FCC's Community Group-Lending

Relieving the Constraint Placed on the Institution's Poverty Alleviation Impact by Program Design Weakness

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Abstract

Fundo de Crédito Comunitário (FCC) is one of the largest microfinance providers in Mozambique, serving more clients than any other institution in nation. About 85% of its client portfolio is engaged in their community group-lending program. Unfortunately, many intra-group delinquencies are occurring, leaving clients to select between one of two costly coping strategies. First, many non-delinquent clients have to use profits or savings to cover the repayments of delinquent group members; this necessarily constrains the net benefit that they are able to realize from borrowing, and may produce a net cost. Second, other non-delinquent clients, in order to avoid ensuring this cost, have resorted to forcefully confiscating the personal possessions of delinquent group members in order to cover their repayment. This leaves the latter clients worse off for having borrowed credits from FCC.

This thesis provides two possible explanations for the sub-optimal performance of FCC's poverty alleviation impact. First, in light of the careful examination of the necessary components that any group-lending scheme must possess, the study argues that FCC's community borrowing group structure is not always conducive to the effective exploitation of necessary group-lending mechanisms (informational advantage, peer-monitoring/pressure, and informal insurance). This inhibits clients' ability to mitigate the costs of borrower delinquency. Second, relying on data gathered during a market research campaign, it is argued that the loan terms are proving to be too onerous for borrowers, causing delinquencies that force other clients to adopt costly coping strategies. Policy reform recommendation are then offered to assist FCC overcome these impact constraining difficulties.

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Chapter I: Poverty, Poverty Reduction, and Microfinance

The first ambition of the United Nations' Millennium Development Goals is to "Halve, between 1990 and 2015, the proportion of people whose income is less than one dollar a day."[1] The provision of microfinance services has become one of the most widely adopted development policies aimed at alleviating poverty, and thereby helping to achieve this target: "Evidence from the millions of microfinance clients around the world demonstrates that access to financial services enables poor people to increase their household incomes, build assets, and reduce their vulnerability to the crises that are so much a part of their daily lives."[2]

Microfinance is therefore driven by one primary goal: poverty reduction[3]. The rationale behind providing small amounts of credit to poor people (broadly defined) in developing countries is that when these credits are employed effectively and as intended by the lender, the income of the beneficiaries will rise (translating into an increase or smoothing in consumption in the present or future if income is saved) and their level of risk vulnerability will decrease[4].

> The poverty reduction potential of micro-credit schemes is commonly perceived as a promotional process through which poor households 'graduate' out of poverty. This graduation can be simplified as breaking a vicious circle of 'low investment- low income – and low investment' by injecting capital in the form of credit to generate productive employment, higher incomes and more investment[5].

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[1] United Nations, *Millennium Development Goals: Eradicate Extreme Poverty and Hunger* (accessed on 4/3/04) available from: http://www.developmentgoals.org/Poverty.htm.

[2] Elizabeth Littlefield, Jonathan Morduch, and Syed Hashemi, *Is Microfinance An Effective Strategy to Reach the Millennum Development Goals?* CGAP Focus Note #24, Jannuary 2003, 1.

[3] It is acknowledged that there is a growing movement to privatize many microfinance institutions, turning them into for-profit ventures. The microfinance provider being considered in this study, FCC, is not aiming to become a profitable venture. Therefore, for the purposes of this study, only the non-profit microfinance sector will be considered.

[4] Jonathan Morduch, "The Microfinance Promise," *Journal of economic Literature*, Vol. 37, no., 4, December, 1999, 1597, & World Bank, *World Development Report 2000/01*, 156.

[5] R. Montgomery, "Disciplining or protecting the poor? Avoiding the social costs of peer press in micro-credit schemes," *Journal of International Development*, Vol. 8, No. 2, 1996, 292.

Beneficiaries enter into a microfinance program if they feel that incurring the present liability of the loan will translate into future gains by using them productively[6].

> The hope is that much poverty can be alleviated-and that economic and social structures can be transformed fundamentally-by providing financial services to low-income households. These institutions, united under the banner of microfinance, share a commitment to serving clients that have been excluded from the formal banking sector. Almost all of the borrowers do so to finance self-employment activities.[7]

In this quote, Jonathan Morduch clearly articulates the first mission of the microfinance sector as one of reducing levels of poverty.

However, in order to achieve this objective, the sector has had to adopt a secondary goal that serves the first: attaining self-sufficiency. Institutional self-sufficiency refers to an MFI's ability to cover all of its operating expenses, including the acquisition of its lending capital, the distribution and collection of its credits, and any needed adjustments for inflation, with the revenue that it generates through the provision of its services[8]. More simply stated, self-sufficiency is a lender's "ability to operate at a level of profitability that allows sustained service delivery with minimum or no dependence on donor inputs."[9]

Self-sufficiency allows an MFI to expand at will, serving more and more clients as long as it can cover its costs, thereby promising to meet more of the unmet demand for financial services that currently exits amongst the world's poor. "It has been estimated that there are 500 million economically active poor people in the world operating microenterpirses and small businesses. Most of them do not have access to adequate

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[6] E Aryeetey, "Rural Finance in Africa: Institutional Development and Access for the Poor," *in The Annual Bank Conference on Development Economics,* Washington, DC: World Bank, April 25-26, 1996, 151.
[7] Morduch, "The Microfinance Promise," 1569.
[8] David S. Gibbons et al., *The Microcredit Summit's Challenge: Working Towards Institutional, Financial Self-Sufficiency while Maintaining a Commitment to Serving the Poorest Families*, CASHPOR, Updated June 2000, 1.
[9] Ibid.

financial services."[10] Most observers of the sector agree that donor supported subsidies simply cannot amass enough resources to fill this demand. In order for a substantial number of the non-served poor to gain access to the financial services that will help them reduce their own level of poverty, service providers need to operate on a self-sufficient basis.

I.A: Purpose of the Study

Fundo de Crédito Comunitário (FCC) is World Relief's microfinance branch in Mozambique. Its lending activities are guided by the double bottom line of alleviating the poverty of many poor people in Mozambique, and achieving institutional self-sufficiency. The primary strategy that the financial service provider has adopted in its pursuit of this double bottom line is the group-lending methodology; loan are disbursed to self-selected borrower groups whose constituents are jointly liable for each others loans.

FCC's community group-lending program has delivered substantial benefits to many of its participants. However, the lender can improve the impact that its programming is able to effect. Many of its clients are experiencing difficulties with the program. These difficulties are constraining FCC's net poverty alleviation impact. It is the goal of this study to identify specifically what those difficulties are, suggest diagnoses for these problems, and provide remedial policy reforms that the lender can adopt in order to scale-up the net poverty alleviation impact that it is to produce.

I.B: Outline of the Study

The study is broken up into four categories: background information on group-lending, background on the case study, identification and diagnosis of the problems, and

[10] Joanna Ledgerwood, *Microfinance Handbook: An Institutional and Financial Perspective*, Washington D.C., The World Bank, 1999, 1.

prescriptive solutions. Chapter II considers the group-lending strategy, providing a detailed description of the necessary, but not necessarily sufficient, components that any successful group-lending program must contain. The chapter also considers how the design of a group-lending program can inhibit its success. Chapter III introduces the subject of the study, exploring the mechanics of the lending program, its rationale, and the context in which it operates. Chapter IV considers the benefits and costs of the current community group-lending program, identifying its main weaknesses that are constraining the net poverty alleviation impact that FCC is able to effect. It ends up offering two diagnoses explaining the presence of the impact-constraining program weaknesses. Finally, Chapter V offers prescriptive solutions design to remedy the identified program weaknesses of the current community group-lending program, with the intended effect of relieving the constraint that those weaknesses have placed on FCC's net poverty alleviation impact.

I.C: Note Regarding the Primary Data

In the summer of 2003, FCC commissioned a market research campaign to examine why it was experiencing such a high client dropout rate. The data gathered in this field study is used extensively in this study, and therefore a brief note on the research methodology of the market research project is necessary in order to contextualize the information that it produced.

The market research campaign was qualitatively based. Focus group discussions were held in six branch offices in the south and seven in the north. Focus groups consisted of current clients (42 groups), former clients (11 groups), and non-clients (13 groups), all of which were assembled by the branch office staff. In addition, 11 branch staff focus group discussion sessions were held. Two staff members facilitated each focus group, with respondent group sizes ranging from 5 to 30 participants. The group discussions were very open ended, but centered on three broad question areas: "Why are clients dropping out of FCC? Why do clients have a hard time repaying their loan? What are the participants' suggestions for how to improve FCC?"[11] Discussion facilitators paid special attention to avoid posing leading questions. The strategy was to probe respondents for the specific 'whys' that were motivating their responses. Therefore, the figures gleaned from the study are not comprehensive[12], but act more as a representation of the general sentiment of FCC's clients. For example, 25% of focus groups mentioned the desire to use their savings to cover loan repayments if needed. This does not mean that 25% of all FCC clients share this desire, but only that 25% of the focus groups mentioned on their own that this was a desire that they had. Please refer to Appendix I for an elaboration of the market research study's method and for the respondent tally sheets.

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[11] David Park, *Client Drop-outs at Fundo de Crédito Comunitário*, Maputo, Mozambique, October, 2003, in the author's possession, 9.

[12] They do not represent every instance in which FCC clients feel or think a certain way.

Chapter II: The Benefits and Costs of Group-Lending

Group-lending is an innovation that has allowed countless microfinance institutions all over the world to provide poor people, the majority of whom have been excluded from the formal financial sector, with credits. However, the model itself does not guarantee successful poverty alleviation results. Many factors contribute to the impact that a group-lending program can have on its beneficiaries.

A first set of factors that influences success falls outside the scope or control of lending programs. The investment opportunities present in the community in which credits are being disbursed can be a major determinant of the returns that they can produce. The level of infrastructure, such as roads, communications, police, legal code, etc., will determine what type of investment activities in which borrowers can engage. Next, the status and composition of the local market conditions determine the availability of viable investment opportunities for borrowers. Borrowers are limited by the supply of inputs, labor, and the purchasing capacity of local markets when making their investments. All of these factors are beyond the control of the credit provider, but must be considered if a loan program is to be successful. The investing environment can cause an otherwise well-designed group-lending program to fail if it has not been properly accounted for.

A second set of factors that influences success does fall under the control of the credit provider. The specific loan terms, the length of the lending cycle, the repayment system, loan value, and interest rate must all be configured appropriately so that borrowers who are investing their credits in a productive manner are able to produce positive returns on their investments, within the particular investing environment in which they are working.

The third set of factors that influence success is the specific structure of the lending group. The group-lending model being used to deliver the credits to individual borrowers will have an impact on the benefits that client are able to gain from participation.

This chapter will examine in greater detail the final determinant of a group-lending program's success: the structure of the group. After outlining the main benefits of group-lending, the necessary structural components of a successful group-lending program will be illustrated, followed by a consideration of how poor or inappropriate design can result in the failure of the potential benefits that group-lending provides from being realized by its participants. Having an explicit understanding of the benefits of a properly functioning group-lending model, and the difficulties in achieving those benefits, are essential to evaluating and proposing how to improve FCC's poverty alleviation impact.

II.A: The Benefits of Group-Lending

A general consensus has emerged amongst academics and practitioners alike that a successful microfinance program must work to achieve two goals simultaneously: reach more of those who demonstrate the greatest need (the very poor) and are still economically active, and have microfinance service institutions operate sustainably, without the need to rely on donor contributions or subsidized funding[13]. The group-lending methodology holds great promise in achieving these two goals simultaneously. It can achieve this feat by making credits available to those for whom access would otherwise be denied, while exploiting administrative economies of scale, rending the

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[13] Joanna Ledgerwood, *Microfinance Handbook: An Institutional and Financial Perspective*, Washington D.C., The World Bank, 1999, 34.

provision of credit services less costly than they otherwise would be under an individual credit delivery system.

Group lending has the potential to be an effective tool in expanding outreach amongst the very poor because it fills the collateral gap that prevents poor people from accessing credit in the formal financial services markets. Gaining access to credit can help poor people raise their level of material well-being and/or decrease their level of vulnerability by increasing their present income and/or future earning power through investment in income generating activities. Service provider self-sufficiency is the only way to reach a significant portion of those who can benefit from microfinance services. The group-lending methodology, through its creation of administrative economies of scale, promises to play a significant role in helping to achieve the latter goal, and through it, the former.

In order to provide credit services to very poor clients, while at the same time moving towards the achievement of institutional self-sufficiency, the design of a group-lending product must consider three broad issues: client selection, credit use monitoring and supervision, and how to secure a high repayment rate without harming clients who have been forced into delinquency by an unanticipated external shock. First, a loan product must be accessible to those with little to no physical collateral (necessary in order to reach the poor), while simultaneously selecting clients that have a high probability of repaying their loan (a relatively low level of risk). Second, the program must contain a mechanism that monitors and supervises the borrower's use of the credits in order to ensure that credits are employed in a way that facilitates repayment. Third, a lending program needs to overcome the incentive for individual members to opportunistically default on their repayment[14]. Simultaneously it needs to ensure that those experiencing a short-term liquidity problem, brought about by an unforeseen occurrence beyond their control, but whose microenterprise activity remains essentially solvent, are given an opportunity to overcome their temporary setback. While these three challenges have been presented separately, the successful mitigation of one is dependent on that of the others. Again, the investment environment, and the loan terms are significant factors in determining the solvency of a borrower's enterprise, and with it a program's success. However, the preceding analysis will focus on how the incentive structure of a group-lending model can help facilitate successful microcredit lending to groups of borrowers.

Joint liability is the central distinguishing feature of the group-lending methodology. Creating joint liability within a group allows lenders to provide credit to poor people with no physical collateral. Lending institutions require a meaningful guarantee of repayment from their clients in order to ensure that they will be repaid. Joint liability allows poor clients to secure credit by using each other as guarantors of their loans. Each member of the group is liable (must meet the repayment of a fellow group member if that member is unable to) for the entire loan of every other group member. The promise of others to payoff a delinquent party's loan is a social asset for borrowers in the absence of any physical assets, and is one that is just as valuable as an equivalent tangible guarantee to the lender[15].

However, the mere possession of a group-guarantee asset itself does not overcome the barriers to effective group lending mentioned earlier. In theory, clients are willing to

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[14] Jonathan Conning, *Group lending, moral hazard, and the creation of social collateral, Center for institutional reform and the informal sector*, Working paper no. 195, May 1996, 3, & Soren Hauge, *Household, Group and program factors in Group-based credit delinquency*, Department of Economics, Ripon College, first draft January 1998, 8.

[15] Morduch, "The Microfinance Promise," 1579.

accept the liability of their fellow group members when this asset is built upon the social capital that exists within the group. Social capital assists groups mitigate the challenge of client selection by exploiting the informational advantage mechanism. It also helps address the difficulty of supervising credit usage and the incentives to opportunistically default introduced by joint liability through the peer-monitoring/pressure mechanism, thereby ensuring a high rate of repayment. Lastly, social capital within a group can account for the high vulnerability of poor borrowers and help them emerge from external shocks through the activation of the informal insurance mechanism.

In the absence of these three group-lending mechanisms, the promise of group members covering the delinquent repayment of a fellow borrower is hollow. Under such a scheme, the 'joint liability' is not an asset, but is merely a veneer, under which uncertainty lies because of the lack of a sufficient incentive structure to give the promise substance. In the interest of avoiding such programs, the following sub-sections will consider each of the three essential group-lending mechanisms in the order in which they must be activated.

II.A.1: The Informational Advantage Mechanism

In seeking to provide credit services to those who have been excluded from the formal financial services market and who therefore lack verifiable credit histories, microfinance institutions are faced with the challenge of lending with imperfect knowledge regarding the credit worthiness of applicants. Therefore, the beneficiaries themselves may be the best source of information regarding the credit worthiness of their peers: "Group-lending contracts effectively make a borrower's neighbors co-signers to loans, mitigating problems created by informational asymmetries between lender and borrower."[16] However, merely assembling a collection of randomly selected individuals from a targeted community will most likely not produce any informational advantage about the applicants' credit-worthiness amongst the group. In order for the informational advantage mechanism to be activated, loan-applicants must be given the opportunity to self-select their peer group. Self-selected peer groups have two significant positive impacts on client selection. First, it ensures that groups are formed around some level of pre-existing social capital, a necessary element for the proceeding two essential group-lending mechanisms. Second, it increases the probability that every borrower is credit-worthy, meaning that, all else being equal, it is more likely that they will repay than default.The self-selection process increases the chances that groups formed for the lending program will contain at least some stock of social capital. Applicants know that in order to access a group loan, they must accept liability for their fellow group members' loans as well as their own. Therefore, any rational prospective client will want to select group members that he/she is fairly certain would be able to productively manage their credits and meet their own repayments. In order to make such an assessment, an applicant must have access to intimate knowledge about the ability of another potential group member's investment capabilities. This type of familiarity is contingent on some form of a relationship, and so suggests that some type of social capital must be pre-existing between individuals for them to have an informational advantage about each other over a lender with imperfect information.

When given the opportunity to select their fellow group members, the presence of a "positive preexisting relationship(s) among (the) borrowers" is generally the first

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[16] Morduch, "The Microfinance Promise," 1570

criteria that perspective borrowers employ[17]. The Grameen Bank, one of the seminal microfinance service providers in the developing world, seeks to foster this principle when it asks candidates to choose "like-minded people of similar economic standing who enjoy mutual trust and confidence."[18] Microfinance service providers in Africa have recognized and attempted to exploit this same principle; studies on the Akiba Commercial Bank in Tanzania revealed that some type of preexisting relationship among the candidates was the primary screening method being used in group formation by the candidates themselves[19]. Giving clients the opportunity to self-select their own group members helps create groups that are conducive to the presence of social capital.

The presence of social capital in a borrowing group is useful for two reasons. First, it facilitates the operation of the peer-monitoring/pressure and informal insurance mechanisms; this will be dealt with in the proceeding sub-sections. Second, the presence of social capital markedly increases the capacity of perspective clients to evaluate the credit-worthiness of other applicants, helping to ensure that only those with a high probability of repaying their loans actually become clients. As already described, clients have an incentive to select fellow members with a high probability of being able to meet their repayments. Therefore, it is the investment ability of an applicant that becomes the second criteria that other applicants use when determining with whom to form a group. Again, turning to the Grameen Bank, a study revealed that 85% of group members selected fellow members based on their ability to repay and not based on other social

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[17] Lisa Young Larance, *Building social capital from the center: A Village-level investigation of Bangladesh's Grameen Banks*, Center for social development working paper no.98-4, 1998, 4.
[18] Thierry van Bastelaer, *Imperfect information, social capital and the Poor's access to credit*, College Park: University of Maryland, Center for institutional reform and the informal sector, Working paper no. 234, February 2000, 13.
[19] The study found that 60% of clients knew their fellow group members as neighbors, 26% as family, 15% through market interactions, and 8% through religious affiliation. (Martin Brown, *Economic and Social Impact of Solidarity Group Lending*, Swiss contact, January 2002, 30.)

bonds[20]. This information is typically based on an applicant's first hand knowledge and interaction with their fellow candidates[21].

