Operation

High operational costs are incurred due to poor and inadequate infrastructure especially in rural locations. It also takes time for staff to reach productivity because of the need for training and re orientation.

External Factors Affecting Sustainability of MFIs

Policy Environment

Government policy especially in rural areas does not favour micro enterprise and agriculture. There is inadequate support to agricultural marketing and little or no incentives to farmers.

Government through the Food Reserve agency dumps cheap fertilizer on the market and spoils the credit culture because of poor repayment.

Legal/regulatory Environment

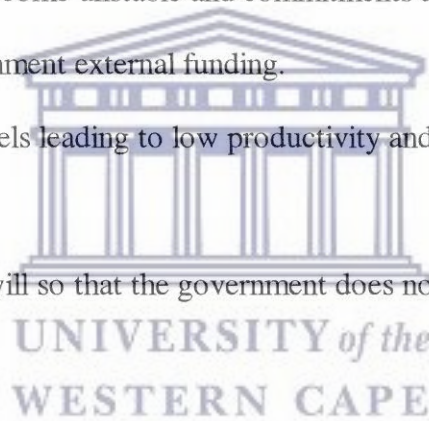
The bank of Zambia is currently supposed to regulate microfinance activities but this has not taken off because some institutions are still not registered with the Central Bank.



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Macroeconomic Factors

- A depressed economy with high unemployment due to closure of companies. Manufacturing is especially affected due to high taxes on imported materials so this introduces unfair competition to local industries.
- An inflation rate of 19.6% per annum and devaluation of the local currency leads to low returns on any investments.
- Donor funding has become unstable and commitments are not honoured. This affects both MFIs and government external funding.
- Very high poverty levels leading to low productivity and investment in economic activities.
- There is no political will so that the government does not adequately implement policy decisions.



APPENDIX 4.

Table 1. Efficiency and Sustainability Ratios of Credit Management Services

Year	1998	1999	2000	2001
End of year Portfolio outstanding	278037613	512382734	1119003860	1797304176
Average portfolio outstanding	225000000	395210173.5	815693297	1458154018
Total expenditure	232625255	648944856	977226116	1448033687
Operating Costs	220814155	467628982	793151266	1304824044
Salaries and Wages	99791789	258391494	431246400	591578374
Provision for Loan losses	0	77603041	95229381	77370903
Cost of Capital	11811100	103712833	88845469	65838740
Operating Income	243334085	396961098	684683777	784493724
Operating costs as % of average portfolio outstanding	98%	118%	97%	89%
Salaries as % of average portfolio outstanding	44%	65%	53%	41%
Operating self sufficiency	110%	73%	77%	57%
Financial sustainability	105%	61%	70%	54%

Source: Calculated From CMS Audited Annual Reports. 1999, 2000,2001.

List of Formulas Used for Calculation of Ratios

1. Operating costs as % of average portfolio outstanding

$$\text{Operating Costs/Average portfolio outstanding}$$

2. Salaries as % of average portfolio outstanding

$$\text{Salaries and wages/Average portfolio outstanding}$$

3. Operational self-sufficiency (%)

$$\text{Operating Income/ Operating Cost + Cost of Capital}$$

4. Financial Sustainability (%)

*Operating Income/Operating Costs + Cost of Capital + Cost of Capital +
Provision for Loan Losses*



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