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Monitoring guidelines for semi- formal financial institutions active in small enterprise finance

Bert Wesselink

POVERTY-ORIENTED BANKING

WORKING PAPER N° 9

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financial institutions active in
small enterprise finance**

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Table of contents

Acknowledgements	vii
Introduction	1
Section 1: Monitoring and evaluation of financial services	5
1.1 What is monitoring and evaluation?	5
<i>Progress monitoring</i>	6
<i>Effect monitoring</i>	6
<i>Impact evaluation</i>	6
<i>Occasional research</i>	7
1.2 The need for monitoring and evaluation	7
1.3 Limitations to monitoring and evaluation	9
<i>Methodological constraints</i>	9
<i>Practical constraints</i>	10
1.4 Recent approaches to monitoring and evaluation	11
1.5 Framework of the monitoring system	12
Section 2: Business monitoring	15
2.1 Client profile monitoring	16
<i>Loan application form</i>	17
<i>Client profile</i>	18
2.2 Business performance monitoring	18
<i>Production and product quality</i>	19
<i>Purchasing</i>	20
<i>Sales and profits</i>	20
<i>Marketing</i>	21
<i>Management</i>	22
<i>Employment</i>	23
2.3 Loan performance monitoring	23
<i>Verification of investment</i>	26
<i>Loan repayment</i>	26
<i>Lending behaviour</i>	26
2.4 Savings performance monitoring	26
<i>Savings mobilization</i>	27
<i>Savings behaviour</i>	27
2.5 Business effect monitoring	27
<i>Growth and change</i>	28
2.6 Business impact evaluation	29
<i>Income and employment</i>	29
<i>Decision-making options</i>	30
<i>Family well-being</i>	30
<i>Training and abilities</i>	30
<i>Participation and association</i>	31
<i>Attitudes</i>	31
2.7 Questions for discussion and research	31

Section 3: Institutional monitoring	33
A. Financial monitoring	33
3.1 Financial health	34
<i>Capital adequacy</i>	35
<i>Degree of indebtedness</i>	35
<i>Degree of savings mobilization</i>	36
<i>Liquidity</i>	36
3.2 Sources and uses of funds	37
3.3 Self-sufficiency	38
<i>Solvency</i>	40
<i>Institutional sustainability</i>	40
<i>Operating self-sufficiency</i>	40
<i>Financial self-sufficiency</i>	40
<i>Full institutional self-sufficiency</i>	41
3.4 Spreads	42
3.5 Profitability	43
<i>Return on equity</i>	43
<i>Return on assets</i>	43
<i>Return on interest-earning assets</i>	44
<i>Operating return</i>	44
3.6 Cost-effectiveness	44
<i>Cost allocation</i>	45
<i>Operating costs per loan and per unit of currency lent</i>	46
<i>Operating costs per deposit account and per unit of currency saved</i>	46
3.7 Portfolio quality	47
<i>Repayment rate</i>	48
<i>Delinquency rate</i>	50
<i>Contamination of the portfolio</i>	51
<i>Loan loss rate</i>	51
3.8 Questions for discussion and research	53
B. Operational monitoring	54
3.9 Institutional vision	55
<i>Stated vision</i>	55
<i>Goals and objectives</i>	55
<i>Institutional memory</i>	56
<i>Capacity to learn</i>	56
3.10 Institutional structure and management	56
<i>Delivery mechanisms</i>	57
<i>Leadership</i>	57
<i>Planning and decision-making</i>	57
<i>Autonomy</i>	58
<i>Staff</i>	58
<i>Facilities</i>	59
<i>Financial management</i>	59
3.11 Internal loan procedures	60
<i>Credit policies</i>	60
<i>Loan application analysis</i>	60
<i>Loan approval process</i>	60
<i>Loan disbursement</i>	61
<i>Loan collection and security</i>	61
<i>Loan follow-up visits</i>	61
3.12 Internal savings procedures	62
<i>Savings policies</i>	62
<i>Savings procedures</i>	63
3.13 Internal audit procedures	63
<i>Management information system</i>	64
<i>Internal audit procedures</i>	64

S))

	<i>Type of internal audit</i>	65
	<i>Results of internal audits</i>	65
3.14	Institutional efficiency	65
	<i>Staff productivity</i>	65
	<i>Loan outreach</i>	66
	<i>Savings outreach</i>	66
	<i>Number of staff</i>	66
	<i>Staff efficiency</i>	66
3.15	Institutional effects and impacts	68
	<i>Institutional growth and change</i>	68
	<i>Service satisfaction</i>	69
	<i>Willingness to pay for the services</i>	69
	<i>Terms of services</i>	69
	<i>Transaction costs</i>	70
3.16	Questions for research and discussion	70
Section 4: Community monitoring		71
4.1	Economic environment	71
	<i>Interest rates and inflation</i>	72
	<i>Foreign exchange rates</i>	73
	<i>Economic branches and sectors</i>	74
4.2	Policy and regulatory environment	75
4.3	The financial marketplace	76
	<i>Market analysis</i>	77
	<i>Promotion</i>	80
	<i>Innovation</i>	83
4.4	Community impacts	84
	<i>Income and employment</i>	85
	<i>Strengthening of the MSE sector</i>	85
	<i>Community well-being</i>	86
	<i>Community strengthening</i>	86
	<i>Institutional building</i>	87
4.5	Questions for discussion and research	87
Section 5: Building a monitoring system		89
5.1	Identifying the information required	89
	<i>Who needs what information and what for?</i>	90
	<i>When is the information required?</i>	90
	<i>How detailed the information has to be?</i>	91
5.2	Selecting indicators	91

S))

5.3	Data collection	91
	<i>Where and how does the institution want to collect the information?</i>	91
	<i>Type of data sources</i>	92
	<i>The use of personal computers and software</i>	94
	<i>Who should collect the monitoring and evaluation data?</i>	94
5.4	Reporting	96
	<i>In what form is the information presented?</i>	96
5.5	Analysis	98
5.6	Assessment and interpretation	99
5.7	Decision-making and action plan	99
5.8	The field officer	100
	<i>Basic skills of the field officer</i>	101
	<i>Structuring the work of the field officer</i>	103
5.9	The monitoring officer	105
	<i>Planning the work programme of the monitoring officer</i>	106
	<i>Presentation and communication</i>	108
	<i>Organizational aspects</i>	108
Conclusions		111
Bibliography		113

List of tables

Table 1:	Framework of the monitoring system: criteria and components	13
Table 2:	Monitoring of borrowers, the case of ADEMI	25
Table 3:	Calculating financial self-sufficiency	39
Table 4:	Interpreting the repayment rate performance of an SFI, an example	49

List of annexes

Annex A:	Criteria for SFIs delivering financial services	123
Annex B:	Credit risk management	125
Annex C:	Delinquency management	129
Annex D:	Formulating performance indicators, the case of Women's World Banking	135
Annex E:	General performance indicators of NGOs	137
Annex F:	Useful addresses	141

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A completely revised version, titled "Monitoring Guidelines for Semi-formal Financial Institutions, Active in Small Enterprise Finance" has been prepared for the ILO Umbrella Programme: Sustained Employment Generation, in Ghana, which has now newly been edited.

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Introduction

Semi-formal Financial Institutions (SFIs) have increasingly become involved in the financing of micro and small enterprises (MSEs). SFIs are unregulated but legal financial entities operating in the semi-formal financial sector which can be divided into membership-based Self-Help Organizations (SHOs) and outside assistance-based Non-Governmental Organizations (NGOs). SHOs are indigenous private institutions which finance activities in poor communities with funds mobilized in the community itself. Examples of membership-based SHOs are local community banks, credit unions, and loan and savings cooperatives and associations. Generally, SHOs are fully engaged in financial intermediation by raising member deposits and transforming them into member loans. NGOs, however, often only distribute and collect loans, resulting in an intermediation function which is much more limited. Usually, NGOs generate their funds from outside donors or governments, making themselves more dependent from outside priorities and availability of funds.

Credit delivery is one of the means to contribute to the development of the MSE sector and improve the living and working conditions of the poor. Practice has shown that financial institutions that perform well generally mobilize a relatively large proportion of their credit funds through deposits. Unfortunately, the provision of savings services is traditionally either omitted, included primarily as an educational device, or added as an afterthought. In this way, the legitimate need of poor people for a safe, convenient savings institution is not addressed. It is emphasized, that individuals benefit much more from having save and convenient places to hold their savings with ready access to money, and having dependable working relationships with financial institutions which offer both lending and deposit facilities designed with client needs and preferences in mind, than they do from getting single loans. For this reason, the monitoring system is addressing credit as well as savings issues.

In practice, SFIs play an important role in the promotion of small enterprise development because they tend to have a better grasp of the local demand of small entrepreneurs than formal financial institutions. SFIs appear to have better knowledge about the micro and small entrepreneurs than banks. Furthermore, because of their dedication and good local outreach, SFIs seem to be more acceptable to these entrepreneurs who place more confidence in the SFI than in bank staff. Finally, SFIs are more experienced in group formation, which can be instrumental for the delivery of credit and mobilization of savings especially for the very small businesses. At the same time, however, it is recognized that many SFIs often do not succeed in small enterprise finance. Many SFIs have only recently began to develop the know-how that is required for delivering financial services. It is felt that their is a growing need within these SFIs for tools that improve their technical, administrative, and business know-how so that they can provide well-organized and effective services to small entrepreneurs.

Purpose of the guide and intended users

This guide is a self-study and reference guide on the design of a monitoring system. It elaborates on the information needs of people in SFIs delivering financial services to small entrepreneurs. It aims at providing a framework of questions and indicators for the building of a monitoring system in order to ensure a continual supply of relevant data and information for determining the effectiveness and efficiency of financial services. It helps management and staff to identify what information is really needed for delivering financial services, what type of indicators and questions may be effective in providing that information on a timely and efficient basis, and how an effective monitoring system can be set up and kept functional within the SFI. Monitoring is here, in the first place, viewed as an internal function, an integral part of good management which is used to control and plan the financial operations of the SFI.

By using the term monitoring system reference is made to both monitoring as well as evaluation practices. By doing so, the monitoring and evaluation functions are attached to the specific needs of the SFI. Monitoring and evaluation is not an easy matter, but this does not mean that people should not do it at all. Institutions should treat these functions not as a special one-off exercise to be done when outsiders demand it, but as a day-to-day management tool of self-assessment and adaption. Hopefully, the monitoring system stimulates people to routinely think

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about how their institutions are doing and how to they can improve their business performance by reaching new clients, offering better services, and operating more efficiently. Loan officers, extension officers and trainers should work with their clients to evaluate their own work, rather than waiting until senior management or even outside evaluators do it for them. This will help them to relate more effectively to their clients, and, eventually, for the SFI to become a more professional institution.

The monitoring guidelines are in the first place meant for SFI management and staff, but may also serve a wider range of users such as project managers, backstoppers and other practitioners active in the promotion and development of micro and small enterprises.

In developing the guide it has been aimed to pay due regard to other ILO policy and procedural documents focusing at the financing of small enterprises and monitoring and evaluation. The monitoring guidelines intend to supplement the ILO checklist "Design and Management of Revolving Credit and Similar Funds in ILO Technical Cooperation Projects" (1994), which is addressing the design and management part of the overall project cycle. The term 'semi-formal financial institution' has been adopted from the ILO paper "Innovations in the Financing of Small and Micro Enterprises in Developing Countries" (1993).

Organization of the guide

In practice, few manuals exist on monitoring and evaluation for local development organizations. The manuals that do exist and merit attention are more of a general nature, and are not specifically focused at the monitoring and evaluation of credit and savings activities. This guide intends to structure, extent and deepen the information available on monitoring and evaluation of small enterprise finance activities. Three levels of analysis are distinguished, i.e. the level of the client, the institution and the community at large. At each of these three levels of analysis the concepts of progress monitoring, effect monitoring, impact evaluation and occasional research are introduced in the monitoring system. Each paragraph contains checklists of questions which can be relevant for the institution to monitor and evaluate performance. All these components come together in a final section where the more practical aspects of building a monitoring system are discussed, illustrated in the annexes by case studies.

Basically, the following issues are addressed in the guidelines. Section 1 is an introduction to the general principles, need and limitations of monitoring and evaluation of financial services. This section provides the framework of the guidelines including the applied criteria and concepts. In section 2, 3, and 4, the various levels of measurement are distinguished of the relevance, performance and efficiency of the SFI's financial services. In section 2, business monitoring is addressing the client profile, business performance, individual loan and savings performance, business effects and impacts, and provides an overview of relevant questions for discussion and research. In section 3, the financial and operational performance of the SFI are analysed, the institutional effects and impacts assessed, and relevant questions at the level of the institution are formulated for discussion and research. In section 4, community monitoring elaborates on the economic environment, political and regulatory environment, the financial marketplace, impacts of financial services at community level, and concludes with relevant research questions. The information provided in these three sections can help the SFI in choosing its monitoring and evaluation indicators depending on the type of analysis it wants to assess. Finally in section 5, all four components of the monitoring system come together in outlining the operational steps for building a monitoring system. The roles of field officer and monitoring officer are also discussed. The Annexes show examples of case studies on monitoring and evaluation of SFIs and provide some helpful instruments.

These guidelines do not want to force its users to follow one uniform set of definitions of monitoring indicators. In fact, it is important to the success of a monitoring system that the objectives and indicators be actually developed by the SFI themselves, and not imposed on them from outside. The guide intends to show practitioners the large variety of indicators that may be used for controlling their financial services in an effective way. In practice, the lesson is to start small. The capability for monitoring and evaluation should be increased gradually, widening coverage and building it up one step at a time.

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To make this document more readable general issues, topics and items are marked by "!", while questions are preceded by "Q". For the same reason checklists of questions are grey-shaded in each paragraph.

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Section 1: Monitoring and evaluation of financial services

This section provides the methodological framework of the monitoring system and discusses the concepts and criteria used for monitoring and evaluation of credit and savings services. Additionally, the need for monitoring and evaluation and the methodological and practical limitations to monitoring and evaluation are highlighted. Furthermore, recent developments in monitoring and evaluation are addressed.

1.1 What is monitoring and evaluation?

An institution involved in the promotion and development of MSEs requires a rich flow of information to facilitate responses to changing conditions and opportunities, and producing the raw material for innovation. This information is generated through monitoring and evaluation of the institution itself and the businesses it supports, taking into account the community in which they both operate. Regular monitoring and evaluation is as important as good product design in ensuring long-term success of SFIs.

- ! **Monitoring** is the routine collection, analysis, and use of information about how well the SFI is going, with the aim of controlling the financial operations and adapting it to circumstances. The performance indicators continuously generated through monitoring alerts management to constraints and opportunities requiring attention and action. Monitoring may also include diagnostic studies of problem areas, but is not usually research oriented.
- ! **Evaluation** is the periodic assessment of the relevance, efficiency, effectiveness, impact, and sustainability of the financial services, with the aim of adapting the strategy and planning to circumstances. Evaluation may be conducted by parties other than those responsible for project management. Traditionally, evaluation can take place during the implementation of the project (mid-term evaluation), immediately or some time after the completion of the project. Evaluation can, however, also take the form of an in-depth research study if this is felt needed by the SFI.

Clearly, the functions of monitoring and evaluation are overlapping, and the data provided through the continuous monitoring are utilized for evaluation purposes. Evaluation uses data from the monitoring system and frequently supplements these by undertaking and interpreting research studies of specific problems and opportunities. In these cases, evaluation measures the extent to which objectives have been accomplished and what these accomplishments mean to the clients, the institution and the community including the overall financial system and the policy and regulatory environment. Although distinguishing the functions of monitoring and evaluations might be useful analytically, in practical terms it is mainly the timing and depth of the data-collection, which makes the difference, and not, as it is often viewed, the institutional objective to be evaluated, the reference periods, or the users. The term monitoring system is used here both for monitoring as well as for evaluation practices. Evaluation includes the assessment of the impacts of an activity that has been undertaken. The function of monitoring, however, is not only limited to progress monitoring of inputs and outputs of a financial activity but includes also monitoring of effects such as employment, income and technology. An on-going monitoring system and data collection indicators of the performance and effects of activities that has been undertaken, will improve the knowledge of what is happening compared to the traditional evaluation procedures of baseline surveys followed by annual evaluations. For this reason, effects are distinguished from impacts. Effects are the short-term, immediate and direct results of a project for its beneficiaries, which can be monitored continuously. Because of its complexity the assessment of impacts requires more in-depth studies and research. Many practitioners, however, do not distinguish effect and impact and use in both cases only the term impact.

In this guide the basic concepts of monitoring and evaluation are defined as progress monitoring, effect monitoring, impact evaluation, and occasional evaluation research.

Progress monitoring

Progress monitoring is the activity, whereby the inputs (such as mobilization of funds and savings) and the outputs (such as number of loans and deposits, number of clients, repayment rates) of the institution's activities are followed and reported, as far as possible both qualitatively and quantitatively. It includes the assessment of the quality and nature of the process of carrying out finance activities at the level of the clients, the institution, and the community at large. Progress monitoring allows an institution to track progress of their activities, and builds on information related to the client profile, business performance, and individual loan and savings performance of the client, as well as the financial and operational performance of the SFI and the changing community in which SFI and clients operate. Monitoring reports must entail a continual and timely exchange of credible, accessible, and practical data regarding these issues.

Effect monitoring

Effect monitoring is the activity, whereby indicators of the short-term, immediate and direct results of the financial services and for its clients are studied, and estimates are given of the effects. The term direct is used for those cases where it is possible to establish causal relationships between an institutional intervention and observed or documented change, such as for example an increase in employment and income of the enterprise. Indirect effects can refer to, for example, a (short-term) improvement in nutrition and education for the client's family.

Effect monitoring requires the provision of reliable and systematic data over time on a limited number of variables for all or just a subset of the client base. Effect monitoring refers both to the effects of the financial services on the clients as well as the other people employed in the enterprise. This is important, because an increase in the client's income from the business does not necessarily mean the situation of the workers in the enterprise has also improved. However, because of the very high costs and the complexity of such an exercise, many institutions often only emphasize the primary beneficiary, that is the person who receives the finance and training. Data collection on the enterprise can provide a global overview of trends in the clients population, and it can be used to establish the context or frame of reference for an in-depth evaluation study. Although effects become specifically apparent at the client level, at the same time it can be very relevant to consider the effects of the financial services at the institutional and community level. Particularly, the client-service relationship may deserve further attention.

Impact evaluation

Impact evaluation is the activity, whereby indicators of the more indirect, wider and sustained results of the financial services, and particularly for the broader community not directly benefiting from the financial services, are studied and estimated as impact. The term "community" is used in general sense and could mean a geographic determination, such as the communities in which MSEs operate, as well as particular groups that could be reached through the SFI, such as the banking community, policymakers, or workers' and employers' organizations.

Impact is an indicator of sustained change, that usually can only be measured after the life-span of a project. Impact tends to be a major and long-lasting consequence of an activity. Impact evaluation can include quantitative and qualitative indicators of sustained change, such as changes in regional or national income and employment, changes in backward and forward linkages of enterprises, and changes in the quality of life of the client and the broader community. Impact may be expected at the individual or household level, through changes in income, housing, nutrition, health status, participation and attitudes of clients. These type of impacts are discussed in paragraph 2.6. At the community level an SFI may have impact for example through altered socio-economic relationships in a community, wider participation by client groups in planning and decision-making at regional and national level, increased capacity for self-reliance and self-sustained development of client groups. These type of indicators are discussed in paragraph 4.4.

Each SFI is operating in a different social and economic environment, which is determined by factors such as the geographical location, the type of government, the level of social stability, and the economic conditions. As a result, the impact of an SFI on the local community will depend not only on the objectives formulated by each institution but also on these exogenous

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variables. In practice, evaluations of the development impact and a conclusive assessment of the achievements are rarely available after an activity or project is terminated. Often, serious ex-post evaluations are absent because base-line data are lacking, records may not be available or updated, or the staff which could give information is no longer around (Frerks, et al., 1990).

Occasional research

Occasional evaluation research is the activity, whereby certain aspects regarding an activity are studied in a more in-depth way, when this is required by management. These studies are not directly related to impact assessment but to the general performance of financial services. Based on progress reports from monitoring staff, it can be decided that certain aspects require more in-depth evaluation research. Information following from these occasional evaluation studies provides management with a means to obtain better knowledge of specific problems and opportunities of the institution's activities. For example, the SFI could initiate occasional research studies to analyse client satisfaction, sector performance or new markets. Issues, which could warrant further study before actual adjustments are made. The SFI could allocate budget for the financing of such studies, or solicit provision of funds from external donors when these studies meet donor needs. Examples of issues to be addressed in these research studies are suggested at the end of each section. The choice, however, to address such research questions is fully determined by the institution's need for in-depth analysis of particular issues.

1.2 The need for monitoring and evaluation

Practice has shown that financial institutions which are linked to a system of continuous monitoring and evaluation operate more efficiently and more effectively than others (DGIS, 1992). The monitoring system is an institution's primary tool for ensuring accountability by allowing the institution to evaluate performance and to respond to the results accordingly. It is a crucial instrument for management and control of a financial institution and can be of great help to effect monitoring and impact evaluation. A monitoring system is essential in increasing productivity and reducing operational costs as well as in providing effective services to the clients. Unfortunately, it is sometimes thought that a monitoring system for small loans is not needed and will only add to transaction costs. Data on successful SFIs demonstrate that in terms of costs per unit of currency lent, even for small loans and deposits, monitoring and evaluation does not necessarily have to cost more than for large loans.

Monitoring and evaluation create the information base for the SFI required for steering and decision-taking during the implementation of the finance activities. They provide the institution with a large variety of information. A simple monitoring system with qualitative and quantitative information will enable management and staff to evaluate the differences between what was planned and what was achieved. Only up-to-date and effective information systems can provide managers with the detailed data necessary to fine-tune institutional performance. Good information systems appear expensive. For this reason, many development institutions prefer to allot their scarce resources to serving the poor, to the detriment of information systems. Unfortunately, quality of the services provided usually suffers in the end because institutions do not have a clear picture of either their client's characteristics or their own service delivery capacities. Information systems are the heart of good financial management. This is particularly true for SFIs active in enterprise finance. Without accurate and appropriate information, management cannot fully understand why and how late payments are affecting the SFI, and are not able to design appropriate strategies to deal with delinquency. It has been shown that many SFIs which fail or have poor recovery share the same characteristics related to an inadequate functioning monitoring system.

A well designed monitoring system:

- ! allows the SFI to ensure that loans are paid back on time, and serves as an early warning system in the case of delinquency in order to prompt corrective action;
- ! allows management and staff to determine if the SFI is reaching its client group with the appropriate services needed by the intended clients, and helps management to obtain knowledge about clients' alternatives;

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- ! enables management and staff to determine whether the financial activities are in conformity with and accomplishing its vision and objectives;
- ! helps the SFI to determine the efficiency of their financial activities and the effects and impacts of these activities on the businesses, the institution, and the community;
- ! helps management and staff make decisions to improve the finance operations. SFIs will have better organized and more useful data of clients, and having the ability to use historical data for projecting needs, funds availability and liquidity requirements, SFIs will be in a better position and be better prepared to manage their financial services, adapt to changes, market their services and plan expansion;
- ! ensures accountability to all parties with a stake in the outcome of the financial activities, such as: borrowers and depositors, staff and management, and donors;
- ! provides the institution with information useful for promoting the financial activities and preparing new funding requests and proposals. The SFI will have information that will permit them to publicise their financial activities and its accomplishments. Additionally, the SFI can provide governments and donor organizations with client information that should provide data for any proposed new interventions in the sector.

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To define the institution's internal monitoring and evaluation system sometimes also is referred to the term management information system, consisting of an internal accounting system and a monitoring system. While the importance of the internal accounting system is recognized, and in practice many SFIs lack accounting infrastructures capable of providing the type of information needed for even the most rudimentary banking effort, the focus will be on the monitoring and evaluation activities.

1.3 Limitations to monitoring and evaluation

Measuring the effects and impacts of financial services on clients and communities is normally a very complex matter because of the difficulties of establishing scientifically defensible conclusions about quantities of change or the reasons for that change. More practical constraints exist in gathering and analysing monitoring information, such as time, high costs, the nature of the MSE sector, and the SFI itself.

Methodological constraints

Methodological constraints to assess the effects and impacts of financial services are, for example, the fungibility of money, additionality, the accuracy of the data collected, and the competitive advantage of receiving financial services (Boomgard, 1991). These limitations will be discussed below.

The *fungibility* of finance makes it difficult to trace the flow of money through a household in order to attribute changes in the performance of an enterprise to the availability of financial services. Clients use finance for a variety of purposes, such as protection against bad times, facilitating business operations, and financing their investments. For example, a weaver may have bought a weaving-machine from her loan. If one week later a family member becomes ill and has to be hospitalized, it very well may happen that the weaving-machine is sold to settle the hospital bill, causing the "disappearance" of the asset that according to the lending institution is supposed to improve the well-being of the entrepreneur. At the same time, the fungibility of money makes it a very complex undertaking to analyse whether the changes that occur in the enterprise can really only be attributed to this specific loan that has been provided. Economic and quality-of-life decisions are affected by a wide range of factors, of which finance is one. Competition, markets, health, weather, and many other factors can all have an overwhelming direct effect. For example an increase in sales may be the result of a loan, but could also follow from a general increase in consumption as the result of a good harvest caused by favourable weather conditions (Boomgard, 1991).

Additionality questions the degree to which a loan generates additional activities. Because it is unknown what alternatively would have been the situation of the client group in the absence of the SFI's financial services, it is hard to discover whether the same changes would not also have had happened without the loan. For example, if employment in a particular assisted enterprise rose by 20% during some time period, what would have happened during the same period to that business if there had been no assistance? Would the entrepreneur have turned to an alternative source of assistance? Might the entrepreneur have even done better? How much of the change in employment can reasonably be attributed to the SFI? It is difficult to tell just by talking to the borrowers. The use of financial services is not a single event, but an ongoing process involving a series of decisions and a range of alternative sources. Tracing the effect of an SFI through all of these processes will be difficult for any evaluation. Therefore, when attempting to measure the effect and impact of financial

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services on clients, we must recognize the limited role of finance, and particular of specific transactions (Rhyne, 1992).

Another difficulty is the so-called *memory recall problem* which questions the accuracy of the data collected from the entrepreneurs, resulting from a combination of bad answers and bad questions. The accuracy of the data collected is framed by the lack of bookkeeping, the complexity of the family and business income that flow together in the household, and the general informality of their economic activities. Additionally, seasonality makes accurate recall difficult. It is, of course possible to distinguish the effects of any given variable, such as finance, from among a variety of contributing factors. The statistical techniques that have been designed for that purpose, however, must be rigorously applied if they are to yield reliable results. Their application requires collection of data at two or more points in time, as well as the use of control groups. However, for most SFIs such data requirements are too expensive to collect (Rhyne, 1992). While alternative ways may exist to improve memory recall by collecting more easily remembered data (see for example Haggblade, 1992), using general working schedules to calculate income) or to replace the use of control groups (e.g. by using general indicators of the level of economic activity in the project area), evaluators often fall back on measurement of subjective responses of clients and reliance on client memories.

Finally, the so-called *displacement problem* refers to a situation of subsidized credit where MSEs are competing for limited demand, and the gains achieved by one group of MSEs as result of the access to subsidized credit may be at the expense of non-assisted ones. Comparison with a control group may exaggerate the benefits of the loan because the subsidy is causing the benefit rather than the credit itself (Haggblade, 1992).

