



Training Manual on Economic Empowerment and HIV Vulnerability Reduction

MICROFINANCE FOR VULNERABLE GROUPS

A TOOLKIT

Prepared under the ILO-Sida Project on Economic
Empowerment and HIV Vulnerability Reduction along
the transport Corridors in Southern Africa

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Acronyms

CEEIF	Corridor Economic Empowerment Innovation Fund
IFC	International Finance Corporation
ILO	International Labour Organization
LED	Local Economic Development
MFI	Microfinance Institutions
MSME	Micro, Small and Medium Enterprises
PAR	Portfolio at Risk
PLWHA	People Leaving With HIV AIDS
SEDCO	Small Enterprise Development Corporation

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SECTION 1: Introduction

This Draft Capacity Building Toolkit for Economic Empowerment targeted at economically active vulnerable groups is designed as a practical set of resources to combine microfinance with sustainable economic empowerment models to better serve targeted groups. The resource toolkit is meant for microfinance institutions, community based organization, development partners and governments that have programmes for economic uplift. The toolkit is inspired by the six-country Corridor Economic Empowerment Innovation Fund Programme put together by ILO in Southern Africa to tackle economic challenges that are faced by populations along transport corridors and are therefore vulnerable to HIV/AIDS. The countries are Malawi, Mozambique, South Africa, Tanzania, Zambia and Zimbabwe. The toolkit deals with issues from a basic and fundamental point of view. The challenges faced by vulnerable groups require innovative and creative solutions at community, private sector and government levels. New models of solving local economic development challenges, new thinking, and new partnerships are all needed to confront the nefarious constraints facing vulnerable populations in developing countries.

Development practitioners are grappling with dwindling resources and the need to demonstrate impact whilst sharing risks with partners both public and private. This toolkit takes cognizance of the fact that local players, particularly the target population, are best placed to determine strategies to building and grow their local economies through enterprise development. There are multiple resources, financial, material and technical, needed to drive the economic empowerment agenda. Linked to these resources, an enabling business environment at both national and local government is necessary to support enterprise development and hence strengthen the impact of empowerment programmes.

The toolkit is not a technical resource on how to manage a microfinance institution or how to implement local economic development programmes. It is just resource guide that should be used in conjunction with more advanced technical resource guides on particular subjects alluded to in this resource guide. The essence of the toolkit is that it be a rapid implementation resource guide for short programmes with small financial outlays.

1:1 Goal of Economic Empowerment

The purpose of economic empowerment is to give a population access to financial, physical, technology, markets and create an enabling environment to catalyse enterprise development. The objective of economic development is a sustainable increase in living standards, including per capita income, education, health, and environmental protection driven by the active participation of targeted or local people.

An empowerment strategy offers government, the private and not-for-profit sectors, and local communities the opportunity to work together to improve livelihoods. Ideally, such a strategy provides a framework for making programmatic and development choices. Most common strategies focus on enhancing competitiveness, increasing sustainable growth, and ensuring that growth is inclusive.

Approaches to economic empowerment can include:

- Ensuring that the local investment climate is functional for local businesses;
- Supporting small and medium-sized enterprises;
- Encouraging the formation of new enterprises;
- Attracting external investment (nationally and internationally);
- Investing in physical (hard) infrastructure;
- Investing in soft infrastructure (educational and workforce development, institutional support systems, and regulatory issues);
- Supporting the growth of particular clusters of businesses;
- Harnessing technology to efficiently serve vulnerable groups;
- Access to finance.

Tools for Economic Development

There is an unfortunate focus on finance as the panacea to all development problems. The needs of people at the base of the pyramid vary and there is need for a barrel of tools to fight poverty. A list of possible interventions is given below. There must be caution to avoid throwing money in the form of credit at every problem. A proper diagnosis is required and the most appropriate solution to tackle a community's problem be devised. Some of the solutions include:

- Access to Markets (Market Linkages),
- Access to Technology (e.g. production, storage, processing),
- Access to skills and training, and
- Access to Infrastructure.

1:2 The specific goal of this toolkit

This toolkit is meant to reduce the failure rate of microfinance backed local economic development (LED) programmes that are targeted at vulnerable groups implemented by development and private sector partners. Specific attention is given to sustainable access to financial resources through microfinance institutions targeted at individuals and groups of micro-entrepreneurs along selected clusters like transport corridors. The toolkit is a capacity building resource guide by the ILO to its partner institutions, particularly microfinance institutions, executing developmental projects.

1.3 Specific Objectives

The specific objective is to help microfinance institutions better serve vulnerable populations through strengthening various aspects of their operations like:

- Understanding the economic needs of vulnerable populations;
- Designing products and services that better serve such a target market;
- Business development strategies that enhances the MFIs' profitability whilst sustainably serving vulnerable populations;
- Choosing the best fit lending methodology for marshalling financial services to base of the pyramid populations or informal sector;
- Risk management in MFIs;

Box 1: Steps in designing an innovative economic empowerment strategy

Step 1: Assess Existing Conditions
Step 2: Assess Local Resources and Barriers
Step 3: Select Outcome or Goal
Step 4: Selection of Market Sector to Target
Step 5: Determine the General Approach for Directing Your Assistance
Step 6: Identify the Appropriate Intervention Activity
Step 7: Write a Mission Statement for the Program
Step 8: Prepare an Economic Empowerment Strategy
Step 9: Develop an Action Plan to Implement the Strategy
Step 10: Monitor, Evaluate, and Update the Strategy

1.4 Structure of this toolkit

Section 1 introduces the toolkit and its essence. Section 2 provides a justification on why development partners particularly MFIs should engage customers at the bottom of the pyramid, in the informal sector and the vulnerable. Section 3 is a practical tool on how to target vulnerable groups and what product offering to consider or design for them spelt out in section 4. Section 5 dwells on how MFIs implementing empowerment programmes can develop profitable business. Section 6 goes deeper on how MFIs and development partners can use a value chain approach in financing livelihoods programmes. Agricultural value chains are used as an example since most people in developing countries derive their livelihoods from agriculture. The advantages of group lending methodology are discussed in section 7. Section 8 guides microfinance institutions on risks that confront them and some few guides on how to tackle them. Section 9 concludes by stating the need for an action plan and a monitoring and evaluation tool for MFIs engaged in partnerships with developmental organisations.

SECTION 2: Justification for Targeting Vulnerable Groups

The size of population at the bottom of the pyramid is so vast that governments alone cannot tackle the challenges it faces hence there is need for multiple concurrent development partners with a myriad of innovative solutions to complement government efforts. The number of people surviving on less than \$1.25 per day is daunting. Increasing their income and maintaining constant inflows requires various economic development tools to be deployed.