Groups being formed around a preexisting stock social capital is not only advantageous to the borrowers, but it also benefits the lender. Social collateral as a loan guarantee is more valuable to the lender if it is based upon information gathered by those with an incentive to assemble credible data, rather than merely being a promise to cover the loan of an arbitrarily selected individual in order to gain access to credits for one's self. In the latter case, it is far easier for a client to shirk their responsibility, blaming the presence of a defaulting group member on the party that placed them in the group. In the former, the responsibility for the presence of every individual in the group falls on the group members themselves. Therefore, it is absolutely necessary for the informational advantage mechanism to function effectively that groups be entirely self-selected by the loan applicants themselves.

II.A.2: The Peer-Monitoring/Pressure Mechanism

The preceding section demonstrated how the informational advantage mechanism could overcome the problem of client selection. However, once the clients have been selected, another mechanism must ensure that individual borrowers pay back their loans. The task of supervising the use of credits, and overcoming the incentive to opportunistically default introduced by joint liability is the function of the peer-monitoring/pressure mechanism.

The success of a group-lending program, or any lending program, is contingent on the creditor's ability to have their clients repay their loans[22]. While the selection process

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[20] Larance, 25.
[21] Bastelaer, 12.

is a necessary step in creating a high repayment rate, it is not sufficient. The use of a client's credits must be supervised to ensure that they are being employed in a productive manner that is conducive to repayment[23]. The microfinance industry typically employs a dynamic model to create incentives for borrower groups to repay their loans; positive repayment of a present loan is rewarded by a subsequent larger loan[24]. While this mechanism could be effective in dissuading entire groups from colluding against the lender, it does not tackle the moral hazard or free-rider incentives to the individual borrower introduced by joint liability. The individual moral hazard and free-rider problems can be overcome by the effective exploitation of social capital within a group. This social capital increases the opportunity costs of engaging in higher risk activities with one's credits (moral hazard) or opportunistically defaulting (free-riding) by individual clients, effectively pressuring clients into meeting their repayments.

Joint liability ties the well-being of each group member to that of all the others, creating an incentive for each individual to ensure that their fellow group members employ their credits in a successful manner that is conducive to repayment: "Cosigning provides an incentive for the consignee to monitor the actions of the person for whom he has cosigned the loan."[25] With the risk of lending transferred from the credit provider

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[22] This obviously is essential for a loan provider that is seeking to achieve self-sustainability. It is also the distinguishing feature between a credit program and a cash transfer program.
[23] This need is especially acute among the poor for two reasons. First, being poor, they have trouble meeting personal needs, and so there is a high probability that credits will be used for non-productive, household consumptive activities. Second, since the investment environment can be less than ideal in poor communities in the developing world, supervision from those familiar with the local market can be invaluable for an entrepreneur navigating their way through the local investment environment.
[24] Thierry van Bastelaer, *Imperfect information, social capital and the Poor's access to credit*, College Park: University of Maryland, Center for institutional reform and the informal sector, Working paper no. 234, February 2000, 15, & E Aryeetey, "Rural Finance in Africa: Institutional Development and Access for the Poor," *in The Annual Bank Conference on Development Economics,* Washington, DC: World Bank, April 25-26, 1996,153.
[25] Joseph Stiglitz, "Peer Monitoring and Credit Markets," *The World Bank Economic Review*, Vol. 4, No. 3, 1990, 363.

onto the individual members of the borrowing group, joint liability produces an incentive for clients to monitor each other's credit usage.

Credit use monitoring is required to identify and mitigate the occurrence of two credit use behaviors that are not conducive to repayment: inadvertent misuse, and willful misuse. Even tough clients were selected based on their business savvy, some might still experience difficulties handling their loan. If this is detected, group members have an incentive to offer the troubled borrower assistance. The monitoring of credit usage is a second quality assurance mechanism, after the selection process, which helps ensure that the incidence of delinquency within the group is kept low, and repayments can be made.

Ensuring that repayments can be made is a necessary step, but is not sufficient. Monitoring can reveal willful misuse of credits: moral hazard and free-riding. As with any lending program, issuing small loans to poor beneficiaries introduces a moral hazard; the credit is not theirs, and so there is an implicit incentive to employ it in more risky ventures then they otherwise would if the money belonged to them. This moral hazard problem is compounded in group-lending because, typically, the borrower is not required to place any physical assets at risk in order to guarantee their repayment of the loan[26]. Group-lending also introduces an incentive for individual borrowers to engage in opportunistic defaulting, or free-riding. This could include any behavior from willfully withholding any portion of a repayment back to taking the loan and running off with the money. This incentive exists because the individual has no physical collateral that the lender can take to enforce repayment, and the willing-delinquent knows that his/her default will be distributed evenly to the other members of the group. Obviously no

[26] In the case of a group loan, instead of the Bank having to absorb the added risk that the moral hazard brings, the joint liability of a group loan shifts that risk burden onto the other members of the group.

group-lending program can function properly under such conditions since this precludes the achievement of the self-sufficiency goal, and it is for this reason that any successful model must activate a peer-monitoring/pressure mechanism that overcomes these barriers to effective collective action. In the case of group-lending, this means that everyone is using their credits appropriately[27].

In order to prevent clients from carrying through with these negative borrowing behaviors, they must be susceptible to the pressure from their fellow group members who have an incentive to stop such activities. Susceptibility to group pressure is dependent on a shared stock of social capital between the members in a borrowing group. Shared social capital between group members inserts an opportunity cost into the equation that a rational individual borrower would use when determining how to employ his/her credits. If social capital is present, group members have recourse to two remedies to enforce compliance when willful credit misuse has been identified: threaten to take away other benefits provided to the offender, and place shame on him/her that inhibits his/her ability to procure future benefits from others in the community[28]. The presence of an effective peer-monitoring/pressure mechanism, rooted in an valuable stock of social capital, renders the decision of whether or not to engage in high risk behavior or to opportunistically go into default on repayment contingent on the lost opportunity cost of receiving other services from the group, and the lost opportunities from gaining a

[27] The same logic that rests behind the informational advantage mechanism that is used when selecting clients can be employed here to justify the need for peer-monitoring/pressure instead of having the lender undertake this task. Peer monitoring is also an "efficient way of getting information in the presence of costly information" about clients' usage of their credits." (Joseph Stiglitz, "Peer Monitoring and Credit Markets," 353.)

[28] This is the exact same principle behind the system of credit history in the formal financial services sector; defaulting on a loan gives one a poor credit rating, or a bad reputation that could persuade other lenders in the future to not lend to the applicant.

negative reputation in the community[29]. It is precisely this ability to pressure an individual borrower in a group that lends the collective guarantee tangible value to the creditor. The effect of peer-pressure/monitoring by other group members effectively becomes a cost of doing business, but it is one that is determined by the level of social pressure that the group is able to exert, and is therefore an endogenous factor[30].

Not only does an effective peer-monitoring/pressure mechanism help a lender achieve their desired level of capital sustainability, but it also can have positive implication for coverage of the poor, increasing the poverty alleviating effect of microfinance programs. Because it is now the borrowers that are bearing the risk of lending, the premium on lower risk levels increase, and so the overall risk exposure that a lender faces is lessened compared to providing the same loans to the same group of people on an individual basis. This lowers the interest rates that lenders need to charge to their clients[31]. The effect of lowering the interest rate that lenders must charge, and the ability to overcome the collateral gap without succumbing to the moral hazard or free-rider problems of joint liability, can allow microfinance lenders to reach more poor clients by providing lower interest rates than they otherwise would be able to with an individual lending program[32].

While the dynamic loan incentive can be effective in dissuading an entire group from colluding against the lender to repay, an effective peer-monitoring/pressure mechanism is essential for the successful operation of a group-lending project because it can identify, and help rectify credit usages that are not conducive to repayment. First, it

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[29] E. Lazear and E. Kandel, “Peer pressure and partnerships,” Journal of Political Economy 100(4), 1992, 805, & Conning, 2.
[30] Ibid., 804.
[31] Montgomery, 290, & Morduch, "The Microfinance Promise," 1580.
[32] Conning, 2, & Morduch, "The Microfinance Promise," 1582.

is responsible for identifying clients that are inadvertently mishandling their loans. Group members then have an incentive to provide assistance to that borrower, thereby ensuring that they can meet their loan repayments. Second, the mechanism is responsible for identifying clients that are willfully mishandling their loans. If social capital exists between the group members, monitoring clients can leverage this shared bond to pressure the offending borrower into using their credits as intended, thereby ensuring that clients do meet their repayments. The presence of social capital within a group is facilitated by the ability of applicants to self-select their groups (exploitation of the informational advantage mechanism).

II.A.3: The Informal Insurance Mechanism

Since microfinance as it is being discussed in this paper is a tool for poverty reduction, then it is not sufficient for the group-lending model to only protect against instances of default caused by intentional credit misuse. Even with the quality assurance mechanisms of client self-selection and credit use monitoring, it is still highly probably that unavoidable delinquencies by individual borrowers will occur. A group-lending model can overcome this barrier to effective lending through the informal insurance mechanism.

The heightened level of vulnerability that characterizes the poor means that it is likely that poor individuals will experience periodic shocks that are beyond their ability to avoid. The informal insurance mechanism operates within a group when one member experiences a legitimate problem with their business caused by an external factor beyond their control (such as an accident, theft, etc.), and is unable to meet his/her repayment[33].

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[33] A short-term liquidity crisis suggests that an immediate payment cannot be met, but that the essential solvency of the borrower's microenterprise remains sound. Immediate payments may be impossible to meet, but with recovery assistance, future payments could be met.

In this instance, other group members cover the repayment of the client experiencing difficulties, giving that client time to recover from their temporary liquidity problem and return to their productive status within the group in the future[34]. This is an essential mechanism for the success of a group-lending program because accidents and 'bad luck' happen, and so clients will experience difficulties that are unavoidable. Microfinance cannot be a zero sum game where only those who have unfettered good luck (not experiencing a shock beyond their control) are the ones that benefit. It must be anticipated that at some point, every client could experience such a shock. The idea is that not every client will experience such a random shock simultaneously[35], and so spread out over time, a group will be able to support each other during such periods of difficulty: "The social objectives of mutual self-help and poverty alleviation, remain fundamental to the boarder goals of these peer group-lending schemes."[36]

The willingness of group members to assist each other with interim repayment insurance is contingent upon two factors. First, those providing the insurance must know that the cause of an individual borrower's delinquency must be the result of a short-term liquidity problem brought about by an external shock, as opposed to being the result of a long-term solvency problem cause by the borrower's own ineffective investing. The informal insurance mechanism is structured around the idea that after gaining assistance in overcoming an external shock, that the troubled borrower will once again be a productive member of the team, or return to their solvent status quo. This assumption is

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[34] Manfred Zeller, "Determinants of Repayment Performance in Credit Groups: The Role of Program Design, Intragroup Risk Pooling, and Social Cohesion," *Economic Development and Cultural Change*, 46, 1998, 2.

[35] There exist many different macro shocks that can produce such an effect. However, in such an instance, the presence of a group-model does not introduce any new problems that an individual lending scheme would not face.

[36] Montgomery, 290.

crucial because it provides the basis upon which the second condition determining clients' willingness to provide repayment insurance is satisfied. Those providing the insurance must trust that such service will be provided, *quid pro quo*, in similar instances should the need arise in the future, that they also have access to this social asset[37]. In order for a client to expect that they will have access to this service, the long-term solvency of their fellow group members' investments must be sound; otherwise they could not be in a position to reciprocate the service when called upon to do so.

In order for the informal insurance mechanism to be activated, the previous two group-lending mechanisms need to have been effectively exploited. A client must be reasonably certain about the cause of a fellow group member's delinquency if they are to provide insurance. Access to the information required to make such an assessment is made easier if the clients are familiar with each other and their businesses before engaging in the lending program and before the onset of the delinquency problem. Effective exploitation of the informational advantage mechanism facilitates the operation of the peer-monitoring mechanism, which then provides the information required by a borrower to assess the credibility of a fellow group member's request for a repayment insurance-disbursal.

The ability for a client to trust that he/she can receive the same repayment insurance service from his/her fellow group members is contingent upon two factors. As already mentioned, the ability for this service to be provided is dependent on the solvency of fellow group members' enterprises. This is determined by the effective operation of the quality control measures described in the previous two group-lending mechanisms.

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[37] S.J. Burki and G. Perry, *Beyond the Washington Consensus: Institutions Matter*, Washington DC: World Bank, 1998, 17, & Morduch, "The Microfinance Promise," 1752.

Second, having established the ability to provide repayment insurance, the stock of social capital within a group can assure a client that if need be, they would actually receive this service. The deeper the level of social bonds that bind clients together, the greater will be the degree of interdependence that links their individual economic success together: "mutual support is inherent in lending group self-selection and is rooted in the small group."[38] It is for this reason that greater social cohesion, meaning a greater degree of social interactions that tie the group members together, has been correlated with positive repayment[39].

Because the occurrence of intra-group delinquencies are impossible to eliminate completely, a successful group-lending program with an aim to affect poverty alleviation must be able to help beleaguered borrowers overcome short-term difficulties. The informal insurance mechanism accomplishes this task by having clients cover the repayments of fellow group members who have suffered an external shock that has induced a temporary liquidity crisis. The functioning of this mechanism is contingent on the insurance being offered for those experiencing only short-term liquidity problems and not for those with long-term solvency issues. The overall solvency of group members' enterprises, along with the presence of adequate social capital within the group, can assure clients that it is highly probable that they could and would receive repayment insurance if they required it. This assurance is the motivation for clients to be willing to provide the service themselves to fellow group members. The presence of these conditions is dependent on the effective operation of the peer-monitoring/pressure

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[38] Larance, 4.
[39] Zeller, 13.

mechanism, which is itself dependent on the exploitation of the informational advantage mechanism.

II.A.4: The Importance of Social Capital

All three of the essential group-lending mechanisms have pointed to the importance of individual group members being able to meet their own repayments, and to a reliance on a sufficient stock social capital existing between the members of a group. The proceeding section will consider the latter criterion.

The preceding sub-sections described why the presence of social capital is necessary for a group-lending scheme to function successfully. People will only possess information about those with whom they share a relationship. People will only be susceptible to peer-monitoring/pressure if there are other social services on the line. And, people will only be willing to assist others in need if they believe that the same service will be granted to them if they need it, and in order to maintain the delivery of that service. Therefore, it is vital to understand the concept of social capital and how it functions in order to fully appreciate how the three mechanisms function.

Social capital is not itself a tangible asset, but signifies a network of relations between people that can generate realizable value for those who share it. It is constructed from the bonds in a relationship that obligate people to one and other: "Social capital refers to the institutions, relationships, and norms that shape the quality and quantity of a society's interactions."[40] It encompasses "the shared values and rules for social conduct expressed in personal relationships, trust, and a common sense of 'civic' responsibility."[41] The shared rules and values that constitute social capital can facilitate organization,

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[40] World Bank, *What is social capital, social capital for development*, accessed on 10/30/03, available from: http://www.worldbank.org/poverty/scapital/whatsc.htm.
[41] Bastelaer, 5.

coordination, and cooperation between people, resulting in the mutual benefit of all who share it in a non-rivulrous manner[42]. By working together, social capital can facilitate the achievement of ends that otherwise could not have been achievable by a solitary actor[43]. The level of social interaction, trust, dependence, collective action, sharing of information and communication, and participation within that group is the measure of the social capital that exists between all of the members[44].

It is widely acknowledged in the microfinance industry that some type of bond, or "natural affinity" needs to exist among members of a community group in order for the strategy to function properly[45]: "In societies with high social capital, where systems and structures have been developed to build trust and foster social and economic transactions beyond the family and kin group, it will be easier and less costly to build sustainable systems for financial intermediation."[46] The description of how the three essential group-lending mechanisms function attests to the validity of this claim. The group-lending methodology strives to create an asset out of a collectivity where on an individual level such an asset cannot exist. In order for this to occur, for the creation of the collective asset to be realized, links must be forged between the members of the group. These links, or relations, transmit trust from one actor to another, facilitating the ability for individuals

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[42] R. Putnam, "The prosperous community: Social capital and public life," *American Prospect*, Number 13, Spring, 1993, accessed on 11/15/03, available from: http://xroads.virginia.edu/~HYPER/DETOC/assoc/13putn.html, and World Bank, *What is social capital, social capital for development*.

[43] J.S. Coleman, "Social capital in the creation of human capital," *American Journal of Sociology*, Vol. 94, Supplement, 1988, S98.

[44] Christiaan Grootaert, Deepa Narayan, Veronica Nyhan Jones, and Michael Woolcock, *Integrated Questionnaire for the Measurement of Social Capital*, Washington DC: World Bank, Social Capital Thematic Group, June 23, 2003, 9, & Deepa Narayan and Michael Cassidy.,"A Dimensional Approach to Measuring Social Capital: Development and Validation of a Social Capital Inventory," *Current Sociology*, Vol. 49(2) March 2001, 4.

[45] William Burrus, *Informational interview session*, the Fletcher School of Law and Diplomacy, Medford MA, October 28, 2003.

[46] Ledgerwood, 41.

to coordinate their actions and work together. The new unified entity that is formed out of previously atomized figures generates a collective identity by which individual members can identify themselves[47]. This collective identity serves to reinforce the emerging norms within a group that facilitates the creation of trust and collective action: "Networks of civic engagement also facilitate coordination and communication and amplify information about the trustworthiness of other individuals."[48]

The formation of social capital is not the result of a divine intervention imposed on individuals, but the result of a process of relationship building by a group of people who share a common interest. Some type of familiarity or relationship amongst people[49] can act as a catalyst for its initial formation[50]. Once this process has begun, it has the potential to become a self-fulfilling prophecy, building upon itself as the bonds that connect the individuals who share a stock of social capital grow[51]. Individuals may come to rely on the services produced by collective action. This dependence creates a mutual interests between people; one actor's interests can only be met if those of another are satisfied, and so it becomes the interest of that actor to help others secure their needs. While this model can become a closed system[52], it can also be expansionary, absorbing newcomers into pre-established relational groups[53]: "networks of civic engagement

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[47] Bastelaer, 5.
[48] Putnam.
[49] These relations can range from family bonds or friendships, to familiarity through shared market space or home locations, etc.
[50] Jonathan Morduch, "Between the State and the Market: Can Informal Insurance Patch the Safety Net?" *The World Bank Research Observer* 14(2). August 1999, 184.
[51] Hauge, 13.
[52] Consideration will be given to this phenomenon in the proceeding section.
[53] Larance, 8.

embody past success at collaboration, which can serve as a cultural template for future collaboration."[54]

II.A.5: Administrative Economies of Scale

Finally, one of the primary advantages of the group lending system is that it allows the lender to reach a great number of clients with minimal administrative costs. The loan promoter is charged with the task of disbursing and collecting loans. However, instead of visiting every client in the group individually, he/she only has to attend the scheduled repayment meeting in order to collect the loans from all of the group members. This efficiency allows for a greater number of beneficiaries to be reached with minimal administrative overhead. Joint liability within the group creates a collective punishment for delinquency, and so group members are given an incentive to monitor each other and make up the difference if a repayment shortfall occurs, further reducing the costs of monitoring and collection for the lender[55]. Having to spend less time per client means that the administrative cost to the lender per client is greatly diminished relative to the cost of servicing them individually. This can be used to either reduce the operating costs of the lender, or the savings can be used to service more clients, as Bank Shinta Daya in Indonesia discovered as late as 1995:

> The impact of the newly introduced group approach is most dramatic with regard to access to credit by the poor. By December 1995 the bank lent to 2,582 poor borrowers individually. The group approach increased the number of poor borrowers to 8,782, which is 69 percent of all the bank's borrowers. Without the group approach, the proportion of poor borrowers would have been only 40 percent.[56]

[54] Putnam.
[55] Lazear and Kandel, 802.
[56] Uben Parhusip, *Rural Bank Shinta Daya - Attaining Outreach with Sustainability – A Case Study of a Private Microfinance Institution in Indonesia*, University of Cologne Development Research Center, 1999, 5.