Practical constraints

Besides these methodological difficulties other more practical constraints exist in gathering and analysing monitoring information, such as time, high costs, the nature of the MSE sector, and the SFI itself (Otero, 1989).

A loan officer who handles up to 100 borrowers is lacking *time* to conduct periodic visits, to assist in credit applications, to participate in training, and to monitor the clients. The collection of monitoring data, even if someone else tabulates and analyses it, adds a considerable load to the work of fieldstaff often at the expense of other important tasks. Staff may not have the capacity to collect the needed information in a reliable manner, while further training in monitoring and evaluation will require additional time and expense.

While assigning data collection responsibilities to one qualified person appears an easy solution, this option raises costs, and still requires assistance from the field officer who is the direct link between the institution and the client. The question of cost also limits the depth of monitoring, because cost is the determining variable in deciding how in-depth the monitoring will be conducted. Since many SFIs have ever-increasing levels of self-sufficiency as a priority goal, most institutions will be reluctant to spend their hard-earned income on for example impact evaluation. For proper data collection and analyses, funds must be set aside for this purpose.

The *nature of the MSE sector* presents another set of constraints. Many small entrepreneurs who lack a fixed location or have workplaces in distant neighbourhoods, are very hard and costly to reach on a regular basis, making the collection of monitoring data difficult for the institution.

Finally, the *SFI itself* can also be a possible obstacle in monitoring and evaluation. To the degree that an SFI sets the tone in monitoring its own work in a constructive manner, the role of monitoring will be perceived as a positive and useful internal exercise. Otherwise, the very institution that delivers financial services can create a defensive and negative attitude that limits proper use of monitoring and evaluation (Otero, 1989).

1.4 Recent approaches to monitoring and evaluation

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Traditionally, evaluations of finance activities are based on the presumption of a direct line of causality between receipt of credit by individual borrowers and a particular desired economic response. For example a change in borrower's income resulting directly from the receipt of a particular loan. From the methodological and practical constraints discussed in the previous paragraph, however, it can be concluded that the path from financial service to changed economic performance or quality of life is full of curves, bumps, forks, and even dead ends (Rhyne, 1992). Evaluations of the impact of loans on borrowers turned out to be difficult, costly, ambiguous, and misleading (Adams and Von Pischke, 1992).

Recent views on finance emphasize the building of financial systems offering savings and credit services on a commercial sustainable basis. Based on these views, some people are concentrating more on the evaluation of the quality of the services and their institutional setting (Rhyne, 1992). Rhyne argues that the focus on the direct causal response to individual loans misses much of the richness of the effects of finance, which are general diffuse, rather than strictly linear. At the same time, it is felt that there is no need for the SFI to try to prove that financial services are valuable, by attempting to measure response of credit. This is a task that is better left to more general research that explores the relationship between the presence of a healthy financial system and economic growth. It is argued that on the basis of what is already known about the value of financial services, one can be confident that wider availability of credit and savings services benefit users, their communities, and their economic sectors (Rhyne, 1992). In fact, individuals benefit not so much from getting a single loan as well as from building their debt capacities, having safe and convenient places to hold their savings, and having dependable working relationships with financial intermediaries (Adams, 1988). Additional knowledge about the benefits of financial services is needed but is best gathered in the context of a rigorous research effort that is not necessarily focused on individual financial institutions. Finally, Rhyne argues that if evaluations of financial activities can be freed from the burden of proving that finance matters, a task for which institutions are not well suited, they can concentrate on evaluating the quality of the services and the institutional setting (Rhyne, 1992). This approach to development finance may also help to reduce the great pressure among SFIs to satisfy donors' desire to demonstrate positive changes in economic activity or quality of life for direct clients and their families, employees, or customers. Rhyne argues that the assessment of effects of finance on clients should stay close to the direct uses of finance. In this approach, the basic question to pose is: "How has the availability of the financial service changed the clients' decisions?" In other words: "What can clients do now that was not possible without the service?" The aim is to explain how the service changed the strategies and options available to the client, and how changed financial decisions affected other economic decisions. Questions should elicit the direct and immediate uses of the services, and also determine how the stated use was filled before the service was available (Rhyne, 1992). Examples, might focus on such changes as ability to purchase raw materials at cheaper prices or accumulation of enough savings to survive a drought year. The line of questioning may have to be as open-ended as the strategies are open to clients. Rather than providing definitive "impact" results on predetermined indicators, such a line of questioning will produce results that are indicative of the nature of the effect. Although they may seem less precise, such results are more likely to be accurate reflections of what the provision of financial services actually accomplishes (Rhyne, 1992).

It is thought that the path is best understood not by examining the end points, but by taking the perspective of the clients as he or she negotiates it. Evaluators too often focus on the egg rather than the goose. The fitness of the goose and its ability to lay a number of eggs is the thing that is important, not getting a single egg (Adams, 1988). More attention should be paid to what is going on in the institutions providing financial services, something which can be achieved by monitoring more thoroughly the quality of the financial services and the institutional setting. More concern is needed for the institutional portion of the evaluation, away from a donor-centric examination of the use of donor funds, which is in essence an audit, to the institution itself and the services which are provided to the clients.

1.5 Framework of the monitoring system

One could argue that credit is in fact self-evaluating, as it either comes back or it does not (Jackelen, 1989). This can illustrate the reality underlying financial institutions and markets. While this basic fact can be simply stated, the issues involved are complex. They are particularly so

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when promoters assign to credit and savings a weighty agenda that goes beyond financial market considerations and possibly even leaves them behind (Von Pischke, 1991). Table 1 provides the framework of the monitoring system, which comprises the following components: business monitoring, financial monitoring and operational monitoring of the institution, and community monitoring.

The table indicates that three levels of measurements are used for monitoring an SFI: the clients, the institution, and the community in which both operate. By combining these levels of measurements with the concepts of monitoring and evaluation, four different components of the monitoring system emerge, each with its own criteria for measuring the performance of an SFI.

! Clients

Business monitoring: the client profile, business performance, individual loan and savings performance, and effects and impacts on the businesses are measured. Examples of questions to be addressed are: Does the institution deliver financial service to the intended client group? What are the socioeconomic characteristics of the clients? How important is the business activity to them and how is it developing? How many people benefit from the business, and how do they benefit?

! Institution

Financial monitoring: the financial performance of an SFI is measured. Questions to be addressed are for example: What is the financial health of the SFI? Can the SFI reach financial self-sufficiency after the removal of donor resources? What is the amount of savings mobilized by the institution? What is the quality of the portfolio?

Operational monitoring: the operational performance of an SFI is measured. Questions to be addressed are for example: Is the SFI a strong, administratively viable institution? Are credit and savings services delivered in a efficient way to the entrepreneurs? What is the quality of the client-service relationship?

Table 1: Framework of the monitoring system: criteria and components					
	Progress monitoring	Effect monitoring	Impact evaluation	Occasional research	Components of the monitoring system
Clients	Client profile	Business effects	Business impacts	Business research	Business monitoring (Section 2)
	Business performance				
	Individual loan performance				
	Individual savings performance				
Institution	Financial performance	Institutional effects	Institutional impacts	Institutional research	Financial monitoring (Section 3A)
	Operational performance					Operational monitoring (Section 3B)
Community	Economic environment	Community effects	Community impacts	Community research	Community monitoring (Section 4)
	Policy and regulatory environment				

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	The financial marketplace				
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! Community

Community monitoring. The interdependence of the SFI and the community is measured. Questions to be addressed are for example: To what extent is the delivery of financial services positively or negatively affected by external factors related to the economic environment, policy and regulatory environment and the financial marketplace? How can the institution adapt to changes in the community in order to increase the self-sufficiency of its financial services? How does the institution contribute to the improvement of the community, facilitating the promotion and development of the MSE sector? What are the effects and impacts of the financial services on the community?

This section provided the framework for the monitoring system. section 2 to 4 will discuss each of the three components of the monitoring system: business monitoring in section 2; financial monitoring and operational monitoring in section 3; and, community monitoring in section 4.

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enterprise performance, but also to match in time the specific needs of the clients. Adequate coordination and a good flow of information between field officers and monitoring staff is necessary for an institution to function well and for accurate and timely reports to be produced. The monitoring staff generates and reviews information on the businesses provided by the field staff and is reporting frequently to management.

During follow-up visits to clients, field officers and supervisors are monitoring different kinds of information. In all cases, it is important to keep written records of the findings during the visits. Standard forms can be of great help in collecting and analysing the data of clients and their businesses. It is essential for management and staff who are making finance decisions to track progress of small businesses. When designing a monitoring system one must strive for analytical rigour at the lowest possible cost. Generally, it is recommended that an SFI sets up a database system for tracking over time certain financial, social and economic indicators to measure the progress of the small businesses receiving credit. Many of these indicators such as the value of fixed assets, sales, costs including employee salaries, and income are generally recorded by the loan officers on the loan application forms. Other indicators such as the number and gender of owner and employees currently working at the enterprise could easily be incorporated into the loan application form. Staff could then enter this information in a computerized database, and compare the baseline data of the application forms with the subsequent business monitoring forms. The forms themselves could be organized so that data could be transferred easily into the computer.

The questions addressed in this section, may help the SFI to design its own business monitoring form aimed at measuring and analysing the client profile, business performance, loan performance, and the effects and impacts of the financial services on the businesses. The best way for the SFI is to make a selection of questions on the issues it considers relevant for its financial activities. The SFI should look for ways to minimize the information on the monitoring form and make it as simple as possible to prevent from working with a time-consuming and costly form.

2.1 Client profile monitoring

Client profile monitoring can provide the SFI with information of who the people are it tries to assist. The profile of clients together with their needs and preferences determine the services a financial institution will offer them. The actual profile of small entrepreneurs tend to be more complex than commonly thought. Often, they carry out mixed economic activities with significant seasonal and geographic variations. Finance is used for a variety of purposes in response to changing needs and opportunities. In many cases wealth is held in primarily non-liquid assets, and short-term cash needs are often met by local informal credit sources. Finally, a complex set of interrelationships usually exists among the economic activities, financial transactions, community structures, cultural values, and social controls (Patten and Rosengard, 1991). Given this heterogeneous client profile, it becomes clear that small entrepreneurs need flexibility and discretion to respond to continually changing and often highly localized circumstances.

Monitoring information on the client profile is necessary to determine the extent to which the institution has reached the intended client group. Before collecting and analysing data on borrowers, the SFI should have formulated a clear definition of the socioeconomic characteristics of the client group to serve as a source of comparison. The most important information base of the client and its business is the *loan application form* filled out by the entrepreneurs, with or without the help of the loan officer. Generally, the loan application form includes the following information:

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Checklist Client Profile: (A) Loan application form

- 9 What are the basic data of the client, such as: name, identification numbers, address, telephone number, type of business, references, loan history, gender, age?
- 9 What are the basic data of the client's business, such as: legal status, ownership, starting or long established business, employment levels and classification, location of business, levels of sales, equipment, inventories, and monthly expenses?
- 9 What are the general social-economic data of the client, such as: marital status, number of dependents, ethnic group, formal schooling, and landowning status?
- 9 For what purposes does the client need to borrow money: consumption, income generation, formal business, debt servicing or other?
- 9 What amount does the client need to borrow, and for how long?
- 9 What are the client's present sources of income? Does the client own other businesses?
- 9 Does the client have a bank account, and if so where and of what type?
- 9 Does the client have debts now, how much and to whom?
- 9 What is the seasonal profile of client's income and expenditure?
- 9 What is the cash flow profile for the borrower?
- 9 What return will the client earn on their potential investments?
- 9 What (informal) collateral can the client provide? For example, livestock, serial numbers of televisions and radios.
- 9 How does the client market his or her products? What market or other centres does the client visit, when and how often?
- 9 Do clients need non-financial assistance to enable them to make profitable use of the loan?

An example may illustrate the importance of this type of monitoring. Client profile monitoring may indicate that the demand for larger loans is higher than expected. If the SFI takes no appropriate action on this signal it will generally mean that given the limited funds fewer loans can be disbursed and the SFI is reaching fewer borrowers. Because of the larger loans demanded the SFI also has to deal with more risk from first loans. There are several ways an SFI can respond to such a signal, for example by analysing its promotion activities, by applying loan ceilings for first loans, and to look for additional funding. An SFI may also decide to redefine borrower criteria by emphasizing working in stead of fixed capital. Similarly, if an SFI detects loan sizes to be smaller than expected, disbursement of loans will be lower than projected and the institution will make more operational costs to disburse the same amount of money. At the same time, however, the increased number of loans for the same size of the portfolio will result in increased income of fees. In those cases, SFIs may decide to take actions such as to increase the application fees, to consider a group lending scheme, and to promote the financial services among somewhat larger small businesses to diversify the portfolio.

Generally, SFIs classify their clients based on the information collected to describe the portfolio composition. The following are the types of questions to consider in analysing the client profile:

Checklist Client profile: (B) Client profile monitoring

- 9 *What is the size of the loans (average, range, and distribution)?* It can help to reveal the scale of assisted businesses since small businesses will have a limited absorptive capacity for funds.
- 9 *What is the amount of savings deposited by the client?* Savings performance can be a useful measure of the capacity to repay a loan.
- 9 *What is the number of repeat loans?* It indicates whether a few businesses have received many loans or whether loans were disbursed among many different businesses.
- 9 *What is the geographic location?* The location can be divided into urban (large city, small city) versus more rural areas, or by geographic region. Often MSE programmes focus on clients located in urban areas to ease loan supervision with the result that a capital city and its suburbs capture high share of loans.
- 9 *What is the economic sector of the business?* The economic sector may be divided into agribusiness, manufacturing, services and trade sectors. The type of sector should be compared with the original objectives of the SFI.
- 9 *What is the branch of industry?* They can be classified in product-specific branches (e.g. food processing and marketing, garments and textiles, transportation); but other industrial subsystems may also be distinguished (e.g. clustering through subcontracting and networking).
- 9 *What is the level of technology used?* It can be traditional, modernizing, or modern.
- 9 *What is in reality the purpose of the loans (working capital, fixed assets, consumption)?* This should be analysed in relation to the type of businesses that receive loans. A trading business will mainly need working capital loans, whereas others may receive a mix of fixed and working capital loans.

2.2 Business performance monitoring

Monitoring of business performance provides the SFI with information of how important the business activity is to clients and how it is developing. The main purpose of monitoring business performance is to help the entrepreneurs to control the pace of development of their businesses so that planned goals and activities are achieved orderly. Monitoring provides feedback and enables the entrepreneur in assistance with the SFI to critically assess the business operations and take timely corrective actions in case of shortfalls and constraints.

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Sound judgements on the progress of a business are only possible where information is available on all important aspects of the business being monitored. The most adequate way of monitoring business performance is by a business plan which is providing the standards against which actual performance will be judged. Business plans are based on an assessment of current and future environment of the business. Changes in this environment can lead to the reexamination of a business plan. By monitoring business performance an SFI is able to assist the entrepreneur in adjusting the business plan to changes in the environment of the client's business. Finally, this may result in a higher quality of the SFI's loan portfolio.

The data collected on business performance are of direct use to the entrepreneurs involved. At the same time, these data are valuable information for the SFI to assess which type of businesses are doing well and those which have less favourable future prospects. This type of information can be used to analyse market conditions, availability of local resources, input and output prices, and sales estimates. The following set of checklists, divided into six subgroups (production and product quality, purchasing, sales and profits, marketing, management, and employment), can be considered for monitoring business performance:

Checklist Business performance: (A) Production and product quality

- 9 Is the business producing at the level foreseen in the business plan or loan analysis?
- 9 What is the quality of products? Is quality changing over time? Is the quality acceptable to the customers, entrepreneur and field officer? How can it be improved?
- 9 Have the type of products changed in the business? Has it enabled the client's market to expand?
- 9 What is the quantity and the quality of the raw materials used in the production process?
- 9 Indicate the quantity and quality of sources of tools and equipment used in the production process. Does equipment break down frequently? If so, are repair services and spare parts quickly available at reasonable prices?
- 9 Indicate the quality of the site location where the goods are produced. Is there adequate space for movement of people and material? Does the business have adequate power and water to support technology?
- 9 What is the additional capital invested in this period by the entrepreneur? Is the client considering sufficiently the risks involved due to his or her financial obligations? Risks may include low liquidity and great dependence of the SFI.
- 9 Describe techniques and production process of the business. What are the conditions of the business related to technology? Indicate whether technology is upgraded or improved. Did capacity utilization improve, is the productline diversified and/or are new models or products developed in the business?
- 9 Has raw material been wasted during the production process? Is the waste re-used or sold?
- 9 Are there any businesses financed entailing high risks of environmental pollution? Examples of such activities are: leather and hides; storage batteries and cells; electrical metallurgy; paints, dyes, and varnishes; greases and soaps. Are there ways to mitigate or eliminate these negative environmental effects?

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Checklist Business performance: (A) Production and product quality (continued)

- 9 Are there any businesses making environmental friendly production processes and products, such as insulation material, recycling of glass and newspapers or producing/utilizing renewable energy? Can they be introduced in other businesses? These examples may also serve for promotion purposes towards donor organizations?
- 9 What percentage of the business' full operating capacity is actually used? How does this compare to previous monitoring visits and similar type of businesses in the local community?
- 9 Does the client maintain a production schedule and are deliveries being met on time? Has the client rejected orders because of capacity, lack of raw materials or because the order was too complicated? Does the business experience stockout? Are stocks well protected by physical supervision, and does the client maintain updated stock records? Has the client insured equipment and stocks against theft, fire and disaster?

Checklist Business performance: (B) Purchasing

- 9 Indicate from whom the client buys the needed resources such as, raw materials, transport, equipment, and spare parts: indicate types and numbers.
- 9 Does the client receive credit terms from suppliers?
- 9 What is the amount of raw materials purchased and equipment and machinery owned by the business (fixed assets)? What is the amount of money available for purchasing of raw material and other items necessary for production (working capital)? What is the stock of finished or semi-finished products (inventory)?
- 9 Has the client negotiated good terms for his purchases? Have the buying patterns for equipment and supplies changed (e.g. client buys greater quantities when price is lower)? Buying now from a wholesaler may indicate that the client has generated sufficient capital to purchase in greater volume at a better price.
- 9 Can the client reduce scrap/wastage of raw materials?
- 9 Are equipment and supplies of sufficient quality, and are they provided in a timely and reliable matter?

Checklist Business performance: (C) Sales and profits

- 9 Indicate types and numbers of buyers of the client's products or services. Has the number of customers increased during the past period? Has the client made efforts to increase sales to existing and new customers? In addition, selling a product to neighbours after first selling in the market could indicate that the client is now producing a predictable supply of higher-quality products, as the buyers are now coming to the client rather than vice versa.

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Checklist Business performance: (C) Sales and profits (continued)

- 9 What are the actual and expected orders and sales and are they at the level that was projected?
- 9 What are the number of units and unit price, or volume and price per volume of the goods sold?
- 9 Has the client increased selling prices in the past period? How is the price of the product determined? Compare price changes with the inflation rate.
- 9 What are the terms of sales? Does the client extend credit to the customers? Is it easy to ascertain outstanding debts for each customer? Are average days of credit extended known to the client? Is the client aware of the cost of credit to customers?
- 9 Can the client lists all business costs and expenses? Indicate what costs are variable and which are fixed: differentiate for costs of inputs, production, energy, labour, maintenance, transport and costs of capital.
- 9 How do the costs compare with client's selling prices? Profitable?
- 9 What are the sources of information: sales book, cash invoices, others?

Checklist Business performance: (D) Marketing

- 9 Who are the customers, i.e. those who want/use the product and have income to purchase it?
- 9 Where are the sites where the goods are sold: from the home, in local shops, in the market place, on the street? Indicate the quality of the sites. For example, the client could have moved from the street into the market, so that her stand now has a roof and counters.
- 9 How are the products distributed? Are there any changes compared to previous business visits?
- 9 Indicate the type of promotional activities done (sign, word of mouth, advertising, flyers, public notes, newspapers, or radio)?
- 9 Is the market for the client's products relatively stable, or highly seasonal and volatile?
- 9 Would the client be able to produce more using the same facilities, amount of equipment, and labour available? If yes: Would the client be able to sell all of the additional production at current prices? At slightly lower prices?; If not: what prevents the client from producing more?
- 9 Describe competition: are there many businesses competing in the community or in neighbouring communities with the same type of activities like the client's business? Are a few number of businesses controlling the market?
- 9 What is better/different about the goods produced compared to what is available from others?

continued

Checklist Business performance: (D) Marketing (continued)

- 9 What is the actual supply/demand ratio of end product?
- 9 If someone started the same business in the client's community, would the client's sales decrease? Would that person be able to make a living as well?
- 9 If clients would have some extra money, would they reinvest in the same business or start a different business?
- 9 Has the number of businesses doing the same activity in the region changed since the client received a loan? If so, how and why?

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Checklist Business performance: (E) Management

- 9 Is the same person still owning the business?
- 9 Is the client at the work site? Repeated absence may signal neglect of the business. Has there been a change in the location of the business? If, yes, what were the reasons?
- 9 Can the entrepreneur spare enough time to participate fully in the activities and/or run the business? Does the entrepreneur stay longer in the business than the employees?
- 9 Are the responsibilities for running the business clearly defined, such as assembling needed resources, producing the product including design and quality control, maintaining inventory, book-keeping and accounting, marketing, and overall supervision?
- 9 Is the client maintaining adequate financial controls and records, such as a cash book, sales book, purchase book, stock book and expense account/ledger?
- 9 Does the client reconcile his cash book with bank statements on a monthly basis?
- 9 Is the client aware of profits and losses on his or her business?
- 9 Is the client drawing too much money for private use from the business? Is the client paying personal expenses through the business account?
- 9 Does the entrepreneur know about upcoming payments due and other loan conditions (especially important in high inflation economies in which interest rates may be indexed or changed after loan disbursement)?
- 9 Does the client prepare: a profit and loss statement; cash budget; balance sheet; costing of his products; costing per order? And, is the client aware of the following targets for the coming months: units to be sold; units to be produced; sales in amounts; raw materials purchased; payments for wages and salaries; other expense payments for each period; interest and other institutional service charges payments; principal payments?
- 9 Does the client have sufficient understanding of the following subjects for running the business: the market; the way to promote the products; the methods to sell the products; the way to organize the work in the business; the calculation of the costs of the products; the setting of sales prices; the financing of the business; government regulations; the distribution of the products; the use of outside assistance?
- 9 Has the client put into place the systems learned in the eventually given training programme? If additional technical assistance and special training is required, how will it be provided?

Checklist Business performance: (F) Employment

- 9 Indicate gender and age group of employees.
- 9 Does the business has the same number of employees as before, less employees, or more employees (include part-time and seasonal workers)? Why?
- 9 Does the business employ the same people as before, or does the owner change often from employees? Why?
- 9 Are the employees skilled for the job to be performed? Are they given the opportunity to be trained?
- 9 Are family members working for the business? Are they paid or unpaid? Has the amount of time the client or his/her family devotes to this business remained the same, increased, or decreased?
- 9 Are employees being paid adequate salaries and other benefits? Are they being paid as piece-rate workers, daily, weekly or monthly? Did it change?
- 9 Do people always report in time for work? Are people always absent from work? Are the employees often requested to work overtime?

2.3 Loan performance monitoring

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Another element of business monitoring is to assess the individual loan performance and to review the quality of the SFI's financial decision-making regarding the loan disbursement and loan follow-up of each borrower. First, *loan performance monitoring provides the SFI with information of what the clients are doing with the funds they are borrowing.* The SFI is to ascertain the extent to which the activities for which loans were issued are undertaken. All too often, institutions provide types of financial products that do not adequately match client needs. Sometimes, institutions demonstrate a general lack of knowledge on the use of finance by small entrepreneurs. For example when they mistakenly assume that the finance is used for a fixed predetermined purpose such as investments, while in fact this does not reflect the way clients actually use it. In reality and as a result of the economic condition of the borrower, financial transactions may have been used for other more important functions such as special family events, home improvement, or purchase of consumer durables. Through frequent business monitoring institutions improve their understanding and knowledge on client needs, which they can use for making financial products more suitable to their clients.

Secondly, individual loan monitoring is *necessary to make sure that the loan will be repaid.* Generally, information on borrowers is processed as aggregated information on the composition of an SFI's portfolio and as desegregated information it is to be found within each client file. The loan application form usually provides baseline data on the business' financial status before loan disbursement. It is important that data on the individual loan performance are well processed and staff has easy access. The less time loan officers have to spend figuring out whose payments are due when, and whose are already late and by how much, the more time they can spend on client visits.

Monitoring of the individual loan performance is mostly done through the carrying out of follow-up visits to the clients. Follow up visits are a way of maintaining an ongoing personal relationship with clients making them feel closer to the SFI, and more responsible for repaying their loans. If an SFI demonstrates interest in the ongoing success of the business and loan officers visit clients regularly, they will be more motivated to repay the loan. The frequency of loan follow up visits depends on the needs of clients, the type of services that is provided through the follow-up visits (often advice and counselling is included), and the costs of providing follow-up services to the clients. Sometimes SFIs may be rather lax in the requirement of regular loan follow-up visits. In those cases, they are often too late with their visits if waiting until the moment the loan has fallen in delinquency. It has become clear that regular visits to the clients and prompt action at the first sights of delinquency are key factors in preventing these loans from being a loss. At the same time, SFIs should be strict in requesting from the small entrepreneurs to submit the information which is required by the SFI. Some financial institutions recommend to schedule a first follow-up visit within five days of loan disbursement to verify the use of loan proceeds. Subsequent visits are often carried out once a month. In this respect one has to be careful not to burden the loan officer with excessive high targets of new loans he or she has to process periodically. In that case, it has been shown that the number and the quality of follow-up visits will suffer at the end. Table 2 describes how ADEMI in the Dominican Republic is monitoring its clients.

Loan follow-up visits will cost the SFI staff time and related costs such as for example for transportation. An intensive schedule of follow-up visits will also limit the number of new clients with which each loan officer can process at a given time. It is recommended to calculate and add these costs to the total transactions cost of providing loans. SFIs must be careful, however, not to spend so much on loan follow-up that it is operating at a loss. Each SFI must carefully determine the balance of costs to benefits, both for the client and the SFI. Some suggestions for savings time in the loan monitoring process, are the following:

- ! Plan a geographic route that enables the field officer to visit a maximum number of borrowers in a given period;
- ! Ensure that all new clients receive a follow-up visit within days of the loan disbursement, so they understand the SFI will not "forget" them;
- ! Visit clients at times that are critical for preventing delinquency, such as several days before payments are due;
- ! Visit clients quickly after a payment becomes past due to assess and solve problems?
- ! Process different strategies for different delinquent borrowers, depending upon their credit

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- histories and how far behind they are on their payments;
- ! Detect trends in the portfolio (such as high delinquency among borrowers with certain activities) that might help identify strategies for reducing delinquency.

Thirdly, as part of loan performance monitoring an SFI should *identify and contrast the characteristics of good payers and of defaulters, and of good loans and bad loans*. The information should permit an assessment of the thoroughness and quality of the SFI's financial services and its loan appraisal, including the institution's effectiveness in dealing with risk. An SFI should facilitate refinement of lending criteria and product design.