The International Finance Corporation (IFC), the private sector arm of the World Bank Group, points out that there is a growing recognition among the development community and policymakers that greater access to financial services for individuals and small businesses has a critical role to play in ending extreme poverty, boosting shared prosperity of the bottom 40 percent of the population, and allowing for inclusive development.

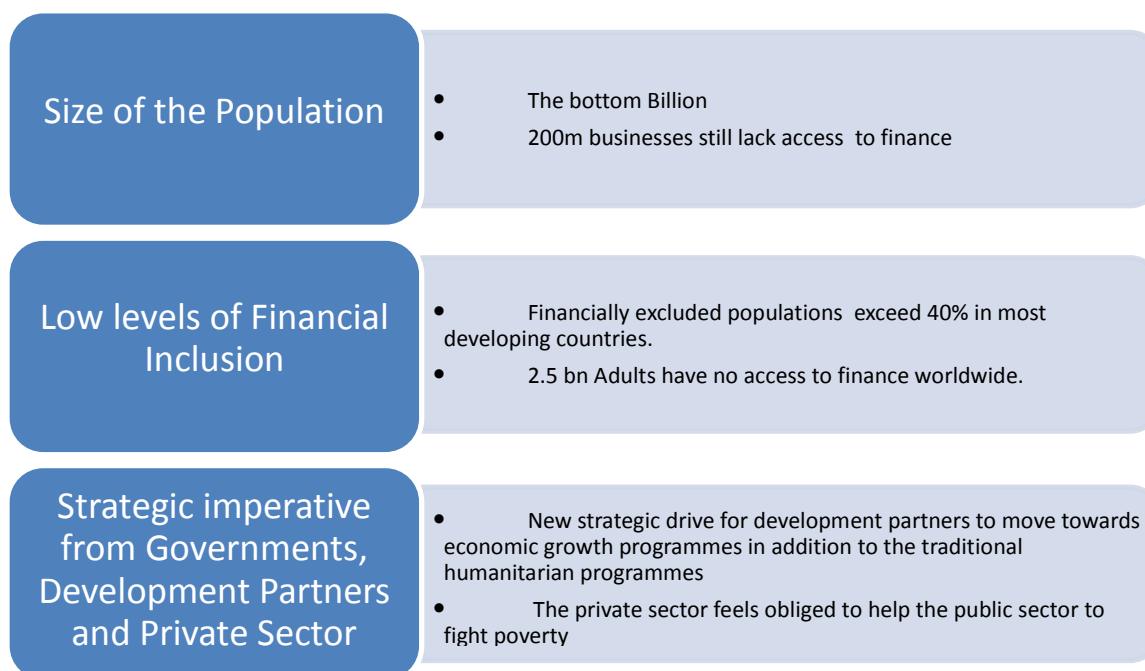
Further mention is made that the challenge of financial inclusion remains enormous, with 2.5 billion adults and close to 200 million businesses still lacking access to credit and basic financial services. The unmet financing needs of micro, small and medium enterprises in emerging markets are estimated at more than \$2 trillion. Much progress has been made in narrowing this gap, but achieving the vision of universal access by 2020 will require a concerted effort by the international community, innovative business models, and close collaboration between private and public sectors, leveraging expertise from across the whole gamut of like-minded development organizations. The IFC asserts that this challenge also presents an opportunity for both policymakers and the private sector to make a lasting impact in the fight against global poverty and aiming for shared prosperity. By intervening at various levels, each has a role to play to encourage better banking services, higher deposit rates, and greater accessibility of credit for micro, small and medium enterprises.

Box 2 and Table 1 below offers further justification for engaging vulnerable populations through the provision of funding for micro, small and medium enterprises (MSMEs). The unsustainable levels of exclusion create self-perpetuating vicious cycles of poverty as people cannot break into profitable undertakings. They remain exposed to engagements that are hazardous to the environment or to their health like commercial sex.

Box 2: Motivation for Targeting Vulnerable Groups

- Access to financial services is limited to the affluent, those who meet financial service providers' eligibility criteria, are near the service providers, those who can afford etc.
- A vast market exists for people excluded by affordable formal financial services and is at the mercy of exorbitant informal providers.
- Competition in the easy to reach market
- MFIs have prioritised breadth of outreach at the expense of depth of outreach (serving the more vulnerable).

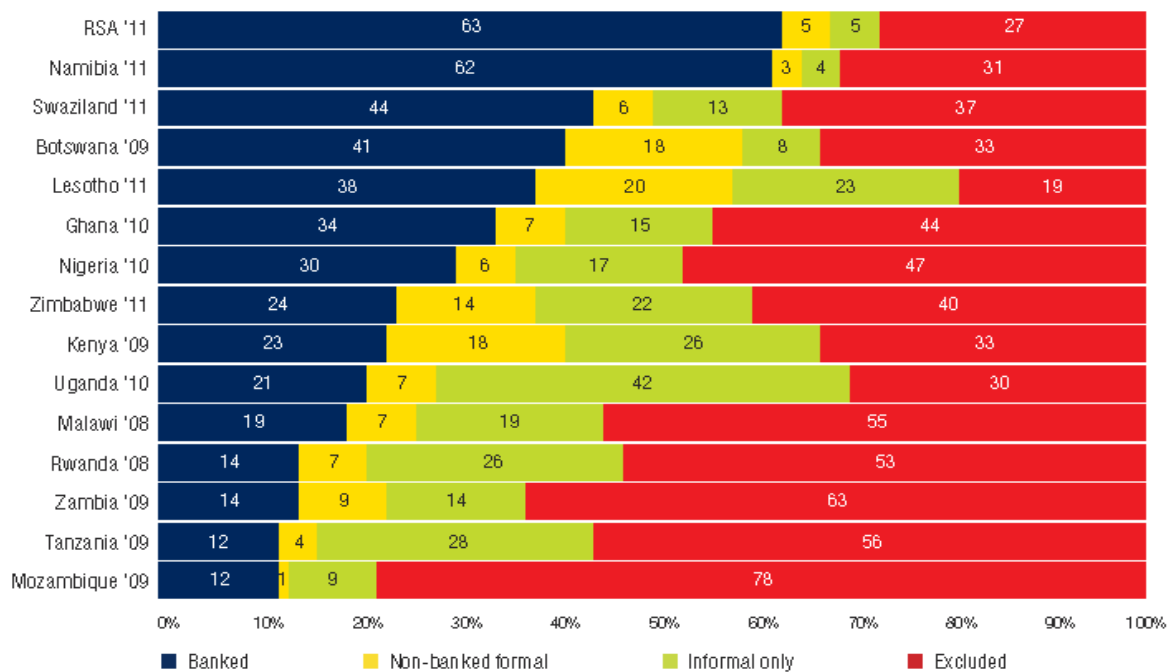
Figure 1: Main Reasons for Targeting Vulnerable and Financially Excluded Groups



Financial exclusion deters poor people's engagement in economic activities that improves their livelihoods. Lack of access to lines of credit curtails the ability of the poor to accumulate assets. Truncated access to savings means that the poor are vulnerable to life's shocks like ill-health and death. They slip back into poverty at the slightest occurrence of such vagaries and the vicious cycle is made worse by a lack of access to insurance services whereby the poor cannot insure their assets and purchase life or medical insurance. The 2011 Finscope Financial Access strand in selected Southern Africa countries is shown in figure 1 below. It shows the level of financial inclusion and exclusion and hence the work that still needs to be done by financial service providers to deepen outreach to excluded poor people.