II.B: Problems with Group-Lending

Having considered the benefits of the group-lending strategy, and having described what are the necessary mechanics for successful implementation of a program, the following section will consider how such initiatives can fail. Again, the analysis will proceed under the assumption that the external investing environment provides viable investing opportunities and that the other loan product attributes allow borrowers to realize returns on their credit investments that, without considering the group-lending system, would leave them with a net profit. This assumption is being made in order to isolate how specific design flaws in a group-lending model can cause an otherwise sound lending program to fail to produce net benefits for its beneficiaries.

While group-lending does allow credit to be delivered to poor people who otherwise could not access them because of their lack of physical collateral, it does come at a cost to them. The joint liability created under group-lending passes the risk of lending from the creditor onto the borrowers. Forcing the borrowers to absorb this risk restrains the poverty alleviation effect that a program can have for its beneficiaries because it increases their level of vulnerability in all instances (any increase in their present/future income is dependent on the success of the other members in their group). The beneficiaries, being poor, already have a difficult time absorbing external shocks, and so adding the liability of their group members only increases that burden, one that otherwise they would not accept[57]. Therefore, the group-lending strategy leaves borrowers with a decision: accept an increased level of risk, or refrain from engaging in the lending program.

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[57] Jameel Jaffer, *Microfinance And The Mechanics Of Solidarity Lending: Improving Access to Credit through Innovations in Contract Structure*, March 1999, accessed on 11/15/03, available from: http://www.law.harvard.edu/programs/olin_center/papers/abstract254.html, 27, & Stiglitz, "Peer Monitoring and Credit Markets," 353.

A logical actor may however, accept this added liability, when he/she assesses that the benefits of accessing credits outweigh the cost of increasing his/her level of risk exposure. However, as explained in the preceding section, the achievement of that level of benefit is dependent on the proper functioning of the three essential mechanisms, and their supporting level of social capital. If the informational advantage mechanism is not properly exploited, leading to a dearth of social capital within the group, there then exists a higher probability that the other two essential group-lending mechanisms could fail, constraining the level of benefit that participation in the program brings. The question can then be posed as to why a rational actor, aware that the level of social capital within a group is low, would then still participate. After examining how the three mechanisms can fail in a group, this question will be answered at the end of the section.

II.B.1: Breakdown of the Informational Advantage

When the informational advantage mechanism breaks down (situations where clients are forced to form groups with people with whom they are not familiar), then the moral hazard introduced by joint liability can cause risk levels within the group to be misaligned[58]. In the absence of adequate knowledge about every candidate's practices or businesses, a borrower can be let into a group that will engage in a riskier venture then the desired risk level of the majority of the group. Acting as though the informational advantage exists when in fact the group is operating under a condition of imperfect information can facilitate the misuse of credits, causing the higher level of risk that joint liability imposes on microfinance beneficiaries to materialize[59]. When group members misuse credits, causing them to default on their repayment, this limits the benefits of

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[58] Zeller, 2.

[59] Aryeetey, 152.

program participation realized by the other group members because the joint liability that they share requires the latter to cover the delinquent payments of the former.

II.B.2: Breakdown of the Peer-Monitoring/Pressure Mechanism

As alluded to in the previous section, effective activation of the peer-monitoring/pressure mechanism is dependent on the effective exploitation of the informational advantage mechanism and the level of social capital that it helps to foster within the group; if this level is sufficiently low, then for a rational actor, it could be worth the opportunity cost of losing access to other social services or a negative reputation to misuse the credits. While the dynamic loan incentive may be effective in dissuading groups and/or individuals from colluding against the lender, when a bank or client has decided that they will not engage in another loan, this incentive disappears, and so a problem of repayment in the final lending cycle emerges[60].

The group-lending model is also vulnerable to forces outside of the program that could erode the effectiveness of the peer-monitoring/pressure mechanism. First, other more attractive loans could become available to an individual borrower, either from another microfinance provider or a local moneylender (if the value of the loans is high enough this case could emerge) that could tip the balance of the equation of how to use the credits in favor of misuse. Clients with a high degree of mobility, those in large urban zones, or those with family in other regions, etc, have a diminished opportunity cost for misusing funds if it is easy for them to leave their current residence[61]. The presence of conflict in a society can also reduce the level of trust in a community and diminish its social capital[62]. Finally, certain cultural traits can erode the effectiveness of

[60] Morduch, "The Microfinance Promise," 1583.
[61] Ibid.
[62] Grootaert et. al., 19.

the peer-monitoring/pressure mechanism. Aryeetey has suggested that in many parts of rural Africa, monetary matters are extremely private affairs, and so, "under credit mechanisms that are communal and transparent, such as group-lending, the shame of being exposed is diminished, along with the collective pressure to repay."[63] All of the examples given above can tip the opportunity cost of credit usage in favor of misusing them. Finally, if an external shock to an individual borrower is bad enough, then they will be willing to forgo future benefits in order to try and meet present needs by defaulting on their loan[64]. The level of vulnerability of the entire community to such shocks could prevent the creation of social capital within the borrowing group if they are all preoccupied with basic survival and thus succumb to the incentive to misuse their credits.

If an individual borrower perceives any of these situations, then their incentive to repay is diminished because he/she thinks that their fellow group members will not repay and so the incentive of the dynamic loan device is rendered impotent anyways, even if they as an individual were to repay[65]. Therefore, when the peer-monitoring/pressure mechanism fails, the void left in its wake creates a great incentive to use the credits from a lender opportunistically, harming those beneficiaries that have not decided to misuse their credits, and harming the program's loan repayment rate due to the theoretical increase in defaulting that fund-misuse would produce.

II.B.3: The Cost and Breakdown of the Informal Insurance Mechanism

In certain contexts, the activation of the informal insurance mechanism may be inhibited, resulting in group members harming delinquent borrowers. The credit provider

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[63] Bastelaer, 17.
[64] Morduch, "Between the State and the Market," 184.
[65] Zeller, 2.

exerts pressure, exercised through the dynamic loan incentive, on the group to meet the entire value of its loan repayments. Clients who are able to repay have an interest in getting their entire group to repay so that they can benefit from future loans. Being rational actors, they also have an incentive not to cover the delinquent repayments of their fellow group members since this would diminish their own accrued benefit. Therefore, when faced with delinquency, non-delinquent clients interested in securing larger subsequent loans can pursue one of two options; they can cover the repayment of the delinquent borrower, or they can forcibly confiscate that individual's personal assets (productive or non) to cover their repayment, which amounts to the breakdown of the informal insurance mechanism[66]. This latter option results in the delinquent borrower being worse off than when he/she enrolled in the loan program.

Clients able to meet repayment might opt for the latter option in situations where either the informational advantage mechanism has not been adequately exploited, and/or the peer-monitoring/pressure mechanism as been ineffectual, resulting in an inadequate stock of social capital within the group, and/or the presence of solvency problems, as opposed to externally imposed short-term liquidity shocks. If the level of social capital is low enough, meaning that the opportunity cost of not assisting a fellow group member through an external shock is lower then assisting them, group members might simply be unwilling to help out those encountering problems: "Informal insurance works best where people value future protection highly and fear future exclusion from the insurance scheme, keep(ing) compliance high."[67]

[66] Grootaert et. al., 24, & Montgomery, 290.
[67] World Bank, *World Development Report 2000/01: Attacking Poverty, 2001*, Oxford: Oxford University Press, 2001, 144.

Alternatively, if clients feel that their fellow group members will be unable to provide them with reciprocal service, they may opt for asset confiscation to cover delinquencies. If either of the two other necessary group-lending mechanisms have broken down, resulting in the presence of group members that cannot properly handle their loans and thus who have developed solvency problems that are causing them to fall into delinquency, borrowers may feel that they will not have access to repayment insurance, and so will not be willing to provide it: "The key feature of informal insurance is reciprocity, self-enforced by the group."[68] In a group with low levels of shared familiarity amongst the constituting members, clients may not be able to judge the cause of another client's delinquency, self-imposed insolvency or externally imposed illiquidity. Under such a condition of imperfect information, it is reasonable to assume that a rational actor would err towards a conservative assessment, opting not to provide repayment insurance, but in all instances recover the value of the delinquent repayment by confiscating the assets of the offending group member.

The cost of the informal insurance mechanism may be greater for people with higher levels of poverty because the need for the mechanism can cause them to be excluded from joining groups, and income heterogeneity within groups can result in a higher probability for the mechanism to fail for them. Because joint liability increases the risk exposure of clients, as mentioned earlier, a high premium is placed on low levels of risk. A low level of risk however is not only defined by the borrower's use of their credits; people assess the risk level of others based on an individual's level of vulnerability to external economic shocks, or their level of poverty. Very poor people

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[68] World Bank, *World Development Report 2000/01: Attacking Poverty, 2001*, 144.

have an increased level of vulnerability, and so they carry with them a higher probability of forgoing the opportunity cost of the future benefits associated with the group loan program and any other services provided by their group members, in order to try and meet present consumption needs in the face of what is for less-poor people a minor economic shock[69]. Therefore, prospective borrowers[70] may be weary of admitting very poor clients into their group, fearing that their elevated level of vulnerability will increase the probability of them requiring repayment insurance. This tendency has contributed to the microfinance sector's weaker coverage of the very poor in relation to the less-poor[71].

In instances where very poor people are admitted into a borrowing group, they may face a higher probability of the informal insurance mechanism breaking down, relative to less-poor borrowers, because their fellow group members may have assessed their ability to reciprocate the provision of the service as low[72]. It is unreasonable to assume that group members would excuse a very poor member from contributing to the provision of repayment insurance if the need arose[73]. However, it is not difficult to envision a group opting to confiscate the personal possessions of a very poor delinquent client because the cost of doing so (to those doing the confiscating) is relatively low; they do not assume that the delinquent client would be able to render them services, such as repayment insurance anyway, and so harming them does not come at the cost of any perceived future service[74]. A review study of the BRAC bank in Bangladesh, another well-documented leader in the microfinance industry, confirmed this assessment, finding

[69] World Bank, *World Development Report 2000/01,* 144 & Montgomery, 290.
[70] Including the poor themselves, a necessarily risk-averse group.
[71] World Bank, *World Development Report 2000/01*, 156 & Morduch, "The Microfinance Promise," 1752.
[72] Bastelaer, 16.
[73] Doing so would voluntarily be increasing the cost of group membership to the less-poor clients.
[74] Andreas Fuglesang and Dale Chandler, *Participation as Process, progress as growth*, Dhaka: Grameen Trust, 1993, 92.

some female clients who "told… with pride that they had pulled down a member's house because she did not pay back her housing loan." There were also many other reported instances of forced acquisition of delinquents' assets, and the same study of BRAC concluded that the poorer clients amongst the membership constituted the majority of the bank's 16% drop out rate[75]. This obviously has negative implications for the poverty alleviating effect of a microfinance program.

Why then, according to the reasoning behind group self-selection and its ability to match up similar levels of risk, do poor clients not simply form together, thus avoiding persecution from richer clients within a lending group? First, microfinance in general does not have very good coverage of the poorer quintiles of the poor[76], and so there are very few very poor clients who enter into group-lending schemes in general. Second, this does occur in many instances, and when it does, the occurrence of poor-borrower persecution may be diminished. However, as the size requirement of a group increases, the likelihood of achieving economic homogeneity within the group decreases: the larger the group, the larger the range of borrower incomes. In very large groups, there is a higher probability that it contains both less poor and poorer clients, creating the conditions for poor client persecution as described above.

II.B.4: Group Formation Practices that are unfavorable to the Exploitation of Social Capital

The actual structure that a group takes can either be conducive to the effective exploitation of the three essential group-lending mechanisms, or it can inhibit their activation. The process of group selection can present the biggest problem for effective

[75] Montgomery, 297.
[76] This is often caused by the inability of the very poor to meet the collateral requirement (such as having a pre-existing business), or their lack of social capital, caused by their dire poverty (their high level of poverty inhibits the ability to form social capital because there is always an incentive to forgo future gains for present consumption).

group formation: "Poorly formed groups and inadequately trained and tested borrowers will form a weak foundation for the program."[77] Social capital is not something that can be imposed on a group of individuals from an outside source[78], but is something that must develop from within the group. Therefore, imposing certain group models, restrictions, or requirements on a community could interfere with their ability to self-select members with whom they have and can develop social capital[79]. The World Bank reviewed a microfinance program in Latin America in 1989 that arbitrarily selected candidates to form groups and noted: "such arbitrary selection is unlikely to achieve good accountability."[80]

There seems to be wide agreement in the literature that groups larger then 10 members erode the effective exploitation of social capital, becoming too big to coordinate and manage, thus inhibiting information flows, diminishing the potency of the peer-monitoring/pressure mechanism, and failing to catalyze the informal insurance mechanism[81]. Therefore, any group that is larger then 10 members has a higher probability of suffering from instances of group-lending mechanism failure, and thus faces a constraint on the level of poverty alleviation that they can effect.

It is worth noting that other factors related to group formation, such as the group's risk exposure, and/or the presence of predatory social capital within the group, could cause a lending-group to fail. If all of the borrowers in a group face the exact same

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[77] Helen Todd, *Cloning Grameen Bank*, London: Intermediate Technologies Publications, 1996, 21.
[78] Larance, 5.
[79] Montgomery, 291.
[80] Timothy Besley and Stephen Coate, "Group Lending, Repayment Incentives and Social Collateral," *Journal of Development Economics*, 46, 1995, 9.
[81] Zeller, 12.

market circumstance[82], the lack of risk diversity could paralyze the group's ability to activate the informal insurance mechanism, resulting in group default, if one element of the market in which they depend was somehow adversely affected. Lastly, certain types of embedded relationships within a group may inhibit transparency and accountability, resulting in the misuse of the informal insurance mechanism. Without verifiable transparency and accountability, group members could collude and make fake claims regarding their own liquidity problems, extracting insurance coverage from their other group members. Such predatory relationships generate greater benefits for some at the cost of the benefits realized by others.

Microfinance providers can attempt to mitigate the occurrence of these negative trends by exerting some influence over the formation of groups. First, they can encourage applicants to form groups with diversified risk (clients investing in different types of activities or in different areas). Second, to combat predatory social capital, lenders can mandate that group decisions be taken by consensus in a transparent and accountable way[83]. They can also require all group members to attend group meetings, and engage in activities designed to foster a sense of group identify and cohesion[84].

II.B.5: Why Rational Actors Participate in Poorly-Designed Group-Lending Programs

Being a rational actor who is interested in increasing his/her material well-being, one can then question why an individual would willingly participate in a group-lending program, assuming the liability of others, where there existed inadequate levels of social capital that could lead to the failure of the group-lending mechanisms, and thereby a

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[82] This could be due to a group of borrowers all engaging in the same type of income generating activity in the exact same local market.

[83] Such a system could be enforceable by providing individual borrowers with a mechanism to register complaints with the loan promoter.

[84] The Grameen Bank employs such a strategy, requiring its clients to attend group meetings and participate in calisthenics and the recitation of the Bank's 16 principles.

reduction in the benefits of participation that one could face? It seems logical to assume that a candidate will know whether or not social capital exists between themselves and their fellow group members. It is also logical to assume that if an individual candidate perceives an incentive to misuse his/her credits because of a lack of social capital, then he/she must also logically assume that that incentive exists for their fellow group members as well; if he/she can exploit the group, thereby materializing the risk of their fellow group members, then others can exploit the group as well, causing their own level of risk to manifest itself. It seems to follow logically therefore that in such an instance, the individual would not have an incentive to participate. Therefore, any group-lending program that has clients willfully participating could be assumed to be effectively exploiting the three essential mechanisms merely by virtue of clients' willingness to participate. Any program that didn't would not have any borrowers.

There are three explanations as to why people would voluntarily participate in poorly formed group-lending programs: lack of knowledge *ex ante*, lack of other financing alternatives combined with client desperation, and a willingness to accept diminished returns to program participation. While the concept of social capital and the group-lending mechanisms that it supports seems obvious enough, it is entirely reasonable that a microfinance beneficiary might not learn this lesson until he/she has actually experienced it. In such a situation, *ex ante*, the potential beneficiary does not know that the program in which they have enrolled contains design flaws that erode the benefits that they can gain from participation. After experiencing the program and failing to realize the appropriate level of benefit, the participant would then drop out. High drop out rates in group-lending programs can therefore help to identify poor group design.

Beneficiaries might also willingly participate in group-lending programs that lack adequate levels of social capital because of a complete lack of other financing alternatives. Microfinance programs target communities that have high levels of poverty and are therefore under capitalized and possess very little economic opportunities. Therefore, even though a rational actor might know that a lending program is not ideal, they might still decide to participate in the program out of desperation caused by a complete lack of other opportunities. This trend was witnessed in Mozambique amongst many participants of FCC's loan program for refugees; many clients and former clients complained bitterly how the program was insufficient for their needs and did not help them, but that if given another opportunity, they would enroll again out of sheer desperation, in the hope, albeit irrationally, that in a second time around they might be able to extract a net benefit from participation[85].

Finally, rational actors might still decide to participate in a sub-optimally designed group-lending program because they are still able to gain some benefit from their participation. The additional costs associated with a failure of any of the three essential group-lending mechanisms might not outweigh the benefits that a client can realize from borrowing. In such an instance, borrowers who decide to remain with the program obviously gain. However, the benefits that they are able to derive are constrained by the unavoidable costs associated with the malfunction of the group-lending model; the poverty alleviation potential of the microfinance program fails to be fully exploited.

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[85] Liv Halperin and Jeffrey Isen, *Report on FCC/WR Micro Credit Programs to War Refugees in Mozambique*, August 2003, in the author's possession.