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<p>Table 2: Monitoring of borrowers, the case of ADEMI</p> <p>"No later than three days after delivering the check, the adviser visits the borrower in order to verify use of the loan for purchases of raw materials or merchandise, to speak with the entrepreneur, and to advise him if necessary. From then on, advisers visit each client 2-3 times a month on average, depending on the need. There are no formal regulations for monitoring, which is done using a variety of instruments. The adviser's visit may be to verify use of the loan, remind the microentrepreneur of the payment, solve problems, or suggest an investment and development strategy. It may last from five minutes to two hours, depending on the purpose".</p> <p>"The adviser is free to decide how many and which microenterprises to visit. They average 4-10 visits to borrowers per day. Although the adviser is responsible for registering the payment for the borrowers, he or she should be sure that the microentrepreneurs do not identify him or her as a collection agent. The adviser should be friendly who gives advice and is trustworthy".</p> <p>"At the beginning of each month, the advisers receive a computerized list of instalments that come due that month, on the basis of which they develop their plan of visits. To be able to plan their daily work, the advisers keep a daily list of payments, updating it as the borrowers make payments. At the end of the month, each adviser receives a report detailing all deposits made by his or her clients, as well as a detailed delinquency report. If there is a discrepancy, the adviser checks with the accounting department and if necessary prepares a report".</p> <p>"On occasion, the borrower is busy and does not have time to go to the office, and so asks the adviser to deposit the copy of the stub and to withdraw the IOU. Even though this practice is acceptable, personal visits have the institution's preference, because they facilitate direct contact with the borrower".</p> <p>"The problems detected in the course of monitoring are varied and depend on the economic activity, the characteristics of the enterprise, the inputs, and other factors. One typical problem detected, particularly with new clients, is that a loan is used not for investment but to pay off a debt to a lender. Another typical problem is that many microentrepreneurs imitate large entrepreneurs and prefer to invest their earnings in purchases of land, houses, or equipment that they do not need. At times they neglect their need for working capital, resulting in low liquidity and great dependence on ADEMI".</p> <p><i>Source: Lewin, A. Christofer, The ADEMI Approach to Microenterprise Credit, GEMINI, 1991.</i></p>

Only if loan officers are closely monitoring their borrowers, SFIs can anticipate on time if delinquency shows higher rates than expected. Normally, higher delinquency results in lower repayment rates and lower income per months for the institution. Other financial effects are a slower rotation of the portfolio and subsequently less funds to lend out. Also income from fees will be less than expected. An SFI can adequately respond to the signal of higher delinquency by improving the information system to detect and analyse the causes and by emphasizing control and follow-up of loans. Furthermore, an SFI can consider to introduce incentives for on-time payments and charge fees for late payments. Additionally, an SFI may also consider an incentive system for loan officers to link the loan officer's level of remuneration to the quality of the portfolio. The following are the types of questions to consider in monitoring the individual loan performance. The checklist is divided into three subgroups, i.e. verification of investment, loan repayment, and lending behaviour:

- | | |
|--|---|
| Checklist Individual loan performance: (A) Verification of investment | |
| 9 | Has the client invested the loan fully into the business? |
| 9 | Has the client purchased with the loan those fixed assets and raw materials, or paid the other costs, which were approved by the SFI? |

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Checklist Individual loan performance: (B) Loan repayment

- 9 Can the client generate sufficient cash in order to meet his or her repayments?
- 9 Is payment of interest been received according to schedule? Is principal repayment up to date?
- 9 Has the client requested for rescheduling?
- 9 What are distinguishing features for identifying and contrasting good payers and defaulters, and of good loans and bad loans? What are the consequences of this information for refinement of lending criteria and product design?

Checklist Individual loan performance: (C) Lending behaviour

- 9 Have there been any changes in the use of other sources of credit, such as moneylender, other (semi-)formal financial institutions or credit programmes?
- 9 What are the client's plans for meeting immediate and long-term finance needs? What alternatives do clients have for our financial services?
- 9 Has the client become more familiar with lending procedures, and has this changed client's attitude to tap new (formal) financing channels?
- 9 Is the client interested in other types of financial services?

2.4 Savings performance monitoring

An SFI should make assessments of its savings performance because savings are the cornerstone of the financial institution. If an SFI is mobilizing savings from the public it shows that the public is confident about the institution's financial strength and stability. At the same time, the savings performance of a client can be a useful measure to the SFI for measuring the client's repayment capacity. Clients who have been able to mobilize an certain amount of savings over a period of time, have demonstrated that their businesses are generating enough profits to be able to repay a loan. Furthermore, savings deposits represent an important service to compete with in the financial marketplace. Most likely savings services will reach a larger number of people than credit, and therefore can reach deeper into the community. The mobilization of savings from the public also increases resources for lending and reduces the SFI's dependency on other financial sources, such as donor organizations.

Savings deposits will suit client's needs when they are safe, convenient in location and opening hours, yield a good return, and enable him or her to make unlimited withdraws at any time when the savings are needed by the client. There are several reasons why clients will be interested in depositing money. First, it develops the habit of saving and deepens the relationship with the financial institution. Savings encourage the saver to think about growth and change of his or her business. In fact, no business will be able to grow without accumulating its own capital. Frequently people spend cash money on hand on superfluous non-productive purchases. Secondly, clients will have the opportunity of earning more income from interest on deposits. Thirdly, savings deposits enable clients to maintain creditworthiness and capacity to borrow loans. Fourthly, savings can be used as an emergency fund which may prevent the entrepreneur of selling precious working capital. Fifth, savings can reduce the need of small entrepreneurs to apply for more expensive loans. Finally, experience has shown that small entrepreneurs not only can save, but also enjoy saving because savings impart self-confidence and personal pride.

Section 3B is addressing savings procedures of the institution. The following two checklists refer to the savings performance of the client:

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Checklist Savings performance: (A) Savings mobilization

- 9 Is it possible to get ahead in the business? How?
- 9 How important are (non-)financial savings to family security? And to the business?
- 9 What is the percentage of income clients are able to deposit each month? This percentage could then be applied to the income levels to estimate a potential range of savings.
- 9 What is the amount saved by the client obligatory, and voluntary?; what is the regularity of savings deposits? What is the use of these savings?
- 9 If the SFI does not have a savings component, what does it prevent from having one in its finance programme?

Checklist Savings performance: (B) Savings behaviour

- 9 Does the client bank all his sales proceeds in a savings or current account? Is the client maintaining an account in other banks? Are clients interested in other type of savings services such as time deposits?
- 9 Has the client become more familiar with savings procedures? Is a savings habit being created? Is there a deepening of relationship between client and SFI?

2.5 Business effect monitoring

SFIs can perform an analysis of what they think the effect of the financial services will be on their client. Collected background information and projections offer a basis for comparison when clients are interviewed and actual results analysed. A time-saving method of measuring and analysing the effects of a loan is to rely on the information which has already been collected through the follow-up visits and the data stored on the business monitoring forms.

Monitoring of business performance provides the SFI with information on the growth and changes of businesses. Based on this information an assessment can be made of how many people benefit from the business activity, and how they benefit. Wherever possible, the SFI should reduce data requirements, and where information must be collected, it must seek ways of integrating data collection into normal SFI activities to minimize the burden of specialized survey efforts. An ongoing monitoring system offers the best means of ensuring that the institution contributes as much as possible to the development of the MSE sector (see for example: Haggblade, 1992). A most valid data source for tracking effects, in combination with the initial loan application form, is the business monitoring form. Such a standard business monitoring form that is to be designed by the institution based on the issues discussed in this section can be filled out by field officers or their supervisors during field visits. The questions on the effect of the SFI's financial services can also be relevant for impact analysis if the changes observed are of a sustainable nature. If reliable quantitative information on clients' social-economic status can not be collected through the loan follow-up forms, a survey may have to be conducted.

It is important for an SFI to assess the growth and changes of the assisted businesses to be able to continue to support clients in the best possible way. This type of information may be more essential for the SFI than the type of data determining against high costs to what extent the loan and savings facilities may have contributed to development. As pointed out in paragraph 1.3, measuring the effects and impacts of a loan is a complex matter because of numerous methodological and practical constraints to assess the effects and impacts of a loan. However, through the information on growth and change of businesses the SFI is collecting the institution can improve the quality of its financial services by adjusting them more to the needs and preferences of the clients.

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The following list indicates the type of questions that can be considered in monitoring the effects of credit and savings services. The questions refer to the data which are collected in the process of business monitoring and are related to the growth and change of enterprises.

Checklist Business effect monitoring: Growth and change

9 What are the changes resulting from the growth or decline of the business which may have been caused by the SFI's financial services:

- ! in the general conditions of the business?
- ! in production and product quality of the business? Have new or improved techniques emerged that have potential for diffusion?
- ! in purchasing equipment and supplies by the business?
- ! in sales, profits and income in the business?
- ! in market conditions and strategies of the business?
- ! in management of the business?
- ! in employment of the business?
- ! in the use of other sources of finance or in the savings behaviour of the clients?

Give quantitative data where possible, otherwise describe. More detailed questions on the above issues can be found in the checklists formulated in paragraph 2.2.

continued

Checklist Business effect monitoring: Growth and change (continued)

9 What are the changes resulting from the risks involved due to client's increased financial obligations? Does the client depend more on our institution than before?

9 Describe the prospects of the business. Do the client and employees think the earnings from the business will increase in the future? Does the client want his or her children to carry on this business. Why?

9 Generally, which type of businesses are growing? Do micro businesses become small businesses due to the availability of the financial services? What is the status of the businesses now: bankrupt; contracting and struggling to survive operating at lower levels (of sales, profits and equity); stable; or, operating at higher levels than before? What are the obstacles and what facilitates the growth process? What kind of growth in the business can be contributed to the financial services offered? Why? Search for cases and examples where people benefit as a result of our financial services.

9 What are the lessons to be drawn, and types of corrective actions to be taken?

2.6 Business impact evaluation

As pointed out, impacts refer to the more indirect, wider and sustained results of the financial activities. If the effects discussed in the previous paragraph are long-lasting they can be viewed as sustained change, and subsequently can be considered as impacts of a financial services. Although they can be relevant for measuring impacts, this paragraph will not repeat the same type of questions dealt with in the case of business performance and effects but will discuss more in-depth the other type of impacts, i.e. the more indirect and wider results of a financial services. Examples of these other impacts can be applied to the changes in income and employment, client's decision-making options, family well-being, training and abilities, client participation and association, and attitudes of the people within the business (ACCION, 1988; Otero, 1989). Ideally, data collection is integrated into normal activities to minimize the burden of specialized survey efforts, and questionnaires are completed at the work sites. In these examples, The following set of questions can be addressed to determine the more sustained and indirect results for the businesses:

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Checklist Business impact evaluation: (A) Income and employment

- 9 How many people are now working in the businesses and what is the increase in their average wage rate? Indicate for gender.

Checklist Business impact evaluation: (B) Decision-making options

- 9 How well do our services fit into the client's financial management process? Are the client's decision-making options on, for example, liquidity, consumption smoothing and investment enlarged by the SFI? What can clients do now, that was not possible without the services? Examples may focus on such changes as the ability to purchase raw materials at cheaper prices, or accumulation of enough savings to survive a drought year.

Checklist Business impact evaluation: (C) Family well-being

- 9 What are the changes in living conditions of families? Changes in family income as a result of a small business activity is the most obvious indicator of how a MSE support institution has affected the economic situation of a client and his family. What services do families (of the entrepreneur and his or her employees) purchase as a result of changes in business income or other changes caused by the financial services? Since most low-income families have various and irregular income streams, it is important to isolate these changes. Social indicators of an improved quality of life are for example: purchase of food and improvements in diet, expenditures on children's schooling, health care, clothing, and home improvement initiatives.
- 9 What are the changes in the distribution of tasks and responsibilities within families, as result of the financial services? And, what are the changes in the distribution of resources within families, particularly between men and women? In many cases, women spend a greater share of the household budget on social expenditures, thus increasing more the well-being of the family than men.

Checklist Business impact evaluation: (D) Training and abilities

- 9 What are the skills learned by those who work in the business? For example, former unemployed or apprentices can become trained tailors while working in the business, skills that could eventually enable them to set up their own business.
- 9 What is the ability of the client to generate responses to perceived problems without the need of an outsider, referred to as self-help? Did any change occur in this ability of the client because of the SFI? In what did this result?
- 9 Is the capacity of the business to respond to changes in the market and economic environment increasing? Give examples.

Checklist Business impact evaluation: (E) Participation and association

- 9 What is the client's involvement in activities such as savings mobilization, training, and decision-making regarding the SFI?
- 9 If SFIs work with solidarity or self-help groups, what is the client's degree of participation?
- 9 The use of group-based lending can help develop the abilities necessary to become involved in broader associations and can stimulate clients towards change. The groups can be a training ground for developing skills needed to engage in collective planning and problem solving. Is there any change in mutual support efforts emerging within the group? Is there an increase or decrease of instances in which group members assist each other financially whether in the repayment of the loan or in other areas?
- 9 What is the involvement of clients in membership associations or other groups that attempt to address issues of mutual concern? Did any change occur because of the SFI?

Checklist Business impact evaluation: (F) Attitudes

- 9 Did participation in the SFI's activities bring about changes in attitudes that had a positive or negative impact on the client's life?
- 9 Has there been any change in client's self-perception in relation to the outside world?
- 9 What is the change in articulation of problems and solutions in group settings?

2.7 Questions for discussion and research

Questions for discussion and research on issues dealt with in this section are the following:

Checklist Business monitoring: for discussion and research

- 9 Are we continuing to listen and respond to the changing needs of micro and small entrepreneurs in creating access to financial services, information, and markets?
- 9 Do we have the ownership, decision-making, and feedback structures needed to ensure knowledge of, and responsiveness to our clients' needs?

continued

Checklist Business monitoring: for discussion and research (continued)

- 9 Do the entrepreneurs feel that we are offering the best services, such as: rapid access to working capital, ready access to repeat loans, limited guidework and other bureaucratic obstacles, reduced traditional collateral requirements, save and convenient savings mechanisms, rapid access to savings, and business services useful in managing and growing their businesses?
- 9 Do we and our clients feel mutual responsibility for results, in providing solid services and getting good repayments?
- 9 Do we have a clear idea of what represents value to our clients?
- 9 What are lessons to be drawn?
- 9 What types of corrective actions are to be taken?

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Section 3: Institutional monitoring

Gathering information on the institutional performance of an SFI is necessary to determine its long-term sustainability. Loan funds will erode rapidly if operating costs are high or collection performance is poor. This weakens an SFI's ability to continue operations as depositors and other funders will lose confidence in the financial status of the institution. Particularly if financial performance has not met expectations, an analysis of the operational performance should help to explain why and suggest recommendations for improvements. In the first part of this section guidelines are provided for assessing the financial performance of an SFI. In the second part, the operational performance is analysed. This section can be illustrated by *Annex A* in which a set of basic criteria for SFIs are formulated that should ensure an effective delivery of financial services to MSEs.

A. Financial monitoring

The following issues are to be addressed with financial monitoring:

- ! *Financial health*
- ! *Sources and uses of funds*
- ! *Self-sufficiency*
- ! *Spreads*
- ! *Profitability*
- ! *Cost-effectiveness*
- ! *Portfolio quality*

The analysis of the financial performance of an SFI is based on the figures found in the financial statements, such as balance sheets, income statements, portfolio statements, savings records, and client files. Financial monitoring is mainly done by using financial ratios. The method of relating these figures is very simple: one number is divided by another number, hence the term "ratio". The result can be multiplied by 100 and expressed as a percentage or it can be expressed as a decimal figure without the percentage conversion step.

Financial ratio analysis has its share of advantages and disadvantages. In all cases, the monitoring staff should be careful in interpreting and drawing conclusions from financial ratios. The advantages of financial ratio analysis include the following:

- ! *They can focus clearly on vital indicators of the SFI's financial performance and, in combination with other information, can be used in diagnosing problem areas.*
- ! *The use of financial ratios can be a powerful diagnostic technique since it identifies the strengths and weaknesses in the SFIs key decision areas.*
- ! *Financial ratios are easy to apply, assuming the relevant information is available.*

The disadvantages of financial ratio analysis are:

- ! *Feedback is slow.* The SFI's mistakes and problems can be detected by other means long before they are reflected in the financial statements.
- ! *Financial ratios often reveal symptoms rather than causes of problems encountered by the SFI.* A poor financial condition can be the result of management weaknesses, mistakes like misuse of funds, or wrong policies such as calculating an interest rate which is too low to cover transaction costs, risks and costs of obtaining funds.
- ! *Financial analysis of past statements focuses on past events rather than on problems that lie ahead.* Projections on financial trends can indicate future problems but the projections are based on past conditions which may not be true in the future.
- ! *If used in an isolated way financial ratio analysis can oversimplify problems.* Financial indicators, then, can become rigidly pursued goals in themselves, rather than being a helpful but important instrument for improving performance.

Great caution and good sense should be used when analysing financial performance. One

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problem facing monitoring officers, particularly in the case of SFIs, is the lack of standards for services aimed at MSEs. Institutions tend to be evaluated without reference to banking norms or to the achievements of well-performing institutions. In practice, it is very difficult to draw conclusions on the performance of one institution compared with the financial results of other institutions. SFIs may differ in numerous areas, such as client group, risk management, costs and financial margins, methodology in calculating costs and default rates, methodologies of reschedule or refinance loans and their supply package of services. As a result, financial indicators vary widely between institutions and staff has little guidance to determine what levels may be considered standard.

An immediate benefit of monitoring financial trends is that they help the SFI to formulate a clear strategy plan. The formulation of key performance targets can increase the institutional strength and can offer the SFI a good platform to negotiate with funding partners (see *Annex D*). More in-depth analyses concerning financial indicators and managing a financial institution in general can be obtained from, for example, "Bank Management, Text and Cases" by Hempel, Simonson and Coleman (1994).

3.1 Financial health

Just as important as knowing whether a service is tailor-made and viable is knowing whether it has a secure institutional base. This requires a look at the financial condition of the institution. The income statement and balance sheet are the prime sources of information to determine the institution's financial health. Analysis of the financial health of an SFI should indicate whether the institution has the adequate equity to absorb possible future losses without putting in danger its external obligations. In some cases, the amount of equity generated by an SFI may depend largely on the capability of management to obtain donations rather than on the capacity to generate earnings. However, in other cases, savings generation can play an important role in creating a lending base for institutions.

A well-known framework for assessing the financial condition of a financial institution is the CAMEL rating system. CAMEL is an acronym for capital adequacy, asset quality, management, earnings and liquidity. The rating system can be applied to formal as well as semi-formal financial institutions. Comparing the institution with its peer group of similar institutions plays an important role in this evaluation process. However, the comparisons may be impossible where no similar institutions exist in the country, or is meaningless where most of the peer group are poor performers and cannot offer a useful standard for comparison. In these cases, peer group comparison should not be attempted. Additional limitations to be overcome for this type of analysis are the limited data availability, poor data quality, and inadequate provision of debt losses of many SFIs (Von Pischke, 1992; Graddy et al., 1990; Mould, 1987). Nevertheless, rating system such as CAMEL can be considered as a useful tool for SFIs which may help the institution to start analysing its financial health.

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Capital adequacy

Capital adequacy measures equity as a percentage of total assets, and is important to determine how much capital is appropriate for an SFI's financial structure. The SFI must have enough capital, generated through grants, loans and savings mobilization, to ensure that the institution can weather unexpected risks. Capital adequacy is an indication of the level of capital that will allow the SFI to absorb loan losses and still have adequate funds to maintain and deliver the financial services as an on-going activity. It reflects financial strength and cushion for the funders and determines whether the SFI is financial "sound".

Formula: Capital adequacy

$$\frac{\text{Equity}}{\text{Total assets}}$$

The equity (or quasi-equity because of being a not-for-profit institution), is constituted by paid-in capital (contributed in the form of equity capital, shares or other capital) augmented by possible existing profits or reduced by accumulated losses. A typical small bank may have equity-to-assets ratios of around 10 percent (Hempel et al., 1994).

Degree of indebtedness

The degree of indebtedness, also called capital gearing (in the United Kingdom) or leverage ratio (in the United States), is mainly used by the providers of funds to indicate their relative amounts of resources. It is a measure of the financial risk of the SFI. Generally, the more debt in the SFI's financial structure, the more volatile its earnings and the greater the risk to the fund providers.

Formula: Degree of indebtedness

$$\frac{\text{Debts}}{\text{Equity}}$$

Debts comprise the following components:

- ! Short-term financial liabilities, defined as all debts payable within 1 year, including savings deposits, time deposits, and demand deposits.
- ! Long-term financial liabilities, defined as all debts maturing at least 1 year after they were incurred, including the loans of donor institutions, bank loans, and debentures.

Generally, an indebtedness ratio of around 20:1 is average for commercial banks, while some SFIs could have indebtedness ratios of only about 8:1 because of the higher risks of their lending operations. In practice, however, few SFIs reach this ratio (Goldmark and Rosengard, 1985). It is important to realize that international standards of indebtedness ratios are not necessarily adequate in financial environments that are general harsh. High risk portfolios require a larger equity base than low risk ones. Separate evaluations of risk should be made and separate standards of indebtedness determined for each SFI dealing with MSEs.

Degree of savings mobilization

The degree or importance of savings mobilization can be measured by the proportion of savings to the total amount of liabilities. Alternatively, it can be calculated by the ratio of the deposits of non-banks to the credit disbursed to non-banks. Both vary according to the type of financial institution. Savings mobilization dominates credit disbursement in most credit unions and in many savings banks, whereas many other SFIs, such as NGOs and cooperatives, are primarily

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involved in credit delivery. SFIs can operate several kinds of accounts. The most common type of account, the current account can be used by clients to pay money in and write cheques to make payments from it. Usually, SFIs will not pay interest on a current account. Sometimes it is possible for clients to take more money out than they have in their account. This is called an overdraft, and can only be done with the SFI's agreement; the SFI will charge interest for this facility. If clients have money which they do not need for some time it can be placed on a deposit account for which the SFI will pay interest. If clients are willing to agree not to withdraw their savings for a longer period of time like six months or one year, such savings may be placed into a time deposit account, which is earning a higher rate of interest than savings accounts.

Formula: Degree of savings mobilization

- (a) $\frac{\text{Deposits of non-banks}}{\text{Total liabilities}}$
- (b) $\frac{\text{Deposits of non-banks}}{\text{Current portfolio}}$

Liquidity

Liquidity ratios measure the institution's ability to meet its short-term obligations with a margin for safety. It is related to liquidity risk, that is the risk for an SFI of not having adequate cash or other liquid assets to meet the claims which have actually been presented. These claims can refer to demands for cash withdrawals or loan requests by clients. A commonly used indicator of liquidity is the acid test, that is the percentage of total assets held in liquid forms such as cash, short term investments and demand deposits held at banks. The acid test indicator measures the ability of the SFI to avoid interruption of lending due to lack of available funds or inability to meet demand for withdrawal of deposits.

Formula: Acid test

$$\frac{\text{Liquid assets}}{\text{Total assets}}$$

In the case the SFI is borrowing from other parties, often the solvency indicator is used for measuring liquidity. Solvency means that if all claimants were imaginary to demand their dues, the institution would be able to satisfy them immediately. The solvency indicator measures the availability of cash and other liquid assets required for daily operations.

Formula: Solvency indicator

$$\frac{\text{Liquid assets}}{\text{Short-term debts}}$$

The liquid assets should be sufficient to cover short-term debts, for example in the case depositors of the SFI choose to withdraw their funds at short notice. For this reason, it is recommended that the solvency indicator should be greater than one (Goldmark and Rosengard, 1985). If the solvency ratio is greater than two, however, it normally means that funds are used in a sub-optimal way for loan disbursement. This is because the SFI will be holding these funds in cash or placing them in low-interest-bearing deposits rather than putting them in longer-term, high-interest deposits. The SFI, therefore, has to carefully monitor its overall liquidity and reinvest any excess in new loans. The examination of an SFI's liquidity is particularly important for banks

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and donors when they are considering additional funding. This type of analysis can determine whether such assistance is warranted.

3.2 Sources and uses of funds

A statement of sources and uses shows where the funds of the SFI came from and how they are used over time. Major inflows usually are in the form of mobilization of local savings, capital contributions from funding institutions, the local government, private investors, and loan repayments. Uses of funds mainly include loans disbursed, increases in short term liquidity, and other short or long term investments.

The statement of sources and uses of funds can be constructed from the last two balance sheets and the prior income statement. Any increase in liabilities (for example because of an increase in capital funds or retained earnings) or decrease in assets (for example because of a reduction in cash) is a source of funds, whereas any decrease in liabilities or increase in assets is an use of funds. To be useful, the statement should be supported by information explaining how changes in certain items came about. An example of a statement of sources and uses of funds is shown in "Design and Management of Revolving Credit and Similar Funds in ILO Technical Cooperation Projects" (Balkenhol, 1994).

The analysis of the portfolio's sources and uses of funds over time gives a clear indication of the areas in which additional resources need to be mobilized or areas where there may actually be an excess of available funds. this exercise also helps management determine relative priorities in the use of locally generated revenue. Furthermore, the sources of uses statement provides the basis of how the SFI allocates fresh resources. Finally, it provides the basis for reporting on the contribution of outside funds to the lending activities.

In order to get a better insight in the package of financial services which make the largest part of the uses of funds, this post may be further differentiated. For example, the term of finance and the growth in the uses of funds for each type of product, such as working capital or fixed assets loans, leasing and hire-purchase operations may be distinguished. The importance of monitoring inflows and outflows of funds is relevant in the case of large fluctuations in cash-flows due to, for example, beginning of school year, religious feasts, holiday seasons or droughts. These events may lead to large savings withdrawals resulting in a shortage of credit funds which may even force SFIs to interrupt their lending operations.

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3.3 Self-sufficiency

Self-sufficiency indicators, like spreads and profitability indicators reflect whether or not the institution is covering the costs. In general, institutions reporting positive profitability also are basically self-sufficient. The ability of an institution to sustain its impact into the future depends upon its self-sufficiency. Institutions that cannot pay their costs cannot generally continue operating. At the same time, the more an institution is able to cover its costs from internally generated income, the less dependent the SFI is from external sources. Generally, these external funds are more costly than the savings mobilized by the institution itself. In addition, external funds might be withdrawn in a given moment, putting at risk the financial future of the SFI. Thus, while self-sufficiency indicators should not become rigidly pursued goals in themselves, they provide an important standard for measuring financial performance.

Depending on whether and how an institution utilizes captured savings, these savings can influence self-sufficiency by increasing the availability of funds for lending or by enabling it to generate additional funds.

Some key factors that can have a negative influence on self-sufficiency, are the following (Otero, 1989):

- ! *Level of delinquency*: the higher the delinquency rate the more the institution is losing on not collected interest, and the less loan funds can rotate.
- ! *Credit policy*: appropriateness of the rules that guide lending activities, especially the interest rate and the terms of the loans, help determine the level of self-sufficiency that can be attained. Credit policy must be outlined in a clearly and detailed manner.
- ! *Size of the portfolio*: self-sufficiency is also affected by the size of the portfolio. The pattern of its development over time will determine the institution's potential to sustain itself. High portfolio rotation also contributes to overall institutional growth and stability.
- ! *Financial resources*: Liquidity can affect a SFI on a very short term, and demolish its potential for self sustainment. Access to guarantee funds or emergency sources of capital to replenish the loan fund, especially if it encounters great demand, is essential to longer-term viability.
- ! *Losses*: the percentage of overall portfolio that is written off is a final factor influencing the institution's self-sufficiency.