An obvious motivation for the targeting of vulnerable populations is that there is a business case. The sheer size of the population is a source of huge volumes of business that any private sector company that finds efficient ways of doing business in this segment can reap huge profits. The poor are willing to pay high prices for the access to financial services whenever they are available. They are less price sensitive than the economically well-off who have options to choose from various service providers.

Figure 2: Financial Access Strand across Countries



Source: Finscope Zimbabwe Consumer Survey, 2011

Most countries in Sub-Sahara Africa (Fig 2 above) have failed to develop the financial sector well enough for it to marshal financial services to the majority of the people. A low percentage of people accessing financial services cause slower growth that is vulnerable to shocks. There is need for a well-developed financial superstructure to finance economic sector of the society.

SECTION 3: Targeting the Vulnerable

Local economic development programmes or economic empowerment programmes should not be implemented haphazardly. Targeting interventions at specific segments of the population, economic sector (like agriculture, mining, informal sector, etc.) has more impact on poverty reduction than a non-focused approach. A focused approach is referred to as targeting. It is often beneficial for MFIs to target certain niches in order to effectively address poverty. Targeted microfinance refers to active approaches to finding, recruiting and serving a particular group of people.

Other general reasons for targeting vulnerable groups are that:

- Some market segments are difficult to identify and serve because they are small, isolated or marginalized and face particular vulnerabilities e.g. HIV/AIDS
- Targets often do not meet an MFI's standard eligibility criteria yet there may be an interest from MFIs/donors to serve the vulnerable market.
- Social Mission – the developmental mandate (MFIs) have to avoid mission drift) - special effort has to be put on reducing inequality and discrimination.

MFIs are critical in development since they can take advantage of the **convening power of finance** to attract people to other development issues. Given this advantage it is easier for them to target specific populations with a raft of solutions.

3:1 Benefits of Targeting vulnerable clients

MFIs find targeting very beneficial in that:

- *It is part and parcel of their anti-poverty mission,*
- *It corrects market failure, and*
- *It builds bridges to those excluded by conventional financial institutions.*
- The poor cannot access for reason like age, ID, proof of residency etc.
- Targeting can be informed by incentives by development partners/governments who want to serve the vulnerable lest they are left behind.
- Donor motivated targeting fuels innovation but critical questions need to be asked – How will access to finance improve the life of the vulnerable group??? Access may not be the panacea!

- The need to give people an alternative lifestyle and means of survival from dangerous/hazardous engagements
 - e.g people at risk along transport corridors
 - Post conflict/war communities
 - People engaged in commercial sex and thus risk contracting the deadly HIV/AIDS virus.

3.2 Targeting Techniques

MFIs and indeed any organizations involved in local economic development use various techniques to target clients. These include but are not limited to:

- Age (e.g Youth)
- Gender
- Geographic location (rural, urban, peri-urban, farm community, transport corridor e.t.c
- Bonded labourers – (ILO Index).
- Levels of Vulnerability/economic status (the poorest). The World Bank's Progress out of Poverty Index (PPI) is a key tool in

Once targeting is done the challenge is how to serve the target cost effectively and efficiently? Targeting can be difficult for characteristics hard to measure like economic status or HIV status.

3.3 The Convening Power of Finance

Despite the fact that microfinance is just one of several interventions, it can be the lead activity because of the convening power of finance.

Access to microfinance services can then lead to:

- Savings & Credit groups
- Vocational Training
- Entrepreneurship training
- adult literacy, or collective action to address community needs e.g. sanitation, family planning etc.

3.4 Key Considerations When Dealing With Vulnerable Groups

Once targeting has been successful MFIs and indeed any development organization needs to consider various issues as it endeavours to tackle economic challenges.

MFIs adopting the integration approach can use some of the following practical tools:

- Combine savings (ASCAs/ROSCAs) products with Credit services.
- Target home based businesses. This reduces cost of traveling by the business owner,
- Help clients transition between activities during illness.
- Design “restart” or “bounce back” products for clients who are recovering from illness, economic shocks, conflict and fragility or environmental disasters.
- Credit with Education programmes
- Credit Life Insurance
- Funeral insurance on loans to clients.
- Subsidies
- Flexible repayment plans (especially during periods of illness).
- Partnerships with health/nutrition service providers; Voluntary counsellors,

3.5 Checklist for the Targeting process

The following is a step by step approach to the process of targeting vulnerable groups and a checklist of the essential components of the targeting exercise.

Step 1: Ensure that the organization is ready to diversify in to a new underserved market;

Step 2: Explore the characteristics of the new market;

Step 3: Explore the nature of the product mix that will meet the market needs;

Step 4: Crafting strategies of how the MFI is going to overcome each challenge associated with the segment. This includes:

- Business development,
- Staffing,
- Outreach,
- Risk management, e.t.c

SECTION 4: PRODUCT DESIGN

Goal: To provide a step by step approach on how MFIs can develop new or refine existing products.

A diversified product offering from financial services providers in a development project include a broad range of variety. Most MFIs will tout the credit product as the best tool to solve problems at the grassroots but this is not the case often times as the needs of the vulnerable are diverse and cannot be solved by credit all the time.

The product range that should be considered by an MFI includes the ones in the list below.

- Savings
- Long-term Savings and Micro-pensions
- Microenterprise Loans
- Housing Loans/Micro-housing Loans
- Emergency and Consumption Loans
- Micro-insurance
- Leasing
- Money Transfers
- Non-financial Services
- Grants

Products, both financial and non-financial have to be well designed to respond to an economic development challenge at hand. The product features have to be well researched in order to respond to the customer needs. The new product cycle below depicts the stages to be followed by an MFI in developing or modifying a product. A market research is almost mandatory lest an MFI jumps to the conclusion that a new product is needed. This might lead to a hasty development of a product that might not respond well to market needs. This might result in the risk of a loss. A product prototype should be adequately pilot tested to verify if the product features are well designed to meet customer expectations.