II.C: Conclusion

The group-lending model provides a way for those with no collateral to gain loans while providing economies of administrative scale to the lender; however, it also comes with several costs. Joint liability necessarily increases the level of vulnerability incurred by participants because it passes the risk of lending from the creditor onto the clients. If the level of social capital in the group, which can be a function of the credit provider's group design, is inadequate to support the effective activation of the three group-lending mechanisms, then participants face a higher probability of the risk that they have taken on manifesting itself, reducing the benefits of participation, or even harming their overall level of well-being.

Once again, the preceding discussion was held under the assumption that the external investing environment, and the other product attributes of the loan, are conducive to the generation of successful returns to borrowers' investments. It is under the layers of these two considerations that the design of a group-lending model will have to be constructed, enabling it to operate effectively in the specific context in which it is deployed.

Chapter III: Description of Group-Lending by World Relief in Mozambique – FCC

FCC, World Relief's micro-credit branch in Mozambique, is one of the largest micro-finance institutions in the country. World Relief started FCC in 1994, operating primarily around the capital region of Maputo in the south. Now, FCC provides Mozambicans with financial services in the southern provinces of Maputo, Gaza, and Inhambane, and the northern provinces of Nampula, Niassa, and Zambezia in the north[86], and continues to expand its number of branches[87]. Because FCC is in the midst of a rapid growth phase, precise figures regarding it operations are difficult to obtain. In 2002 it reported 120 employees[88], with 49 loan officers in 2003, and a client/loan officer ratio of 201[89]. FCC currently offers four different credit products: community banks, special groups, solidarity groups, and individual refugee loans[90]. The community group program is their largest lending initiative, both in terms of loan capital allocation and client numbers.

This chapter will consider FCC's community group-lending program, it's rationale for utilizing the model, and the particular difficulties introduced by the Mozambican context that complicate its implementation.

III.A: FCC's Community Group Lending Program

This section will detail the procedures, eligibility, and status of FCC's community group-lending program.

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[86] Please refer to Figure III.1, Map of Mozambique, in the Appendix.

[87] David Park, *Client Drop-outs at Fundo de Crédito Comunitário*, Maputo, Mozambique, October, 2003, in the author's possession, 5.

[88] MIX Market, *MFI Profile*, (accessed on 12/3/03) available from: http://www.mixmarket.org/en/demand/demand.quick.search.asp.

[89] Fundo de Crédito Comunitário, *Activity Report, Month Ending 09/30/2003*, in the author's possession.

[90] Fundo de **C**rédito **C**omunitário, *Products of FCC: Policies and Procedures for each product*, in the author's possession.

III.A.1: Procedures

FCC's community group clients receive approximately US$50 in the first lending cycle[91]. At the beginning of the lending cycle, the loan promoter disburses the loan to each individual at a group meeting (clients must be there themselves, they cannot send someone else).[92] The loan cycle is 4 months long for a group's first loan and has a flat (non-declining) interest rate of 5% per month. A minimum of 12% of the value of the loan must be deposited as savings in an account with FCC (these accounts bear 3% interest for the borrower[93]), but cannot be withdrawn during the first cycle to repay the loan. The loan is repaid in bi-weekly installments; group members meet and submit their individual portions and retain a receipt of their repayment. When the entire repayment sum for the bi-weekly period has been attained it is then given to the loan promoter. FCC charges 2.5% interest per week to the group on an outstanding repayment and requires that the group enter into a three session retraining seminar. It also renders the group ineligible for another loan, and blocks withdraw of their savings until the outstanding debt is repaid. Successful repayment of a loan throughout the cycle is rewarded by larger subsequent loans; the value of these loans are determined by the total amount saved by the group and their demonstrated repayment-history in the previous cycle, relative to the value of the preceding loan. The maximum loan value is about US$330[94]

III.A.2: Eligibility

There are three basic eligibility requirements that prospective clients must meet in order to qualify for an FCC loan: they must complete FCC's training seminar, possess a functioning business, and be a member of a 30 person community group. FCC runs

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[91] Fundo de **C**rédito **C**omunitário, *Products of FCC: Policies and Procedures for each product*, 2.
[92] Ibid.
[93] David Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 2.
[94] Fundo de **C**rédito **C**omunitário, *Products of FCC: Policies and Procedures for each product*, 1.

training seminars (consisting of six sessions held one a week) in the communities where it lends. Anyone can attend the training seminars free of cost. The first three sessions cover: the mechanics of the lending program and the individual responsibilities of each client, and rudimentary best practices for small business owners. The remaining three sessions are used for group formation, with the final output being a participant-produced set of group by-laws[95]. The second requirement for eligibility is the ownership of a functioning business. There is no size requirement for this business. The final eligibility criterion requires borrowers to be part of a 30-person community group. The groups are self-selected by the members during the training seminars.

III.B: The Status of FCC's Community Group Lending Program

The community group program has facilitated FCC's substantial increase in its nominal coverage of the poor in Mozambique, now serving over 9,000 clients[96], up from just over 5,000 in 2000[97]. In September 2003, the community group program had 8,482 clients, with an average group size of 32, and an average loan per client of US$80[98]. The majority of these clients live in, or at least very near to, urban areas, and engage mostly in commerce (vending products from food to beauty supplies) or service activities (hair salons to milling grain), with about 45% of the borrowers being women[99].

However, FCC is suffering from a high drop out rate[100]. Without adding new clients, FCC would have lost 60% of its active client base in the south and 80% in the

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[95] David Park, *Phone interview from Baltimore to Boston*, 146 Curtis St. #1, Somerville MA, 11/11/03 at 10:30 Am.
[96] Ibid.
[97] ICC, *II Study of the Microfinance Sector in Mozambique*, February 2001, financed by MICRONET and PNUD, in the author's possession, 22.
[98] Fundo de Crédito Comunitário, *Activity Report, Month Ending 09/30/2003.*
[99] Ibid.
[100] "FCC defines a drop-out as a client that has indicated that she or he is neither returning nor 'resting' from taking a loan." (David Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 5)

north from May 2002-03[101]. This occurrence is troubling for two reasons: it suggests that FCC is not delivering benefits to its clients, and it runs counter to the lender's goal of achieving self-sufficiency.

It is reasonable to assume that if borrowing from FCC is benefiting a client, then that individual will remain in the program so that he/she can continue to receive benefits. Therefore, it also follows logically that an individual will remove him/herself from the program if it not longer delivers net benefits. FCC's high drop out rate may be fueled by its large expansion; client join, realize that they cannot generate net benefits from borrowing, and drop out. Such a scenario does not achieve FCC's goal of producing a poverty alleviation impact in Mozambique. Even in the event that this hypothesis is not correct in explaining why clients are dropping out, incomplete or truncated participation, which is characterized by a high drop out rate, fails to maximize the potential poverty alleviation effect that FCC is able to have on the individual client by not enrolling in a subsequent loan[102]. It is doubtful whether the process of gradually lifting beneficiaries out of their current level of poverty can be affected by receiving only one introductory-valued loan[103].

A low client retention rate also runs counter to FCC's goal of attaining operational self-sufficiency. The administrative cost of enrolling a client into the lending program represents a sunk cost to FCC[104]. Since it is part of the lender's mission to have many clients, a higher client turnover rate translates into a higher aggregate

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[101] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 6.
[102] Bastelaer, 17.
[103] Donald R. Snodgrass, Jennefer Sebstad, *Clients in Context: The Impacts of Microfinance in Three Countries, Synthesis Report*, January 2002, Assessing the Impact of Microenterprise Services (AIMS) Washington DC, 62.
[104] This includes the cost of the training seminar and other costs related to enrolling a client into the program.

administrative sunk cost that FCC must absorb. If FCC's client retention rate was higher, thereby facilitating a lower administrative cost per dollar lent by the creditor, then it could sustain a large client base without constantly having to direct money into new client registration. Its cost per lending-dollar would also decrease because older clients, due to the dynamic loan incentive, receive larger loans. It is necessarily cheaper for the lender to distribute its capital stock through fewer larger loans then through more smaller-disbursements because of the increased administrative requirements of the latter strategy.

III.C: FCC's Rationale for Employing the Group Lending Model

FCC has identified two primary goals that is seeks to achieve: "(I) facilitating a transformation in the lives of many, very poor people; and (II) becoming a financially and operationally self-sufficient Mozambican microfinance institution."[105] The lender has decided to adopt the group-lending strategy to accomplish its mission. FCC has selected this method for two primary reasons[106]. First, it is thought that joint liability fills the collateral and informational gaps of the poor; people with no physical assets guarantee each other to the lender, and through the process of client self-selection provide the lender with information about candidates' ability to repay the loan in the absence of any formal credit history. While the risk of cheaters colluding to default does exist within this system, it is felt that the occurrence of this risk is still smaller then having the lender select clients in the absence of any verifiable information regarding their credit worthiness. The dynamic incentive and client-self selection mechanisms of the community group system give the lender a loan that "induces the borrower to act in ways

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[105] Fundo de **C**rédito **C**omunitário, *Vision and Mission*, in the author's possession.
[106] David Park, *Phone interview from Baltimore to Boston.*

that benefit the bank and attract low risk borrowers."[107] By exploiting the group-lending model, FCC aims to reach clients that have the ability to repay, and will have the incentive to make those repayments.

Second, it is thought that group lending allows for greater coverage of the poor because it maximizes administrative economies of scale. Loan promoters do not have to evaluate the viability of each individual client's business when selecting clients, and are able to disburse and collect loans to 20-30 people at a time at group meetings. By exploiting administrative economies of scale, FCC is able to pursue its goal of self-sufficiency by reducing its operating cost while still reaching many clients.

III.D: The Mozambican Context

The Mozambican context provides some very unique difficulties for FCC to overcome in producing a substantial poverty alleviation impact. The state of the nation's financial sector is weak, the level of infrastructure needed to facilitate viable small business investment is poor, and the high level of cultural diversity within the country complicates the implementation of nation-wide programming.

III.D.1: Mozambique's Financial Sector

By the mid 1990's, Mozambique's financial sector had undergone substantial reform, including the deregulation of the interest rate, a separation of the central bank from commercial activities, and the ability for foreign investors and banks to take part in the nation's banking system[108]. However, the country's formal financial sector remains inadequate[109]. As figure III.2 illustrates[110], even relative to its income group[111],

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[107] Joseph Stiglitz and Andrew Weiss, "Credit Rationing in Markets with Imperfect Information," *American Economic Review*, 71, 1981, 394.
[108] Economist Intelligence Unit, Mozambique Country Report, July 21, 2003.
[109] David Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 7.
[110] Please refer to Appendix II.

Mozambique's financial sector supplies the domestic economy with a very small percentage of the total credit as a percentage of GDP. While the financial services sector is opening up and showing positive signs of growth, Mozambique remains a high-risk destination for banking investment[112]. There is also generally very little interaction between the formal and informal financial markets in Africa[113]; even the limited credit services that are available to very few Mozambicans do not end up having any impact on the poor who are stuck in the informal sector without direct access to formal financial services.

The microfinance sector is also small in Mozambique, with most lending taking place around Maputo, and very little taking place in rural areas. Market research conducted by FCC found that there is very little knowledge about other microfinance service providers in Mozambique (22% of the groups surveyed mentioned that they knew nothing of other microfinance lenders[114]). Microfinance in sub-Saharan Africa in general has had a difficult time in achieving financial self-sufficiency, on average only being able to recover 70% of operating costs[115]. The variable and higher rate of inflation, relative to the US, also renders it more difficult for lenders to simply maintain the value of their lending stock[116]. The sector has a high client turn over rate in general in Mozambique,

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[111] The comparative income group was selected based on countries having a per capita GDP (1995 USD) plus or minus US$100 averaged from 1999-2002. This group included: Burkina Faso, Burundi, Chad, Eritrea, Ethiopia, Guinea-Bissau, Liberia, Madagascar, Malawi, Mali, Nepal, Niger, Nigeria, Rwanda, Sierra Leone, Tanzania, and Mozambique.
[112] Aryeetey, 158.
[113] Ibid.
[114] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003, in the author's possession.*
[115] Morduch, "Between the State and the Market: Can Informal Insurance Patch the Safety Net? 200.
[116] Please refer to figure III.3 at the end of the chapter.

and typically serves more rich clients[117]. It is perceived that FCC serves those who are moderately poor, but not the non-poor or very poor[118].

III.D.2: Cultural Complications

Mozambique is an extremely large and diverse country, with the majority of its population, about 80%[119], living in rural areas. There are about 16 main ethnic groups in the country[120], which makes nation-wide programming difficult to implement since many of those cultural differences renders receptivity to strategies difficult to predict on an aggregate level. In market research, staff and clients in the north of the country commented that since the culture was different there than in the south, the policies that were developed in the south were not always appropriate in the north. For example, certain towns in the north seemed to suffer from a far lower degree of social capital within the groups than others, resulting in more frequent instances of any or all of the essential group-lending mechanisms breaking down.

III.D.3: Lack of Asset Compatibility in Mozambique

There are several other factors that make the achievement of poverty reduction in Mozambique difficult for microfinance programs, including the level of infrastructure in the country, the level of poverty, and the vulnerability to economic and natural shocks. The level of infrastructure in the country is extremely underdeveloped. Only 18.7% of its roads are paved[121]. Clients in the north continually complained that many of their difficulties in repaying resulted from the high cost and time of transportation in the region; 37% of the groups cited this as a major problem causing clients to drop out of the

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[117] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 7.
[118] Ibid, 15.
[119] Mary Fitzpatrick, *Lonely Planet: Mozambique*, Melbourne: Lonely Planet Publications, 2000, 21.
[120] Ibid.
[121] World Bank, *World Development Indicators* (accessed on 1/22/04) available from: http://80-devdata.worldbank.org.ezproxy.library.tufts.edu/dataonline/.

program[122]. This severely constrains small vendors' ability to import products from other regions, including getting products from small producers in rural areas. The extreme level and pervasiveness of poverty in the country also makes running businesses difficult. The high and extreme level of poverty in the country[123] means that the clients that give small entrepreneurs their business are very vulnerable to economic shocks. Many groups cited an acute lack of business during the dry seasons; with nothing in the fields, customers have no money to spend, and so small business people also find themselves without income. During these periods, clients have difficulty repaying their loans and express a low demand for them as well because they lack a market with which they can use their credits productively[124].

[122] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[123] The World Bank's *World Development Indicators'* last figures were for 1997, where it reported that 69% of the population lived below the poverty line. World Bank, *World Development Indicators*.
[124] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.

Chapter IV: Benefits, Costs, and Critique of the Current Community Group-Lending Program

This chapter will consider the impact of FCC's current group-lending program. First, the benefits from program participation will be outlined, followed by the costs that participation brings to individual borrowers. Potential explanatory theories that can account for constraint of the net benefits that the program is able to deliver will then be detailed, suggesting the different directions that remedial actions can take.

IV.A: Benefits of the Current Program

The current community group-lending program has delivered substantial benefits to many of those whom it has served through the provision of access to credit and savings services. FCC's group-lending model has facilitated the delivery of these benefits to a significant number of poor Mozambicans.

Mozambique has a dearth of reasonably priced[125] financial services for the majority of its population. As section II.C.1 suggested, poor Mozambicans, the nation's largest constituency group accounting for 69% of the population[126], are generally excluded from the formal financial services sector. The microfinance sector is growing, but it is still small and relatively young[127], and therefore it is being assumed the sector has not yet saturated demand[128]. Other informal sources of financial services, such as moneylenders or community based savings schemes that deliver periodic lump sums of money to its members, most likely exist in the communities where FCC operates. The cost and prevalence of such services are undocumented, rendering it impossible to assess

[125] This term alludes to the levying of a fee that financial service providers charge that does not preclude their customers from improving their long-term financial position.
[126] This figure is for 1997, the last year provided by the World Bank. World Bank, *World Development Indicators*.
[127] In comparison with more well established sectors such as in Bangladesh, Indonesia, or Bolivia.
[128] The rapid growth that FCC's client portfolio has witnessed in the last five years also speaks to this condition.

precisely their impact relative to the benefits delivered by FCC. However, it is reasonable to assume that FCC's financial services are delivered at a cheaper cost to the user than that of other informal financial service providers since any price above the latter group's would prevent clients from voluntarily participating[129]. Therefore, the following analysis will proceed under the assumption that in the absence of FCC's community group lending program, the majority of the program's current clients would not have access to similarly priced financial services.

The average community group borrower receives US$80[130], or about 35% of the average Mozambican's yearly income[131], of working capital to invest in their income generating activity. FCC enjoys a repayment rate of about 89%, with just 11 loans being written off in the community group program[132], suggesting that clients, at least at the aggregated level of the group, have the ability to repay their loans. Data is not available on the returns that borrowers have been able to realize from their investments, or regarding how borrowing has affected their consumption patters.

The savings requirement[133] for the community loan also delivers benefits to FCC's clients by creating a monetary reserve that gives them a buffer should they encounter some type of external shock, reducing their level of vulnerability. In September 2003, the average savings balance of community group clients was US$22[134], bearing an interest rate of 3%. These required savings can be produced wholly from the

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[129] FCC does not provide any 'credit-plus' services to its clients, and so the provision of benefits derived from any other source apart from those received from access to financial services should not factor into a rational actor's decision to participate.
[130] Fundo de Crédito Comunitário, *Activity Report, Month Ending 09/30/2003*.
[131] This figure is based on the per capital GDP in purchasing parity dollars of USD$229 in 2002. (World Bank, *World Development Indicators.)*
[132] Fundo de Crédito Comunitário, *Activity Report, Month Ending 09/30/2003*.
[133] 12% of the value of the loan.
[134] Fundo de Crédito Comunitário, *Activity Report, Month Ending 09/30/2003*.

initial loan disbursement, which diminishes the income generating capacity of participation, but increase the positive impact that participation has on a borrower's level of vulnerability.

Specific data regarding the economic position of FCC's clients is lacking, however the evidence that is available suggests that FCC is reaching the poor. In 2002, the MIX Market reported that 98% of its clients earned an income under US$300 per year[135]. In addition, as previously cited, the amounts of money that are dispersed as credits and are deposited as savings are small[136] (average of USD$80 and 22 respectively). Because client voluntarily select to participate in a program that deals with micro sums of money, it can be assumed that that most if not all of FCC's clients are poor.

Utilization of the community group method has helped to facilitate FCC's current expanding outreach in Mozambique. FCC's mission is clear; the institution's aim is to impact the lives of *many* poor people. Requiring group sizes of 30 to begin the lending process allows an individual loan promoter to reach a far greater number of beneficiaries then he/she would be able to if group sizes were smaller and the operational budget was held constant. FCC currently serves 9,831 active clients, 8,297 of which are enrolled in the community group program, comprising 85% of the client portfolio[137].