An SFI is self-sufficient, when it is able to continue operating because income covers expenses. However, more definitions of term self-sufficiency do exist because what constitutes income and what are the appropriate expenses to match against that income is subject to the development stage of the institution. Donor institutions and SFIs must recognize stages in the pursuit of self-sufficiency, including a start-up stage during which the goal is for income to cover operating costs and followed by a second stage when income covers the real costs of capital at non-subsidized rates. One task is to examine which current subsidies are start-up subsidies and which are chronic (Rhyne, 1992). An SFI may very well be acceptable if it has not reached self-sufficiency but is showing a convincing trend towards smaller subsidies and eventual commercial operations.

At its most basic level, self-sufficiency is the ability of an institution to continue to cover its costs over time, no matter what the sources of its income are. In this case, the term sustainability is often replacing self-sufficiency. At its most stringent level, self-sufficiency is the ability of an institution to cover all costs, including the costs of capital, the costs of default and the cost of inflation or devaluation, out of income generated from the own institutional operations, i.e. through interest and fee income.

Table 3 provides an overview of the type of income and expenses which must be included for calculating the short-term and long-term financial self-sufficiency (Cranfield, 1992). The operating costs of an SFI include salaries, rent, supplies, and all other costs of operation. Because SFIs in their early phases of operation have relatively high costs in relation to their small start-up portfolio, they must estimate their operating costs as a percentage of an expected future portfolio. Earning that percentage on the expected future portfolio will generate enough income for the SFI to pay its operating costs.

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Table 3: Calculating financial self-sufficiency

INCOME		
9	What are the earnings from loan interest?
9	What interest is earned on funds not yet lent?	.....
9	Is there any other income, from consultancies, technical or training fees, rent of space or other facilities?	.....
	Total operating income per year	.....
EXPENSES		
9	What is the cost of funds per year?	.....
9	What is the cost of defaults?	.....
9	What is the cost of wages and salaries?	.....
9	What other employment costs are paid?	.....
9	What is the cost of rent of central and field offices?	.....
9	What is the cost of staff training?	.....
9	What is transport cost?	.....
9	What are the legal costs?	.....
	Total operating expenses per year	.....
	Total profit or loss per year	.....

The **short-term financial self-sufficiency** is defined as:

$$\frac{\text{Operating income from interest and fees}}{\text{Operating expenses (including cost of capital and default)}}$$

For calculating the **long-term financial self-sufficiency** the following two questions concerning the cost of inflation need to be included:

- 9 What is the effect of inflation on the loan fund?
- 9 How is compensated for the inflation effect?

Until the SFI reaches the expected future portfolio and its break-even point, the operating deficit could be covered from a source other than the income earned on loans. However, the costs of the institution, particularly the operating costs and those related to maintaining a loan loss reserve, will depend to a large extent on its efficiency. Borrowers should not have to pay high interest rates to cover institutional inefficiencies.

Six self-sufficiency indicators are discussed below: solvency, institutional sustainability, operating self-sufficiency, long-term and short-term financial self-sufficiency, and full institutional self-sufficiency. Because of seasonal influences it is recommended to compare the selected self-sufficiency indicator at similar time periods.

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Solvency

At the most basic level, solvency can indicate whether the institution has enough cash to pay the bills and making some loans (see also paragraph 3.1). It does not show whether or not the loan fund is being decapitalized. As such, solvency can also be defined as:

<p>Formula: Solvency</p> $\frac{\text{Cash inflows}}{\text{Cash outflows}}$
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Institutional sustainability

Institutional sustainability is the ability of an institution to sustain operations. It may only cover part of its costs with self-generated income, but has the ability to obtain grant income to make up deficits. The ratio of institutional sustainability can be defined as:

<p>Formula: Institutional sustainability</p> $\frac{\text{Operating income from grants, interest, and fees}}{\text{Operating expenses}}$

Operating self-sufficiency

Operating self-sufficiency indicates that an SFI is able to pay for the operations costs of financial services with the income that these services generate. In contrast with sustainability, self-sufficiency indicates that no outside sources such as grants or cheap capital are involved.

This definition does include the cost of capital but does not include the cost of default, cost of inflation and cost of additional technical assistance. The ratio of operating self-sufficiency can be defined as:

<p>Formula: Operating self-sufficiency</p> $\frac{\text{Operating income from interest and fees}}{\text{Operating expenses (incl. cost of capital)}}$
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Financial self-sufficiency

Financial self-sufficiency can be divided into short-term and long-term financial self-sufficiency. Short-term self-sufficiency means that an SFI is covering operating costs, including cost of capital and default costs, with income generated from the institution itself. Long-term self-sufficiency also takes into account the costs of inflation.

The costs of inflation can be obtained by multiplying the equity of the institution with the annual inflation rate. In this way, the SFI is able to maintain the value of its portfolio. In practice, it may be difficult in getting to know the exact inflation rate of a country. Equally, for example, inflation may only be given one year before the relevant period for which one wish to calculate the self-sufficiency. In that case, the operating self-sufficiency indicator is given preference over the financial self-sufficiency indicator.

The ratios of short-term and long-term financial self-sufficiency can be defined as:

Formula: Short-term financial self-sufficiency

$$\frac{\text{Operating income from interest and fees}}{\text{Operating expenses (incl. cost of capital and default cost)}}$$

Formula: Long-term financial self-sufficiency

$$\frac{\text{Operating income from interest and fees}}{\text{Operating expenses (incl. cost of capital, default and inflation costs)}}$$

Full institutional self-sufficiency

Full institutional self-sufficiency signifies that the SFI covers operating costs, cost of capital, default cost, inflation cost and the cost of additional technical assistance (T.A.) with income generated from the programme itself. Full institutional self-sufficiency is the most stringent of the six self-sufficiency indicators, and can be defined as:

Formula: Full institutional self-sufficiency

$$\frac{\text{Total operating income from interest, fees, T.A., and other income}}{\text{Total operating expenses (e.g. cost of capital, default, inflation & T.A.)}}$$

SFIs can increase self-sufficiency by improving the repayment rate, by increasing the size as well as rotation of the loan portfolio, mobilizing higher level of savings, and having access to guarantee funds or emergency sources in the case of lack of liquidity. If an SFI is not able to reach the targeted self-sufficient level, it can be useful to carry out a break-even analyses. The SFIs does break-even at the point at which income from operations can fully absorb all operating costs without earning profits or incurring losses. There are three types of break-even analyses that may be considered:

- ! Estimation of what interest charges on MSE loans would be required to enable the SFI to break even, assuming that operating expenses, bad debts, and loan volume remain constant.
- ! Estimation of what loan volume would be required to enable the SFI to break even, assuming that interest rates, operating expenses, and bad debts remain constant.
- ! Estimation of what loan loss rate (amount declared nonrecoverable divided by the relevant portfolio) would be required to enable the SFI to break even, assuming that interest rates, operating expenses, and loan volume remain constant.

In practice, calculating the break-even point of financial services is a complex matter and, obviously, few software is yet available for SFIs to support this type of analysis. SEEP Network has developed a computer model on self-sufficiency that works with LOTUS 123. The financial model can show SFIs the relationship between self-sufficiency of an SFI and product design decisions such as loan size, interest rate, number of borrowers per loan officer, and external factors such as inflation (King and Reed, 1989).

3.4 Spreads

The operating spread indicator (or interest rate spread, or margin) is the percentage points between the cost of money to the SFI and the effective interest rate charged to the client. The operating spread indicator compares the weighted interest rate for each of the loans in the portfolio with the weighted cost of funds used to finance that portfolio:

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Formula: Operating spread

$$\frac{\text{(Outstanding loans) x (Their specific interest rate)}}{\text{Current portfolio}} \quad \text{Less}$$

$$\frac{\text{(Amount of mobilized funds) x (Their specific costs)}}{\text{Current portfolio}}$$

For example, if an SFI is financing its loans fully through savings mobilization and the interest rate paid to clients on these savings deposits is 15 percent while the interest rate on loans is 35 percent, it follows that the operating spread is 20 percent.

The second ratio of this indicator concerning the cost of funds refers to the effective rate of interest that institutions pay on their savings deposits. Alternatively, for granted or concessionary loans it may refer to the inflation rate. If SFIs operate in economies where interest rates for time deposits are positive in real terms, then they should use the opportunity cost of money instead of the inflation rate as the cost of funds for donated or concessionary funds. The opportunity cost of money is the interest rate that those funds would earn if they were invested in low-risk time deposits (Christen, 1990).

The spread on a loan should be sufficient to cover all costs from operations, risk reserve, and inflation. The spread should also be sufficient to earn some income to help capitalize the loan fund and to reinvest in the institution so that the quality of operations can be improved. When a SFI holds down costs and sets interest rates correctly it will earn income. If it sets interest rates either by choice or by government mandate with an insufficient spread, the SFI will suffer a loss. Similarly, it will make a loss if operating costs or loan losses get too high.

Usually, in the first period SFIs do not have sufficient lending volume to break even and earn sufficient income to cover its costs. In that case, it must estimate the spread they will need to cover their operating costs when they reach early maturity. Based on budgets and financial projections an institution can estimate its operating costs as a percentage of expected portfolio. This percentage at the SFI's break-even point should produce the amount of income needed to cover operating costs. Until the SFI reaches this point of stability the operating deficit will have to be covered from a source other than the interest earned on loans.

The behaviour and percentages of operating spreads may differ considerably between countries and SFIs. In some countries operating spreads are dependent on decisions of government agencies. In other countries they will change only very slowly since interest rates charged are the same for all loans and seldom change while inflation may be relatively stable. In other cases, spreads may change frequently since they are readjusted frequently for daily changing loan and savings interest rates.

Generally, operating spreads need to be higher for small enterprise lending than for normal commercial bank lending. This is because of the tiny average loan size disbursed to this client group which makes it relatively more expensive for MSE support institutions. Operating spreads reflect the economic and financial context in which an institution operates, but also the legal interest rate ceilings, the type of clients served, and the access of the institution to concessional funds.

3.5 Profitability

An SFI should increase the ability to generate its own income base. Analysis of the profitability of the institution over a period of time should be based primarily on its income statement. This statement, also called profit and loss account, provides information on income and expenses incurred during the year. An example of such an income statement is shown in the ILO document "Design and Management of Revolving Credit and Similar Funds in ILO Technical Cooperation Projects" (1994). In essence the institution is viable if income exceeds costs. The basic ratios that can be used to judge the profitability of the SFI are given below. The SFI should

examine the extent to which each asset can generate income and ensure that income covers expenses and a positive net margin is created.

Return on equity

Return on equity is the rate earned on the own resources of the SFI.

<p>Formula: Return on equity</p> $\frac{\text{Operating income} - \text{Operating expenses}}{\text{Equity}}$

If the return on equity is less than the inflation rate the SFI is decapitalizing because inflation eats away the value of the SFI's portfolio. The institution's own resources will lose value as inflation increases.

Return on assets

Return on assets is the rate earned on the assets of the institution.

<p>Formula: Return on assets</p> $\frac{\text{Operating income} - \text{Operating expenses}}{\text{Total assets}}$

This indicator is more relevant for institutions with large liabilities which may include for example long term concessionary loans from funding organizations. This indicator of profitability is of limited use where self-sufficiency is concerned since many SFIs benefit from implicit (subsidized loan funds caused by inflation) and explicit (grants and soft government sources of funds) subsidies. The numerator may additionally include interest paid.

Return on interest-earning assets

Return on interest-earning assets is the rate earned on liquid assets (cash and demand deposits at banks) of the institution.

<p>Formula: Return on interest-earning assets</p> $\frac{\text{Operating income} - \text{Operating expenses}}{\text{Liquid assets}}$

The return on interest-earning assets should be close to the effective rate of interest charged by lenders unless the institution has a large quantity of non-interest earning assets, such as immobilized bank accounts.

Operating return

Finally, the operating return indicator reflects the rate earned on operating income of the institution.

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Formula: Operating return

$$\frac{\text{Operating income} - \text{Operating expenses}}{\text{Total operating income}}$$

3.6 Cost-effectiveness

In the design and management of financial services an SFI needs to pay constant attention to cost-effectiveness of the services. Cost-effectiveness means minimizing costs and maximizing income and can be viewed as a measure of institutional efficiency. Institutional efficiency is the ability of an institution to cover its operating costs from income earned and is closely related to self-sufficiency. Cost-effectiveness enables an SFI to compare costs and determines the value of the resources used by the institution in relation to the magnitude of the benefits resulting from these resources.

Cost-effectiveness is playing an important role in all financial decision-making. When defining its markets an SFI needs to measure the relative costs of delivering services to clients of different sizes, types and locations. When establishing its financial products, an SFI should clearly calculate the costs of delivering the planned services and the income each product will generate to cover the costs. In addition to the financial services, SFIs may decide to offer often very extensive non-financial technical assistance such as extensive client training programmes. Because these programmes are generating little income to cover costs an institution may have to look for outside subsidies to cover the costs. Finally, when deciding to expand into new areas of the country an SFI needs to assess whether the additional costs can in time be covered by the estimated income.

The aim of successful SFIs is to generate the most income possible through their financial services in order to secure long term viability, just as they expect clients to maximize sales. An SFI will probably receive income from a variety of sources not necessarily directly related to its financial services. These income sources can include the following:

- ! Interest earned on the loan funds and other investments
- ! Grants and donations to cover operating expenses
- ! Income from services offered, such as management services or consulting
- ! Income for use of fax and copy machines
- ! Rent of office space if the SFI owns building
- ! Spreads earned on health and insurance programmes for clients
- ! Charging different types of fees such as: application fees, loan processing fees, closing fees, guarantee fees, membership fees, training fees, and collection fees.

The other side of cost-effectiveness is minimizing expenses. Examples of direct costs are salaries and benefits of loan staff, transportation, documentation, cost of funds and provision of losses. These type of costs can be distinguished from indirect costs, such as general management and support staff salaries and benefits, staff training, rent, utilities, office supplies, printing and copying, communications, transportation, depreciation, equipment maintenance and insurance, marketing and promotion, and legal plus accounting and auditing expenses. Both direct and indirect costs can be either fixed or variable.

Cost allocation

Each activity should be set up as a separate cost or profit centre. In this way, the SFI can monitor the income generated by each activity and the expenses incurred for each activity, and calculate the degree to which each activity is attaining self-sufficiency. Through this cost allocation, the institution is able to manage their programme more effectively and plan the programme accordingly. Cost allocation is not only useful for internal management, but is also important when donor funds are being used to cover operating costs. Donors often specify that their grants be used only for specific activities, not for the SFI's general overhead. In this respect, good functioning report systems and transparent data are essential.

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Besides covering the direct costs of running the activity, the income generated by each activity should also be able to support the portion of the indirect costs, or institutional overhead, associated with the activity. The SFI therefore needs to allocate indirect costs to each activity in proportion to the amount of staff time and other resources expended on that activity. In this way the true costs of running the activity are reflected. Usually, the majority of indirect costs are allocated on a percentage basis, by estimating the amount of general administrative resources attached to each activity. Often, staff time-schemes are used as the justification for the allocation. General management and support staff record the amount of time they spend on various activities each month. At the end of a period, the time-schemes are tabulated to arrive at an overall percentage of administrative support provided to each activity. If the time-schemes show that staff spent 75 percent of their time on delivering financial services, then 75 percent of all other general and administrative expenses are also allocated to that activity.

Operating costs per loan and per unit of currency lent

Two important indicators of cost-effectiveness, and thereby of institutional efficiency, are the operating costs per loan and the operating costs per unit of currency lent:

<p><i>Formula: Operating costs per loan</i></p> $\frac{\text{\underline{Total operating costs for the year}}}{\text{\underline{Number of loans disbursed during the year}}}$ <p><i>Formula: Operating costs per unit of currency lent</i></p> $\frac{\text{\underline{Total operating costs for the year}}}{\text{\underline{Value of loans disbursed during the year}}}$

Preferably the operating costs are divided in variable costs and fixed costs. Also training costs might be examined separately. In this way the management can get a better understanding of the expenses that are involved in delivering the financial services and make the appropriate decisions as result of signalled inefficiencies. If, for example, training costs are higher then expected, the SFI could increase training fees, look for special grants to subsidize training, and try to make training more efficient. If the SFI operates with one or more branches, the indicators has to be analysed at branch level.

Some data suggests that it would be unrealistic to expect administrative costs to account for less than 5-6 percent of the average annual loan portfolio, even for an institution that has performed very well. This is especially so for new institutions that operate with long average loan terms, are involved in intensive training, cope with frequent repayment of small loans, and may be involved in the handling of small deposit accounts. The stage of growth of an SFI and the rates at which cost per dollar lent and cost per dollar saved decline as an institution matures, are important determinants affecting the ratio of operating costs as a percentage of the average annual portfolio (Yaron, 1992).

Operating costs per deposit account and per unit of currency saved

The same exercise can be done for operating costs per deposit account or per unit of currency saved:

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Formula: Operating costs per deposit account

$$\frac{\text{Total operating costs for the year}}{\text{Number of deposit accounts during the year}}$$

Formula: Operating costs per unit of currency saved

$$\frac{\text{Total operating costs for the year}}{\text{Value of savings deposits during the year}}$$

In practice, savings as well as lending activities designed to benefit the MSE sector are notorious for their high administrative cost because of the high transaction costs involved. Although the cost per loan or deposit account may vary, their administrative costs should only be a fraction of the value of loans disbursed or deposits mobilized.

3.7 Portfolio quality

The quality of the loan portfolio is determined by the amount of risk that is involved in lending the available funds to clients. An SFI cannot always be sure that their loans will be repaid. As a result, the quality and size of a portfolio changes continually as loans are disbursed, payments are made and loans and payments become past due. The loan portfolio represents the largest asset of the institution. At the same time, the loan portfolio is important for the SFI's survival because it generates the SFI's income through interest payments. Therefore, an SFI need to monitor the quality of its loan portfolio carefully in order to be able to deliver financial services to small entrepreneurs on a continual basis.

The portfolio, or amount outstanding, is commonly referred to as current, active, actual, or outstanding portfolio, and is the total loan principal owed by borrowers that the SFI expects to receive. Interest owed by clients is not usually considered part of the portfolio. Principal and interest should always be considered separately because principal is part of the SFI's asset whereas interest contributes to the SFI's income and cash flow.

An important tool for monitoring the portfolio is trend analysis. Changes over time are the first indication of a problem or of the effectiveness of an attempted solution. The monitoring system should provide the SFI with enough information to detect trends and determine the likely causes of those trends. Managers should be able to analyse and compare over time, the amount, number, and percentage of payments past due and the extent of portfolio at risk by variables such as:

- ! *Age (number of months) of delinquency:* Are the payments past due by 30 days moving into the 30-60 days category, or being paid off from one month to the next?
- ! *Loan officer and geographic location of entrepreneur:* Has the portfolio grown too large to permit adequate follow-up with existing staff? Has the SFI extended geographical reach beyond their capabilities? Does the portfolio of one particular loan officer have a disproportionate share in the delinquency?
- ! *Size of loan and repayment terms:* As loan size grows, is delinquency increasing?
- ! *Single or group loan:* Does the interchange of information and ideas, and peer pressure in groups result in better repayments than with individual loans?

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- ! *Activity of entrepreneur.* Is delinquency concentrated in particular economic sectors, or is it related to the size of the businesses financed? For example, are carpenters or shoemakers and tailors falling behind more than producers of touristic handicrafts or garments? Why? Has the price of wood changed? Has there been a change in government's policy for elementary school parades on a national holiday?
- ! *Type of enterprise:* For example, are starters a higher or lower risk for the institution than the established businesses?
- ! *Purpose of loan:* For example, are loans used for buying machinery causing more problems than working capital loans?
- ! *Gender of entrepreneur.* Do men show higher or lower delinquency rates than women? Are opening hours in harmony with women's business and domestic obligations?
- ! *Number of repeat loan:* Are new clients more or less inclined to fall behind their payments than those who have been with the institution for a while? Should screening or selection procedures be changed?
- ! *External factors:* Are political or macroeconomic factors affecting many of the client group? Are there demand or climatological constraints affecting the businesses?

Each of the above mentioned variables carries its own level of risk. Overconcentration of lending resources in relation to any of these factors may increase the portfolio risk of the SFI. If one of these variables face a higher lending risk, the SFI may decide to limit the number and amount of loans made to that specific group or sector of entrepreneurs to a small percentage of the portfolio. If, for example, the SFI has decided to limit fixed asset loans to 40% of the portfolio because it feels that these loans are more risky than working capital loans, the monitoring staff must provide the percentage of loans made for fixed assets at all times. If these loans have reached or exceeded 40% of the portfolio, the management should restrict new fixed assets loans until repayments have lowered the outstanding percentage of these loans in the portfolio. The established portfolio variables should be revised over time as the factors that influence risk change.

The following four indicators are generally used in combination to analyse the quality of the loan portfolio:

- ! *Repayment rate*, an indicator of recovery performance. Repayment rates usually measure the amount of payments received with respect to the amount due and past due.
- ! *Delinquency rate*, measures the percentage of a loan portfolio at risk or in danger of being lost.
- ! *Contamination of the portfolio*, an indicator of the potential risk of losses due to nonrecoverable loans.
- ! *Loan loss rate*, measures the amount an SFI has declared nonrecoverable, or written off, as a percentage of the portfolio.

To understand fully the soundness and quality of the loan portfolio, it is recommended to calculate all four indicators and present them in a combined way.

Repayment rate

Poor loan repayment is often the single most important factor affecting the viability of an SFI. When loans are not repaid, the funds available for new loans are reduced unless renewed capital is secured. Loan recovery performance is best measured by the repayment rate on loans, presented below. The SFI should make transparent fully the formula used and reflect the extent to which repayment rate figures represent the true recovery performance. If they are unsatisfactory and overstating the true recovery performance the SFI should try to reformulate the repayment rate used. The repayment rate can be defined as:

<p>Formula: Repayment rate</p> $\frac{\text{Amount of payments received in period}}{\text{Amount due in period plus amount past due}}$

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Delinquency rate

Delinquency, also referred to as arrears or late payments, measures the percentage of a loan portfolio at risk. Loans are considered at risk when any portion of the loan principal is past due, meaning that it has not been paid even though the due date has passed. Delinquency is calculated by the amount of payments or loans past due as a percentage of the portfolio:

<p><i>Formula: Delinquency rate</i></p> $\frac{\text{Amount of payments past due}}{\text{Current portfolio}}$
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Although the delinquency rate indicator is commonly used among SFIs, it usually understates the risk to the portfolio because it only counts the payments as they become past due and not the entire current portfolio actually at risk. For example, if no payments have been received on a loan during 3 periods possibly the whole amount is at risk. The delinquency rate indicator depends to a large extent on the credit policies and practices of the institution which makes it relatively easy to manipulate. For example, the following measures can cause a decline in the delinquency rate while in fact there is no improvement at all in the recovery of loans disbursed or the portfolio quality:

- ! *Rescheduling of past due loans* reduces the value of payments past due while it does not change the current portfolio. The use of long loan terms can result in an artificially low delinquency rate, because of the relatively small payments involved. Each payment has a small effect on the rate of delinquency, even though the amount of risk to the portfolio might be increasing.
- ! The quickness of *declaring past due loans unrecoverable*, and the resulting withdrawal of these loans from the balance, results likewise in a considerable reduction of the value of payments past due and a relative decline of the value of the current portfolio.
- ! *SFIs in expansion* normally report an artificially low delinquency rate, because of the large increase of the current portfolio and the fact that new loans normally only gradually become past due.

The definition of "past due" should reflect the time frame in which risk increases, considering the type of loan, the loan term, the payment schedule and the SFI's past experiences. Some SFIs consider loans past due when a payment completes one entire cycle without being made or, in most cases, when two payments are past due. In that case, loans with monthly payments are considered past due 30 days after a missed payment. While loans may not be considered delinquent until two payments have been missed, efforts to recover payments should be undertaken as soon as any payment is missed (Stearns, 1991b).

Generally, it is considered that delinquency rates between 10 and 20 percent require very careful monitoring while delinquency rates exceeding 20 percent are cause for major alarm. Some SFIs that provide credit based on group methodologies like solidarity groups or self-help groups, recommend that these activities should not have delinquency rates exceeding 5 percent. In the case of delinquency rates between 5-10 percent, it is recommended that corrective measures are undertaken immediately (Christen, 1990). Depending on the causes, corrective actions may include the revision of the SFI's credit

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policies, hiring more staff, limiting geographical expansion, or restricting new loans temporarily. In *Annex C* strategies and practical guidelines are formulated for managing delinquency.

Contamination of the portfolio

This indicator measures the percentage of the portfolio which is contaminated by late payment, also called the portfolio at risk. Whereas the delinquency rate measures the amounts that are actually past due, this indicator considers that the entire outstanding balance of a loan is at risk that has any payment past due. The formula calculating the contamination of the portfolio indicator is:

Formula: Contamination of the portfolio

$$\frac{\text{Outstanding balance of loans with payments past due}}{\text{Current portfolio}}$$

The contamination of the portfolio indicator is used to analyse the potential risk of losses due to nonrecoverable loans. However, the hypothesis that all loans will not be recovered is a very pessimistic and unrealistic one. In order to determine the portfolio risk past due loans can be classified into the following four categories: loans past due less than three months; loans past due between three and nine months and no legal action has been taken; loans past due between three and nine months and legal action is being pursued; and loans past due between nine and twelve months. Most SFIs consider that, when the final instalment of the loan is more than six months in delinquency, legal action may be initiated to recover SFI's losses. Usually, when the final instalment of the loan is delinquent in excess of 12 months the loan is written off by these institutions.

Loan loss rate

The loan loss rate indicator measures the amount that the SFI has declared nonrecoverable, or written off, as a percentage of the portfolio. Loans are written off when their recovery is in doubt and the institution does not expect them to be repaid. After a loan has been written off the outstanding amount of the loan is removed from the SFI's portfolio so that the SFI's assets of which the portfolio is part are accurately reflected. The formula to calculate the loan loss rate is:

Formula: Loan loss rate

$$\frac{\text{Amount declared nonrecoverable in period}}{\text{Average portfolio in period}}$$

The loan loss rate indicator is complementary to the indicator on delinquency. An institution with very low delinquency might maintain that low delinquency by declaring loans nonrecoverable soon after they become delinquent. In the same way, high delinquency in a portfolio can be caused by a lack of write off policy. Loans made several years earlier may still be in the portfolio and thus reflected in the delinquency rate. While delinquency rates show how much of a portfolio is at risk, loan loss rates indicate how much has already been lost.

Loans should be written off against a *loan loss* or *bad debt reserve* established by the SFI. A well-defined policy that establishes a loan loss reserve and periodically declares loans nonrecoverable saves an institution from declaring large amounts nonrecoverable all at once, and thereby drastically decreasing assets. Institutions that do not write off loans on a yearly basis run the risk of having their portfolio gradually decapitalize or lose value without realizing that this is happening. A sound write-off policy also enables an institution to present more accurate financial statements, for its own internal management and for external reports (Stearns, 1991b). A

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standard recommendation is that loans past due for more than one year, without any payments being made, should be written off. Ideally, the SFI's own experience of when recovery of delinquent loans become unlikely should determine the time period beyond which those loans are written off.