Box 3: Main Message on New Product Design

- **Innovate and develop products based on market research to ensure that products offered are aligned to the changing needs of clients**
- **Explore new channels of delivery such as electronic and mobile to facilitate efficient delivery**

Steps in Product Development

There are 5 distinct activities in the process of product development representing steps in the product development cycle. Each of the 5 steps and activities involved at each step are given below:

Step 1: Evaluation and Preparation

Activities at this stage include the MFI assessing the market needs and the product portfolio they have. Specifically the MFI evaluates:

- Product development ideas it has identified;
- The product mix it has;
- identifies weaknesses and gap the products are not serving;
- evaluates the changing needs of the market;
- Assembling a product development team;
- Prepares to do a market research on market needs.

Step 2: Market Research

Market research involves:

- Identifying the respondents,
- Questionnaire design;
- Training personnel on data gathering;
- Pilot testing the questionnaire;
- Refining the questionnaire;

Data gathered should be able to point the MFI to information leading to the analysis:

- Customer needs;
- Market potential;
- Competitor analysis;
- Operating environment, and

Step 3: Prototype Design

Market research makes it possible to define an initial concept of the new or improved product. Once this is done other key issues are done namely;

- Operational procedures,
- Risk identification and control,
- Cost analysis;
- Product pricing;
- Revenue projection;
- A prototype, ready for pilot testing, is designed.

Step 4: Pilot Test

Pilot testing helps the organization to assess market demand and institutional readiness.

Two distinct activities at this stage are:

- Introducing the prototype to the market;
- Few selected locations or branches are used to test the prototype for a certain period of time;
- Monitor the results;

Step 5: Product Launch

Pilot testing may point the organization to various actions needed. These include:

- Conclusion that the product can be rolled out;
- The prototype needs modification as recommended by pilot test;
- Integrate the new product into existing product mix and ongoing operations;
- Training of staff members;
- IT reconfiguration to include the new product.
- Loan capital is allocated for the product, and
- A marketing strategy is developed to spur new product uptake.

Figure 3: Product Development Cycle



Source: G. N. Wright et. Al, 2011

There are other pitfalls that should be avoided in product development. There is always the assumption that new product development is a distinct process. This is unfortunate as it limits the MFI's innovative potential. It should rather be treated as an ongoing process which exploits market opportunities and MFI's creative potential. The process can also be triggered by information technology developments that are released on the market which the product developer is harnessing. In the financial services sector such a development that has triggered widespread response is mobile financial services.

There has to be some significant effort to ensure that new products have synergy with existing products – this reduces the risk of Orphan Products that are often marginalized by an organisation's frontline staff who do the sales.

There are many triggers that result in new product development. A summary of most of them is given in table 1 below. MFIs need to be proactive in identifying opportunities as they occur. Products designed for vulnerable populations should aim at infusing flexibility in the product features to better serve the unique needs of clients who need economic empowerment.

SECTION 5: BUSINESS DEVELOPMENT

The role of every business is to find a customer – (P. Drucker).

The essence of business development is to generate sufficient thresholds of business to sustain the MFI business financially whilst meeting developmental goals. Private sector organisations should be profitable in order to support vulnerable communities sustainably. A loss making organization can easily go bust and shutter the hopes of those that they are trying to assist when they discontinue services.

There is need for aggressive business development by MFIs since they are faced with competition in urban market that they have been serving. So finding niche markets to serve helps MFIs avoid head on competition with various other competitors. New markets are necessary to allow MFIs to expand customer base. New markets help the lending organization to reduce credit risk and accommodate stakeholder preferences like the needs of donors, governments or shareholders.

The following broad categories of essential areas of an MFI's operations should be part checklist of profitability and sustainability should guide it:

- a) Financial Indicators (Key ratios include Financial Self Sufficiency, Operational Self Sufficiency, Operational Cost Ratio, etc a full set of the financial ratios can be found on Mix Market website and the formulae are given in annex 4 of this toolkit).

Ratios in a microfinance operation are mainly categorized under five key categories, namely **profitability ratios, productivity ratios, efficiency ratios, sustainability ratios, financial Structure/Leverage and asset and liability management ratios.**

- b) Portfolio performance
- c) Social Performance monitoring

5.1 New Business Development Process

The process of New Business Development is almost similar to that of new product development.

Step 1: Strategic Decision to develop new business

The MFI should make a strategic decision to enter into new markets. The decision should be based on tangible evidence and ability by the organization to exploit an existing opportunity in the new market.

Step 2: Market Research (to determine which market to be targeted)

This helps determine the organisation's ability and preparedness to enter new markets, risk associated with it and the product mix to it.

Step 3: Design a strategy for delivering a portfolio of products to the target market

The delivery function of the MFI is the way the MFI offers its products and services, the method of reaching to the customer (staffing, branch network, use of agents, mobile money platforms etc).

Step 4: Costing

The MFI has to identify the costs associated with exploiting the new market. If the costs outweigh the profit of entering the market then there would be no need for the financial service provider to enter the market unless there are subsidies from other development partners or shareholders.

Step 5: Testing

Before full plunge into a new market segment or niche there is need for pilot testing with limited resources, both physical and material.