IV.B: Costs of the Current Program

FCC's current community group-lending program comes at a high cost to the lender, and introduces particular costs to the borrowers that can constrain the lender's net poverty alleviation impact. While FCC is able to collect 89% of the repayments due to it,

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[135] MIX Market.
[136] Small in the relative sense to a person falling in a higher economic quintile.
[137] Fundo de Crédito Comunitário, *Activity Report, Month Ending 09/30/2003*.

in 2002 it was only able to achieve 27.2% operational self-sufficiency[138]. Therefore, the provision of the services offered by the community group program come at a high cost to FCC, running counter to the institution's goal of achieving self-sufficiency.

Participating in FCC's community group program comes at the cost of an increased level of risk to the individual borrower. This risk has manifested itself in the prevalent occurrence of two costly, medium and high stress coping strategies. Clients are being exposed to two separate kinds of risk, both associated with meeting loan repayments. First, the joint liability of the group-lending program is resulting in many clients seeing the benefits that they derive constrained by the requirement to cover the loans of delinquent group members. Second, many delinquent group members are being left worse off because of their participation when group members resort to forced confiscation of personal assets to cover their delinquent repayments. The manifestation of the first type of risk can, but does not necessarily leave borrowers worse off. It does however necessarily constrain the benefits that they are able to realize from borrowing. The manifestation of the second variety necessarily does leave clients worse off than if they had not borrowed.

Many factors render the occurrence of repayment delinquency in Mozambique highly probable; as demonstrated in section III.D, the investing environment is poor, increasing the risk of investing for borrowers, while their level of vulnerability is high. Therefore, FCC's clients are highly susceptible to delinquencies caused by external shocks that are beyond their ability to anticipate and prepare for, or to prevent or control. When these instances do occur, the beleaguered borrower and their fellow group

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[138] MIX Market.

members have to resort to costly coping strategies that allow them to overcome such external shocks.

Some coping strategies are not very costly, and include measures such as reducing present consumption, or having a household members engage in an additional income generating activity. These types of activities are low-cost because they are easily reversible and recoverable (assuming that a child is not undernourished or withheld from school) once the crisis is mitigated; regular consumption patterns can be reinstated and alternate income generating activities abandoned if they are undesirable under normal conditions. This represents the ideal type of coping strategy that a microcredit lender seeking to produce a poverty alleviation impact on its beneficiaries should hope to see in the case of repayment difficulties.

Medium-cost coping strategies are slightly less reversible and recoverable by the borrowers that engage in them. Such measures include dis-saving or taking emergency loans. The length of time involved in rebuilding a savings stock or in paying off a debt (especially if the interest rate is high, as with many money lenders in undercapitalized poor communities) renders these strategies more difficult to overcome compared to the former category.

Finally, high-cost coping strategies are extremely difficult to reverse, and include measures such as the liquidation of assets, both productive and non-productive, at prices below their market value[139].

It is a prevalent phenomenon in FCC's community group-lending program for clients to chose between one of two costly coping strategies when faced with intra-group

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[139] It could be rational for someone to liquidate their assets below their market value if their need for cash is great enough, not leaving them sufficient time to find a buyer at the fair market price. (Montgomery, 293.)

delinquencies. The first coping strategy is a medium-cost measure where non-delinquent clients are forced to cover the loans of delinquent group members, using either the profits generated from their own enterprises, or by dis-saving. If a borrower defaults on their entire introductory US$50 credit repayment[140], this debt then becomes spread out over the remaining 29 group members. This amounts to an additional US$1.70 charge for each remaining borrower. In a country where the GDP per capita in 2002 (in constant 1995 US$) was 229[141], an additional $1.7 represents approximately 2.5 days' income. This is a significant amount to a person living below the poverty line, and therefore having a high level of vulnerability. In addition, as the loan values increase, and/or the occurrence of delinquency increases within a group, this fee, and the impact it has on those who must pay it, also increases. Because all of this activity takes place beneath FCC's 89% repayment rate, it is impossible to state definitively how often these medium-cost coping strategies are employed. However, market research revealed that not wanting to pay for the delinquencies of others in the group helped account for 88% of FCC's high client dropout rate[142]. In addition, 54% of focus groups in the south cited a desire for individual loans, while 27% cited that desire in the north[143], reinforcing the hypothesis that many clients are having to adopt the aforementioned medium-cost coping strategy.

The occurrence of non-delinquent clients covering the repayments of delinquent group members can be a costly phenomenon within FCC's community group-lending program because in many instances, those who are paying the additional repayments are not receiving any return for their additional expense. Joint liability requires group

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[140] This could be the result of a failed investment or the borrower willfully deciding not to repay their loan.
[141] World Bank, *World Development Indicators*.
[142] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[143] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 9.

members cover the delinquent repayment of a borrower. In an ideal group-lending program, as detailed in section II.A, the decline in present income or savings in the short term, used to cover the repayment of a delinquent group member, is an investment in the maintenance of the promise to receive similar assistance if needed, in the future. While there is still an immediate reduction in benefits gained from program participation in this scenario, it is only a short-term cost that helps ensure returns in the future. This is why it is beneficial for a poor borrower to accept joint liability.

However, in contexts where clients cannot expect to receive repayment assistance services from delinquent clients, either because they are unable or unwilling to reciprocate the provision of the service, then joint liability amounts only to a cost of doing business for a non-delinquent borrower. Clients must absorb the value of the delinquent repayment without realizing any of the benefits expected in an ideal group-lending program. Covering the repayment of a stranger whose business inexperience or higher risk venture caused repayment default, or simply because the borrower ran off with the credits, is not an investment in future benefits for the non-delinquent group member. In this case, their present benefit from program participation is constrained without securing other present or future benefits; the poverty alleviation impact affected by FCC is restrained. It is impossible to say definitively how often this scenario has occurred, but market research suggests that it is wide spread. 75% of focus groups mentioned that they encountered problems with having to cover the delinquency of fellow group members[144].

[144] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.

The second costly coping strategy that many clients are employing when faced with intra-group delinquency is the high-cost measure of forcefully confiscating the personal assets of the delinquent borrower in order to cover their repayment. The effects of this coping strategy are almost impossible for the delinquent client to reverse. Again, it is not possible to specify exactly how often the taking of delinquent clients' assets is taking place, but market research has shown it to be a prevalent problem. 63% of focus groups mentioned fear of losing their guarantees as a motivating factor for dropping out of the lending program[145]. 47% of focus groups cited that there exists a problem of assets of delinquent clients being taken in order to cover their loan, as one focused group participant in Nacala (a city in the north) noted: "If you can't repay your loan, other group members come to your home and take your goods, your personal items, or your roof."[146] It is most likely for this reason that 20% of focus groups felt that the guarantee policy should include a provision that banned the taking of borrowers' roofs[147]. Clients who find themselves in this situation are then often kicked out of their group, labeled a liability to the other members, and therefore do not get another chance to rebuild their income-generating business with future loans from FCC. 39% of focus groups cited this phenomenon as being a problem within the community group program[148]. This obviously leaves beneficiaries worse off then when they began participation in the program, constraining the poverty alleviation impact that FCC is able to produce.

IV.C: Potential Causes for the Occurrence of Costly-Coping Strategies

The presence of intra-group delinquencies is resulting in the occurrence of two costly coping strategies that are constraining the poverty alleviation impact that FCC's

[145] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[146] Ibid.
[147] Ibid.
[148] Ibid.

community group-lending program is able to effect. The first phenomenon is a medium-cost measure; non-delinquent clients are forced to use profits from their own income generating activities or dis-save in order to cover the repayments of delinquent group members. The second phenomenon is a high-cost measure; non-delinquent clients have resorted to forcefully taking the personal possessions of delinquent borrowers in order to cover their repayment. Neither phenomenon is an inherent result of utilizing the group-lending method. Since these costs can be avoided, their presence points to one or several areas of design weakness in the current community group-lending program.

The proceeding section will argue that the sub-optimal performance of FCC's community group-lending program is partly attributable to weaknesses in the structure of the borrower groups, and is primarily attributable to the onerous set of loan terms to which clients must adhere. In light of the discussion presented in chapter II, it will be suggested that the current group structure is not conducive to the effective exploitation and activation of the informational advantage, peer-monitoring/pressure, and informal insurance mechanisms. This inhibits groups' abilities to mitigate the costs to individual members associated with intra-group delinquency. However, the main cause of the costly coping phenomena is the result of delinquencies caused by the onerous terms of the loan. The high interest and mandatory savings rates and strict repayment regime could render the loan unprofitable to many borrowers, even if the groups functioned well, resulting in their inability to meet repayments. Both diagnoses will be treated separately in order to present them in a coherent manner. However, neither operates in isolation of the other. The cost to beneficiaries brought about by the group structure is compounded by the terms of the loan, and vice versa. Furthermore, it will be argued that onerous loan terms are the primary cost driver because, even if the group structure were problem free, clients would still be forced to adopt a costly coping strategy if the loan terms continued to produce intra-group delinquencies.

IV.C.1: Current Group-Structure is not Conducive to Effective Group-Lending

When assessing the cause of the sub-optimal impact that FCC is able to produce, it makes intuitive sense to begin the investigation by considering the borrower group's structure. In light of chapter II's description of how the informational advantage, peer-monitoring/pressure, and informal insurance mechanisms function, this section will argue that it is highly probable that FCC's current community group design is not conducive in all instances to the effective exploitation and activation of these three essential group-lending mechanisms. It will then be suggested that this weakness most likely contributes to clients' inability to mitigate the costs of intra-group delinquencies.

Chapter II asserted that a successful group must be self-selected for two reasons: to ensure that group members share social capital, and that all the members are credit worthy. FCC's large 30-member size requirement effectively represents the lender distorting the self-selection process. Groups are being forced to recruit others who are unknown, compromising the informational advantage mechanism in the selection process. Market research found that 20% of focus groups thought that FCC's size requirement was too big[149].

The presence of unknowns in the borrowing group can have two negative impacts on group composition. First, the quality assurance mechanism has been compromised, increasing the potential for non-credit worthy clients to be admitted into groups. Market research has found this to be a prevalent problem. 51% of focus groups mentioned that

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[149] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.

problems exist within borrowing-groups of clients mishandling their loans because of their inexperience. Second, it decreases the potency of social capital the binds the group together because certain individuals may not share in it. 17% of focus groups claimed that it was "hard to find people (when forming a group) you can trust".[150] The prevalence of these two sentiments, the presence of non-credit worthy borrowers, and a lack of individuals who share in a stock of social capital, suggests that the informational advantage is not being optimally exploited by the group design.

The breakdown of the informational advantage mechanism within FCC's group-lending program may also be resulting is a misalignment in intra-group risk levels. 22% of focus groups cited a desire to see clients grouped according to loan size/economic status[151], suggesting that risk levels are not uniform within all groups. Misaligned risk levels can contribute to intra-group delinquencies because of the incentive to exploit the moral hazard introduced by joint liability.

Again, as suggested in section II.B.2, groups that are not able to effectively exploit the informational advantage mechanism are highly vulnerable to suffer from a breakdown of the peer-monitoring/pressure mechanism as well. Sub-optimal group selection can also, along with moral hazard, increase the probability of fostering free riding within the group. 52% of focus groups cited that a problem of clients willfully misusing their credits exits[152]. It can also be inferred that the large groups, lacking social capital, creates a free-rider problem that erodes the potency of the peer-monitoring/pressure mechanism:

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[150] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[151] Ibid.
[152] Ibid.

> "With large group there is a free-rider problem – each would prefer that others expend the energy required to monitor and incur the ill will that would result from reporting offenders who have misused the funds lent to them. Moreover, the costs to each as a result of a default by any member are sufficiently small that incentives to monitor – even apart from the free rider problem – would be minimal."[153]

It is for this reason that Grameen Bank began their lending program with groups that were larger then 10, but then lowered their required size when they discovered that "these groups were too large to be effective."[154] Market research found that 57% of focus groups mentioned problems of individuals in the borrower groups not being susceptible to the pressure exerted upon them by their fellow group members[155].

Finally, as already detailed in chapter II, the activation of the informal insurance mechanism relies on the effective functioning of the previous two group-lending mechanisms. However, since it has been suggested that the design of FCC's community group is not conducive to the functioning of these two mechanisms, it therefore follows logically that the status of the informal insurance mechanism is questionable as well. The presence of strangers within a group, and the tendency of larger groups to have greater socio-economic diversity[156] means that group members have less social capital between them that would motivate one person to help out another at their own short term cost. There exists greater uncertainty surrounding the ability and willingness of fellow group member's to provide reciprocal service; this heightened level of uncertainty can cause borrowers to withhold the provision of informal repayment insurance disbursements.

This diagnosis of the negative-poverty reduction trends present in FCC's community group-lending program identifies the structure of the group as an important

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[153] Joseph Stiglitz, "Peer Monitoring and Credit Markets," 361.
[154] M.M. Islam, A.N.M. Wahid, and Z.H. Khan, "The Grameen Bank: Peer monitoring in a dual credit market," in A.N.M. Wahid ed. *The Grameen Bank: Poverty relief in Bangladesh. Boulder*. CO: Westview Press., 1993, 29.
[155] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[156]Islam et. al., 29.

contributing factor. The community group size requirement of 30 people is too large to foster the social capital needed for the essential group mechanisms to function properly. The large size requirement may be stymieing the informational advantage mechanism, creating space for inappropriate individuals to join groups. Inappropriately constituted groups may be voiding the peer-monitoring/pressure mechanism of its potency. Finally, the poor functioning of these two group-lending mechanisms may be inhibiting the functioning of the informal insurance mechanism. This section has argued that is reasonable to assume that these breakdowns are contributing to the withholding of the level of poverty alleviation that FCC is able to affect through its community group-lending program.

IV.C.2: Rigor of the Lending is too Difficult, Causing Delinquency

While it is reasonable to assume that the structure of FCC's community groups contributes to the constraint of the positive impact that the program is able to produce, this diagnosis alone does not address the root cause of the problem: intra-group delinquency. Ultimately, what is causing the majority of borrowers to have difficulty meeting their repayments is the rigor of the community group-lending program's loan terms. Applied in the context of the informal Mozambican investing environment, the terms of the loan are prohibiting many clients from generating a profit from the credits they have borrowed. If the loan is actually costing clients money, then they will most likely not be able to meet their repayments. Therefore, even if the group structure did not contain any design weaknesses, burdensome loan terms could still cause delinquencies that would lead to the occurrence of the two costly phenomena.

The rigor of the community group's lending parameters, a high interest rate, a high and rigid savings requirement, and an immovable bi-weekly repayment period might be too demanding for many borrowers, forcing them into default, and leading to the costly phenomena that is constraining FCC's poverty alleviation impact. Market research found that clients having difficulties repaying their loans contributed to 51% of dropouts in the south and 46% in the north[157]. 15% of groups surveyed cited that beneficiaries dropped out of the lending program because they were not making a profit from their credits, but were just working to pay them off. 50% of focus groups surveyed noted that the pressure to repay by FCC was a contributing factor to clients dropping out of the program[158]. These figures are all the more troubling when FCC's extremely high drop out rate, losing about 45% of its clients in the north and south[159], are taken into consideration.

The non-declining interest rate of 5% per month is not enough to render FCC's lending self-sufficient, however, it represents a substantial amount to the beneficiaries. Assuming a client is in his/her first lending cycle, receiving US$50, and that he/she receives the average Mozambican income of US$229 per year, the total interest paid out for a four month lending cycle would be US$10, or 4.4% of the client's yearly income. It is perhaps for this reason that 34% of groups surveyed cited high interest rates as a motivating factor for clients dropping out of the lending program, and 40% of the focus groups suggested that FCC lower its lending rates in order to improve its credit products[160].

The mandatory savings requirement lowers the level of vulnerability of the beneficiaries to external shocks. However, this comes at the cost of also lowering the

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[157] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 9.
[158] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[159] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 6.
[160] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.

increase in income that the credits can provide for them. Again assuming a loan size of US$50, a first-time borrower has to store US$6 with FCC, upon which they will earn US$0.18 over a four-month period. Therefore, combined with the non-declining interest rate, borrowers are paying US$9.82 in interest for a US$50 loan, only US$44 of which they can use towards their respective businesses over a four-month cycle. In microenterpirses that face very slim net profit margins, such as those that many FCC clients engage in, the inability to productively employ the savings requirement could potentially render the borrowing exercise unprofitable for some borrowers. It is perhaps for this reason that 31% of focus groups cited FCC's savings rates as being too high[161].

Finally, the strict bi-weekly repayment period of the community group-lending program may be contributing to some borrowers not being able to meet repayments. Under the current program, borrowers repay their loan through 8 US$6.25 payments. Therefore, in conjunction with the current interest rate policy, borrowers lose access to 1/8 of their loan that they are still paying interest on every two weeks. This means that borrowers have to be able to turn a profit on US$5.50[162] worth of credit in two weeks[163]. This could pose a problem in areas further away from urban centers where the volume of market activity is slower. Apart from the Maputo area in southern Mozambique, this case can apply to the majority of the country. The lack of easily accessible roads means that it can take a long time to get products from one area to sell in another; 38% of focus groups in the north cited long times and expensive costs as a factor rendering repayment

[161] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*
[162] The loan minus interest and savings requirement, divided by 8.
[163] Alternatively, clients can attempt to scale back their present consumption and save more in order to meet repayments.

difficult[164]. The pervasive poverty of the population means that vendors can face very long inventory turnover ratios. Poor markets were cited by 62% of the focus groups in the south and 35% in the north as being a leading problem for loan repayment[165]. The constant need to repay a portion of one's credit every other week in these difficult investment conditions can make it difficult for some beneficiaries to effectively employ their credits; the effect is delinquency. This explanation could help account for the finding that the bi-weekly repayment period helped motivate 72% of all client dropouts in the south, and 84% in the north[166].

The rigorous terms of the loan may be burdensome for many clients, causing them to be unable to meet their repayments. Tying up 12% of the loan value in interest payments and savings requirements, and possessing an inflexible bi-weekly repayment regime in what can be characterized as a difficult investing environment can render it impossible for many clients to generate a profit form their borrowing. The resulting effect is repayment delinquencies. When certain borrowers fail to meet their repayments, their fellow group members who have an interest in not falling into default with the lender[167] are left with only one of two choices of action. Their first alternative is to use the profits generated from their own investments, or call upon their own savings to cover the delinquent repayment, a medium-cost coping strategy. Their second option is to forcefully confiscate the personal assets of the delinquent borrower in order to cover their unmet repayment, a high-cost coping strategy. In both cases, the occurrence of the costly

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[164] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 9.
[165] Ibid.
[166] Ibid., 10.
[167] People may not want to fall into default with the lender because of the dynamic loan incentive, hoping to get a high subsequent loan that could render their participation profitable. Clients may also want to avoid default for less rational reasons, such as of fear of social stigmas associated with defaulting, or fear of legal action by the credit provider.

coping strategy, an event that constrains the net poverty alleviation impact affected by FCC's lending, is the result of delinquencies within the borrowing group. This section has attempted to show that a majority of these delinquencies are the result of an onerous set of loan terms attached to the community group-lending product.