The amount of the loan loss reserve on the balance sheet is calculated based on the SFI's experience of recovering loans past due and on the quality of the portfolio. Goldmark and Rosengard argue that, as a general rule, well-managed SFIs should not have loan losses exceeding 3 percent of the average portfolio in any given year. Some less experienced and mature institutions may use as estimation for the possible future amount of loan losses, the value of the outstanding balance of loans with 3 or more payments in default. For example, KUPEDES in Indonesia previously maintained a loan loss provision at 6 percent of loans outstanding or 100 percent of all loans more than 3 months beyond the final due date. However, as the institution matured the loan loss reserve policy was changed so that provisions for loan losses are maintained at 3 percent of total loans outstanding, plus 50 percent of loan amounts past due up to 3 months beyond the final loan instalment due date, plus 100 percent of amounts overdue over 3 months beyond the final loan instalment due date. The new loan loss reserve policy is a more conservative one than previously applied (Boomgard and Angell, 1990). In order to formulate appropriate strategies it is important to classify a loan which has been written off into different categories, such as:

- ! Still trying to collect the loan without legal action
- ! The loan is in legal action; still trying to collect the loan
- ! Attempts to collect the loan are no longer being pursued.

Many SFIs do not write off loans because they wrongly believe that declaring a loan nonrecoverable means that no further action will be taken to collect payment. They fear that delinquent borrowers will interpret this action that they no longer must repay their debt, and word will spread among clients that loan repayment is not taken seriously. This problem can be easily avoided, however, if the SFI maintains a strict distinction between its official policy toward delinquent clients and internal bookkeeping adjustments. Institutions should pursue the recovery of loans even after they have been written off. In that case, the amount recovered should be accounted for as "other income" on the income statement (Stearns, 1991b). For a more complete discussion of establishing and managing loan loss reserves, see Stearns (1991b), Goldmark and Rosengard (1985) and Christen (1990).

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3.8 Questions for discussion and research

Key questions on the issue of financial monitoring are addressed below:

Checklist Financial monitoring: for discussion and research

Financial health

9 Is our capital base large enough to generate sufficient (interest) income to help cover operating costs, risk a portion of our capital funds to build a track record in lending, and leverage sources through savings deposits and other fund providers?

Sources and uses of funds

9 Do we have established an adequate, reliable source of funding for the next three years, allowing us to realize our planned operations?

Self-sufficiency

9 If self-sufficiency is a core objective of the SFI, are our strategies and activities consistent with this objective? Do we succeed in getting a substantial amount of savings deposits to realize our objective of building our operations to higher levels of self-sufficiency?

9 Can we diversify the portfolio mix by focusing also on the larger small businesses in order to reach self-sufficiency levels, without increasing costs and maintaining focus on poor clients?

Spreads

9 Are our interest rates and fees charged adequate to cover operating costs, cost of capital and cost of default? And, in providing credit-related training?

9 How do our interest rates compare with commercial rates and rates of traditional moneylenders?

Profitability

9 Do we have any difficulties in combining the businesslike approach required for delivering financial services with our social oriented roots? Do the financial services contribute to increasing the SFI's ability to generate its own income base?

Cost-effectiveness

9 What will be the number of loans, portfolio size, the cost per loan and savings deposit, and the cost per unit currency lent and saved for having covered the financial and administrative costs by the income from our operations?

continued

Checklist Financial monitoring: for discussion and research (continued)**Portfolio quality**

- 9 *Institutional image and philosophy:* How does the organizational image and philosophy influence the delinquency of our credit programmes? How can we improve this?
- 9 *Formulating effective credit policy:* How can we make our credit policy more effective and reduce the risk of delinquency and default by providing tailor-made credit services to the clients? What adequate financial and non-financial incentives can we introduce so that the costs of paying on time are greater than the benefits? Do we have made adequate provision for doubtful loans?
- 9 *Selecting credit-worthy entrepreneurs:* How can we improve the selection process of loan applicants in order to make sure that loans will be repaid? What criteria can we use to assess the creditworthiness of small entrepreneurs? How can we develop reliable information about the sectors and markets in which the entrepreneurs operate?
- 9 *Loan follow-up:* How can we improve our knowledge of recognizing a potential delinquent loan? How can we identify and contrast in an early stage the characteristics of good payers and of defaulters, as well as of good loans and bad loans? How can we improve our strategy for servicing a delinquent loan and take steps to work out problems (e.g. through rescheduling and increased frequency of supervision) before it defaults? How can we improve the operations of the field officers and how can we control their workload so that their activities keep manageable?
- 9 *Portfolio quality:* How can we improve the measurement and monitoring of the amount of risk in the portfolio? How can we increase our understanding of the way the quality of the portfolio affects the institution's financial situation and future ability to lend? What policies can be formulated to improve our control of delinquency and to increase the portfolio quality?

B. Operational Monitoring

A primary concern when monitoring the institutional performance of a financial institution is to determine how efficiently the financial services have been delivered to the clients. Another important issue is the effect of the financial services on the SFI's institutional strength and long-term institutional viability. It appears obvious that if an activity is effective, the institution is also strong. However, institutional development is a complex area of study and assuming that this simple relationship exists may overlook factors essential to institutional stability.

The main topics to be addressed when analysing the operational performance of an SFI are:

- ! *Institutional vision*
- ! *Institutional structure and management*
- ! *Internal loan procedures*
- ! *Internal savings procedures*
- ! *Internal audit procedures*
- ! *Institutional productivity and efficiency*
- ! *Institutional effects and impacts*

3.9 Institutional vision

Vision is the ability to think creatively and critically about the institution. The vision and purpose of an institution are defined by basic principles and beliefs that has to grow out of and respond to local needs. The vision of an institution should make clear who the clients are with whom mutual rights and responsibilities are shared, and why. It should also reflect the social and ethical principles that guide the work of the SFI, combined with principles such as cost-consciousness and self-sufficiency.

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The delivery of financial services can have influence on how an institution evolves. In some cases the vision of an institution may limit the expansion of operations. Finance services need a certain volume to operate efficiently and to reach self-sufficiency. However, the SFI's vision may be translated in such a way that operations only take place in a small, well-known region where the necessary loan and savings volume cannot be made to reach self-sufficiency. In that case the SFI has to consider alternatives such as to coordinate its finance activities with other financial institutions in the region, to revise its vision and expand its outreach to other regions, or to concentrate on other aspects than credit and savings (Edgecomb and Cawley, 1991).

The checklists on the following page addresses a set of basic questions all dealing with the institutional vision. The questions are divided into four subgroups: stated vision, goals and objectives, institutional memory, and capacity to learn (Otero, 1989):

Checklist Institutional vision: (A) Stated vision

9 Each institution develops a system of ideas that guides its work and maintains this system as the unifying force behind all of its activities. A question to be addressed is whether clarity exists among staff regarding the institutional vision and objectives, the manner it has evolved during the time of implementation of the financial services, and if sufficient time is given to reflect on issues that pertain to this subject? For example, people within the institution may find it difficult to combine the business approach required for delivering financial services with their social oriented roots. If an institution does not address the inherent tension, its own underlying philosophy can become unclear or contradictory.

Checklist Institutional vision: (B) Goals and objectives

9 The long and short-term goals and objectives of an institution are the link between the stated vision and established activities. Does exist congruence between objectives and stated philosophy? Are the objectives clear and unambiguous and well understood and accepted at all levels of the institution? The experience with the financial services can affect the overall goals and objectives of an institution. It may be that greater emphasis is given to institutional self-sufficiency, or that provision of finance becomes a new stated goal, or that the target population is to be redefined.

Checklist Institutional vision: (C) Institutional memory

9 Is an institutional history being developed? The degree to which an institution records its evolving sense of vision allows it to develop an institutional history that outlives staff and contributes to cohesion in thought and deed. Documents such as strategy plans, evaluations, and minutes from staff retreats are examples of ways in which institutions attempt to build their own history.

Checklist Institutional vision: (D) Capacity to learn

9 In order to grow, an institution must have an established system that allows it to review its work periodically, to identify its strengths and weaknesses, to learn from its mistakes and to experiment with new approaches. Does the SFI conduct learning and feedback exercises on a regular basis? Does exist flexibility to adapt to changing circumstances?

3.10 Institutional structure and management

This aspect encompasses a wide range of questions, and the pursuit of answers could become needlessly time-consuming and complex. To keep the task manageable the monitoring staff could focus on the influence of the financial services on the institutional structure and management, and visa versa. Monitoring staff must identify and propose relevant changes in the institutional structure and management of the financial activities to eliminate any existing constraints for these activities. To conduct an overall institutional analysis, however, is beyond the daily tasks of the monitoring staff.

External factors which lay outside the direct influence of institutions may also affect the institutional structure and management. In the case of financial activities implemented by SFIs in coordination with public institutions, SFIs may have limited control over for example personnel policies. (Otero, 1989).

A checklist of questions which can help monitoring staff in analysing problem areas regarding the institutional structure and management can be divided into the following seven subgroups: delivery mechanisms, leadership, planning and decision-making, autonomy, staff, facilities, and financial management and status.

Checklist Institutional structure and management: (A) Delivery mechanisms

9 Are the financial activities fixed to one particular office or are they independent? If independent, does the legal form of the SFI have any consequences for operating the financial activities?

9 Are the lending and savings services direct or via one or more intermediaries? If intermediaries, which are they, and how are they chosen, motivated and controlled? What consequences does working with other intermediary institutions have on the SFI's financial activities? Is the SFI participating in a government initiated finance programme? Such a finance programme can favour the SFI considerably in fundraising and promotion of its activities. However, strong political identification with a MSE programme also creates dependency for the SFI that could work counterproductive at the end when government changes.

9 Is loan approval considered as a separate function from loan analysis or subject to frequent internal audits? Separating loan analysis from loan approval helps to ensure that loan approvals are made on strictly technical and non-personal grounds. Unfortunately, sometimes participating SFIs carry this policy to an extreme and require all loans to be approved by the central office, frequently leading to lengthy delays in loan disbursement. In those cases, it is recommended to establish independent credit committees of local staff, or to conduct frequent internal audits to spot problem loans.

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Checklist Institutional structure and management: (B) Leadership

- 9 Does exist strong and charismatic leadership by an individual with strong links to local business society and government?
- 9 What is the support of the board of directors to the financial activities? What is the extent to which the board has learned and changed by the experience of delivering financial services?

Checklist Institutional structure and management: (C) Planning and decision-making

- 9 Does the institution develop annual plans, establish goals, draw annual budgets, and in general spend time preparing for the future? Do exist clear objectives (short and long term) of the institution and a clear strategy concerning the way in which these objectives will be realized?
- 9 Who participate in this planning process and the integration of institutional planning and implementation?

continued

Checklist Institutional structure and management: (C) Planning and decision-making (continued)

- 9 How clear is the process of decision-making in the institution and the level of decentralization in making decisions? Does the institutional structure allow for independent decision-making? When the financial services are only a small part of the institution's entire activities, management often lack the autonomy to set the administrative procedures that may be more appropriate for that specific client group. Responsibility without authority provides a powerful personal and institutional disincentive to good performance, just as anonymity through aggregation may greatly hinder an effective management response to poor performance.

Checklist Institutional structure and management: (D) Autonomy

- 9 Does exist administrative, managerial and financial autonomy?
- 9 Is field staff granted a significant degree of autonomy to allow them to fulfil their responsibilities effectively?
- 9 Does each branch office have its own balance sheet and income statement so that performance is judged on the basis of its own financial position? It is difficult for head office to assess, and if necessary assist, branch offices with a low profitability if desegregated raw data are directly put into a computer and outputs consist only of consolidated financial statements.
- 9 Is delegation of responsibility and authority balanced by uniform standards, systems, and procedures across similar functional units of an institution to enhance professionalism, ensure adherence to laws, regulations, and policy directives, facilitate training, and accelerate inspection and audit activities?

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Checklist Institutional structure and management: (E) Staff

- 9 How many field staff, supervisors and support staff does the SFI have, and are actually needed? Does exist a high staff turnover? A high staff turnover results often in higher training costs than expected, lower productivity and fewer borrowers, and subsequently lower income, higher costs and increased delinquency. In those cases, it is recommended that an SFI analyses causes of high turnover, improve training incentives of employees, and conduct activities to increase morale and commitment to the institution such as for example improvement of transport facilities.
- 9 What is the staff commitment to the institution and its work? What is the knowledge of and agreement with the institution's philosophy, goals and objectives? What is the degree of institutional ownership assumed by staff?
- 9 What is the human quality of the staff? What is the staff's attitude towards the clients, such as their perception of poor people, and their capacity to communicate in respect and trust to the clients? And, what is the client perception of their relationship with the SFI's staff?

continued

Checklist Institutional structure and management: (E) Staff (continued)

- 9 What is the technical expertise of the staff? Does the staff's level of knowledge in specific areas change as a result of the implementation of the financial activities? Is the level of technical expertise available to the institution appropriate for its own growth and stability?
- 9 Is SFI staff communicating and cooperating effectively? For example, collection of delinquent loans requires smooth cooperation between the staffmember who follows the client after loan disbursement. The staffmember should also cooperate effectively with the staffmember who decides what actions should be taken to enforce loan repayment or collection. At the same time, the staffmember who controls the cash situation should warn those in charge of loan approval and disbursement of any foreseeable cash shortages so that approved loan applicants are not kept waiting endlessly because of lack of funds.
- 9 What is the location field staff is working from: central office or field offices? What transport is available and needed, who owns and maintains it?
- 9 How is staff performance monitored? How are they paid and supervised? Do personnel plans exist within the institution? Does staff receive any pay or non-pay incentives for good performance? What is the differential between lowest-paid and highest-paid loan officer?
- 9 Is staff trained, how and when? Is more training needed?

Checklist Institutional structure and management: (F) Facilities

- 9 What office space and other physical facilities are present, and actually needed?
- 9 What computer or other office equipment is present, and is actually needed?
- 9 What recording system is used for the loans and savings deposits, who updates it, and where do the data for disbursement and repayments come from? Does it function well?

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Checklist Institutional structure and management: (G) Financial management

- 9 Does exist a solid and tight management information system including forms of financial control? Is it computerized?
- 9 Besides having a sound and up-to-date accounting system in place, it is also crucial to have the capacity to produce reports that analyse and summarise the financial condition of the institution. Does the delivery of financial services upgrade or diminish the institution's capacity to generate the necessary financial information?
- 9 Institutions with a diversified funding including savings deposits base tend to be more stable than those that depend on one or two outside funding organizations. Does the delivery of financial services have consequences for either concentrating dependence on one donor or on expanding the funding base? Has the ability to fundraise from new or existing donors changed?

3.11 Internal loan procedures

The internal loan procedures promote the efficient delivery of services to clients according to preset internal criteria. The efficiency of these procedures determines how long the loan approval process takes and whether the procedures are appropriate for reaching the intended client group. A checklist to ask staff on the internal loan procedures, divided into five subgroups (credit policies, loan application analysis, loan approval process, loan disbursement, loan collection and security), would include (Goldmark and Rosengard, 1985):

Checklist Internal loan procedures: (A) Credit policies

- 9 Are internal credit procedures clearly spelled out in a manual or other internal policy document?
- 9 Do loan officers in the field as well as in the central office have easy access to these manuals?
- 9 Are loan officers fully informed about loan criteria and institutional objectives?
- 9 Are credit policies realistic and appropriate to enable us to reach the intended client groups?

Checklist Internal loan procedures: (B) Loan application analysis

- 9 Is the loan application analysis rigorous and carried out in a professional manner, based on good cost calculation, realistic projections and adequate risk analysis?
- 9 Have the loan officers been provided with internal guidelines and methods to determine a feasible loan amount and the applicant's loan repayment capacity?
- 9 Are loan applications rapidly analysed and forwarded to the loan approval committee with appropriate recommendations?

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Checklist Internal loan procedures: (C) Loan approval process

- 9 What form do the loan agreements take?
- 9 Does the credit committee meet regularly?
- 9 Is the composition of the committee adequate to analyse applications on their technical merits?
- 9 Are meetings recorded?
- 9 Are all committee members usually present?
- 9 Are approvals granted independent of outside influence?

Checklist Internal loan procedures: (D) Loan disbursement

- 9 How are the loans disbursed: cash, in kind or through cheques?
- 9 Who is disbursing the loans, where and when? Does it function well?
- 9 Are loan conditions corresponding with those set by the credit committee, regarding loan terms and conditions, guarantees, security, and capital or equity contribution from client?
- 9 Are safeguards adequate at the time of disbursement for the SFI and the borrower?

Checklist Internal loan procedures: (E) Loan collection and security

- 9 How are repayment schedules calculated, and by whom?
- 9 How frequently do clients have to repay: daily, weekly, monthly or at longer intervals? How does this compare to the seasonal profile of client's income and expenditure?
- 9 Where do the clients repay, in what form and to whom?
- 9 How are clients be reminded when repayments are due?
- 9 What happens to clients if they are late in repaying?
- 9 What pressure is applied to motivate repayment? Interest penalties, social or group pressure, threat of seizure of security, or others?
- 9 If assets are seized, where will they be stored, and how will they be disposed of?
- 9 Who decides on rescheduling if it is necessary?
- 9 At what point are loans be written off?
- 9 What legal means of enforcing repayment are used?
- 9 Are clients receiving any positive incentive to repay on time?
- 9 What rate of write-offs is expected?

Checklist Internal loan procedures: (F) Loan follow-up visits

- 9 Does the institution have well-defined policy criteria that explain under what circumstances loan officers make follow-up visits?
- 9 What do officers discuss when visiting clients? Are visits conducted only in case of delinquency?
- 9 How often do loan officers make visits on average (weekly, monthly)? How often is a typical borrower visited during the life of the loan?
- 9 How often are delinquent clients visited, on average?
- 9 What do loan officers discuss and observe during their client visits?
- 9 Is the content of visits documented in such a way, that the information can be used for monitoring institutional and business performance? What is the quality of the data transmitted?

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3.12 Internal savings procedures

SFIs have to fulfil a whole set of management tasks with regard to savings mobilization. First, SFIs should organize and maintain an efficient system to enable clients to deposit savings regularly. Internal savings procedures have to secure the efficient mobilization of savings deposits from the public according to preset internal criteria. The efficiency of these procedures determines how long the depositing and withdrawal process takes and whether they are suited to the needs and preferences of the public. Secondly, SFIs should have formulated savings policies that assure all surplus or liquid reserves to be safely invested at banks at favourable terms. These terms should allow for sufficient liquidity to pay out future withdrawals while earning an adequate margin to cover operating and interest costs. Thirdly, SFIs must match assets to liabilities to ensure adequate liquidity and match terms, such as for example short-term assets to short-term liabilities. Fourthly, SFIs have to keep reserve deposits according to national and local reserve ratios required by law. Fifth, staff must review all accounts regularly. For example, large accounts may be withdrawn for a better rate or other reasons. Sixth, the SFI should be able to forecast both sources and uses of funds to assure adequate funding. It should track cash flows over time and use this as a basis for planning. Seventh, the SFI must assure a "safety net" lender (of last resort) who will meet unexpected liquidity needs. Finally, the SFI should promote regular savings by keeping the public informed about its deposit facilities (Mahon, 1987).

A checklist concerning savings policies and savings procedures would include the following:

<p>Checklist Internal savings procedures: (A) Savings policies</p>	
9	Does the SFI policy on savings comply with the country's regulations on mobilization of savings deposits, reserve requirements, and other regulations for protecting depositors from dealing with questionable institutions that could endanger their assets?
9	Do clients have enough safeguards that the SFI will still be in operation when their savings are required?
9	Is the amount deposited by clients worth as much in real terms when they are returned as when they were put in the SFI? Is the interest paid on SFI savings accounts comparable to the market rate?
9	Is the SFI able to find safe and profitable investment opportunities for its savings in order to serve its own interest and those of its depositors? Does the SFI maintain sufficient portfolio diversification in its overall credit policies?
9	Is the SFI able to restrict its term transformation and maintain liquid reserves by maintaining part of its deposits at a bank account where it can earn interest?
9	Do government or other institutions provide a deposit insurance fund to protect depositors against the risk of an SFI becoming insolvent and not able to return the savings? Will such deposit securing facilities threaten the autonomy of the SFI and subsequently its orientation towards MSEs?
9	Is the institution able to combine the risk-averse savings policies with its developmental vision?
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Checklist Internal savings procedures: (A) Savings policies (continued)

- 9 Are savings mobilized on a voluntary basis? Or, is the mobilization of savings compulsory and directly tied to credit so that every time clients receive a loan they must deposit a specific amount in savings? If savings mobilization is tied to credit, what is the ratio of savings to credit applied by the SFI? Usually, in a first cycle of loans, institutions start with a conservative ratio of savings to credit reflecting the SFI's assessment of risks involved. If repayment has been satisfactory, the ratio may be increased up to the limits of the absorptive capacity of the small businesses.
- 9 Is the SFI able to limit their administrative and personnel costs while dealing with very small regular deposits? Are bookkeeping machines and computers with simple software available for monitoring?
- 9 Is savings mobilization stimulated through solidarity and self-help groups?

Checklist Internal savings procedures: (B) Savings procedures

- 9 Is the SFI able to reach the prospective clients and collect their savings? Do the location and opening hours of the SFI meet the needs and preferences of the clients? Is the SFI applying innovative forms of savings mobilization such as mobile savings collectors who visit marketplaces on a daily or weekly basis to mobilize savings?
- 9 Are the procedures to open an account simple and efficient, and is the withdrawal of funds easy and prompt?
- 9 Are clients aware of the differences between demand deposits, savings deposits and shares in cooperative institutions? An SFI treating all of its accounts as demand accounts endangers not only its own existence, but also the loan fund with which it has been entrusted.
- 9 Are internal savings procedures clearly spelled out in a manual or other internal policy document?
- 9 Do officers have easy access to these manuals? Are loan officers fully informed about the procedures?
- 9 When SFIs require that clients demonstrate a savings track record before being eligible to receive a loan, is savings performance really taken into account in the loan analysis? Is it an effective criteria for screening and selection of clients?
- 9 Is the SFI using the savings as cash collateral to cover delinquency if necessary? Does it easily obtain the authorization of the client prior to loan disbursement?

3.13 Internal audit procedures

Internal audit procedures should be monitored because they reflect the solidness with which the financial activities are run. Generally, the internal audit procedures refer to the following accounting and audit activities: regular verification of cash; a bank reconciliation to ensure that client savings are all accounted for; verification of SFI investments; verification that all accounts balance; check if loans in the ledger balance with the total loan balances of client's individual accounts; verification of passbooks; checking of loan applications and notes for signatures, dates, and proper authorization and loan terms; checking if all disbursements are authorized and appropriate; checking if financial and statistical reports are accurately and promptly prepared; checking if the minutes of meetings are properly maintained; and checking if corrections have been made of all exceptions disclosed by the last audit. Finally, the auditor has to report its findings to management stating whether or not records are in good order, whether the internal controls are adequate to protect the interest of the clients, staff and management, and whether management has eliminated all possible limitations on service (Mahon, 1987). Particularly among smaller SFIs, audits may actually consist of management reviews and more informal internal controls. Common signs of ineffective internal audit systems include incomplete or lost files, improper accounting

procedures, mishandling of funds, and a low frequency of internal controls.

If assessing the internal audit procedures, monitoring staff should include in the analysis whether auditing staff has the means like transportation and independence to perform its duties properly. It should also assess if staff is dedicated to improve institutional efficiency, whether the audits are thorough, and if audit recommendations are promptly implemented. A checklist of questions to ask staff on the internal audit procedures, divided into four subgroups (MIS, internal audit procedures, type of internal audit, and results of internal audit) would include the following (Goldmark and Rosengard, 1985):

Checklist Internal audit procedures: (A) Management information system

- 9 Does an MIS exist to ensure regular accounting, monitoring and evaluation of planning and implementation activities?
- 9 Is information stored so that it can be retrieved, used, and updated easily? Are files complete and in order?
- 9 What is in general the degree of systematization, simplicity, and adherence to the system?
- 9 Is information from the MIS received on time?
- 9 Is information desegregated by user level and decision-making needs?
- 9 To what extent does this information contribute to decision making?
- 9 How do we find out about opportunities and prices? Does the system provide a broad overview of possibilities?

Checklist Internal audit procedures: (B) Internal audit procedures

- 9 What is the nature and quality of the institution's internal audit system, in design, frequency of application, and level of staff participation? To what extent is it used as a feedback and learning mechanism?

Checklist Internal audit procedures: (C) Type of internal audit

- 9 Is the auditing person viewed as "a policeman" who concentrates on procedural errors committed by the staff or are audits seen as constructive?
- 9 Do internal audits analyse management performance? At the start of delivering financial services, influential local business persons might try to circumvent the loan approval process by going directly to the management. If the management concedes to this pressure, there is high probability that funds will be misused and will result in delinquency.

Checklist Internal audit procedures: (D) Results of internal audits

- 9 What do managerial staff especially at the branch level think about the quality and usefulness of these audits?
- 9 Are internal audit recommendations promptly implemented?

3.14 Institutional efficiency

Inefficiencies in lending and savings procedures are a real cost to clients. Since small

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entrepreneurs often require loans to meet urgent short-term obligations or take advantage of unique opportunities a loan may be ineffective or even counterproductive if not rapidly disbursed. Institutional efficiency is to a large extent determined by the people who are actually working in the institution. Factors related to staff which affect institutional efficiency are for example staff capacity, the level of staff motivation and identification with institutional objectives, and management capacity. An institution requires staff with adequate knowledge of community and social development issues as well as with a solid grasp of business and financial concepts. In addition, staff's commitment to the SFI plays an important role in increasing institutional efficiency by maintaining a high repayment rate and a rapid portfolio turnover. Finally, the quality of management directly contributes to efficiency by considering issues such as delegation, strategic planning, review of financial issues, and decision-making patterns and relationships with staff.

Staff productivity and efficiency are important measures of the institution's efficiency and effectiveness. Indicators which can be used to measure staff productivity are loan and savings outreach and number of staff involved in financial service delivery. Indicators to measure staff efficiency are, for example, the value and number of loans and savings deposits handled by staff.

Staff productivity

The responses to the questions regarding loan and savings outreach provide the institution with useful information for analysing staff productivity. The outcomes can then be related to the number of staff involved in the activities. In order to improve staff productivity the institution may use additional incentives to good individual and institutional performance. However, for incentives to be effective, staff must clearly understand at each level of the institution the objective of the institution; the conditions within which each institutional unit and each manager is expected to perform; the basis for judgement of success or failure; the financial and career rewards for good individual and institutional performance and the penalties for failure. Finally, staff has to be well trained to be able to respond to these incentives (Patten and Rosengard, 1991).

Checklist Institutional efficiency: (A) Loan outreach

- 9 How many loans were extended during each year and since initiation of loan disbursement, by the amount of loans, number of loans, number of different businesses, and by branch? What is the amount and number of total outstanding loans? Compare these figures with the stated goals of the institution, and indicate for variables such as gender, location, income status, and economic sector.
- 9 What are the growth rates of clients served and loans distributed? What is the pattern of growth over the last three years: sporadic, sudden or gradual?

Checklist Institutional efficiency: (B) Savings outreach

- 9 How many savings were mobilized during each year and since initiation of savings mobilisation, by amount of savings and number of savings accounts. Compare these figures with the stated goals of the institution?
- 9 What is the ratio of savings to loans? And, by branch?
- 9 What are the growth rates of mobilized savings?
- 9 What is the percentage of the target clientele served in the region or market covered by the SFI?
- 9 What is the geographic area covered? Is the SFI increasing its geographic zone?
- 9 Are there sufficient incentives for borrowers to save? How can savings be encouraged?