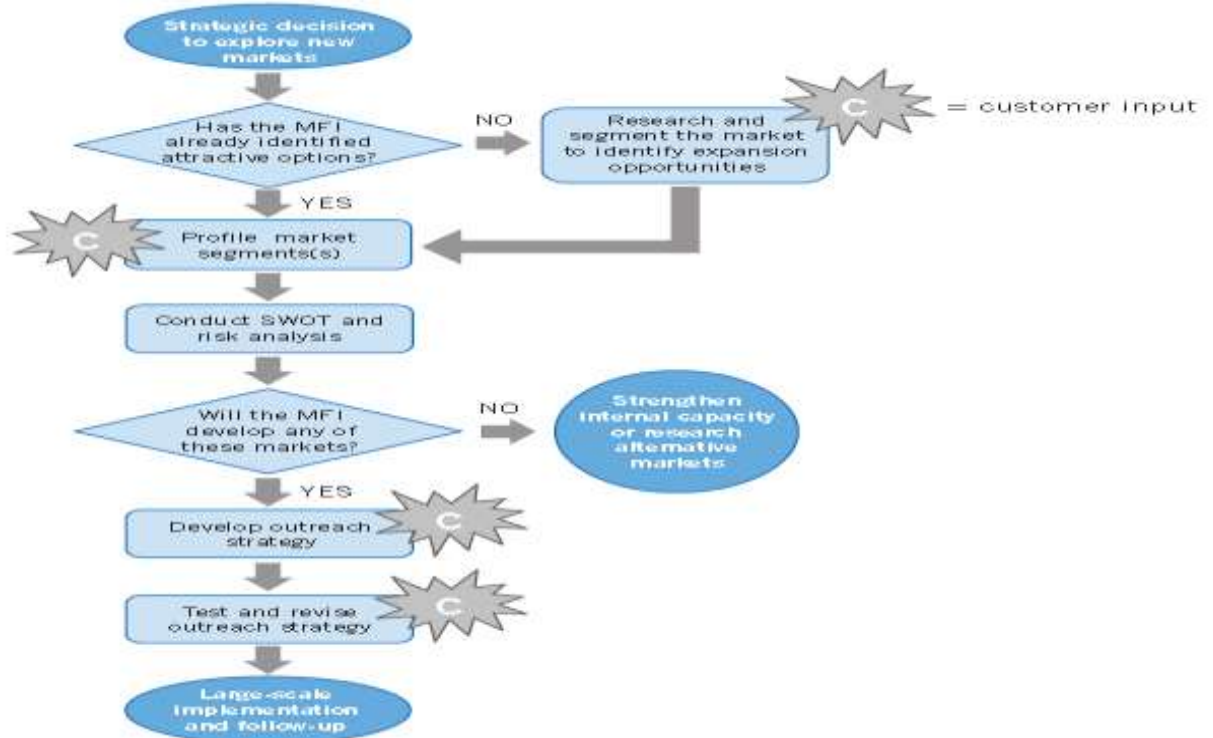
Step 6: Implementation

If the pilot testing phase shows that the market being exploited is good enough then the business development strategy can be rolled out across the whole organisation

Step 7: Control

Control and evaluation guides the organization towards the critical thresholds that would have been set out from the onset particularly at the strategic decision making stage, market research and costing stage.

Figure 4: New market/business Development Process



Source: Churchill et al, 2011

A quick guide on new market development is depicted above to help MFIs easily institute a business development process in its operations. Business development is the art of getting new clients, retaining old ones and offering new products to existing customers. The process of new business development should be well calculated because a conscious effort to extend product offering or finding new customers can result in inherent risks like an increase in costs unmet expectations of customers.

5.2 Impact of Business Development

If MFIs aggressively execute business development strategies to targeted niches' (even to the vulnerable) the resultant impact would be reflected on two key operational areas – portfolio quality and profitability. These are discussed briefly below.

Portfolio Quality

- If you an MFI grow bad business loan portfolio quality is going to decline and the losses on the organization are increases. A business development strategy for a financial service provider should be cognizant of the risk of bringing garbage in as this will really result in garbage out.
- If the MFI's growth is too rapid this could stretch the MFI's staff capacity, IT capabilities and funding needs. The outcome would be disastrous on portfolio quality.

Organisational Profitability

- If an MFI develops a business by targeting niches that are difficult and expensive to service the impact on profitability would be huge.
- An organization, whether developmental or humanitarian should at least break-even in order to preserve its assets. Most donor supported programmes have the notion that providing cheap, often times not commercially viable, services it is doing good. The feel good effect is by and large short lived since resources are quickly depleted leaving needy customers with shattered hopes.
- A strategic business development function of the organization should be focused on attracting profitable market segments which often times include the vulnerable if the organisation has the right product mix and the efficient delivery mechanisms.

SECTION 6: The Essence of Value Chains in Empowerment Programme

Most developing countries are heavily reliant on agriculture. A well-developed agriculture sector is essential in helping vulnerable communities reduce vulnerabilities and ensure food security. Post-conflict communities emerging from either war or long periods of economic crisis normally use agriculture development to quick start the economy again. A rapid rise in agricultural development cushions an economic from shocks. Emerging urban food markets in most developing countries particularly Africa is driving a new wave of agricultural growth as demand increases. A rising middle class and a general increase in wages have seen a recent surge in agricultural production. A competition between food crops and commercial crops for agricultural land has seen a general increase in food crop prices. The use of food crops for industrial outputs like bio-diesel and stock feeds has seen a sharp rise in prices of food crops. This recent development could offer a lifeline to vast populations that are relying on agriculture for their livelihoods. In that regard, economic empowerment programmes can significantly improve their impact by working through agriculture value chains to uplift their target populations.

Microfinance institutions can make agricultural lending less risky by using a value chain approach in financing players at each stage of the value chain. A value chain approach considers all the stages an agricultural produce goes through from input supply, through production and processing and finally to the table. This is normally called from farm to fork.

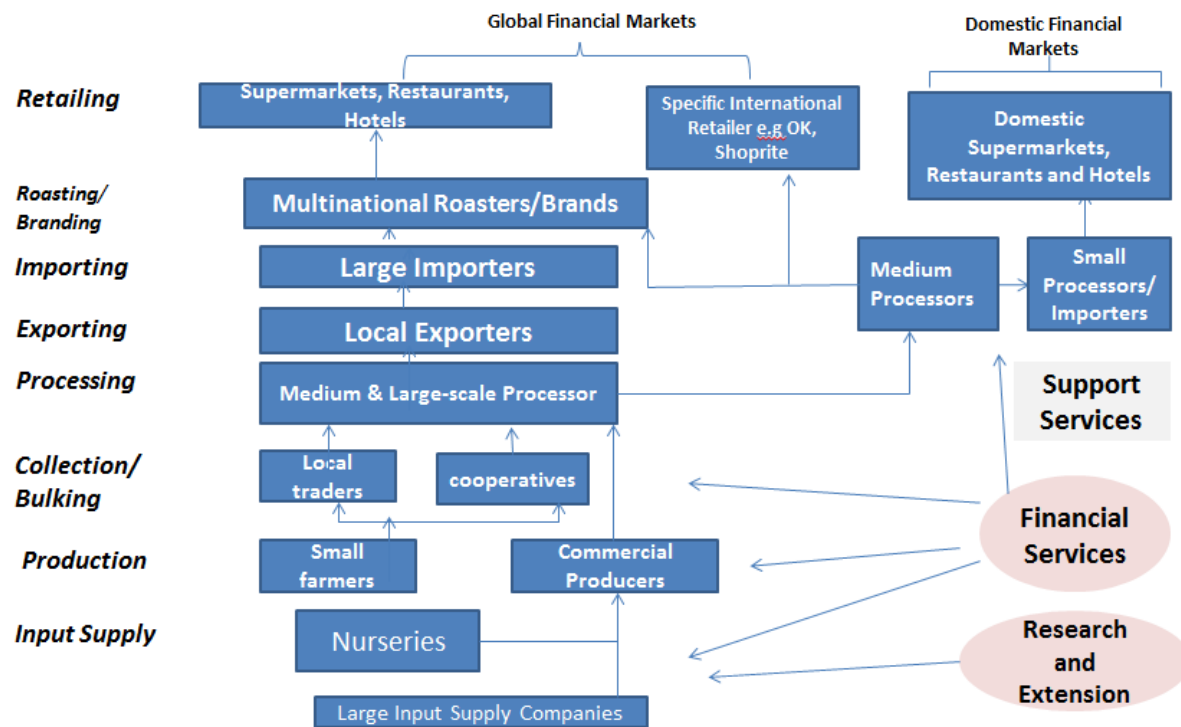
Value chain financing ring fences the lender from risks that are inherent in agricultural lending. An MFI can pick on the most appropriate value chains to finance and at what stage of the value chain should the financing be targeted at. Figure 5 and Figure 6 below depict a value chain maps with the various stages and players at each stage. Financing, training, technological and access to market interventions by organisations working in the empowerment space can be well targeted at each of the players to meaningfully have an impact on both the player and the whole value chain.