IV.D: Conclusion

This chapter has examined both the benefits and costs of the current community group-lending program. It has identified the biggest costs to be the occurrence of two delinquency related phenomena: non-delinquent borrowers having to cover the delinquent repayments of others, and delinquent clients having their personal assets taken by group members to cover their defaulted repayments. The first phenomenon necessarily results in the constraint of the net level of benefit that non-delinquent clients are able to realize from borrowing. In a worst-case scenario, resorting to this coping strategy could end up costing a client more than what they were able to earn on their credit-supported investment, leaving them worse off for having participated in the lending program. The second phenomenon necessarily results in delinquent clients being worse off for having participated in the lending program; they have lost personal possessions and have most likely been kicked out of their group, rendering a recovery extremely difficult if not impossible for them. While these two costly phenomena do not occur in every community borrowing group, this chapter has shown, through evidence gathered from market research, that their presence is prevalent in the program. The resulting effect is a constraint in the poverty alleviation impact that FCC is able to effect through its community group-lending activities.

After having outlined the problems with FCC's community group-lending program, this chapter has put forward two diagnoses that offer explanations for why these costly phenomena are occurring. The first explanation cited the weaknesses in the borrower group's design as being a contributing factor to the lending program sub-optimal impact. It is reasonable to assume that the large size requirement inhibits the effective exploitation of the informational advantage mechanism, causing the peer-monitoring/pressure and informal insurance mechanisms to breakdown, hampering a group's ability to mitigate the benefit-constraining costs of intra-group delinquency. The second explanation cites the rigorous terms of the loan product as inducing the intra-group delinquencies that lead to the need for the costly coping strategies to be employed by borrowers. A significant portion of the loan is tied up in non-productive uses by the interest rate and mandatory savings requirement, constraining clients' ability to generate income from their borrowings. In addition, an inflexible repayment system fails to give the time required by many clients to generate a positive return from their credit-fueled investments. The resulting outcomes are repayment delinquencies within borrowing groups.

The two diagnoses were presented separately, however each has a profound impact on the other. While it may be necessary to address the design weakness of the group structure in order to mitigate the occurrence of the two costly phenomena, it may not be sufficient. Even with a perfectly designed group structure, if the terms of the loan are simply too difficult to allow many clients to generate a net profit from their credit-sponsored investments, then intra-group delinquencies will occur and clients will be forced to resort to one of the two costly coping strategies. Likewise, if the terms of the loan are perfectly conducive to borrowers generating a profit from participation, an imperfect group design may not be able to overcome the incentive to misuse borrowed credit, causing intra-group delinquencies that force clients to adopt one of the two costly coping strategies.

The discussion of the diagnosis has however revealed a primary cause for FCC's sub-optimal poverty reduction impact: onerous loan terms. With appropriate loan terms and a weak group structure, it is not an inevitability that borrowers will adhere to the incentive to misuse their credits, causing delinquencies and the occurrence of the two costly coping strategies. It is possible, although highly unlikely, that for some reason not accounted for in the discussions within this study, clients would not succumb to the incentive to misuse their credits in the context of a poorly designed group structure. Conversely, even if there are no problems with the group's design, onerous loan terms that do not allow a significant number of borrowers to generate positive returns will necessarily lead to intra-group delinquencies, and the need to resort to a costly coping strategy. In addition, the evidence used to argue that the design of FCC's community group is contributing to the lender's sub-optimal performance, while logical, is based primarily on inferences drawn from the theoretical discussion of the group-lending method's requirements. Meanwhile, the evidence used to demonstrate that FCC's loan terms are onerous for many borrowers has been taken directly from primary data gathered from the clients themselves. Therefore, it is being suggested that the latter diagnosis is the primary culprit responsible for the constraint of the poverty alleviation impact generated by FCC.

The following chapter will propose policy solutions designed to address the weaknesses identified in the diagnoses provided in this chapter. Again, while the individual policy reforms are each presented separately, they are not all meant to function in isolation of each other. The goal of each reform is to mitigate the occurrence of the two costly phenomena, thereby increasing the net poverty alleviation impact that FCC's community group-lending program is able to effect. The benefits and drawbacks of each solution will be detailed so that FCC can ultimately decide, based on its own set of institutional goals and priorities, which policy reforms would be most appropriate.

Chapter V: Policy Reforms

V.A: The Need for Remedial Policy Action

FCC's community group-lending program is in need of policy reforms. Chapter IV has identified the presence of two significant phenomena that are constraining the poverty alleviation impact that the lender is able to produce: many clients are having to employ their own profits or savings to cover the delinquent repayments of their fellow group members, and many delinquent clients are having their personal possessions forcefully taken from them by their fellow group members to cover their missed repayments. The chapter then went on to attribute the occurrence of these costly phenomena to two loan product design weaknesses. First, it has been suggested that the large mandatory group size inhibits the effective exploitation and activation of the informational advantage, peer-monitoring/pressure, and informal insurance mechanisms, potentially contributing to the presence of intra-group delinquency, and inhibiting the ability of the group members to mitigate the costs of delinquency when it does occur. Second, the primary cause for presence of the two costly coping strategies has been identified as the terms of the loan product. The high interest rate and savings requirement diverts a substantial portion of the loan away from productive uses, and the rigid repayment system does not leave enough time for many clients to generate a profit from their credits.

This chapter will consider remedial policy options that FCC could adopt to address both of the identified causes for the constraint of its impact. Remedies designed to address both diagnoses will be given separately, with consideration given to the benefits and drawbacks of each recommendation.

V.B: Modified Community Group Structure Reform

In order to improve the effectiveness of the group-lending system, it is recommended that FCC reduce its size requirement from 30 members down to 10[168]. In addition, it is recommended that FCC require the following provisions to be included in the by-laws of every borrowing group:

- Groups are not allowed to take essential possessions[169] of individual members in order to use them to pay-off delinquent repayments.
- Every group member has the right to file a complaint if they feel that a regulation has been violated with the group president. If after a period of 1 week they feel that the president has not taken proper actions, the borrower can then file a complaint with the loan officer.
- The president of the community group shall not be eligible for a two or more year consecutive term[170].

V.B.1: Benefits of the Reform

Stiglitz has suggested that the success of any group lending program is dependant on three conditions: first, that the group is self-selected (this exploits the informational advantage), second that "the number of members in a group is small in order to enhance the effectiveness of monitoring," and third that the members of the group are appropriately insentivized to monitor each other[171]. This reform option is designed according to these criteria. By reducing FCC's size requirement from 30 to 10 members, the community group design should be able to effectively exploit the informational

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[168] The selection of 10 is a somewhat arbitrary number. However, it has been selected on the assumption that it is reasonable to expect that one individual working in a market knows 9 other individuals, while knowing 19-29 is a less-reasonable assumption.
[169] Such possessions include non-productive assets like cooking utensils or corrugated metal roofs.
[170] Todd, 21.
[171] Islam et. al., 28.

advantage mechanism, rendering the quality control element of client selection more rigorous. The intended effect is for groups to be formed around a pre-existing stock of social capital, with uniform risk levels[172].

It is anticipated that the more effective exploitation of the informational advantage mechanism, combined with a smaller group size, would have a positive impact on the effectiveness of the peer-monitoring/pressure mechanism within the community group program. Smaller and more intimate group sizes provide a less-conducive atmosphere for the free-rider syndrome to occur; it is more difficult to have anonymity and shirk one's monitoring responsibility within a smaller group of people. In a small group with a uniform risk level, the incentive to see every other member succeed should be greater than in the present model. The individual loss for failure to properly monitor/pressure effective credit usage by other group members (insufficient monitoring that allows a group member to default on their repayment) is far greater since the cost of covering that default is now being spread across fewer people. In the case of the Grameen bank, this increase in the expected impact of default served to increase "the incentives for peer monitoring. The gains from the latter exceeded the losses from the former." [173]

It is further anticipated that groups that enjoy effective informational advantage and peer-monitoring/pressure mechanisms would also benefit from a more effective informal insurance mechanism. Creating a system of mutual dependence between group

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[172] It is noted that this very process tends to take place within FCC's current community group-lending program in later lending cycles. The first lending cycles tend to rarify the members who are inappropriately matched to the core group; when someone defaults, they generally are not asked to rejoin for a subsequent cycle, and in time groups will become small and share a closer range of risk. This reform option is attempting to achieve this same end in the very first lending cycle, maximizing the potential benefits that can be gained from the program by avoiding the inefficiencies of the current rarerification process.

[173] Zeller, 12.

members creates of process that builds upon itself. Individuals depend on each other for their own success, creating a shared set of interests within the group, which is composed of the ability of each individual member to succeed. This shared interest is a growing stock of social capital that serves to bind group members to one and other[174]. It is anticipated that the informal insurance mechanism will have an even higher probability of functioning properly under this reform then it does under the current program because the structural change being recommended creates stronger incentives for the mechanism to be activated.

V.B.II: Drawbacks to the Policy

While the reform can maintain the large administrative economies of scale attained with the status quo program by grouping the smaller size groups into larger administrative units, the fact that more autonomous groups do exist will most likely result in a higher loan officer time per client ratio than is currently enjoyed by FCC[175]. Under the same budgetary limitations, this would mean that its nominal coverage of the poor would decrease.

The larger drawback to this reform policy however, lies in the limited impact that it promises to provide, given the finding that onerous loan terms are mostly likely behind the majority of the delinquencies that drive clients to adopt one of the two costly coping strategies. Shrinking the group size requirement comes at almost no cost to FCC in terms of its desire to achieve institutional self-sufficiency. It may also decrease the incidence of delinquencies caused by borrowers succumbing to the incentive to misuse their credits. However, assuming that the investing environment that FCC clients face does not change,

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[174] Conning, 5.

[175] For instance, the loan officers will have more group presidents to work with, and this will decrease the officer's overall efficiency.

this policy alone does not address the root cause of the problem: many clients are not able to generate positive returns from their borrowing because the terms of the loan are too rigorous. Therefore, a comprehensive reform policy must consider this issue as well.

V.C: Ease the Terms of the Loan Reform

In order to address the primary cause for the occurrence of the two costly coping strategies, it is recommended the FCC ease the terms of the group-lending product. First, it should reduce the interest rate that it charges. Second, it should lower the mandatory savings requirement. Third, it should introduce more flexibility into the repayment system. Borrowers should have the option of applying for repayment assistance in the event that they experience an unanticipated external shock. Such assistance can include three measures: rescheduling a repayment, being able to use one's savings to meet a repayment, or accessing a special 'catch-up' loan to help them recover[176]. The entire group should guarantee this additional loan. In order to receive any of the assistance measures listed above, a borrower must have experienced an unforeseeable shock that she/he had no way of overcoming or preventing. The group president should have to accompany the borrower when applying for repayment assistance. In the case of the group president being the applicant, another board member must accompany him/her. It should be the final determination of the loan promoter whether or not an applicant can qualify for this assistance.

This reform policy can take on a multitude of forms because it is composed of three separate steps. Under the current program, first-time borrowers receiving US$50 in credits have US$34 to use productively after interest payments and the savings requirement has been deducted. If FCC wishes to increase this amount by US$6 (for

[176] Catch-up loans should be given on a repayment deadline basis. Therefore, if one is needed for a bi-weekly repayment, it should be US$6.25, or US$12.50 for a monthly installment.

example), they have a wide variety of options to implement this change, through a combination of adjustments to either and/or both variables. Making adjustments to each variable requires that a unique set of considerations be made; the proceeding section will examine these issues. It is for this reason that specific reductions are not being recommended. Ultimately, it would be up to FCC to decide, based on its own institutional goals, which type of adjustments would be most appropriate for it to adopt.

V.C.1: Lowering the Interest Rate

It is recommended that the interest rate be lowered from its current non-declining 5% per month rate. The intent of lowering the cost of borrowing for clients is to increase their ability to generate net profits from participating in the lending program. It is anticipated that such an increase in client's capacity to generate net gains from borrowing will diminish the incidence of their not being able to meet repayments. Groups facing fewer instances of delinquencies within their ranks will not be forced into adopting either of the two costly delinquency-coping measures as often as they currently are with a higher interest rate. In this manner, the current constraint placed on FCC's net poverty alleviation impact by the two costly phenomena can be relieved.

Market research has shown the current cost of borrowing from FCC to be a prevalent problem for many of the lender's clients[177]. 34% of focus groups cited high interest rates as motivating factor for clients dropping out of the lending program, and 40% of the focus groups sessions suggested that FCC lower its lending rates in order to improve its credit products[178].

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[177] FCC's 88% repayment rate would suggest otherwise. However, other variables, such as the under-capitalized nature of the credit market combined with the lure of subsequent loans could account for this high collection rate, as already mentioned.

[178] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*

Ultimately, FCC would have to consider two different variables when selecting a new interest rate. The first variable would be the paying capacity of FCC's targeted beneficiaries, and what degree of impact the lender wishes to have on them. If FCC wishes to deliver substantial benefits through its lending to very poor people, then it will need to select a lower interest rate in order to achieve this goal[179]. FCC can relax this constraint on the interest rate level that it wishes to charge either by targeting less-poor clients who can afford high rates[180], and/or reduce the desired impact that they wish their lending activities to have on their beneficiaries.

The second variable that FCC would have to consider when selecting a new interest rate would be the level of institutional self-sufficiency that it wishes to attain. Providing credits costs a lot of money. Lenders face administrative costs, plus the cost of currency fluctuations that can decrease the value of their capital lending stock. If a lender wishes to be self-sufficient[181], then it must generate enough revenue to cover these costs; revenue is generated through the interest charges that it collects. Therefore, the higher the interest rate charged (and collected), the more self-sufficient a lender can become[182].

Finally, in order to lower the cost of lending to the borrower, FCC could employ a declining interest rate that reflects the amount of loan principle that has already been paid

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[179] Many have argued that micro-entrepreneurs can in fact afford to pay very high interest rates since they can face extremely high rates of return on their investments. (CGAP, *Microcredit Interest Rates*, CGAP Occasional Paper #1, Revised August 1996, 10.) Assuming that this were true, this fact still does not take into consideration the level of benefit that a non-profit oriented credit provider may want to deliver to its clients. A profit-oriented lender will simply want to charge the highest possible rate that its targeted market group can afford. A credit provider with a bottom line of positively impacting the economic position of its beneficiaries must consider not only what its clients can afford, but also what type of impact their borrowing will have on their net income.

[180] This assumes that the extremely poor clients will not be able to afford as high an interest rate as less-poor borrowers.

[181] Self-sufficiency is this sense represents the lender breaking even in its activities.

[182] There are obviously limits to how far this logic will operate; if a credit provider set their interest rates well above the market clearing price, they might not attract enough borrowers and end generating less revenue than they would have with a lower interest rate.

back. Such an alteration would decrease the revenue earned from each borrower for the lender, and it would most likely come at a higher administrative cost, introducing individual calculations into every client's repayment.

V.C.2: Reducing the Savings Requirement

It is also recommended that the mandatory savings requirement of 12% be reduced in order to free up more of the credits for productive use by the borrowers. Lending money for clients to invest productively assumes that the borrower knows how to use their credits. This reform step seeks to give borrowers more freedom in determining the use of their credits, with the intended effect of increasing their ability to generate larger returns. It is anticipated that if clients are able to realize higher net returns from borrowing, that the incidence of intra-group delinquencies would diminish relative to the current program. Again, by diminishing the incidence of intra-group delinquencies, the frequency of clients being forced to adopt one of the two costly delinquency-coping strategies will decline, thereby relieving their constraint of FCC's poverty alleviation impact. 30% of market research-focus groups complained that the current savings requirement was too high and expressed their desire for it to be lowered[183].

Again, the selection of a new mandatory savings rate will depend on the consideration of two variables. The first concerns what type of impact FCC wishes to deliver to its beneficiaries. Requiring fewer credits to be tied up in savings provides borrowers with more investment opportunities, producing the possibility to produce higher income returns. However, reducing the level of mandatory savings that they must keep with the lender comes at the cost of increasing their level of risk, relative to what

[183] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.

they would face under a program with a higher savings requirement. Having savings necessarily reduces one's level of vulnerability because those reserves can be called upon to absorb the impact of an external shock; diverting money away from reserves into productive uses depletes the cushion that clients can fall back on in an emergency. In addition, investing always has a higher level of risk than does saving, and so lowering the required level of savings will necessarily increase the risk faced by borrowers[184]. Evaluating the investment environments in FCC lending communities, and the returns that clients are generally able to face may help policy makers determine the value of trading off lower risk levels with increased investment opportunities.

The second consideration when selecting a mandatory savings rate is the level of risk that the lender is willing and/or able to be exposed to. Holding borrowers' deposits is another form of loan guarantee for the credit provider; in the case of client default, the lender's losses are diminished by its ability to collect the defaulter's deposits. Decreasing the level of mandatory deposits will necessarily increase the level of risk that FCC would be exposed to.

V.C.3: Repayment Assistance

This element of the policy reform recommends that FCC introduce greater flexibility into its repayment system by giving clients the opportunity to apply for repayment assistance. Three forms of assistance are being recommended: repayment rescheduling, the ability to use one's savings to meet a repayment, and access to 'catch-up' loans. Providing clients who are experiencing short-term liquidity problems with assistance could help mitigate the costly impacts that delinquency has on FCC's poverty alleviation impact. Instead of leaving the group with only two options when delinquency

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[184] This assumes that borrowers will react to the incentive that a lower required savings rate produces, resulting in lower levels of deposits being held by the financial service provider.

occurs, non-delinquent clients seeing their benefits reduced or harming the defaulter, special assistance could provide them with an alternative that creates the opportunity for a liability to the group, the delinquent, to once again become an asset. This section will consider how each individual form of assistance can mitigate the occurrence of the two costly delinquency-coping strategies. It will also consider the implications of each measure.

The suggested application procedure for repayment assistance employs both the group's informational advantage and FCC's technical expertise by providing strict criteria upon which determinations of eligibility can be made. The fist layer of screening is done by the group (through their president), and the second layer is done by the loan promoter, thus ensuring that the repayment assistance system is not abused by individual clients who are only seeking to get more money for non-emergency purposes.

FCC's community group-lending program does not allow, under any circumstances, a repayment to be missed without meting out punishments to the offending group[185]. Part of what defines the poverty of FCC's clientele is their high level of vulnerability; what would be considered a minor shock for a richer family can have a devastating effect on a poor household because they lack the financial resources (either through savings, present or future income), and/or access to services (health care services, other financial services, etc.) to overcome such an event. The difficult investment environment in Mozambique[186] and high level of vulnerability of FCC's clients means that, even with an appropriately designed group structure and loan terms that are generally conducive to clients generating net gains from their borrowing,

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[185] Please refer to section III.A.1 for a description of the penalties for defaulting.
[186] Please refer to section III.C.

instances of clients not being able to meet repayments for reasons that are beyond their control are still bound to occur. When these repayment difficulties do materialize, without repayment assistance alternatives, clients will be forced into adopting one of the two costly delinquency-coping strategies. It is for this reason that in market research clients expressed a strong desire for the provision of such a service. 49% of focus groups cited their desire for FCC to show some degree of flexibility regarding repayment in the case of a shock such as an accident or death[187].