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Checklist Institutional efficiency: (C) Number of staff

- 9 How many loan officers in person-years are involved with loan analysis, disbursement, approval, and supervision, each year and since initiation, in total and by branch?
- 9 How many employees are involved in savings mobilization and withdrawal, each year and since initiation, in total and by branch?
- 9 What is the number of employees including supporting staff working with the SFI, in person-years, in total and by branch?

Staff efficiency

Common quantitative indicators of efficiency include the number of loans or savings deposits handled by the SFI staff, the administrative costs per loan or savings account, and the number of days it takes average loans or savings deposits to be processed. Some examples of the quantitative measures which can be applied for both loans as savings handled are shown below. The same exercise can be done for value and number of loans or savings deposits handled by each staff member.

Formula: Value or Number of loans handled by SFI

$$\frac{\text{Value/Number of loans extended during period}}{\text{Number of loan officers involved}}$$

$$\frac{\text{Value/Number of total loans outstanding}}{\text{Number of loan officers involved}}$$

Formula: Value or Number of savings deposits handled by SFI

$$\frac{\text{Value/Number of savings mobilized during period}}{\text{Number of officers involved}}$$

$$\frac{\text{Value/Number of total savings mobilized}}{\text{Number of officers involved}}$$

Another indicator for measuring the efficiency of lending activities is the loan processing-time. Loan processing-time is the number of days between giving the client the loan application and receiving all required documents; between receiving loan application and completion of analysis; between completion of analysis and approval; and, between approval and disbursement. The longer the processing-time the more costly the financial service is to the borrower, who has to wait a long time or travel great distances to receive their loans or deposit savings. Good screening before appraisal can limit the processing-time and prevents the SFI a huge amount of work without results.

These efficiency indicators are most useful for tracking the growth and change of a specific institution by comparing its performance with prior periods. It is less useful to compare different types of SFIs because they are very sensitive to differences in loan and savings terms. Factors that affect the interpretation of results are for example the age of the institution, the amount of follow-up of clients by the SFI, the amount of technical assistance to clients from field officers, the geographic dispersion of clients and the distance of clients to branch offices, loan and deposit sizes, and client attitudes toward loan repayment and savings mobilization.

The importance of monitoring efficiency indicators can be illustrated by the following

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example. When loan officers cannot handle as many borrower as expected this usually results in a lower portfolio per loan officer, and subsequently means less income per loan officer and higher cost per loan. The SFI now can adequately respond to such a situation by first analysing institutional operations to find the cause of lower loans extended per loan officer. Examples of such causes are too geographically dispersed operations or too much paper work to be done by the loan officers. This can mean for the SFI that it may consider a group methodology resulting in less paper work for the officer and clients. Alternatively, the SFI may stimulate further training of loan officers, an incentive system for loan officers, or increase travel budgets. Monitoring staff efficiency is an essential activity to take swift action when problems arise. A form to calculate the fieldworker's caseload can be found in "Design and Management of Revolving Credit and Similar Funds in ILO Technical Cooperation Projects" (Balkenhol, 1994).

3.15 Institutional effects and impacts

The institutional effects and impacts of financial activities focus on the growth and change within the institution, transaction costs, and the quality of services provided by the SFI to clients. The institutional growth and change as result of delivering financial services refer to the issues already dealt with in this section. Monitoring of transaction costs and the quality of financial services is equally significant for assessing the institutional performance as it is for decision-making by management. Transaction costs can be defined as the non-interest expenses incurred by the institution and its clients. The institution's transaction costs for deposit mobilization and lending and other financial services include costs for labour, buildings, credit insurance, and others. Analyses of transaction costs by loan size indicate how transaction costs increase with decreasing loan sizes (Feekes, 1993). By addressing the client-service relationship, institutions are better able to improve performance by reaching new customers, offering better services along the line of market research, and on internal operations. Through market analysis SFIs can improve their understanding of the needs, preferences, and alternatives of clients as they relate to the use of the financial services offered.

Institutions should learn about the terms and transaction costs associated with available alternatives for clients to lend and to save in their community. At the same time, they should understand why and when clients select one option or another. The requirements to assess other credit and savings services places a significant burden of information gathering on monitoring staff but is an essential requirement if conclusions are to be useful. Monitoring of the quality of the financial services avoids the limitations of measuring effects and impacts of services on individual borrowers. Rather than providing definitive "impact" results on predetermined indicators, the set of questions presented produce results that are indicative of the nature of the effect. Although they may seem less precise, such results are more likely to be accurate reflections of what the provision of financial services actually accomplishes (Rhyne, 1992). The quality of services provided by the SFI and the alternatives open to the clients can be assessed by the responses to the following set of questions concerning institutional growth and change, service satisfaction, willingness to pay for services, terms of services, and transaction costs (Rhyne, 1992):

Checklist Institutional effects and impacts: (A) Institutional growth and change

- 9 What institutional changes did occur as result of the financial services:
- ! in the general financial situation of the SFI, such as financial health, self-sufficiency, cost effectiveness and portfolio quality?
 - ! in product and service quality? Have new or improved financial products emerged which are marketable?
 - ! in institutional vision, structure and management, and procedures?
 - ! in institutional efficiency?
- Give quantitative data where possible, otherwise describe. More detailed questions on the above issues can be found in the checklists formulated in this section on institutional monitoring.

continued

Checklist Institutional effects and impacts: (A) Institutional growth and change (continued)

- 9 What are the changes resulting from the institution's increased financial obligations? Has the institution become more dependent on outside assistance than before?
- 9 What are the lessons to be drawn, and types of corrective actions to be taken?

Checklist Institutional effects and impacts: (B) Service satisfaction

- 9 To what degree clients believe the SFI's services are responding to their needs?
- 9 Does a system exist, either through periodic meetings, visits to the working place or informal conversations, for integrating clients requests into the SFI's credit and savings methodology?
- 9 What is the degree of identification of clients with the SFI, and what is the willingness of clients to promote the institution? What is the degree of participation in solidarity or self-help groups? What is the quality of the relationship between client and field officers?

Checklist Institutional effects and impacts: (C) Willingness to pay for services

- 9 What is the willingness of clients to pay for the services provided by the institution? This question can indicate the value or benefit of the services, and whether it is responding to the needs and preferences of clients. If people pay full cost for a service on an ongoing basis then we can be sure that the service is valued at least as highly as its price. By their actions clients reveal information on the value of benefits that may be at least as credible as verbal responses to questionnaires. However, this market test of demand is less valid when services are underpriced or subsidized, because the price to clients does not include the costs of subsidy.

Checklist Institutional effects and impacts: (D) Terms of services

- 9 Do the terms of the financial services, such as loan size, maturity, collateral, group guarantees, grace period, and liquidity of deposits, coincide with the preferences of the clients? For example, the length of the loan and the repayment schedule should reflect the timing of income from client's business, perhaps longer for agricultural enterprises and shorter for retail businesses. We should ask ourselves whether the institution has developed the right product or whether other products may perhaps have a greater demand.

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Checklist Institutional effects and impacts: (E) Transaction costs

- 9 Are the transaction costs borne by the clients, such as transport costs, legal fees, membership fees, mandatory savings deposits that earn a low interest rate, attending mandatory meetings and courses, and the cost of time that must be diverted from the business in order to obtain services, sufficiently convenient and time-reducing for the clients? Minimizing time between loan application and disbursement increases service value to clients, as small borrowers are often very sensitive to time.
- 9 Can the transaction costs borne by the SFI, such as labour costs, rent, depreciation and maintenance costs for the building, and credit insurance costs be justified considering the earnings of the institution? As transaction costs tend to increase considerably with declining loan sizes, the SFI might consider to ration its credits below a certain loan size, and compensate negative credit margins of smaller loans with the positive credit margins of larger loans. Alternatively, they may want to differentiate their interest rates according to loan size.

3.16 Questions for research and discussion

Questions to be addressed for research and discussion regarding the operational performance of the institution are the following:

Checklist Operational monitoring: for discussion and research

- 9 What are our mission and objectives? Are our strategies helping the us to achieve these objectives?
- 9 Do all employees of the SFI understand and feel committed to its vision and its clients, and do they see the importance in building a successful SFI that opens clients' prospects and meets clients' needs?
- 9 Does the management style, incentive systems, and staff selection reflect the importance of loan and field officers in the institution because they are closest to the client?
- 9 Has the staff developed certain procedures and skills which are worthwhile to institutionalize?
- 9 How can we improve efficiency and cut costs without reducing key client services and without eroding repayments? Is the institution focusing on rapid and efficient loan and savings transactions as the key to effective financial services?

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Section 4: Community monitoring

Community monitoring is the collection, analysis and reporting of general data concerning the regional and national economy, the political and regulatory environment, and the financial sector as far as relevant to the SFI. The term community is used in general sense and could mean a geographic determination such as the communities in which small entrepreneurs and support institutions operate, as well as particular groups which are related to the SFI such as the banking community, local, regional and national policymakers, or membership institutions of entrepreneurs.

Although an SFI may initially experience short-term prosperity, its continued survival is dependent on the capacity to adapt to a changing environment. Particularly, responsiveness to the specific market conditions in a community is a prerequisite for long-term success of a financial institution. The working environment of financial institutions is changing rapidly. In many cases the financial market is more developed now than it was a few years ago. Leasing companies and commercial banks have also entered the small enterprise market, working mainly with the better part of the market. At the same time, SFIs and government agencies often serve the bottom part of the market represented by the microenterprises. If the institution is not able to adapt to the change of circumstances that determine its success in a community, such as prices, laws, government policies, and people, it will disappear.

At first sight, it might appear that many external factors do not have to be considered by the SFI. However, the fact is that these factors may greatly determine the viability of the institution. Community factors which negatively influence the delivery of financial services are for example: sparse population, economic stagnation, weak physical and human infrastructure, ethnic diversion, lack of a social ethic to ensure that repayments are made on unsecured loans, and the lack of a strong and visible government policy support for market-based savings and lending strategies (Patten and Rosengard, 1991). In reality, effective institutions do not operate in a vacuum but seek to shape an enabling environment for themselves and their clients.

The following issues concerning community monitoring are considered to be important for SFIs:

- ! ***Economic environment***
- ! ***Policy and regulatory environment***
- ! ***The financial marketplace***
- ! ***Community impacts***

4.1 Economic environment

Changes in general economic variables and trends can have important consequences for the SFI's success. Important economic variables which a financial institution should monitor closely are the interest rates and other terms for lending and savings deposits and the inflation rates. These economic variables are important for an SFI to verify whether interest rates charged are still appropriate for the prevailing economic conditions. Similarly, an SFI needs to track the value of the local currency in relation to other foreign currencies. Furthermore, the institution should monitor the viability of the different economic branches and sectors which are financed by the institution. The analysis of the prospects of each of the branches and sectors enables an SFI to take corrective actions if considered necessary to maintain a balanced portfolio and minimize risks.

If the information is available, the institution may also try to collect data on local, regional and national economic trends, including consumer price indexes and price trends for input and outputs of the businesses receiving SFIs finance and support. This information may for example help SFI clients in defining the prices for their products. Depending on the situation in each country and region, these data could be obtained from general economic bulletins, central bank newsletters or other general publications like newspapers and magazines. Important data such as the level of interest rates of other small enterprise lenders can be obtained from local banks and informal moneylenders.

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The following are the type of questions that can be considered regarding interest rates and inflation:

- Checklist Economic environment: Interest rates and inflation**
- 9 What are the recent changes in general economic variables such as bank lending and deposit interest rates and inflation? What consequences do they have for the SFI?
 - 9 How is the SFI's real interest rate affected by inflation? Is the interest rate rapidly adjusted for inflation in order to maintain the value of the portfolio?
 - 9 What is the effect of inflation on the portion of the portfolio that is the institution's own resources? And what on the portion that is borrowed from banks?
 - 9 What financial institutions can offer the SFI resources for its financial operations? Which of them is offering the most favourable conditions?

Foreign exchange rates

Generally, a high percentage of the electrical equipment and machinery used by small entrepreneurs is imported. In these cases, the propensity to buy of entrepreneurs may decrease when foreign exchange rates change and the local currency is loosing value relative to other foreign currencies. The small entrepreneurs who managed to obtain a loan will no longer be able to buy the demanded machinery because the loan amount in local currency will be insufficient due to the changes in exchange rate. Therefore, the SFI should monitor the value of the local currency in relation to other important foreign currencies. The frequent devaluation of the local currency may result in an periodic increase of the average loan amount to maintain the same level of purchasing power.

The following questions can be considered concerning foreign exchange rates:

- Checklist Economic environment: Foreign exchange rates**
- 9 What are the recent changes in the value of the local currency relative to other important foreign currencies? What consequences do they have for the SFI?
 - 9 How is the SFI's average loan amount affected by fluctuations in foreign exchange rates? Is the average loan amount quickly adjusted for foreign exchange rate changes in order to maintain the same purchasing power of the loans?
 - 9 Do small businesses have the same access to foreign currencies against the same terms and conditions as large enterprises? If distortions exist, what is the SFI doing to change this situation?

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Economic branches and sectors

Some economic branches and sectors are more appropriate to provide finance to than others. An SFI engaged in the financing of micro and small enterprises should distinguish those activities that are viable and secure for the provision of credit, and those that are probably less secure in their repayment behaviour. Overconcentration of lending resources in relation to any identified high risk factor increases the possibilities of losses for the SFI. For example, agricultural production is riskful due to factors over which the producer has no control, such as weather and crop disease; entrepreneurs working with garments and textiles might be greatly affected by the dumping of imported second-hand clothes; or, businesses producing wooden handicrafts may be very sensitive to shortages of wood in the community. Therefore, the SFI must also monitor what is happening in the branches and sectors it has decided to finance and track trends and situations that affect the businesses. SFI's may assist in the identifying interventions that are associated with viable branches and sectors in which MSEs dominate. SFI's can become active parties for example by educating the public, advocating on behalf of groups of entrepreneurs, and participating in the regional and national debate about the MSE sector.

It can be worthwhile to examine the linkages between the businesses in a specific branch. By doing so, institutions can get a better understanding of the flexibility and innovative potential of small businesses. Businesses compete with, supply inputs to, utilize the output of, or in any way impinge on the production processes of other businesses. Through the clustering or networking among businesses that may take place and the subcontracting linkages that may exist, it becomes clear that firms interact with each other, with some enterprises showing a higher profit and innovative potential than others (Rasmussen et al., 1992). Governments, SFIs and other institutions involved in small enterprise development need to create the enabling environment which balances competition and cooperation amongst firms and encourages innovation.

The analysis of the portfolio by economic branch and the performance reports coming from the field officers can serve as a first source of information for analysing the performance of branches and sectors. Additionally, manuals are available for a more thorough analysis of a specific branch or subsector (Haggblade and Gamser, 1991). A first help in classifying activities is to make a business code list, reflecting the most common activities in the SFI's context. Alternatively, the International Standardized Industrial Classification (ISIC) codes can be used.

A checklist on economic branches and sectors would include the following key questions:

Checklist: Economic branches and sectors

- 9 In which economic branches and sectors are poor people working? And the very poor?
- 9 How are economic sectors such as agribusiness, manufacturing, services and trade, developing over time? Are some economic branches more attractive for disbursing loans than others considering the risk of default?
- 9 In which economic branches are the businesses located with the highest growth potential?

4.2 Policy and regulatory environment

It is the responsibility of an SFI to have a clear understanding of the financial, taxation, trade, labour and other policies as they relate to the economic activity of their clients. Government policy implications can be of major significance for the development of small enterprises. It is this policy environment which helps to determine the prices small entrepreneurs get for their products, the costs of the production inputs they use, the availability of and knowledge about alternative technologies, the availability of infrastructure, and so on. In fact, an MSE support institution should not lose sight of the importance having issues publicly debated which are closely related to the MSE sector so that they are addressed in a serious manner. It should be recognized that

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the SFI's contribution in this broad field may be quite limited and its direct impact is likely to be minor. However, formulation of an enabling policy environment should be the result of a participative and consultative process involving all the partners concerned in the public and private sectors (ILO, 1994). If it is the aim of an institution to stimulate growth and change in the businesses of its clients, it is of great importance that the institution does not operate in isolation and is not perceiving its sphere of influence only as limited as to its direct clients. An SFI should be an active party in the events that ultimately shape its own work, and understand its own potential to influence the economic and social conditions of a community (Otero, 1989).

The importance of drawing attention to the policy and regulatory environment can be illustrated by the following examples:

- ! To get a better understanding of the problems small entrepreneurs are dealing with, it is important to take a better look at the distortions that may occur due to policy and regulatory measures. It makes no sense, for example, to favour a few small businesses with credit, while at the same time *the large-scale sector is favoured greatly* in terms of overall credit and foreign exchange allocation and government regulations. In many countries, coordinating policies and removing privileges enjoyed by the larger enterprises would do much more for the small enterprises than many of the support activities currently executed.
- ! *Research* is often directed at larger enterprises. Therefore, SFIs may call for more action research to assist small enterprises with productivity and market improvements through, for example, identifying new and improved technologies, organizing exchange visits between different sizes of enterprises, bringing producers and end-users together to improve quality of end-products, and developing private sector linkages (Tanburn, 1995). In some countries it has been established that small-scale production is more efficient than large-scale production (Stewart, 1989; Stewart et al., 1990). While SFIs are normally no research institutions, they can have their voices heard and call for more attention to research these particular conditions that have impact on the development of the enterprises they try to assist.
- ! The legal and regulatory environment affects SFIs directly because it should allow for swift action designed to impose *sanctions in the case of delinquency*. However, frequently the legal and regulatory environment is too complicated or overcrowded to prevent adequate action on delinquent entrepreneurs. SFIs may lose a major portion of their time and energy in dealing with time-consuming court cases, in the end leading to little benefits and undermining the sustainability of the institution.
- ! Local innovations from small entrepreneurs often have little *legal protection*. Reforms in the legal and regulatory system may encourage the use of local innovations, for example through the establishment of a system of "utility" model patents as is practised in several countries (SATE, 1991).
- ! Many of the small enterprises can not provide the *labour standards and conditions* needed to safeguard against accident and unfavourable or unsafe working conditions. SFIs may assist in identifying the areas where standards are most needed to promote welfare and essential protection for the entrepreneurs as well as for their employees. The structuring of social security provisions may supplement financial incentives for safer and healthier working conditions (ILO, 1994). Additionally, the SFI may consider to encourage the role of workers' organizations in protecting working conditions and labour rights in small enterprises. SFIs can call for more attention on this issue and initiate or stimulate the elaboration of studies on these subjects. In practice, the political space created by successful activities can enable an institution or group of institutions to increase their capacity to leverage changes from the policy and regulatory environment.
- ! Organizing small entrepreneurs in *product or sectoral associations* for the purchase of raw materials, marketing of products and transfer of technology can be seen as a step forward of changing an hostile into an enabling environment. Generally, an SFI is strongly rooted in the community. Therefore it can play an important role for example by initiating a policy dialogue aimed at the required policy changes.

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A checklist of questions concerning the issue of policy and regulatory environment would include the following:

Checklist Policy and regulatory environment

- 9 Is it the SFI's aim to contribute to the improvement of the enabling environment for small enterprises? If so:
- 9 Is there a clear understanding within the institution of the social, economic, legal and political factors that influence the MSE sector?
- 9 Does the SFI has the capacity to analyse how the unfolding of current events will affect the economic activities of their clients?
- 9 Is the SFI trying to build up the capacity to participate in political and regulatory debates regarding the MSE sector?
- 9 Does the SFI has the clarity to define the nature of the financial activities in the local context?

4.3 The financial marketplace

SFIs have a comparative advantage in serving small entrepreneurs within the existing financial marketplace. Their focus on small entrepreneurs provides them with knowledge of these client groups that enables these institutions to offer innovative and more attractive services to their clients. An SFI should know what is actually happening in the financial marketplace, and should assess which type of financial product and service meet best the financial needs and preferences of their client. Similarly, it must know what its strong and weak points are as well as its opportunities and threats in delivering services to MSEs.

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Patten and Rosengard argue that successful development of financial markets takes place where financial institutions segment the market in which they operate, and establish market niches based on comparative advantages over competitors. In these cases, financial services are initially tailored to an institution's relative market strengths and subsequently modified as needed to accommodate changes in market conditions. Identification of market position is closely tied to the operational effectiveness and financial sustainability of an institution. It enables the institution to offer appropriate services at a reasonable cost. Effective and rentable financial institutions in turn ensure the self-sustaining supply of financial services in response to market demand.

In order to operate effectively in the financial marketplace, market analysis, promotion of the financial services and innovation will be highlighted in this paragraph.

Market analysis

Successful SFIs adopt a marketing point of view that emphasizes knowing as much as possible about clients, competitors, community and the institution itself. Based on market information the services to the clients can be improved and may serve to identify new segments of the small enterprise market which are not yet covered by the institution. At the same time, it can provide valuable information on other lending institutions active in the same market segment such as other informal and (semi-)formal financial institutions. In addressing these questions to other parties active in the market, SFIs can search for areas of cooperation with the other lenders for example in the interchange of information on frequent defaulters. Furthermore, an SFI must know the products and services these other institutions have to offer to the small entrepreneurs, for improving their own services and in helping to search for market niches.

Many SFIs tend to ignore the issue of competition which focuses on client's financial incentives and transaction costs regarding financial services and the confidence in institutions performing these financial functions. SFIs should anticipate on the situation that might arise of losing their best clients to other institutions which are also providing services to MSEs. SFIs can learn about the terms and the transaction costs associated with the financial alternatives an entrepreneur can choose, and understand why and when clients select one option or another. While in practice, competition is not likely to seriously affect the market of the SFI, its impact may be felt more in the larger loan sizes and in keeping pressure on interest rates and costs.

On the other hand, institutions must avoid that because of limited competition in financial services clients subsidize the inefficiency of financial services by paying unnecessarily high rates. Clients should be served at prices that reflect the full cost of providing a service, but should not have to bear the consequences of inefficient service delivery. These inefficiencies may occur easily when competition is too low to ensure that these inefficient services are driven out of the marketplace (Rhyne, 1992).

Finally, for an SFI to be effective in the marketplace it must have the ability to establish relationships with a wide variety of institutions and individuals who will increase their outreach and capacity to influence others. Two types of linkages can be distinguished: the enabling linkages, i.e. the relationships with those institutions which control allocation of authority and resources needed to function; and, the functional linkages, i.e. the relationships with those institutions which are similar or complementary in function. When an SFI is well connected and respected, policy-making bodies, financial and banking institutions and others who can have influence on the MSE sector are more likely to listen carefully to the SFI's assessment of what barriers must be addressed to improve the situation of small businesses. Additionally, in certain political contexts where self-help efforts are viewed with suspicion, strong ties with other institutions will also serve as protection and coverage for the institution (Otero, 1989). An extensive checklist of questions for market analysis, divided into three subgroups (clients, community, and institution) would include the following:

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Checklist Market analysis: (A) Clients

- 9 Who are our clients and what are their needs?
- 9 How many clients does the SFI have? How often do they come to the SFI for soliciting financial services? Why do they come to us, and do not go to another institution? Have we lost any significant number of clients recently? If so, why? Does, for example, the SFI try to control clients by enforcing them how to make use of the money they borrow? Have we gained any significant number of new clients recently? If so, how?
- 9 What are our major market segments taken into account for example the activity, location, population, benefits, and distribution linkages?
- 9 Try to attach a money value to each segment. How much do clients in each segment sell in a week/season/year? Are any of the segments growing/declining?
- 9 Which segment is the most important to us?
- 9 How do clients arrive at a decision within their businesses? Who initiates the loan application, who specifies and who authorizes? For example: owner, employees, and/or family members of the clients?
- 9 What are the transaction costs of clients, such as transport costs, fees for collateral registration, expenses on certificates needed for loan applications, bribes, paperwork expenses, and the cost of time that must be diverted from the business in order to obtain services, comparing to other lenders?

Checklist Market analysis: (B) Community

Competition

- 9 Are there sufficient customers of the businesses with spending power in the community?
- 9 Which market sectors do we and the clients consider as potential growth sectors?
- 9 Is there much competition from other institutions and banks in providing financial services to small entrepreneurs? Can it be described and/or quantified?
- 9 Why are the successful competitors what they are in providing financial services to small entrepreneurs?
- 9 In what ways are we different to these competitors?
- 9 In what ways can we improve our products and services to make this difference greater and better?

continued

Checklist Market analysis: (B) Community (continued)

Institutional linkages

- 9 What are our linkages with government agencies, including legislative and policy making bodies?
- 9 What are our linkages with local and regional private institutions, including the media, entrepreneurial membership institutions, workers' organizations, research institutions, universities, other SFIs and grass-roots institutions?
- 9 What are our linkages with international institutions?
- 9 What are our linkages with financial and banking institutions?

Community factors

- 9 What is happening in the local economy? Is it seasonal, is it growing, or is it stagnant?
- 9 Are there any cultural or social factors which affect the growth of the businesses of our clients?
- 9 What is the political situation in the community and how might it affect the business?

Checklist Market analysis: (C) Institution

Financial products and services

- 9 What is the physical infrastructure like? How is the availability of local transport and electricity?
- 9 What are characteristics of our main products and services? How do clients benefit from them? How do they contribute to the development of the business?
- 9 Are the products and services seasonal? Is there a supply problem with any of them?
- 9 Do we have a balanced range of products? For example: both credit and savings services.
- 9 What is the quality of our products and services? Can we make changes to include other segments of the market? Are products and services well adjusted to meet the key market segments? Are loan and savings terms in line with the preferences of these clients? For example: loan size, maturity, collateral, group guarantees, grace period, and access to deposits.
- 9 How can we improve the product range to better meet the needs of our clients?
- 9 How long does it take to decide on a loan application or deposit request?
- 9 How far, how often, and at what cost must these clients travel to deal with our institution? Are the opening hours in line with clients' preferences?
- 9 Is the location of the SFI well presented? Is it easily visible and accessible to both men and women?
- 9 How do we get our funds for credit disbursement? Do we mobilize savings in the market? Besides the market are there any other constraints for savings mobilization, e.g. our image or legal aspects?
- 9 What are our main strong and weak points, opportunities and threats in delivering services to MSEs.

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Checklist Market analysis: (C) Institution (continued)**Pricing**

- 9 Are we a price taker or a price maker?
- 9 Is the level of competition light or intense?
- 9 Is our interest rate paid on savings competitive with the return on traditional forms of savings?
- 9 What are the SFI's transaction costs for this client group, such as lender's risk and operational and administrative costs of reaching often dispersed individuals and processing loans?

Growth*Market penetration*

- 9 Can we deliver more of the current financial products to existing clients? Do clients buy most/all their needs from our financial products?
- 9 Are clients loyal to us or do they change frequently from institution looking for the cheapest services?
- 9 Can we help to develop closer relationships with clients to increase loyalty and service delivery?

Market extension

- 9 Can we find new or additional segments of the market to whom we can deliver our current products and services?
- 9 If for example our location will be moved, or additional changes will take place, will existing clients stay, and will any new ones be gained?
- 9 Can we gain any new clients by increasing advertising and communication?

Product development

- 9 If the SFI has a narrow range of financial products: is there anything that we can do to the product to increase its value? For example: quality, terms, and amounts.
- 9 Can financial products be added or deleted to increase client's benefits and improve service delivery?
- 9 Are there any financial products that are sold now that have a low demand? Have clients been lost to competitors or do clients no longer want these type of financial products?
- 9 Do we notice an increased demand for any particular product which is or could be delivered? Have we developed the right product? May other products have greater demands?