The main advantages of using a value chain approach to economic empowerment and financing are given below:

- it greatly reduces **transaction, business acquisition & retention** costs,
- It rapidly increases outreach for the MFIs,
- It reduces credit and market risks hence make lending to vulnerable groups less risky,

- A value chain approach helps link beneficiaries to markets and suppliers, a relationship which can last for a very long time even after a development project or intervention has lapsed.
- **Contract farming** is easily enabled through targeting specific value chain

Figure 5: Value Chain Mapping in Agribusiness



In the section above, mention of agricultural value chains, in table 2 below, there are few case studies of value chain financing in various countries that have successfully marshalled support to the agricultural sector.

Table 1: Examples of Innovative Agriculture Financing Models

Country	Nature of Project	Brief Description
Swaziland	Sugarcane Finance	Swazibank finances Vuvulane Farmers, a cooperative of sugar farmers, Seasonal loans are given and are garnished from the sugar mill at harvest when the
Nigeria	Reaching out to Fulani nomadic Herders through Veterinary Drug Suppliers	Kwara Commercial Microfinance Bank (KCMB) had difficulties in financing the livestock value chain due to the nomadic nature of the predominantly Hausa-Fulani cattle herders. The solved the problem by working with Veterinary Drug Suppliers.
Zimbabwe	USAID Funded Agritrade Credit programme	The USAID Programme in Zimbabwe established a multi-year, multimillion dollar agriculture credit programme managed by 2 commercial banks and a microfinance institution. The credit lines was based on a risk sharing arrangement between the USAID and the disbursing banks which were lending to small-holder fed agribusinesses.
Southern and Eastern Africa	Africa Enterprise Challenge Fund	An innovative credit programme to agribusinesses that demonstrate innovation and impact to rural farmer. The programme is a multi-country fund with contributors like Soros Foundation, Alliance for Green Revolution in Africa (AGRA) and Australia Aid (AusAID).
Zimbabwe	Create Loan Fund for Smallholder Agriculture	Danish Aid, UK Aid and Hivos put together a fund for agriculture that is being disbursed through 3 banks in Zimbabwe. Product lines include loans to players at all stages of the value chain and guarantees.

A financial service provider has an array of product to choose from or design for the agricultural sector. Most of these financing instruments are suitable for target populations of economic empowerment programmes.

Table 2: Examples of Agriculture Finance Products

Category	Financing Instrument
Agricultural product based	• Trade credit • Input supply credit • Agribusiness/Marketing company credit • Lead firm financing / contract farming
Accounts receivable based	• Trade receivables finance • Factoring
Physical asset based	• Warehouse receipts system • Leasing
Risk mitigation	• Insurance • Forward contract • Futures
Financial enhancements	• Securitization • Loan guarantees • Joint ventures

6.1 Business Linkages and Partnership

Economic empowerment needs sufficient resources to achieve and no one organization can adequately serve vulnerable groups. There is need for joint interventions by various organizations who utilize their comparative advantages to solve developmental challenges at hand. This toolkit is an emanation of programmes implement through MFIs in 6 countries. Their core competencies are in financial services provision. However, the challenges in the target market they serve are far beyond financial challenges. This requires that partnership be forged with other organisations whose competencies can tackle challenges like health, access to markets (including exports) and access to training services.

There has to be an ecosystem of partners to tackle local economic challenges and to exploit emerging opportunities. Since the MFIs are on the ground they have to use the convening power of finance bring together a multiplicity of players.

It is often cheaper and more sustainable to use business linkages and partnerships in serving vulnerable groups. These can be forged with local suppliers, retailers, manufacturers and business services providers. Multiple players understand the local economy and its sectors and resources available in each and for each sector. Business linkages and partnerships result in some multiplier effect. Backward and forward linkages emerge and blockages to investments are unclogged.

Innovative partnerships are highly encouraged for MFIs. These can be with bigger banks, insurers, NGOs, international development organisations and package together service offerings

Steps in choosing the right partner involve the organisation thoroughly assessing the following issues about the potential:

- The potential partners Mission, Vision and values;
- The resource base that the organisation has for the envisaged project;
- The experience in tackling the problem at hand or achieving the development objective;
- Adequate staffing;

SECTION 7: LENDING METHODOLOGY

The lending methodology by a lending institution is part of its delivery function and affects the effectiveness of the intervention it is offering to the market. The choice to select an appropriate lending methodology lies solely with the lender given the target market's unique characteristics and preferences. Cultural considerations are also important in that some societies can work well together as groups and others not very cohesive hence individual borrowing is the norm.

The ILO programme in 6 Southern African countries has chosen to use group lending methodology and in here we only discuss group lending methodology.

- Advantages of Group lending are multiple fold:
 - Use of peer selection
 - Group social cohesion
 - Lower dropout rate
 - Peer support for members to other vulnerable group members
 - Social Collateral as group members co-guarantee each other
 - Easier to reach to many people through group membership
 - If used well, repayment incentives increase loan performance in group lending.
 - Group borrowers are less likely to make informal transfers to families and friends while borrowers in individual-lending villages are more likely to do so.
 - joint liability may deter borrowers from using loans for non-investment purposes.

SECTION 8: RISK MANAGEMENT



This section helps the MFI to identify, manage or minimise risk in order to run profitably and sustainably.

- *The Success of any economic empowerment programme lies on agile risk management effort by the participating MFIs/Banks.*
- The success is heavily dependent on how each partner manages risks that are inherent in the targeted intervention.
- Many risk are inherent in managing an MFI.
- Risk management is defined as “the culture, processes and structures that are directed toward the effective management of potential opportunities and adverse effects.”