It is anticipated that providing borrowers with the ability to reschedule their repayments[188] would reduce the incidence of intra-group delinquency, thereby lowering the frequency of clients having to adopt either of the two costly delinquency-coping strategies. In Mozambique it can take even small entrepreneurs a long time to realize a positive return on their investments. This investment period is primarily the result of two conditions of the Mozambican informal sector-investing environment. First, many of FCC's lending communities suffer from a suboptimal transportation infrastructure. Travel costs and time related to business being too high accounted for 38% of clients having difficulty repaying their loans in the north[189]. Second, a pervasive and deep level of poverty characterizes these communities; the patrons of FCC's borrowers generally are not able to spend money very easily, slowing down vendors' inventory turnover rates. Businesses problems caused by poor markets and expensive goods accounted for 62% of the difficulties that clients had in repaying their loans in the south, and 35% in the

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[187] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[188] Such a policy would need to be pilot tested and would most likely be most effective if it were region specific. However, to give the argument context, it is recommended that clients be able to reschedule repayments on a repayment-installment basis; a client's repayment could be deferred by a two-week period.
[189] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 9.

north[190]. By providing clients with the ability to take the time necessary to generate positive returns from their investments, it is anticipated that many instances of delinquency can be avoided. Alternatively, rescheduling a repayment could give a client who has just experienced a shock the time they require to re-stabilize their business and regain the capacity to meet their repayments[191]. Providing assistance to those in need[192] recognizes the special circumstance of the poor and their elevated level of vulnerability, acting as a protective mechanism for those who experience difficulty during the course of their loan[193]. A higher probability for successful repayment diminishes the risk that non-delinquent group members (having to cover defaulted loans) and clients who run the risk of becoming delinquent under current program parameters face.

Providing a beleaguered borrower with a rescheduled repayment plan comes at no additional cost to the group members (they do not have to take on any added risk or erode the benefits that they face by covering a delinquent repayment), and no additional capital cost to the lender (repayment is simply delayed). However, processing applications and rescheduling paper work would increase the time that loan officers would have to spend on each client. This could drive up the cost of lending, and/or result in FCC being able to service fewer clients, holding its staff and staff work hours constant.

An alternative to repayment rescheduling is allowing clients to use their savings to meet repayments when they are experiencing difficulties. Clients are not allowed to utilize their savings requirement, at least during the first cycle, to cover any delinquent

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[190] Park, *Client Drop-outs at Fundo de Crédito Comunitário*, 9.
[191] Hauge, 26, & Bastelaer, 17, & FCC staff, Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*.
[192] The application procedure has been included specifically for this purpose, to ensure that only those who do require assistance receive it.
[193] Montgomery, 304.

repayment, forcing group member to either draw from their own savings and/or business profits, or take the possessions of the delinquent group member to cover the default. Relaxing this rule would provide beleaguered borrowers with an opportunity to avoid delinquency and its associated costs, recover from their shock, and return to being productive members of their group. 25% of focus groups cited in market research their desire to use their savings with FCC to cover delinquencies within their groups[194].

This reform step does bring with it two costs, one to the borrower and one to the lender. As described above, depleting one's savings increases one's level of vulnerability[195]. Also, as described above, depleting the deposits held by the lender increases their risk exposure.

Finally, it is reasonable to assume that certain shocks can be severe enough that a simple rescheduling of repayments[196] would be insufficient for borrower recovery. In such an instance, the provision of a catch up loan could be used to reinstate the operating capacity of the borrower's enterprise before the onset of the shock[197]. Creating joint liability for a catch-up loan provides a disincentive for the group to employ this service. Because they will be liable for the loan, the incentive will be for the group to cover the would-be delinquent's portion. If a group decides to take this course of action, they will activate the informal insurance mechanism, investing in the provision of future services from the group member receiving their assistance.

Only if they feel that the risk is worthwhile taking on will they do so. It is being assumed that, if the cause of the defaulted repayment is indeed solely an external shock,

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[194] Fundo de Crédito Comunitário, *Market Research Talley Sheet 2003*
[195] Although, the case could be made that overcoming an external shock that induces repayment difficulties is the very function that savings are meant to serve.
[196] Using one's savings to meet a repayment has the same effect as a rescheduling.
[197] Snodgrass, 66.

then an appropriately valued loan could bring the beleaguered borrower back up to their positive operating level before the onset of that shock. Under this assumption, it would make sense for a rational group member to agree to accept the joint liability of an additional catch-up loan instead of undertaking one of the two costly behaviors; if the beleaguered borrower was an effective business manager before the shock (measured by his/her ability to meet their loan repayments), then after receiving a loan that reinstates their pre-shock status, it can be reasonably assumed that this individual would once again be an asset to the group. While the short-term risk of the other group members is increased with the additional joint liability of the catch up loan, it is being accepted based on the same criteria for which they accepted the initial risk (a level which has now been reinstated with the catch up loan), without the cost of having to cover the troubled client's repayment, or the cost of losing any services that the social capital from that member can render to them (such as informal repayment insurance). This regulation also creates an environment more conducive for repayment success by bolstering the peer-monitoring/pressure mechanism within the group. Because the individual loan is jointly liable to the rest of the group, other group members will have more incentive to monitor the use of the credits by the individual and ensure that they are managed properly so that the additional risk that they have accepted through the loan does not materialize. Once again, the intent of this repayment assistance reform step is to provide a means for groups to avoid the occurrence of delinquencies that forces them into adopting a costly coping strategy.

Providing catch-up loans does however come at the cost of increasing the level of risk faced by borrowers. First, it increases the incentive for clients to take their loans and run off because they now stand to gain even more free money. This obviously presents a substantial harm to the rest of the group and harms FCC's sustainability. The risk of the catch-up loan is born by the group, and in a case where the individual is not able to pay it back, the added risk will diminish the poverty reduction effect felt by the other group members because they will have to cover that additional amount.

V.D: Conclusion

It is being recommended that FCC adopt two reform policies in order to free the poverty alleviation impact that it is able to produce from the occurrence the two identified costly phenomena. The first portion of the reform policy recommends that the community group size requirement be lowered from 30 down to 10 in order to better exploit and activate the three essential group-lending mechanisms. It is anticipated that such an improvement in the group structure could lower the incidence of delinquency caused by credit misuse and better enable clients to mitigate the costs of unavoidable delinquency when they do occur. The second portion of the reform addresses the primary cause of FCC's impact constraint: making the loan terms less onerous for poor borrowers in a difficult investing environment. It has been recommended that clients be given more of their loan to use productively through a reduction of the interest rate and/or required savings deposit, and that they have recourse to repayment assistance if they are faced with an unavoidable and unanticipated external shocks. This reform step is intended to decrease the incidence of intra-group delinquency, thereby reducing the need for clients to resort to either of the two costly coping strategies. The final chapter will consider how these reforms can be reconciled with FCC's double bottom line.

Chapter VI: Conclusion

FCC has improved the lives of many poor Mozambicans over the last 10 years. Today it is one of the country's largest microfinance service providers, serving more clients than any other institution in the sector. FCC is continually taking steps to help it simultaneously achieve both of its goals: alleviating the poverty of many poor Mozambicans, and achieving institutional self-sufficiency. It is in the spirit of constantly improving the impact of FCC's programming that this study has been written. Many of the lender's current clients have very positive borrowing experiences, seeing their net incomes increase as a result of their participation in the community group-lending program. It is the vision of the author for this segment of FCC's client constituency to expand. Therefore, attention has been paid to those amongst the borrowing portfolio who have seen the benefits realized from borrowing constrained, and to those whom borrowing credits from FCC has actually harmed.

VI.A: Summary

Chapter IV has identified two costly phenomena that are constraining FCC's poverty alleviation impact. First, many non-delinquent clients are seeing the level of benefit that they realize from borrowing limited by the need to cover the delinquencies of fellow group members. In some cases, this can lead to non-delinquent clients actually losing money. The second trend sees delinquent clients having their personal possessions taken by their fellow group members in order to cover their repayment. Two potential causes for the appearance of these phenomena have been offered. First, following the discussion in chapter II outlining the necessary components for a successful group-lending program, it has been inferred that the structure of FCC's borrowing group is not conducive to the proper functioning of the three essential group-lending mechanisms (the informational advantage, the peer-monitoring/pressure, and the informal insurance mechanism) because it does not foster the necessary level of social capital to exploit and activate them. This can contribute to credit misuse-induced delinquency and constrain the ability of group members to mitigate the costs of delinquency. Second, through the use of data gathered during the summer-2003 market research campaign, it has been concluded that the primary cause for delinquency, and its associated costs, is the terms of the loan. The loan requirements are proving to be too difficult for many clients to handle, causing them to fall into delinquency, which results in their fellow group members having to resort to one of the two costly coping strategies.

Chapter V has provided two solutions for FCC to overcome the constraints placed on its net poverty alleviation impact by the unaltered community group-lending program. It first proposed that the group structure be altered so that it is more conducive to the fostering of the level of social capital needed to effectively exploit and activate the three essential group-lending mechanisms, thereby avoiding the costs brought about in the current program. This reform step however possesses only a limited potential impact because it does not address the root cause of delinquencies. The second proposal was to ease the terms of the loan product in order to decrease the incidence of delinquencies within the borrowing groups, thereby avoiding the costs that they bring about. This reform step could however come at the cost of FCC's goal to achieve self-sufficiency.

VIII.B: Selecting the Appropriate Reform

As previously stated, what will ultimately determine the choices that FCC would make if it decides to institute a reform would be the type of impact that it aims to affect on its beneficiaries, and the level of institutional self-sufficiency that it wishes to achieve. These two goals are certainly not mutually exclusive: "microfinance institutions wanting to reach and benefit truly large numbers should be consciously working toward institutional sustainability… (Self-sufficiency) should be pursued at a rate that is consistent with substantial poverty-reduction."[198] The timeline for attaining institutional self-sufficiency that FCC settles upon will have a determinative effect on the poverty alleviation impact that it can achieve:

> While serving the ultra-poor may indeed be possible in a financially sustainable way, it is likely that the time frame to reach financial self-sufficiency will be shorter for MFIs serving the economically active poor. If the target market identified is the poorest of the poor, donors and practitioners alike need to be committed to supporting the institution over a longer period[199].

While FCC's parent organization, World Relief based in the United States, does not show any overt signs of abandoning their Mozambican microfinance branch, internally, FCC is determined to become an autonomous, self-sufficient financial service provider in the near future; over the past year FCC has been undergoing the process of legally separating itself from World Relief and becoming an autonomous Mozambican entity[200]. This desire is incompatible with the long-term support commitment that Ledgerwood alludes to in the preceding quote. The current desire of FCC to impact many poor people may be inconsistent with the realities of its current base of support and its desire to become a self-sufficient lender.

In deciding upon what appropriate course of action FCC should take if it chooses to apply reforms to its group-lending program, the financial service provider needs to consider the compatibility of its two primary institutional goals. As FCC is maturing, it is beginning to face many challenges, including: "rising client dropout rates, evidence of

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[198] David S. Gibbons, Jennifer W. Meehan, Financial Advisor, *The Microcredit Summit's Challenge: Working Towards Institutional, Financial Self-Sufficiency while Maintaining a Commitment to Serving the Poorest Families*, CASHPOR, Updated June 2000, 1.

[199] Ledgerwood, 39.

[200] It is also worth noting that four of FCC's major contributors, USAID, UN Capital Development Fund, the Mozambican Ministry of Agriculture and Rural Development (MADER) and SIDA (Swedish), have not recently renewed their financial support.

limited outreach to the extremely poor, and debates about whether microcredit may encourage poor clients to take on detrimentally high levels of indebtedness, rather than reducing their poverty."[201] This study has focused primarily on the latter challenge. It has exposed the difficulty that FCC faces in trying to achieve both of its goals simultaneously. Currently, the achievement of FCC's first goal, alleviating the poverty of many poor people, is facing a sub-optimal impact because a substantial portion of the program's beneficiaries are not able to generate positive returns due to loan terms that are too onerous for these borrowers. Easing the terms of the loan will mostly likely result in less revenue being generated by FCC, and in an increase in its level of risk exposure; this runs counter to its second goal of achieving institutional self-sufficiency.

It is now up to FCC to prioritize its goals. Currently, the organization is not moving as effectively as it could in either direction; it is producing a sub-optimal poverty alleviation impact, and it is very far from being self-sufficient. Evidence has not been provided that can prove that FCC's provision of services to the very poor is the cause of its lackluster self-sufficiency performance. However, evidence has been provided demonstrating that its goal to achieve self- sufficiency, represented in its rigorous loan terms, is negatively affecting the poverty alleviation impact that it can produce. FCC must ultimately decide at what cost it wishes to achieve institutional self-sufficiency, and set explicit targets for the type of poverty alleviation impact that it desires to produce. A careful consideration of the timeline for both goals may help to reconcile the current conflict between the two goals. These considerations will inform what type of policy reforms would be most

[201] Snodgrass, 13.

appropriate for FCC to adopt.

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Appendix I: FCC's Market Research Study

Market Research Methodology

The following outline has been coped from: David Park, *Client Drop-outs at Fundo de Crédito Comunitário*, Maputo, Mozambique, October, 2003, in the author's possession, 37-40.

Participants

Participants were selected from four categories of people: existing clients, former clients, non-client community members, and FCC staff. The rationale for selecting these categories is as follows:

- **Current clients** would offer insights into why clients are leaving FCC, based on their personal experiences with other members of their community banks. They would also be able to offer a current client's perspective on how FCC could improve its products and policies.
- **Former clients** would offer the most direct perspective into why clients have left FCC in the past. In addition, former clients could feel more open to discussing reasons for exiting than current clients or staff members.
- **Non-clients** are community members who are not, and who have never been, clients of FCC. These people would provide an understanding of the different reasons why people are not joining FCC, as well as provide the perceptions of the marketplace toward FCC.
- **FCC staff** have the most tacit knowledge of why clients are dropping out. Discussing client drop-out from their perspective would provide an additional vantage point for coming to conclusions and making recommendations.

Participants were selected from the following branches:

South

1. Chokwe Branch
2. Xai-Xai Branch
3. Manhica Branch
4. Maxixe Branch
5. Massinga Branch
6. Vilanculos Branch

North

7. Cuamba
8. Gurue
9. Nacala

10. Monapo
11. Lumbo
12. Nampula

There were 287 participants in the South and 282 in the North.

	Current Clients	Former Clients	Non-Clients	Staff	Total
Chokwe	33	11	9	6	59
Xai-Xai	29	9	4	6	48
Manhica	56	5	5	5	71
Maxixe	36	2	5	7	50
Massinga	18	-	3	-	21
Vilanculo	34	-	4	-	38
Total	206	27	30	24	287

	Current Clients	Former Clients	Non-Clients	Staff	Total
Cuamba	33	4	7	4	48
Gurue	42	-	23	3	68
Nacala	19	5	-	10	34
Monapo	16	-	9	3	28
Lumbo	14	-	-	-	14
Nampula	26	13	34	17	90
Total	150	22	73	37	282

Mobilizing the Branches

The preliminary market research plan was drafted and presented to FCC's Director of Operations, Stieneke Samuel, who reviewed and approved the research proposal.

This information was given to FCC's Training Officer, Catarina Langa, who then contacted each supervisor (through fax and telephone) and facilitated communication between the research team and the branch supervisors, in addition to organizing the logistics of where the team members would be staying at each location.

A schedule was written for each branch, with two participant groups scheduled at each 8:30 and 11:00 time slot, during the two-day period, for a total of 8 groups. Lists of current and former clients were chosen at random, from the records on file, and were submitted to each branch supervisor. They were asked to put together groups of 6-8 participants; from different community banks, according to the distribution requested (i.e. 5 groups of current clients, 2 groups of former clients). In addition, they were asked to organize one group of members of the community who had never been clients of FCC (non-clients), and also to schedule a time for the research team to talk with each office's branch staff.

Branch supervisors were asked to organize the groups into three different participant categories: current clients, former clients, and non-clients. Supervisors were told to encourage their promoters to put together groups that represented, if relevant, a number of different community banks, so that the discussion responses would represent a less biased perspective.

Unfortunately, with each group's further separation from FCC comes a decreasing incentive to participate in the research discussions. The willingness of current clients to attend is matched by perhaps some of FCC's former clients, who appreciate the opportunity to express their grievances. However, non-clients often have no particular reason for meeting and talking with the research team.

Therefore, the team met more often with current clients, because their attendance was easier to attain than, for example, former clients, who would likely yield more direct results.

Research Tools

While the branch offices arranged the groups, the research team organized their specific research tools. As in similar market research projects, the two methods of interactive interviewing chosen to structure each group interview session were focus group discussions (FGDs) and participatory rapid appraisals (PRAs).

Focus Group Discussions (FGDs)

The focus group discussion (FGD) is essentially an hour-long question and answer period. The FGD is unique from other research methods because it allows for group interaction and greater insight into why certain opinions are held. A focus group is typically composed of 6 to10 participants who are selected because they have certain characteristics in common that relate to the research topic.

Different FGD guides were written for each of the three participant groups, and were subsequently translated into Portuguese. In this form, the translators reviewed the discussion guides, to ensure that the questions made sense in Portuguese, and that none of the meaning was lost in the translation process.

Roles of Research Team

Members of the research team assume the roles of moderator, assistant moderator, and translator. The moderator is the person who explains the purpose of the meeting to each participant group and leads the discussion. The assistant moderator, unless the group is without one, is responsible for transcribing all participants' responses to the questions that the moderator asks. This person assists with passing out nametags, the technical recording of the conversation, and also frequently leads the participant group in a PRA, following the FGD. A translator accompanies each research team pair or individual, in order to facilitate participants' conversations in Portuguese and Shangaan.

FGD Procedure

Once seated, the moderator explains to the group that he or she is part of team from a research organization, called MicroSave-Africa that has been asked by FCC to talk with participants, in order for FCC to understand the reasons that clients are leaving. After participants have a clear understanding that the purpose of the meeting is simply to exchange dialogue, the moderator begins with introductions. Each member of the group is given a nametag while general, introductory questions are asked, in order to facilitate a more comfortable atmosphere. The majority of the FGD is structured around questions that address the issue of client drop-outs. Following the discussion period, participants are again told that the research team members are not part of FCC, and therefore do not make any promises for FCC. Finally, participants are offered sodas, as a token of appreciation for their time.

FGD Modifications

Welcome
Since some participants were confused about the reasons for the group discussions, the research team decided to stress that its members do not work for FCC and therefore cannot make any promises that FCC will change any of its products or policies. Additionally, participants were told that the research team was not there to ask them to join FCC.