Diversification

- 9 What are areas, such as innovative financial or non-financial products and instruments, type of activities, client groups, regions, which are not yet covered by us, meet the needs of entrepreneurs, and may be offered to the clients at a viable basis?
- 9 By combining our skills and market awareness, can we gradually move into new markets with different or highly modified products? For example: client information services, equipment rental, and leasing facilities.
- 9 What are the main assumptions we have to make in developing new strategies?

Promotion

The main objective of promotion is to inform potential clients about the institution and the services it is delivering. At the same time, promotion is an important element in shaping the image that the public hold about the institution. The image of an institution is one of the factors which determine SFIs role and strengths within the financial marketplace. If financial services are delivered well, often clients themselves become promoters of the SFI by word of mouth. Similarly, field officers can participate to start the spread of information. SFIs which have been in existence for some time may consider periodic promotional campaigns to attract more clients. An SFI may decide to start such a campaign when it wants to offer services in a new area or is introducing new services. A campaign can also be used by an SFI to get to know its market by tracking the clients who are responding to it. Promotion has to be planned carefully to prevent from generating more clients than the SFI can handle efficiently.

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SFIs can use a variety of means to promote their financial services, including public meetings, posters, contact by staff, letters, information packages, newspaper advertisements, radio messages, and word of mouth. It is important that the means chosen to reach potential clients is appropriate. For example, if the majority of the client group is illiterate, radio publicity in the local language will be more effective than newspaper ads. Or, if the clients are women in remote rural areas who do not have access to radios, speaking at village meetings may be the only way of promoting the institution. To determine the appropriate means for promotion the SFI may rate each of them as to impact, swiftness, outreach and costs.

To be effective, promotion must be targeted to specific geographic areas in which the SFI is working or is planning to work and to the type of clients for which the activities are designed. The SFI needs to look carefully at the costs as promotion can be very expensive. SFIs should seek for innovative ways to promote their services at low costs.

A checklist of questions on promotion would include the following:

Checklist: Promotion

Promotional campaigns

- 9 How often and in what way are the financial activities promoted? Do advertising plans exist?
- 9 What are the main objectives of promotion? For example: to change client's perceptions, to direct client's action, to deepen market penetration, to improve or reinforce our image, to pass on information, to reassure clients, to fight competition, to enter new markets, to create awareness, to back up promotions, to remind clients about products, to defend market position, to launch new products and services, to inform about product availability, to educate clients, to communicate our strengths, to announce a change of location, to reach new geographical areas.
- 9 Which of these objectives cannot be achieved by personal communication, but will require a specific promotion campaign?
- 9 What type of medium will be most appropriate for the advertising campaign in the case of the targeted client group? Determine the characteristics, atmosphere, size and comparative costs of each of the following media in relationship to the clients: local and national newspapers, "technical" SFI press, magazines and periodicals, direct mail, leaflets, directories (yellow pages, SFI guides), television, posters, on transport (buses, vans), cinema, and local radio. Decide on the type of language: national or local.

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Checklist: Promotion (continued)

- 9 Does an advertising plan already exists for each or some of the above listed media? If not, decide on making one, for example including: brief description of advertisement, timing, responsibility, budget, actual cost, criteria by which success will be judged, and evaluation comments.
- 9 Does the way in which we deliver financial services and project ourselves through its publications, public statements, staff, and participation in events, influence the level of trust expressed by clients? How clients perceive an SFI is directly related to its ability to bring about change.

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- 9 Does the way in which we deliver financial services and project ourselves through its publications, public statements, staff, and participation in events, influence the level of trust expressed by clients? How clients perceive an SFI is directly related to its ability to bring about change.

Institutional image

- 9 Does the image of our institution among local development institutions change as result of the implementation of financial activities?
- 9 To what degree are we increasing our growth and stability by operating independently from the government? What are the potential political forces that influence our institution? What is, given the political climate, the most appropriate relationship for us to maintain with the government?
- 9 What are the opinions held by members of donor institutions about our institution? Generally, SFIs rely to a certain extent on granted funds for their operations, even in the case when they have achieved a high level of self-sufficiency. Donor's impressions of the SFI are important as it will affect the institution's fundraising capacity and hence its survival.
- 9 What are the opinions held by members of the banking community? Do they perceive us as creditworthy institutions?

Innovation

For an SFI to be successful in the marketplace it should stimulate financial service innovations that reduce transaction costs for the institution and clients. These transaction costs can be compared to the friction of a motor. If friction is reduced, it causes a motor to run more smoothly and to last longer (Adams, 1988). Likewise, if transaction costs of a loan are lowered through innovation, financial markets work more efficiently and financial institutions have greater strength. Innovations that reduce transaction costs can be achieved by introducing new types of

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financial products and services to existing clients and extending existing services to new groups of clients, or both. Some examples of these innovative financial products and services, of which many are already being implemented by SFIs, are the following:

- ! *Mobile banking*, the frequent visiting by field officers of local communities on for example market days to collect loan repayments and savings deposits.
- ! Using *social and peer group pressure* in solidarity or self-help groups, to lower transactions costs of SFI and clients, and to improve loan collection. Some SFIs make use of character-based lending (see *Annex B*) and rely on both individual loan histories as well as community recommendations for their loan decisions.
- ! To rely on *non-traditional collateral*, for example valuables such as jewellery, consumer durables such as televisions, livestock, or assignment of wages.
- ! Using a *progressive lending methodology*. Portfolio risk is managed through small initial loan limits that can be progressively increased if repayment is successful. Borrowers are classified into a number of categories on the basis of their repayment record and this classification is establishing the loan limit for a subsequent loan.
- ! *Interest rate-related incentives* for clients to stimulate repayments.
- ! Using *(non-)financial staff incentives*.
- ! Providing *additional financial services* to small enterprises, on a fee-for-services basis, such as collecting bills for electricity, telephone, and property taxes, paying pensions and teacher salaries, and transferring funds.
- ! Introducing venture capital or *equity financing lines and revenue participation* as a way of repaying loans and interest.
- ! Providing working capital instruments such as *credit lines and factoring*.
- ! Providing term financing arrangements such as *loan brokering, equipment rental, and leasing facilities*. As banks may begin to appreciate that small entrepreneurs are good credit risks, if properly screened and supervised, they may engage the SFI to provide services on a fee-for-service basis. This can be, helping entrepreneurs to prepare strong loan proposals, screening of loan proposals, providing business services to reduce banks' risks, supervising loans and enterprises, and assisting in collections. Accordingly, the SFI charge fees for these services to cover its costs. A leasing service can allow certain client groups who often can not find securities to have access to small capital goods, such as sewing machines or electric equipment.

An SFI must be careful not to uniformly replicate successful innovations. It should not adopt the form of a relatively successful model without a grasp of the substance that animates and sustains it. Furthermore, institutions should be aware that any attempt at innovation contains risks, many of which are not apparent at the outset of financial activities. Innovation and market analysis can be difficult, costly and time-consuming. This is especially so when clients are highly dispersed, illiterate, and marginalized by cultural barriers that keep them out of the formal economy (Holt and Ribe, 1990). Outstanding management and well-capitalized financial structures may be required to neutralize these risks (Adams and Von Pischke, 1992). A basic checklist of questions on innovation would include the following:

Checklist: Innovation

- 9 What are new market segments, products and services which can be developed?
- 9 What are our strategies for these segments? For example: what, how and to which new client groups should we deliver?
- 9 Who are the people we must communicate with? For example: clients, policy makers, local government and bank officials, donor agencies?

4.4 Community impacts

Previous sections addressed the effects and impacts of financial services on clients and the institutional performance. This section will discuss the impacts of financial services at the

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community level. As explained in section 1, the impact of financial services on a community is in practice difficult to determine because there are many external variables to consider and the data collected by most SFIs does not permit this level of analysis.

Nevertheless, it is considered important not to lose sight of the overall social and economic impacts of the services for a community. The collected data can serve to determine whether the financial services contributed to the improvement of the quality of life of a community and whether they have alleviated poverty in this community. It is, therefore, suggested, rather than searching for definitive impact results on predetermined indicators, to look for results that are indicative of the nature of these impacts. Although they may seem less precise, such results are more likely to be accurate reflections of what the delivery of financial services accomplishes in a community. Through data collection, observation and conversations the SFI can determine changes in these areas and the role the SFI has played in these changes.

Generally, employment and the returns to labour are considered as the key to monitor the progress of the poor, who have only their labour to sell. Labour is the input common to all business activity and wage rates allow easy translation from labour use to income. In addition, since indicators as sales may be concentrated or infrequent, productive labour is spread more evenly over time and general working schedules more easily remembered by the entrepreneur. Large changes in business volume may lead to reallocations of labour from other activities, thereby offering a further check on the direction and magnitude of change in business activity. The focus on labour has the important further advantage of retaining employment, returns to labour and equity at centre stage throughout the monitoring process.

However, while many SFIs measure the impact of financial services on employment, it is a complex exercise to measure impacts of financial services on clients and communities. Besides the general constraints mentioned in section 1, measuring the impact on employment is complex because the standard methods for assessing employment generation fall short when applied to the MSE sector. Usually, the SFI is comparing the number of employees the business had at the time of loan application with the number of jobs that has been created according to a monitoring visit. Alternatively, it is using "administrative figures" of the employment a loan is expected to help create. These numbers usually are not reliable and do not reflect the degree of underemployment or use of seasonal labour. There are no uniform definitions of job creation, of how to differentiate displacement versus job creation, or how to account for jobs that are sustained versus jobs that emerge for the first time. Especially in the case of micro enterprises it is important to distinguish the support of an existing job which would otherwise disappear, or turning a part-time position into a full-time one (Otero, 1989). Therefore, as far as employment is concerned, it is important that the institution at least determines ahead of time how it will define job creation and job stability. Similarly, when collecting employment data, the institution should differentiate between full-time, part-time, and seasonal employment.

A checklist of questions concerning the indirect, sustained and wider results of the financial services for the community would include the following (ACCION, 1989; Otero, 1989):

Checklist Community impacts: (A) Income and employment

- 9 What impact did income changes of owner(s) and employees have for the prosperity of the community? Have purchases from other local businesses resulted in an increased prosperity of the community, such as the creation of additional indirect income and employment?
- 9 What is the contribution of the MSE sector to the national income? Has the capacity of our clients increased in this field?
- 9 What is the contribution in job creation and maintenance of precarious jobs of the MSE sector to the community? Has the capacity of our clients increased in this field?

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Checklist Community impacts: (B) Strengthening of the MSE sector

- 9 Do the financial services contribute to the growth potential of businesses and subsequently to a stronger MSE sector? Does general productivity, capacity utilization, and profitability in the community improve due to the availability of the financial services?
- 9 What is the contribution of the MSE sector in creating and strengthening backward and forward linkages between businesses of different types and sizes, for example in the production of raw materials and in the creation of marketing channels?
- 9 Does the business subcontract any production components to other local businesses? For example, a tailor may subcontract some of his orders for trousers to other tailors in the community when he has a backlog of orders; and, the tailor may receive, because of the increased quality of his products, subcontracting orders from other larger enterprises.
- 9 Are the improved businesses driving out other established enterprises? This represents a negative community impact.

Checklist Community impacts: (C) Community well-being

- 9 What changes did occur, as a result of the increase/decrease of income due to the availability of the services, in meeting basic needs in the community, such as: purchase of food and improvements in diet, expenditures on children's schooling, health care, clothing, and home improvements?
- 9 Is there a change in the availability of goods and services in the community as a result of changes in the enterprise? For example, new food products or transport services might have been introduced by the entrepreneur in the community.
- 9 Is the SFI sensitive to the financing of for example environmental-aware enterprises and child-care facilities thereby increasing its social value for the community?
- 9 Does the SFI by operating in the smaller cities and towns help to create job opportunities in these cities which could decrease migration and concentration of urban poor in the capital cities?
- 9 A concentration of migrants can be found among street vendors. What is the percentage of street vendors attended by the SFI?

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Checklist Community impacts: (D) Community strengthening

- 9 Has the perception of people in the community about the importance of MSEs changed?
- 9 Has the availability of the financial services sparked other financial services and innovations in the area? Have other banks started providing financial services to MSEs? What are their terms and conditions and what is the volume they process? What marketing strategies do they use?
- 9 Is there an indication that informal financing terms and conditions have been adjusted as a result of the availability of the credit facilities of the SFI? Give examples. What is the percentage of people now using formal financial markets compared to before starting the financial services delivery?
- 9 Does the SFI have a strong public awareness component? Is information disseminated through the media, such as articles in local newspapers, interviews on the radio and other means of exposure that can increase the public's knowledge and interest in the sector?
- 9 Is the SFI stimulating other mechanisms, such as conferences, workshops aimed at specific audiences, that can generate debate and interest among academic, development, church, government or business groups who otherwise may not consider this issue?
- 9 Is the SFI stimulating research on relevant topics that can help to increase the knowledge base in a country and strengthen arguments that underline the importance of MSE sector activities?

Checklist Community impacts: (E) Institutional building

- 9 Does the exigencies of delivering the financial services spill over to other activities of the SFI and does it affect the overall management, financial systems and the decision-making process?
- 9 Do we besides to contributing to entrepreneurs also create a base of competent local MSE institutions? Does the SFI help shaping linkages with institutions or sectors of the economy which in turn can help to increase the attention given to the sector? Are more institutions now engaged in technology, marketing and institutional support for MSEs?
- 9 Does the delivery of services increase or decrease SFI's leadership potential and thereby its ability to affect or shape policy and other issues related to development?
- 9 To what extent is the SFI supporting initiatives from clients to achieve a new level of institution which is expanding the negotiating power of small entrepreneurs? Entrepreneurs may organize along trade activity or region and begin to extend control over their immediate situation.
- 9 To what extent does the SFI assist public institutions (for example through training) to consider reaching this sector through existing activities, or modifying their training approach to allow access to those employed in the MSE sector?
- 9 To what extent does the SFI enhance the flow of attention and resources from private financial and non-financial institutions and other SFIs to the sector? In practice, most private institutions in the financial, banking or industrial sectors simply ignore the needs and potential of the MSE sector.

4.5 Questions for discussion and research

A checklist to be addressed for discussion and research would include the following questions:

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Checklist Community monitoring: for discussion and research

- 9 What are the needs, preferences and alternatives of clients as they relate to the use of financial services generally and the offered services in particular? Which categories of clients use specific types of services? Which categories repay promptly and save regularly? How does the information on clients compare to data about the general population of the area covered by the institution? Analyse, for example, on the basis of market penetration ratios whether a service is well accepted and how much growth potential services have?
- 9 What are the differences in cash-flows and access and costs of financial services between the formal and informal sector? What is the role of financial intermediary institutions and the functioning of informal financial markets in the community? Particular attention may be paid to innovative ways and means to attract savings from the MSE sector.
- 9 Which type of institution, financial product and service cause the greatest developmental impact, including impact on the MSE population? What are the distributional, both regional and income-based, consequences of different products and institutions? Is the SFI positioning itself for major impact?

Section 5: Building a monitoring system

In the previous sections each of the three components of the monitoring system have been explained. In this section the components come together when the practical steps of the monitoring system are discussed. Information and data needed to steer the finance operations of the SFI must be collected, processed, analysed, documented and assessed, and finally interpreted as to the consequences they have on the implementation of the finance operations. Depending on the size of operations a monitoring unit or a single monitoring officer may be appointed to implement these activities. Generally, a monitoring system operates through the following steps:

- ! *Identifying the information required*
- ! *Selecting indicators*
- ! *Data collection*
- ! *Reporting*
- ! *Analysis*
- ! *Assessment and interpretation*
- ! *Decision-making and action plan*

Many SFIs already have an information system, an internal reporting system or some reporting activities to external institutions. When setting up a monitoring system, an institution must build on these existing facilities and procedures by using them as much as possible and by improving them if necessary. At the same time, each SFI must tailor its system to suit the specific information needs and requirements related to its financial services. Successful monitoring and evaluation activities must be geared to the needs and background of all actors involved and its intended users. It is therefore crucial to motivate actors by actively involving them in the design and implementation of monitoring and evaluations, even if this affects the speed or cost of evaluations (Frerks, et al., 1990).

The design of a monitoring system should be a function of type of activities, the scale and scope of activities, the flexibility of the design of activities, trained personnel available, the operational constraints, and the planning and management capacities of the SFI. In practice, a monitoring system has to be improved continuously to prevent from system fragmentation and data redundancies, data inconsistencies, and a lack of timely access to critical information. Unfortunately, too often the introduction of a monitoring system is thought to be synonymous with the purchase of personal computers. While computerization can be a very instrumental tool for monitoring and evaluation, a monitoring system still needs a well-organized and highly-trained human being to define problems, set objectives, resolve issues, and reorganize and strengthen the institution. After addressing the practical steps of the monitoring system, the role of field officer and monitoring officer will be highlighted. Both play a central role in building the monitoring system.

5.1 Identifying the information required

The first step in setting up a monitoring system is to identify the information that is required by the institution in order to manage the financial activities. The monitoring and evaluation should be decision-oriented, i.e. it should supply the management with the information needed to control the performance of the finance operations. Designers of the monitoring system should identify who needs what information, when, in what form, and why.

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Next, the programme designers should specify the level of financial, personnel, and support resources that the SFI can allocate to meet these ongoing information needs. Institution and information flow charts may be constructed to show who supplies and receives information.

These charts can also indicate the active feedback mechanisms in the institution. Finally, the system should have built-in checks for information reliability and validity.

Who needs what information and what for?

Monitoring serves a variety of purposes, some of which become unclear because the audience addressed is not well defined. A key concern is to identify the target audience from the outset and to frame the presentation and analysis of the information with these users in mind. Five different groups, each with their own set of priorities and perspectives constitute possible users of the SFI's monitoring system:

- ! *The SFI itself*: on the basis of monitoring and evaluation findings the institution can make operational decisions, improve its performance, change operational objectives or simply learn more about its own work.
- ! *The clients*: business monitoring helps clients to control the pace of development of businesses and provides feedback to the client on the performance of the business.
- ! *The banking community*: commercial banks may consider the MSE sector as a very promising sector for strategic and commercial reasons. While few reports are written for this user group, they represent perhaps one of the most important groups to take in consideration for developing the MSE sector.
- ! *The donor community*: monitoring and evaluation results enable funding agencies and policymakers to determine if the SFI has done what it set out to do, if funding this specific activity is the best use of money, and if the activity continues to fall within its funding priorities.
- ! *The development community*: policymakers and programme implementors throughout the developing world learn from the experiences recorded in monitoring and evaluation reports and in some cases apply this learning to their own initiatives. This group is of course the most heterogenous and very few evaluations are written for this users group.

The information collected must satisfy both the internal management needs of the SFI and possibly the reporting obligations to external bodies like donor institutions and governments. In essence, however, the monitoring system is a tool for meeting internal needs and not those of outside donor organizations. For this reason, the SFI should start with the information requirements of the entrepreneurs, loan officers, managers, and other technical and administrative staff of the SFI involved in delivering financial services. It is important that not just any 'interesting' information is collected but only information that is relevant for decisions to be taken in controlling the delivery of financial services. To ensure that the data collected will actually be needed, it must always be clear what the data are used for. Sometimes data are collected and transferred via internal reports which in practice may not be required or used by the management. In such cases, it may be recommended to reduce the data collection input of the monitoring system.

When is the information required?

Even the best information is useless if it arrives too late. Deadlines when information must be available are important in decision-oriented information systems. For example, in order to manage and control portfolio quality, the SFI needs timely and up-date information on loan payments. If an SFI does not know when loan payments were supposed to have been made and cannot track when they are actually made, the institution does not know the quality of the portfolio and cannot take corrective actions to improve it.

How detailed the information has to be?

Generally, the level of detail is determined by the time aspect in combination with technical aspects, the importance of the issue, and cost considerations. Monitoring information should provide enough detail to enable the SFI to identify the cause or responsibility for constraints. If,

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for example, it is established that the delinquency rate has increased significantly, the institution must know which type of loans are affected for what activity and for what reason, in order to take corrective action accordingly. The generally valid principle is that it is better to be almost correct, cheap and on time than very exact but expensive and too late.

5.2 Selecting indicators

To systematise data collection for measuring changes related to the financial services, an SFI should decide on the indicators it wants to use. Indicators can be defined as specific and objectively verifiable measures of change of results brought about by an activity. Indicators are used as markers of progress towards reaching objectives. They are not quantitative targets in themselves. Often, it is not easy to select the right indicators since short term, intermediate and long term objectives are not always formulated in clear and ambiguous statements. Indicators should be valid, reliable, relevant, sensitive, specific, cost-effective, and timely. They should be unambiguous and not biased towards for example gender or monetized economies. Finally, it can be recommended to use a small number of indicators because not all potentially relevant information improves decision-making or is eventually worth knowing.

Sections 2, 3 and 4 emphasized which type of indicators can be used for monitoring and evaluation at the level of the business, the SFI, and the community. Certain changes are difficult to translate in adequate indicators, such as for example the degree of participation or institutional change. In these cases, descriptive statements of the state of affairs and the changes that have occurred are preferable to inaccurate figures.

5.3 Data collection

After we have identified the information that is needed, the next step in monitoring and evaluation is to organize a regular flow of relevant quantitative and qualitative data and information regarding the selected data and indicators. It should be decided on: where and how does the institution want to collect the information?; and, who should collect the monitoring and evaluation data?

Where and how does the institution want to collect the information?

Monitoring and evaluation of financial services is mainly based on the records of the SFI and sometimes of other financial and non-financial institutions linked to the SFI's services. Preferably, the client information is entered into a database which then can be used as a tool for tracking the performance and economic progress of individual businesses.

Generally, each institution creates its own formal and informal ways of information exchange among staff. The type of communication flow affects the quality of the relationship between staff and supervisors. SFI's ability to create an information system that is responsive to staff needs and also enhances institutional efficiency constitutes an important measure of institutional strength. In this respect, the degree of systematization, simplicity, and adherence to the monitoring system are important factors to address (Otero, 1989).

Type of data sources

Information to control the financial services can be obtained by different types of data sources:

- ! Files available on each client or group of clients with base line data. The file could contain the following: client baseline data, client monitoring form, savings pass book, pledge form of savings account balance, a copy of business plan and loan application, loan approval and disbursement form, and all other relevant documents and correspondence concerning the client.
! Loan application forms, generally filled out by the client with or without assistance of a loan officer or adviser.
! Field reports, with data on each individual borrower or household, following from the visits from loan officers and supervisors to the clients.

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- ! Surveys, based on in-depth and open-ended interviews and/or questionnaires with a sample of clients. Interview protocols and questionnaires should have a clear focus, few and objective questions, questions should rely as little as possible on memory, appropriate use of language, understanding of working habits and conditions, and should be field tested before they are finalised.
- ! *Financial reports and statements*: portfolio reports, balance sheets, income statements, cash flow statements, and sources and uses statements of the institution.
- ! *Informal channels*, such as: seminars, group meetings, observations or informal interviews with the borrowers themselves or with persons who know the situation well enough to answer relevant questions.
- ! *External data sources* concerning clients or sectors in which they operate. These data might be extracted from the central bank, cooperating banks, government agencies or other institutions working with small entrepreneurs in that specific region or country. The reliability and availability of data and information from external institutions constitute often a major criteria for deciding whether or not the SFI itself should collect general data on client groups.

In the case of *business monitoring* the monitoring officer is using the client baseline data, field reports, and loan and savings documentation for assessing client profile, business performance and individual loan performance. The business effects and impacts can be measured by a sample of the businesses. Institutions probably will rely on a combination of questionnaires and interviews to obtain as reliable information as possible on their sample of businesses. Impact indicators may be collected via a sample survey of clients who have had their loans for at least 12 months. Finally, these impact indicators might be collected during "exit" or refinancing interviews, or when a client either pays off an old loan or rolls it over into a new one. However, refinancing interviews carry the risks of producing less reliable data because clients have an interest in producing favourable data in order to obtain a refinance. Haggblade provides a good example of collecting evaluation data by integrating data collection into normal activities to minimize the burden of specialized survey efforts. This procedure is cheaper, since the data to be collected can be combined with other information that the client is asked to provide during loan repayment or refinancing (Haggblade, 1992). However, there might be a justification for undertaking the more expensive sample survey in the case the institution feels that there is a broader relevance of this type of study for increasing the knowledge about the MSE sector. Such a sample could include some assisted and non-assisted businesses. Provided that such information is really needed by the institution, it may solicit additional funding from donor institutions that are also interested in this type of information.

Data collection concerning impacts of financial services on clients implies frequent visiting by field officer of the businesses financed by an SFI. To obtain this qualitative information it is important to get close to the entrepreneurs in order to understand the realities and details of their everyday life. Continual monitoring is the only means by which the qualitative descriptions can be obtained to explain the process which has occurred. This type of information is compatible to the quantitative data collected. Commonly, more informal data collection methods are used to collect social and human development impacts. These methods call for a much more active role on the part of the client and often capture dimensions of impacts outside the grasp of quantitative information. While more susceptible to subjective interpretation, the lack of formalization in data collection should not necessarily be viewed as a deficiency in the case of small institutions where staff know their clients intimately (Von Pischke, 1991).

In the case of *financial monitoring*, the monitoring officer has to collect the information emerging primarily from the SFI's own records and systems of control in the areas of accounting and financial statistics. Portfolio reports from field officers, client files, balance sheets, income statements, cash flow statements, and sources and uses statements of the institution, are some of the most important data collection instruments for financial monitoring. Information gathered regularly on a daily, monthly, quarterly and semester basis should provide the bulk of the information needed. If an institution is unable to obtain this information from its own existing records, this in itself indicates that its monitoring function is weak, and must be upgraded. It should be noted that describing the quality of circumstances or trends often is just as informative as detailed statistical analyses, while only a fraction of their cost is involved. This is especially so with portfolio analysis.

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When assessing the *operational performance*, the most important sources of information are, in the first place, the SFI's files and records and its staff. Secondly, an institution can rely on instruments such as informal questionnaires, meeting with clients, self-evaluation techniques among staff and short surveys with a sample of clients to complement the information obtained from baseline records. Thirdly, a key source of information is the review of written documentation routinely produced by an SFI on vision, policy, methodology and procedures, results and financial data. Finally, conversations with representatives from other institutions will provide a broader perspective on where the SFI fits in the community. Observation also represents a valuable tool for assessing operational performance. In these cases, the monitoring person must know what to observe and when. Observation can be useful in situations of exchanges between staff and clients, training courses, flow of financial information, and decision-making procedures (Otero, 1989). For an assessment of management capacity, usually, an outsider will be able to assess management strengths and weaknesses with greater clarity than anyone who is directly involved in the management and delivery of the financial services.

In the case of *community monitoring*, data collection may be required from a wide variety of sources, including government agencies and financial institutions. The issue of time here is particularly relevant here, since merely obtaining basic data on employment levels, financial policy, trade legislation and others can require a complete monitoring staff. Therefore, the monitoring system should develop clear guidelines for this area, so that enough information can be obtained to make an important contribution to existing knowledge in this field. The most useful type of data sources in addition to the previous mentioned are fact-finding and data collection interviews with key persons; basic data publications from ministries, the Central Bank, financial institutions, and workers' organizations; research studies from universities and donor agencies; case studies of one or several small entrepreneurs; and interviews with staff of SFIs regarding their own assessment of impact in these areas.