8:1 Microfinance Banana Skins Report

There are risks inherent in microfinance and can wreak havoc to the industry and institution. Below is a list of the most common risks identified by the 2012 Microfinance Banana Skins ranked in order of severity. The 2011 rankings are in brackets.

- | | |
|-----------------------------------|--------------------------------|
| 1. Over-indebtedness (-) | 11. Mission drift (9) |
| 2. Corporate governance (4) | 12. Back office (13) |
| 3. Management quality (7) | 13. Macro-economic risk (17) |
| 4. Credit risk (1) | 14. Staffing (8) |
| 5. Political interference (5) | 15. External risks (-) |
| 6. Quality of risk management (-) | 16. Technology management (11) |
| 7. Client management (-) | 17. Too little funding (23) |
| 8. Competition (3) | 18. Interest rates (21) |
| 9. Regulation (6) | 19. Too much funding (22) |
| 10. Liquidity (16) | 20. Foreign exchange (24) |

MFIs should manage risks religiously in order to avoid pitfalls that will see them lose money, partnerships and credibility.

8.2 Other Risk Categories

- The Basel II Accord on Banking Supervision, identifies three major types of risks for the banking industry:
 - Credit Risk,
 - Market Risk,
 - Operational Risk.
- Operational risk is further divided into 7 level 1 event type categories:
 - Internal Fraud
 - External Fraud
 - Employment Practices and Workplace Safety
 - Clients, Products, & Business Practice
 - Damage to Physical Assets
 - Business Disruption & Systems Failures
 - Execution, Delivery, & Process Management

8.3 The Risk Management Process

A lending organization should have a good risk management framework in place. A risk management culture should be pervasive within the organization from the top to the lowest rung of the corporate ladder. Figure 7 below shows steps in the risk management process.

The Risk Management process that an MFI should follow is given below:

Step 1: Risk Identification

At this stage the MFI should identify the implicit risks that its institution is susceptible to. The business operational environment, the Microfinance Banana Skin should all be used

Step 2: Risk Analysis

Risk analysis is the process whereby the organization categorizes risk in term of probability or likelihood of occurrence and severity. The highly probable and very severe risks are normally categorized as high or red. Some risks are categorized as medium and low risks.

Step 3: Designing a Risk Management Plan

A risk management plan guides the organization on how to lower or eliminate risks. Some risks cannot be avoided and can only be solved by financing them (e.g through insurance) or sharing them with other parties.

Step 4: Risk Monitoring

Constant monitoring of risk help the organisation identify those risk that are increasing in severity e.g from low to medium to high. Risk monitoring is an ongoing process that should never be avoided at all.

Step 5: Responds

Responding to risk depends on the risk appetite the organisation is willing to take. Tackling some risk is obligatory to the organisation particularly if they have to deal with governance and regulatory issues.

Figure 6: Risk Management Process



8.4 Risk Management Policy

Risk management policy is the outcome of the risk management planning process.

It should include the following:

1. The organization's rationale for managing risk
2. Purpose, audience, principles, benefits, objectives and relationship with objectives and other policies
3. Risk approach and methodology

4. Management commitment for the risk management process
5. Roles, responsibilities and accountabilities for the risk management process
6. Risk management budget
7. Sequence and timing of the risk management processes
8. Scoring metrics for risk analysis
9. Organization's risk appetite, threshold and escalation procedure
10. Risk response reporting formats
11. Tracking method of risk activities
12. Variations and dispensations from the policy and the process for requests for this

8.5 RISK TREATMENT OPTION

1. Avoiding the risk by deciding not to start or continue with the activity that gives rise to the risk
2. Taking or increasing the risk in order to pursue an opportunity (Risk Seeking)
3. Removing the risk source
4. Modifying the risk either by changing the likelihood or the consequences or both
5. Transferring or sometimes sharing the risk to another party or parties e.g. insurance, credit, guarantees, risk sharing, contracts, etc.
6. Retaining the risk by informed choice e.g. residual risk

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Annex 1: 5 Cs of Credit

The 5 Cs of Credit guides the lender on what to look for in a business in order to determine the credit worthiness of a borrower. This annex is designed to harmonise the expectations of the loan analyst and the credit committee both at Branch level all the way to the board level. The five key areas to look at a microenterprise are: Capital, Cashflow, Collateral, Character and Capacity. Each of these components shall be considered separately below.

1. Capital

The lender needs to know how much capital the borrower has injected into the business. It is determined by the cash at hand, debtors, stock and fixed assets less liabilities against the business. The level of capital is a pointer to the additional amount a lender can inject into a business. Normally lenders never extend credit that is more than what the borrower has in the business. The risk of funding more than the entrepreneur has is that, in case of a loss, the borrower loses less than the lender. The best practice is to lend considerably less than what the business has in the form of capital and gradually grow with the enterprises. Any huge injection into the business will result in the entrepreneur diverting the 'new found wealth' to other uses.

So it is always prudent to consider how well capitalized is the company? How much money has been invested in the business? Lenders often want to see that the owner has a financial commitment and has taken on risk for the company. Both the company's financial statements and the personal credit are keys to the capital question. If the company is operating with a negative net worth, for example, will the owner be prepared to add more of his or her own money? How far will his or her personal resources support both the owner and the business as it is growing?

The capital levels guide the lender from overburdening the enterprise by a huge loan that will be a burden to a small capital base in that the capital in the business will not be able to generate revenue sufficient to meet costs and repay a loan.

2. Character

The character of an individual borrower or a company determines the willingness that they have towards repaying a loan. The individual's character is gleaned from the way they pay their bills, their educational levels, the feedback received from suppliers who supply on credit and customer reference checks. For companies good questions to ask include those based on the management team. What is the character of the company's management? What is management's reputation in the industry and the community? Lenders want to put their money with those who have impeccable credentials and references. The way the owner/manager treats employees and customers, the way he or she takes responsibility, timeliness in fulfilling obligations are all part of the character question. This is really about the owner or manager and his/her personal leadership. How the owner or manager conducts business and personal life gives the lender a clue about how he/she is likely to handle leadership as a manager. What is the company's borrowing history and record of repayment? It is a lender's responsibility to look at the downside of making a loan. The owner/manager's character immediately comes into play if there is a business crisis. Small business owners place their personal stamp on everything that affects their companies. Often, lenders do not differentiate between the owner and the business. This is one of the reasons why the credit scoring process evolved, with a large component being personal credit history.