Warm-up and General Questions
The time being spent on the more introductory questions was detracting from the value of the research project, because the moderator was not able to ask as many direct questions about client drop-outs as desired. Therefore, except for the non-client FGD guide, the warm-up and general question categories were condensed into one group.

Many of the probing questions were dropped and simply replaced with a note emphasizing the need to ask for clarification to participants' responses.

Drop-out Questions
For current and former clients, the questions were reworked to focus on two primary questions about reasons clients are leaving FCC and suggestions for how FCC could improve its loan product. As the research objective, this first question was explored extensively in each group, to ensure that the moderator had a strong understanding of each participant group's opinions.

Questions for non-client participants were revised to focus on getting an understanding of how much they knew about FCC, and what exposure they had to other similar programs. In addition, their general questions were consolidated, in order to address how participants save and where credit is obtained.

Conclusion

Few changes were made to the concluding remarks in any of the three FGD guides, other than adding a reiteration that the team's purpose was solely that of research.

Focus Group Discussion Tally Sheet

The following outline has been coped from: David Park, *Client Drop-outs at Fundo de Crédito Comunitário*, Maputo, Mozambique, October, 2003, in the author's possession, 21-28.

The following is a summary of the focus group discussions.

FGD Tally Sheet	South				North					
By Participant Type	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	NORTH TOTAL	SOUTH TOTAL
How did you hear about FCC?										
From FCC (advertising, attending loan group meetings)	4	1	1							6
Friends and neighbors	3		1							4
Current clients	1		1							2
Pastor at church	1									1
What makes people like yourselves decide to join FCC?										
Poor and need money (to make money, improve business)	12	2	2		17	5	3	3	28	16
The only option to receive credit	5				1		1	2	4	5
Saw how FCC helps people	5				3		1		4	5
Able to save money	2				2			1	3	2
Low guarantee requirements	1				1		1	1	3	1
Group support	1									1
To learn how to better manage one's business					2				2	
Unemployment, and loans gave opportunity to work					5		2	1	8	
To exchange experiences and learn from others					2				2	
How do people use the loans received from FCC?										
For ongoing business (expansion, working capital)	14	4	3		17	2	3	3	25	21
To start a business	5	4			1	1			2	9
Food and other necessities	4	1			6			1	7	5
Children's school-related expenses	2	2			1			1	2	4
Did the loans you received help you? Did the loans allow you to meet your needs?										
No, loan amount is not enough (cost of products/cost of living increasing)	11	1			9	1			10	12
Yes, helps with meeting basic living needs	4	3			1				1	7
No, bi-weekly repayment period is too short	4				8	1			9	4
No, even when payments are difficult to make, they still have to repay	3				1	1			2	3
No, additional loans are based on savings, so need to do very well and save well to get larger loans	1				2	1			3	1
No, loan is too expensive	1					1			1	1
No effect	1				3	1			4	1
Yes, helps to buy things to sell in the market	1									1
Participating in the FCC loan program harmed clients.					3	2			5	

FGD Tally Sheet	South				North					
By Participant Type	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	NORTH TOTAL	SOUTH TOTAL
Why are people dropping out/leaving FCC? (FCC related issues)										
Problems repaying the loan (see Section 7 for more detail) [People are unable to pay the money to FCC]	13	3	2	2	9	2	2	4	17	20
They are going to other organizations	3	2	1	2	3			2	5	8
They are really just resting and haven't dropped out	2	1	1	1		1			1	4
Loan product attributes/policies										
Bi-weekly repayment period is too short	19	6	2	1	16	5	4	6	31	28
Loan size is too small	11	2	3	2	13	4	2	5	24	18
Interest rate is too high	6	3	2	1	10	1		2	13	12
Difficulty using savings to cover for group shortfall (not allowed to early in cycle, group becomes delinquent and is penalized)	1	1			4	1			5	2
Mandatory savings for loans is too high					7				7	
People are not making profit off of the loan, but are only working to pay it back					7		2	2	11	
No incentive to save since savings can be used to pay for others (lose savings, next cycle loan is smaller)	2									2
Interest rate on savings is too low					1				1	
Group loan/group guarantee issues										
Good clients leave because they don't want to pay or be penalized with extra training for bad clients	12	3	2	3	7	2	1	4	14	20
Do not want to lose/afraid of losing/have lost guarantees	11	3		2	7	2	1		10	16
Groups make some clients leave because of difficulty repaying	7	2		3	2			2	4	12
Entire groups, with both good and bad clients, close because they were delinquent	1			1	4	1		1	6	2
Guarantees that are taken are worth more than what clients owe	1				2	1			3	1
FCC as an organization										
No consideration for difficult circumstances that arise for clients	4	2			4	1			5	6
Hearing negative things about FCC from former clients	2	1								3
No recognition for long-term clients	2				5	1		1	7	2
FCC doesn't care what clients have to go through when trying to recover debts from other members	1				3	1			4	1

FGD Tally Sheet
By Participant Type

	South CC Sub Total	South FC Sub Total	South NC Sub Total	South S Sub Total	North CC Sub Total	North FC Sub Total	North NC Sub Total	North S Sub Total	NORTH TOTAL	SOUTH TOTAL
Why are people dropping out/leaving FCC? (Non FCC related issues)										
Inflation/prices rising	1	3	2							6
Natural disasters (floods, famine)	2	2						1	1	4
Don't/Can't really know why people are leaving	1	1	2							4
Want to travel, not do business				2						2
Get a job somewhere (become employed by someone)	1	1				1			1	2
Choose to farm instead (during rainy season)	1			1						2
What are the main reasons why members have a hard time repaying?										
Business is not going well (poor markets, expensive products)	12	5	3	4	6	2	1	4	13	24
Problems handling the loans	13	3	2	3	4			2	6	21
Use the money for non-business purposes/mismanage money	11	2		1	5	1		2	8	14
Sickness and death	7	4		1	2			1	3	12
Have more than one loan/use one loan to pay for another	4			1	1				1	5
Other family issues	1	2	1		1	1			2	4
Business is not going well (lack of experience)	2				5	1		4	10	2
Other reasons	1		1							2
People use the money to buy food instead	1				3				3	1
Take advantage of group and wait for them to repay	1				4			2	6	1
Interest is too high	1				3				3	1
Travel costs/time related to business are too high to facilitate repayment					7	3	1	3	14	
Customs at the Malawi border have been raised so high that it is no longer worth it to go there										
Addicted to cigarettes and alcohol					2				2	
Money gets stolen or there is an accident					3				3	

FGD Tally Sheet
By Participant Type

	South CC Sub Total	South FC Sub Total	South NC Sub Total	South S Sub Total	North CC Sub Total	North FC Sub Total	North NC Sub Total	North S Sub Total	NORTH TOTAL	SOUTH TOTAL
What are your suggestions for improving FCC's product/service?										
Longer repayment period (monthly, bi-monthly, 40 days)	19	6	4	2	19	5	3	5	32	31
Have individual loans	10	3	4	4	7	1	1	1	10	21
Larger initial loans (ex: 1.5 mm, 2.5 mm)	8	2	6	2	6	4	1	1	12	18
Larger loans for larger businesses	11	2	2	2	5			1	6	17
Larger loans	4		3		11	2	2	1	16	7
Recognize/give incentives to long-term clients (financial - larger loans, repayment periods in select groups of LT clients; non-financial)	13	2		1	7	2			9	16
Lower the interest rate	9	3	3		6	2			8	15
FCC should understand when there are difficult circumstances (ex: sickness, death) and give a grace period or be more flexible	7	3	1		4			1	5	11
Other suggestions outside of FCC's product/service/scope	6	2	2							10
Non-repayment within a group should be that individual's responsibility	7	1		1	6			1	7	9
Allow clients to use savings to pay for loans or to cover a shortfall in the group	5	4			1	1			2	9
FCC should be directly involved in following up on delinquency or taking guarantees, not the group	7	1	1		4			3	7	9
Longer loan terms (for people with larger businesses, larger loans)	7		1		6	1			7	8
Evaluate clients to determine loan size (can work with groups to do this)	7			1	5	1		3	9	8
Group clients according to loan size/economic status (business type and business experience can be indicators for this)	4	1	1	2		1			1	8
There should be special groups that are allowed to choose the payment period (bi-weekly or monthly)	5			2	2	1			3	7
Amount of savings should not determine subsequent loan sizes	4	2			3				3	6
Increase the amount of each payment going to savings (related to interest is too high)	4	2								6
Differentiate between good and bad clients (move good clients out of bad groups, treat good clients differently within groups, make groups of good clients)	3	1		2	5	2		1	8	6
Larger loans for solidarity groups	2		1	2	3				3	5
Review and revise FCC policies	1	1		2				2	2	4

FGD Tally Sheet
By Participant Type

	South				North					
	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	NORTH TOTAL	SOUTH TOTAL
What are your suggestions for improving FCC's product/service? (Cont.)										
Mandatory savings is too high	3				7	1	1		9	3
Do not have clients start over with low loan sizes if savings are withdrawn/clients resta and withdraw savings	3									3
FCC should study what to do in the case of sickness/death and how to help clients	2	1				1			1	3
FCC should clarify policies/give policies to group members	3				2			1	3	3
FCC should know better whether clients really live in certain areas	3				1			1	2	3
Extend 1st payment to 1 month, but keep 15 day payments after that	2									2
Flexible loan terms (shorter for people that want to repay earlier)	1			1	1				1	2
Change guarantee policies (no taking of roofs, allow clients w/out moveable guarantees to have loans)	1			1	4		1	1	6	2
Promoters should continue making deposits to the bank	2									2
Keep current payment period for first loan to see how a client does	1									1
Larger loans (more than double) for the 2nd cycle	1				6	1		1	8	1
Evaluate clients during first loan to determine their capacity for subsequent loans	1				3				3	1
Lower the interest rate to 10%	1					1			1	1
Lower the interest rate for larger loans	1				1				1	1
Interest rate should be declining	1							1	1	1
Increase savings incentive (for ex 1% per month or 5% on cycle)	1				1				1	1
Hold meetings with clients that are thinking of leaving to talk to them about their reasons for leaving				1						1
Change policy of only transferring clients to new groups when they move to a new place				1						1
When someone dies on the 2nd cycle and on, group should cover but not on death during 1st cycle	1									1
FCC HQ needs to try to understand the "field way" of doing things				1						1
Do not allow promoters to collect money early, or double payments, just because it is a holiday		1								1

FGD Tally Sheet
By Participant Type

	South				North					
	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	NORTH TOTAL	SOUTH TOTAL
What are your suggestions for improving FCC's product/service? (Cont.)										
FCC should look for safer places to conduct disbursements/payments	1				2				2	1
FCC should give training in how to do business better, save, etc.	1				1				1	1
FCC should cover the shortfall at the end of the cycle with money from the next loan		1								1
When clients drop out, group should be allowed to continue without replacing them (less people)					1			1	2	
An incentive system should exist for FCC staff to improve their services								1	1	
Stronger involvement from the authorities (police, courts) when dealing with delinquent clients					3			2	5	
Instead of loans, give other services to develop businesses (transport, storage, etc.)					1				1	
Lease capital goods (tractor, grinding machine, water pump, etc.)							1		1	
Include police in training sessions to reinforce perception of authority								2	2	
Have a place for the CB admin bodies to conduct their business and keep their papers					1				1	
Allow clients to take loans without the savings requirement					3		1		4	
Pay interest on savings since they cannot be withdrawn					1				1	
Differentiate clients and products from region to region depending on relative levels of development					1				1	
Have a deposit system, like that at a formal bank, to pay back loans.					1				1	
FCC should allow clients to form special groups, even with only 2 people					2				2	
Do not keep people waiting for a new loan once they have already retrained or paid the penalty for being delinquent					1	1			2	
Allow clients to use savings during the cycle to support their businesses						1			1	
Reduce the size of groups to maximum of 8						1			1	
Keep groups, but have individual responsibility						1			1	
Continue doing market research!						1			1	

FGD Tally Sheet

By Participant Type

	South				North					
	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	NORTH TOTAL	SOUTH TOTAL
What do you know about the lending institutions in your community? Are there other places to borrow or save in the area?										
Unaware of other options/programs or do not know anything about the other programs that do exist	7	3	4	2						16
FCC is the only or best option	4	3	1		1				1	8
Some people borrow from friends and family	2	2	1	1			2		2	6
Xitiques	2	1	1	1						5
It does not matter because the interest rates are the same	1	1	1							3
Save at home, though it is better to save at banks	2		1							3
Know that other program exist and are able to weigh the choices	2									2
Our businesses are too small to save or get a loan	1		1							2
Only know people who suffer from it			1							1
Some people invest their money in more products to sell		1								1
Can sell an animal for funds for the business			1							1
Moneylenders							1		1	
Information about other MFIs										
Save the Children	3	2		2						7
There are other MFIs and FCC clients use them	2	2		2						6
Tchuma	2	1		1						4
CARE (for women only)	1		1							2
Credit Association		1								1
Save the Children's interest rate is lower than FCC's				1						1
Novo Banco				1	2	1	1		4	1
Caixa Comunitario				1						1
Ndjombo	1									1
ADC (for women only)							1		1	
World Vision (Karela)								1	1	
GAPI					1		1		2	
Casa de Mulhers								1	1	
AMODER					4		1		5	
Formal Banks										
Able to save at the formal banks, though it is difficult to open accounts b/c of minimum balance requirements	2		2							4
Banco Austral (for savings)	2		2							4
Banks don't consider them for loans	1	1	1							3
Used to save at banks, but don't anymore because business dropped	1		1							2
Save at banks, not at home; money is safe and accessible at banks	1	1								2
Banco Austral was here but they left		1								1

FGD Tally Sheet

By Participant Type

	South				North					
	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	CC Sub Total	FC Sub Total	NC Sub Total	S Sub Total	NORTH TOTAL	SOUTH TOTAL
Why are people not joining FCC/other MFIs?										
First loan/loans is/are too small	3		5				3	1	4	8
Payment periods are too short	5		2				3		3	7
Do not like group loan (being responsible for others)/group guarantee (losing guarantee)	2		3	1				3	3	6
Afraid of getting a loan and not being able to repay	2		2				1		1	4
Business is not doing well	3		1							4
Have no collateral (guarantee)	1		1				2	1	3	2
Are not able to join a group because the groups are full			1							1
Already have money	1									1
Interest is too high	1									1
Save the Children prefers to serve women (only 1 man per group)			1							1
FCC recieves a bad reputation from former clients who had a negative experience										
The training period of 6 weeks is long							1	1	2	
Groups are not working well - sometimes people pay but the payment is not registered by the other group members							1		1	
Too much pressure to repay							1		1	
Waiting to see how things go (b/c of how badly things went with Karela/WV)					1		1		2	
Current clients are sort of keeping others out							1		1	
Not easy to form such large groups							1		1	
What do you think of group loans/group guarantee system?										
Ok, but some take advantage of the system/hard to find people you can trust	5				2				2	5
Good, guarantees are necessary to borrow money (and individuals do not have these guarantees)	4				1		1		2	4
Don't like it, person should be responsible for their own loan	3		1		5			1	6	4
Good, can support each other through difficult times	3						1		1	3
Ok, but put people in groups according to the size of the loans they need	2									2
Ok, there haven't been too many problems so far	1									1
Ok, but don't think that the roof over your head should be taken	1									1
Ok, it's better for the institution, otherwise FCC would lose a lot of money				1	1				1	1
Don't like it, but don't have choice	1				1	1			2	1
Group size required by FCC is too big					2	3	1		6	
Group lacks the ability to pressure delinquent clients into repayment					3			2	5	

Appendix II: Figures for Chapter III

Figure III.1
Map of Mozambique[202]

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[202] *Mapa de Mozambique*, (accessed on 4/20/04) available from: http://www.mozambique.mz/mapa.htm.

Figure III.2[203]

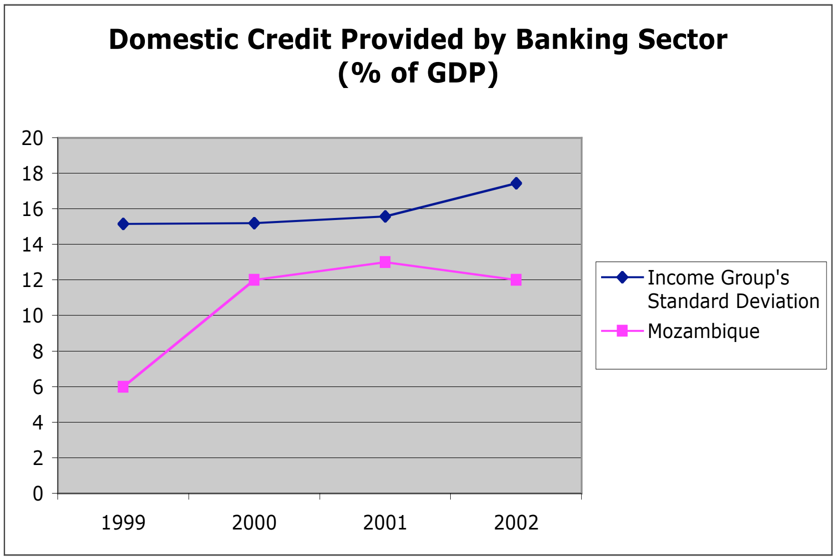
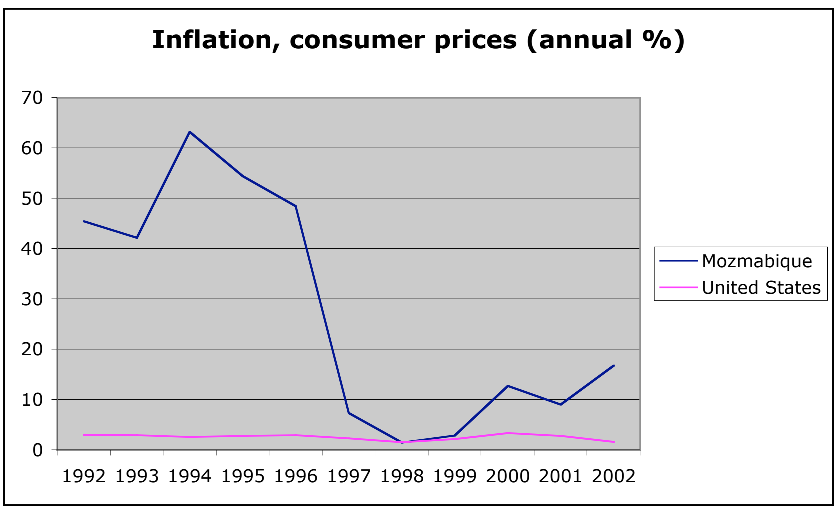


Figure III.3[204]



[203] World Bank, *World Development Indicators* (accessed on 1/22/04) available from: http://80-devdata.worldbank.org.ezproxy.library.tufts.edu/dataonline/.
[204] Ibid.