3. Capacity

Capacity determines the ability of the borrower to pay his obligations when they fall due. Some borrowers could be very willing to pay but willingness that is not coupled with ability does not cover the lender. Capacity to repay a loan is drawn profitability and size of the business. Normally loan size granted is based on the capacity of the borrower to take on a certain threshold of liability. Key questions could be how much debt can the company handle? Will it be able to honor the obligation and repay the debt? There are numerous financial benchmarks, such as debt and liquidity ratios, that lenders evaluate before advancing funds. Become familiar with the expected pattern in the particular industry. Some industries can take a higher debt load; others may operate with less liquidity. The balance sheet of a borrower is a good indicator of how easy it is for a borrower to repay a loan.

4. Cashflow

The old adage that cash is king hold water in lending and gained higher credence after the 2008 financial crisis. Historically lenders would base credit decisions on how well a debt is secured by collateral predominantly immovable property. In recent times cashflow is the key consideration when determining when a loan would be repaid or not when it falls due. The lender should be cognizant of cash cycles in the business, sector and economy. Seasonal sweeps in business determines the ability of the borrower to pay a loan even when the business, sector or economy is going through lean periods. Cashflow based lending takes a very new dimension when borrowers are coming from the agricultural sector which is susceptible to seasonal cashflows linked to crop, weather and market seasons.

5. Collateral.

A well collateralized loan is preferable because in case of failure to repay by borrower the lender will take over the pledged asset and sell it off to recover his capital. While cash flow will nearly always be the primary source of loan repayment, bankers should look closely at the secondary source of repayment. Collateral represents assets that the borrower pledges as an alternate, often secondary, repayment. Most collateral is in the form of hard assets, such as real estate and office or manufacturing equipment. Alternatively, accounts receivable and inventory can be pledged as collateral, though in some countries, these “movable assets” are not well supported by the legal framework. The collateral issue is a bigger challenge for service businesses, as they have fewer hard assets to pledge. Until the business is proven, a loan should nearly always have collateral. If it doesn't come from the business, the bank should look to personal assets.

It is useful to note that in evaluating the five C's of credit, lenders do not give equal weight to each area. Lenders are cautious, and one weak area could offset all the other strengths. For example, if the industry is sensitive to economic swings, the borrower may have difficulty getting a loan during an economic downturn — even if all other factors are well covered. If the borrower perceived as predisposed to doubtful integrity, then there is little likelihood of receiving a loan even when the financial statements are good. Lenders should evaluate the borrower holistically, which is often more than the sum of the parts.

Annex 2: Sample Action Plan Template for MFIs

Action Plan for MFIs Implementing Economic Empowerment Programs									
Name of MFI:									
Target									
	Tasks/Plans	Who?		What Specific Task?	Timelines		Expected result	How to Measure Performance?	Cost attached to the Task
		Implementer	Monitor		Start Date	End Date			
1									
2									
3									
4									
5									
6									
7									
8									

Annex 3: ESSENTIAL ELEMENTS OF RISK MANAGEMENT FRAMEWORK

Culture

1. Context, key stakeholders, and existing capability and maturity of risk management
2. Purpose and scope of risk management
3. Risk appetite, tolerances, and criteria

Processes

1. Risk categories
2. Tools and techniques
3. Risk management activities

Structures

1. Roles and responsibilities
2. External and internal communication/reporting
3. Templates and formats

Annex 4: Key Ratios in Microfinance Operations

KEY PERFORMANCE INDICATORS - RATIOS

EFFICIENCY RATIOS

(The lower the ratios, the more Efficient an MFB)

Formula

Operating Expense Ratio	$\frac{\text{Total Expenses}}{\text{Average Gross Portfolio}}$
Staff Costs to Avg. Portfolio	$\frac{\text{Salaries \& Benefits}}{\text{Average Gross Portfolio}}$
Cost Per Unit of Currency Disbursed	$\frac{\text{Total Expenses}}{\text{Total Amount Disbursed in the Period}}$
Cost Per Loan Made	$\frac{\text{Total Expenses}}{\text{Total Number of Loans Made in the Period}}$

PRODUCTIVITY RATIOS

(The higher the ratios, the more Productive an MFB)

Formula

Number of Active Loans Per Credit Officer	$\frac{\text{Average Number of Active Loans}}{\text{Average Number of Accounts Officers}}$
Average Portfolio per Credit Officer	$\frac{\text{Average Value of Loans Outstanding}}{\text{Average Number of Accounts Officers}}$
Average Portfolio per Staff Member	$\frac{\text{Average Value of Loans Outstanding}}{\text{Average Number of Staff Members}}$
Amount Disbursed Per Credit Officer	$\frac{\text{Total Amount Disbursed}}{\text{Average Number of Account Officers}}$

SUSTAINABILITY RATIOS

(The higher the ratios, the more Sustainable an MFB)

Formula

Financial Spread

$$\frac{\text{Interest \& Fee Revenue} - \text{Financial Costs}}{\text{Average Gross Portfolio}}$$

Operating Cost Recovery

$$\frac{\text{Total Income}}{\text{Total Expenses excluding Depp \& Loan Loss}}$$

Operating Self-Sufficiency

$$\frac{\text{Total Income}}{\text{Total Expenses excluding Loan Loss}}$$

Finanical Self-Sufficiency

$$\frac{\text{Total Income}}{\text{Total Expenses}}$$

PROFITABILITY RATIOS

(The higher the ratios, the more Profitable an MFB)

Formula

Return on Assets

$$\frac{\text{Net Profit after Tax}}{\text{Average Total Assets}}$$

Return on Equity

$$\frac{\text{Net Profit after Tax}}{\text{Shareholders' funds}}$$

FINANCIAL STRUCTRE / LEVERAGE RATIOS

Capital Gearing Ratio

$$\frac{\text{Loan Capital}}{\text{Equity Capital}}$$

Proprietary Ratio

(The higher the %, the better the security for the creditors in case of liquidation)

$$\frac{\text{Shareholders' funds}}{\text{Total Assets}}$$

ASSET/LIABILITY MANAGEMENT RATIOS

Portfolio Yield	$\frac{\text{Interest Income} + \text{Fees Income}}{\text{Average Gross Portfolio}}$
Portfolio to Assets	$\frac{\text{Gross Loan Portfolio}}{\text{Assets}}$
Cost of Funds	$\frac{\text{Financial Expenses on funding liabilities}}{\text{Average Deposits} + \text{Average Borrowings}}$
Liquidity Ratio	$\frac{\text{Cash} + \text{Trade Investments}}{\text{Total Liabilities}}$
Write-Off Ratio	$\frac{\text{Values of Loan Written-Off}}{\text{Average Gross Portfolio}}$