To keep data collection cost-efficient it should be kept as simple as possible. Data collection should not be more complex and more comprehensive than actually needed. Interviews, questionnaires and forms should be kept as short as possible to avoid the collection of redundant information. Furthermore, short interviews may more easily elicit cooperation of the respondents. Sample surveys may be replaced by other more simple and cheaper research methods needed to get the desired insights. Most of these methods are well known and well described in available publications on research methodology. Each of these methods can be categorized according to costs, expertise required, timeliness, relevance, validity, reliability, involvement of decision-making levels, staff and client groups. Finally, if possible monitoring systems should be based on data which would be obtained anyway in the course of financial service delivery. At the same time, it is always cheaper to tap information from secondary sources than to gather primary data. Collecting other monitoring data not directly needed by the SFI should be kept to a minimum unless for example donor institutions are willing to subsidize this extra information and its collection does not hinder or delay service delivery.

The use of personal computers and software

Computerization, combined with appropriate software, maintenance systems and training, can facilitate analysis and documentation and represent a very instrumental tool for monitoring and evaluation. Computerization requires a change in business and operations methods. It requires changes in the way staff works and the way time is used. If computerization is done carelessly, it can consume the SFI's resources, retard its growth, and hinder the ability to serve clients. But if properly and carefully accomplished, it can improve record-keeping, simplify routine tasks, and provide information quickly and accurately (World Council of Credit Unions, 1989).

Who should collect the monitoring and evaluation data?

Data collection is centred around the *monitoring officer* who is responsible for coordinating the monitoring function. This includes periodic checks for data reliability, initial data analysis, preparation of documentation and interaction with outside evaluators. Throughout the monitoring process the officer has to collect information processed by the operational staff and external data sources. Additionally, the monitoring officer presents these data to management in summarized reports. Furthermore, the monitoring officer should help management in collecting and analysing

financial market information. Together with the feedback received from field staff the monitoring officer may assist management in identifying opportunities and innovations.

Obviously, the appropriate person for collecting data from clients is the *field officer*. The field staff maintains frequent contacts with their clients and therefore may inspire more trust and be more adept at obtaining data. Because adding data collection to his many other tasks may affect the quality of the services, management should carefully monitor the workload of its staff. The reliability of client data collection is strongly linked to many of the characteristics of the businesses themselves. Their numbers are vast, their locations are widely dispersed and often temporary, problems of classification are complex and the entrepreneurs' incentives to cooperate are weak. Moreover, much of this activity is invisible from the street and is hard to discover for outsiders of the household. Furthermore, most small entrepreneurs do not keep written records, which means reliance must be placed on the accuracy of their memory recall. Therefore, an urgent need exists for field officers being professionally and client-sensitively trained. Field staff should be able to build a good relationship with the entrepreneurs which is vital to the collection of reliable data in specific, and good financial service delivery in general. The reliability of the data collection can be further strengthened if the field officer does not only rely on answers from clients but also on observations and conversations with other people in the business and community.

An SFI should understand from the outset that additional data gathering requirements together with the inputs needed to store and process the data will create an extra workload for staff and particularly for field officers. In this respect, three possible major bottlenecks to the successful implementation of a monitoring system can be identified. First, the willingness of staff to fill out data. When monitoring appears to be a low priority, data simply may be not filled out or are filled out superficially. Secondly, the willingness of staff to probe for correct answers. Often, the first answers to many questions are not correct. Getting a correct answer requires extra efforts from the field officer. The importance of reliable monitoring data should have been explained very clearly to staff. Thirdly, the ability and willingness of staff to accurately process the data in monthly statistical summaries. In this respect, difficulties might especially arise in those cases where the SFI already is operating for a long time and the staff never has been accustomed to collect monitoring data. Generally, there is a great need for further elaboration of monitoring and evaluation indicators, testing, and training of the staff in this regard, before comprehensive results can be expected (Otero, 1989). It should be emphasized that the regular participation of staff in the monitoring process will create an important learning potential inherent to monitoring and evaluation.

Clearly, *the client* plays an important role in data collection particularly with business monitoring. An entrepreneur must understand that business monitoring is a continuous surveillance of the business to ensure that performance is according to plan. It gives the entrepreneur the opportunity to take timely corrective action in the case of shortfalls in his or her business. Business monitoring is not a single activity only to be undertaken when problems arise, but has to be included in his or her daily management of the business.

The entrepreneur can facilitate business monitoring by collecting the relevant information of business and loan performance and providing this information to the field officer in a timely manner. In this way, delays are avoided which facilitates timely reaction to possibly shortcomings in the business. The entrepreneur needs to understand that he or she is ultimately responsible for decisions affecting the business. The field officer can only advise and give recommendations. The entrepreneur should not expect the field officer to provide the solutions and to be fully involved in the implementation of the recommendations. Finally, the entrepreneur needs to have a fair understanding of the business environment. In this way he or she can adapt his business to the changes which are taking place and the impact the community may have on the business. This knowledge will facilitate the entrepreneur's ability and readiness to accept recommended operational changes of the business. The entrepreneur needs to realize that changes are inevitable if the environment on which decisions were originally based, alters.

Participatory techniques in data collection, based on informal, periodic meetings guided by open-ended questions, will surface effect and impact information. For example, some SFIs which work with solidarity and self-help groups transfer the responsibility for data collection to the groups. Other institutions have facilitated the formation of associations that assume some of the field staff's responsibility, thereby enabling the institution to serve more borrowers and the field

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staff to spend more time as business consultants and less as loan officers. Although problems do exist regarding the reliability of this self-monitoring strategy, it will reduce costs, rationalize follow-up, improve information on which credit renewal is based, strengthen group cohesion, and serve as a pedagogical tool for the client, besides generating the necessary baseline data for evaluation purposes (Fisher, 1992). Besides in the monitoring process, clients can actively participate in the process of evaluation, often called participatory evaluation. Active involvement of the part of the clients is considered crucial, because the institution's continued success is based on the capacity to be responsive and flexible to the client's input in the evaluation process.

Outsiders can play a significant role in providing insights and analyses that reside outside the grasp of the staff. Their contributions may involve a more objective eye than the one solely produced by the implementing institution. An outsider is less likely to develop the necessary trust relationship with the client in a short period of time, and yet may have the expertise to supplement the information provided by the small entrepreneur with observation, carefully worded questions and secondary material. Time constraints and excessive costs advise against using an outsider to collect and analyse all data. Nevertheless, particularly in the case of evaluation some outside participation will be required as well. Without outside participation in evaluation, respondents may feel obliged to flatter project staff with overoptimistic assessments of business progress resulting from their support. SFI staff will likewise be tempted to inflate client response in order to appear more effective (Hagglade, 1992). In the case of evaluation studies, it may be that the most suitable manner of assuring reliability of data is by combining local persons, preferably SFI staff, with an outside evaluation expert, with each assuming those functions that they can best perform in the most cost-efficient manner (Otero, 1989). Often, an outsider can help identify strengths and weaknesses with greater clarity than anyone who is directly involved in SFI activities.

5.4 Reporting

After information has been collected it must be compiled and summarised in reports, in such a way that it can easily be analysed by the users in order to formulate conclusions and recommendations. The monitoring officer must ensure that the information is not affected in any form in the process of compiling and summarizing data in reports. Reporting must be systematic and consistent.

In what form is the information presented?

An SFI needs frequent monitoring reports as managing tools to assess the overall progress of its financial activities. Standardized forms have to be developed so that information can easily be processed. The SFI has to decide whether reporting has to be in written or verbal form, what type of report will be required, which staffmembers have to meet report requirements, and the frequency of the reports. The institution should be careful not to produce large quantities of information which is not really used and only absorbs time and raises costs. Each SFI has to decide on the type of reports best suited to its operations and the minimum level of reporting needed to effectively manage its activities. Reports must be useful and necessary and the information produced should be easy to handle and analyse. The following types of reports can be distinguished for the SFI:

First, the monitoring system should provide *reports that help the loan officers manage their portfolios*. The reports should permit timely follow-up and monitoring of loans. An SFI should be able to access instantly a client's entire credit history with the institution. This information should include the dates, principal amounts, classification of payments received on prior loans to data, and an indication of the creditworthiness of the client. The monitoring system must be capable of tracking individual loan performance. Reports for the field staff, listing current portfolios, loan and repayment due dates, and individual loan performance for each of their clients should be produced on either a daily or weekly basis depending on the urgency of the response required. The less time that field staff must spend figuring out whose payments are due when, and whose are already late and by how much, the more time they can spend with borrowers. A combination of good and timely reports enables a field officer to manage large numbers of borrowers and minimize delinquency (Stearns, 1991).

Secondly, the monitoring officer should be provided with tools for analysis of the overall

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portfolio of the SFI. *Reports on the overall quality and structure of the portfolio* should be produced at least on a monthly basis so that problems can be identified and dealt with promptly. Information about levels and actual status of late repayments, amounts disbursed and recovered, the current portfolio, and numbers of active clients are critical for management. This information should appear in summary form and be desegregated in categories, like for example field staff, region or branch office, or other relevant criteria that management needs to evaluate. The system should be designed in such a way that the monthly reports are already addressed to the various managers as well as to the staff who provided the information in the first place. In this way, they can quickly see what has been done with the information and correct this if necessary. It may be recommended to work with self-duplicating forms to reduce administrative work as much as possible. Monitoring staff has to make sure that information is useful to the users. The monitoring staff should understand the meaning of the reports and receive feedback on their reports from the users.

Thirdly, *reports on savings behaviour* of the clients are required to control deposits and withdrawals of the client's savings account and to avoid solvency problems. These reports should at least contain the amount of savings mobilized and number of depositors including an analysis of the seasonality of the savings deposited. Based on the savings reports an SFI should determine the extent of its term transformation and the amount of liquid reserves it wants to maintain.

Fourth, preferably every month, but depending on the size and situation of activities, a *comprehensive report covering all aspects of the financial services* could be generated, comparing projections for a specific period. These monthly reports could include information on the financial performance of the SFI, such as: financial health indicators, sources and uses of funds, self-sufficiency indicators, portfolio quality indicators, analysis of the cost structure of the financial services, but also up-dates on commercial interest rates of loans and deposits and inflation rates. In the same report, more client related indicators can be included, such as: number of clients identified, number of loans approved, by category and condition, number of late repayments, number of loans rescheduled during the quarter, output achieved, and improvements identified and implemented.

Fifth, a *summary report* of the above mentioned comprehensive monthly reports could be prepared for discussion during quarterly management and staff meetings. During these meetings, recommendations can be made to adjust the activities or take corrective measures where necessary. Furthermore, based on the monitoring reports it can be decided that certain aspects might require a more in-depth evaluation study before actual adjustments are made.

Sixth, The SFI's financial service delivery can be evaluated thoroughly on an annual basis. The *annual evaluation report* could indicate certain changes within the community and the economic scene that may affect the financial services negatively or perhaps create new opportunities for the SFI. The annual review can provide a brief assessment of the economic situation in the country and region, including an analysis of the actual situation and prospects of delivering financial services to the MSE sector. These evaluations could suggest changes for the SFI such as an extension of its outreach to new areas or new client group.

Finally, a sample of clients could be surveyed once a year. Besides the normal economic characteristics the *survey* can determine the adequacy of the credit manual, the use of character assessment and other policies used by the SFI in assessing the prospect of the businesses. Practical guides on how to conduct a baseline survey of MSEs may help the SFI to determine whether a baseline survey is really what they need (McPherson, 1992; Nichols, 1991).

Besides for internal reporting, the SFI may also need to report on its activities to other institutions, such as partner banks, government agencies or donor institutions. In those cases, the SFI should try to establish a single reporting system that will satisfy both internal and external needs. Preparing reports on different formats for each partner institution will absorb time and raise costs for the institution.

5.5 Analysis

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An important task of the monitoring staff is to analyse the performance reports of the businesses, institution and community environment. It should analyse the collected information to assess whether and how the financial services are delivered; determine delays and constraints which require redressing; review new and previously unforeseen developments and opportunities in relation to objectives and strategies for the SFI; and, provide feedback on the status of performance to management. A first step in data analysis is not to examine the numbers themselves but to choose the analytical framework within which the data are to be analysed. Within the analytical framework the rate, direction, nature and amount of change have to be assessed. After answering the question what the changes have been, the more fundamental question of what has caused the change has to be answered. The most critical part of this process is the formulation of relevant questions that have to be dealt with. Monitoring and evaluation should provide data that reveal causal relationships between underlying assumptions and indicators on the one side, and the realization of objectives on the other hand. Often SFIs record that change has occurred, but the more difficult analysis of whether or not this change can be linked to its financial services is not made. The analyst should check the validity of the main propositions formed at the beginning of the analysis.

The methods of analysis must be geared to the quality of the data on hand and have to satisfy the users of the information. In the case of data analysis the monitoring officer should bear in mind the following principles:

- ! *Try to avoid separating data analysis from its theoretical framework.* Indicators used in the monitoring reports should be defined clearly and explicitly to avoid misunderstandings. For example, it should be clear to all parties involved which of the various indicators for measuring self-sufficiency is used, or how the repayment rate is defined by the institution.
- ! *Try to avoid observing single aspects in isolation.* It is more important to obtain an approximate idea of how different aspects relate to each other in the overall context, than just obtain very detailed knowledge of individual aspects without being able to recognize how they fit into the overall picture.
- ! *Try to avoid basing analyses only on averages.* Statistical averages are usually insufficient and even misleading for monitoring performance, because these averages do not provide any information on how the values observed are actually distributed over different variables. For example, an SFI should be able to differentiate delinquency by age of arrears, loan officer and geographic location of entrepreneur, size of loan and repayment terms, activity of entrepreneur, purpose of loan, gender, and number of repeat loan.

The quality of analysis depends on a whole set of factors. A crucial factor to consider is the person who is responsible for analysing and interpreting the monitoring data. Important in this respect is also the quality of the data collected by field staff. It is still not uncommon to find institutions that rely on annual evaluations to gather all the data used for performance analysis. The degree of staff participation in data collection also directly affect the depth of the analysis attained. Finally, the quality and range of analysis can be improved if computer capacity is available for data processing and analysis.

5.6 Assessment and interpretation

Good management requires continuous and regular review of performance and tendencies that enables the institution to identify its strengths, weaknesses, opportunities and threats. These reviews should facilitate the institution to make the necessary adjustments for obtaining the desired results and impacts. The information transmitted to management is generally interpreted by comparing the actual performance with the initial set or updated targets. Depending on the problems or opportunities identified, management has to assess the effects these will have on each activity and then decide whether any corrective action has to be taken. Similarly, the causes for the differences between actual performance and set targets have to be analysed. This again should be decision-oriented: only situations relevant to future decision-making should be analysed.

The responses of people, such as staff and clients, or institutions which are affected by the problem or opportunity should be incorporated in the process of assessment and interpretation. Usually, this will take the form of a qualitative description or individual observation because comprehensive statistical surveys are often too costly. Teamwork is in all cases

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advisable to assess information and interpret causes. Persons who are directly affected must be involved in the process of assessment and interpretation of data, such as SFI staff, borrowers, or perhaps staff of other institutions.

Slight deviations between actual and planned situation do not automatically mean that results are optimum. Planning may not be correct because of insufficient information, lacking knowledge of interrelations, or inappropriate assumptions. Alternatively, information may be incorrect, distorted or incomplete. In both cases a comparison of the planned and actual situation will not allow for meaningful conclusions.

If information is not used to improve the delivery of the financial services, time and money have been wasted. Unfortunately this sometimes happen. Therefore, both at the design and implementation phase of activities, effective communication between SFI staff, clients and partner organizations is essential. Particularly, the SFI should try to avoid that evaluation results will not "disappear" in files. Instead, these results should form the basis for a dialogue for better mutual understanding, improvement and policy formulation.

5.7 Decision-making and action plan

When problems or opportunities are identified, the first step is to decide whether corrective action has to be taken. This may depend on the type of activities involved and the importance of the problems or opportunities identified. Alternative actions or changes in the internal workplan or operational plan should always be discussed within the management team. External resource persons, who can provide important knowledge and experience for such discussions, can also be included. Based on these discussions management can decide that appropriate action will be needed. Should there be evidence that changes have taken place in important areas but no accurate information is available, the SFI can decide for an in-depth evaluation study.

If agreement is reached to take action to solve a problem or to take advantage of an opportunity management should decide on the type of action which best matches the situation given the circumstances. In this stage a list of possible actions should be generated, followed by a selection of the most appropriate one. The SFI should determine which actions best address the issues at hand given the resources available. If money, time and equipment are insufficient than the type of action is not feasible. The SFI should also assess the staff's acceptance of the actions to be taken. If staff has been actively involved in developing a solution they are more likely to support it.

After the type of action has been selected, a plan of action must be determined to understand how the solution is to be implemented. This plan should set clear measurable goals and appropriate strategies, list the key tasks which must be performed, set a clear timetable, and describe how to monitor the action. After the selected action has been implemented, staff follows up to assess whether the action has been effective in addressing the problem cause or opportunity constraint. If it comes out that the action has not been effective, staff may have to work back through the problem solving or opportunity identification process to establish where the deficiency lies, so that appropriate revisions can be taken. The failure of a chosen action could result from the fact that the constraint or opportunity was not defined correctly, the correct causes or constraints were not identified, the wrong action was selected or the action was not implemented correctly.

5.8 The field officer

Field officers such as loan officers and extension officers are key actors in the monitoring process. Especially in business monitoring the field officer is a key person because he or she maintains the direct relationship with the client. Usually, field officers are responsible for initial screening of clients, completing the loan application process based on visits to the businesses and analysing the loan requests, participation in the final loan decision, carrying out loan monitoring and follow-up activities, providing business counselling to clients, and dealing with defaulted loans. Most of the field officer's time is spent in the field to keep the client's transaction costs low. In many ways field officers must be trainers able to provide business advice by understanding small entrepreneurs and their businesses. Equally, they should be well equipped

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with knowledge about local business norms and trends affecting the client group. The relationships that field officers establish with clients are essential for the success of an SFI. In order to ensure a reasonable degree of commitment and identification with the interest of the institution, the SFI might consider to pay the loan officer a (low) basic salary and a (high) performance bonus which can be a function of their individual loan volume, the number of loan contracts in their portfolio and their default rate.

It is in the direct interest of the institution and subsequently the field officer to ascertain the extent to which activities for which loans were issued are undertaken and to verify whether clients did reach the projected levels of repayment. Furthermore, the field officer should be consulted in the assessment whether the financial services were remunerative to the clients, their employees, and the community. Another essential task of the field officer which is of direct interest to the clients is to help them improve the profitability and performance of their businesses and explore opportunities for growth. Although it is the entrepreneur who is ultimately responsible for making decisions on his or her business, field officers may be able to help the entrepreneur by providing ongoing support as well as assistance with problem solving. To be effective in this role, field officers must have good skills in problem identification, problem analysis, and problem solving (READI, 1991).

The degree of involvement of a field officer depends on three major factors. First, the capability and experience of the client is an important factor. The more capable the client is in monitoring the business, the less the involvement of the field officer can be. Secondly, the seriousness or complexity of the situation is a determining factor. The more serious or complex the problem is, the higher probably the level of involvement by the field officer. Finally, the SFI's and subsequently the field officer's investment in the business is a decisive factor. The higher the loan amount disbursed to the client, the higher normally the level of involvement by the field officer.

Field officers work closely with entrepreneurs during the business monitoring process. The effectiveness of field officers depends to a great extent of their relationship with clients and the skills they possess. The officer-client relationship is a function of the way in which the two sides perceive each other. The expectation that clients have from a field officer can be summarized in the following way:

- ! Have fair knowledge and understanding of the client's business.
- ! Be really interested, that is beyond debt collection, in the success of the business.
- ! Solve problems and respond promptly to the client's call for assistance.
- ! Respect confidential information, without informing unauthorized persons including competitors.
- ! Provide not only constructive criticisms but also showing personal involvement in the implementation of the recommended solutions.

Basic skills of the field officer

Based on the expectations of the clients and the challenges field officers may face, there are some basic skills which the officers should possess in order to be effective in the performance of their monitoring duties. Depending on their perception of the problem and their assessment of the usefulness of the field officer, clients may not be cooperative and may regard the involvement of the officer as an interference. Among the basic skills an officer should possess, READI identifies communication skills, problem solving skills, information management skills, interviewing skills and consulting skills (READI, 1991).

(A) *Communication skills* (READI, 1991). During the monitoring activities officers communicate with clients to collect business performance data, and to solve problems that may arise. Communication skills refer to the ability of the officer to communicate clearly with the client, knowing what to say and why, how and when.

Preferably, field officers should possess intimate knowledge about his or her working area and are fluent in the most common languages spoken in that area. The officer should be capable to interact with clients in their own environments in order to explain the financial services correctly and adequately, to educate the entrepreneurs on certain financial concepts, and to stimulate

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creative thinking and participation among them.

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It is essential at all times to ensure that the means of communication are clear and concise because communication can often be misunderstood. The following aspects may be taken into consideration by the field officer: using simple, clear and concise words; avoiding complex explanations which may confuse; being sensitive to the receivers feelings; taking time for the client and weighing up the receivers ability to comprehend. Additionally, when addressing groups of people it is important to use an appropriate volume of speech based on the surroundings; maintaining continuous interaction with the group, for example by asking frequent questions; and, if available, making use of slides, flipcharts and other useful tools to increase understanding of the group (Rural Finance Facility, 1993).

Field officers should try to pay careful attention to what is said at meetings with clients as this will assist them in understanding the constraints and opportunities of the businesses. The following aspects may be taken into consideration (Rural Finance Facility, 1993):

- ! The mind should be clear and tuned to the speaker.
- ! Thought is faster than speech, so use the spare time to assess the communication. For example: are facts being presented? Is the speaker sincere? are there gaps? Is there a personal bias?
- ! Do not interrupt the speaker, make notes and ask your question when he or she has finished speaking.
- ! Do not allow yourself to be distracted.
- ! Do not criticise the speaker in public.

(B) *Problem solving skills* (READI, 1991). When a client needs assistance from a field officer, the officer should be capable of assisting the entrepreneur in developing sound solutions:

- ! To identify the issue or problem, enabling the officer to distinguish symptoms from problems in order to address the right solution.
- ! To identify the causes of the problem, enabling the officer to make suggestions for workable solutions which are acceptable to the client and are implementable.
- ! To break down the causes into manageable components, in order not to generalize causes but to understand the various aspects of the causes.
- ! To identify alternative solutions and to select those relevant to the issue at hand.
- ! To evaluate the selected alternatives to determine their suitability in relation to the problems. This calls for skills to assess the various consequences of each alternative.
- ! To decide and choose a good solution. It is one of the tasks of the officer to influence the choice of workable solutions.

A set of guidelines for how to deal with delinquency is annexed (see Annex C). In working with clients, field officers may need to have the following key qualities: self reliance, psychological maturity, objectivity, honesty, respect commitment, confidentiality, and maintain positive criticism. For loan officers other qualifications can be added, such as: discipline, street smart and business sense, energetic and motivated, very informed (networker), tough and creative (Rural Finance Facility, 1993).

(C) *Information management skills* (READI, 1991). Information is vital in monitoring as it provides the basis upon which actual results are compared with planned outputs. Therefore, the field officer requires skills in information gathering, analysis, interpretation and usage. The officer should know the information required; the purpose of the information; where and how to collect information; how to present information; how to interpret the information; and, how to use the information.

Field officers should be capable of producing clear concise reports and preparing a consolidated weekly time sheet for the institution. They must ensure that all clients sign all required documentation and that application forms are correctly completed. Similarly, the field officer must ensure that all documentation required for monitoring purposes is correctly completed. Finally, they must secure on-time repayments and ensure the correct documentation of repayments. Field officer should be able to acquire information on delinquency quickly. If clients at any stage feel that the SFI does not know exactly whether they have paid or not, they will feel far less inclined to pay.

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- ! A change in the repayment pattern of a loan, e.g. payments in advance being allowed to fall back into delinquency; change in amounts deposited; creeping in of late payments.
- ! Direct observation during client visits, e.g. resistance to meeting a loan officer. This could indicate the client has difficulties in confronting or recognizing a problem.
- ! A change in the meeting pattern, in the case of solidarity or self-help group loans. If a group is no longer meeting regularly or attendance at meetings is falling off this may indicate that problems are developing. Field officers should regularly check attendance registers and minute books.
- ! Review of financial and operational information provided on the business. Officers must ensure that at all stages the entrepreneurs has up-to date information on repayments. Financial accountability needs to be continually enforced.
- ! Secondary information sources and "rumours" about the business.
- ! Signals brought up by the client.
- ! Announcements in the media or government publications.
- ! Questions related to clients, customers, and competition.

After signals have been identified, the client and the field officer must decide which of the signals will receive further attention. Questions addressing the issue of classification of signals include the following (READI, 1991):

- ! *Who identified the signal, the client or the field officer?* If the client identified the signal and brought it to the attention of the field officer, the client will probably be more eager to pursue the signal further than if it was brought up by the field officer. Thus signals identified by the client will generally have a higher priority than those identified by the field officer.
- ! *Is the client interested and engaged in pursuing the signal?* If the client does not seem to be very enthusiastic about pursuing the signal it may be difficult to get cooperation when doing additional work on the signal. Thus, highest priority would generally be given to those signals that receive the highest interest of the client.
- ! *Are there resources available to do the additional work?* There may be signals worth pursuing but if the resources such as field officer's and client's time, money, and information, are not available then it may not be feasible to pursue the signal further.
- ! *What is the field officer's interest in the project?* A field officer working for a financial institution will generally have a different type of interest in his clients than the field officer working with a business advisory institution. A loan officer has the responsibility to protect the institution's investments. Thus the loan officer may feel it necessary to pursue signals which would otherwise have a low priority.

(B) *Problem and opportunity identification stage* (READI, 1991). Before solving a problem or taking advantage of an opportunity it must be clearly defined. Similarly, the causes behind a problem or the constraints to an opportunity must be well identified. In this stage the field officer must gather more information and analyse the signals which deserve the highest priority. There are a number of business information analysis tools which can be used to assist the field officer with this task. General tools such as a cause and effect diagram and a pareto analysis; production information tools, such as production flow charts and routing diagram; financial information tools, such as financial ratio analysis, funds flow analysis, cash flow analysis and break even analysis; and, marketing information tools, such as channels of distribution chart and positioning map, are discussed in various industrial extension manuals (see for example: Technonet Asia, 1985).

(C) *Solution stage* (READI, 1991). In this stage a list of possible solutions should be generated, followed by a selection of the most appropriate solution. Each solution must be judged on the impact it could have on the business. Aspects to consider when selecting a solution would include:

- ! Assessment of what is expected to be achieved. Is there agreement on the issues which must be addressed? will the solution being reviewed adequately address these issues?
- ! Compare the resources required and available such as money, time, and materials for carrying out each of the solutions. If the resources are insufficient, than the solution is not feasible.
- ! Determine which solution best addresses the issues at hand given available resources.
- ! Assess the client's acceptance of the solution. If clients have been actively involved in developing a solution they are more likely to support it.
- ! Select the solution which best matches the situation given the circumstances.

(D) *Implementation stage* (READI, 1991). After a solution has been selected, a plan of action must be determined to understand how the solution is to be implemented. This plan should include all of the required inputs, such as money, time, materials, personnel and machinery. In general the field officer will not be too actively involved in this stage as the client takes on primary responsibility for implementation of the chosen solution. The involvement of the field officer may vary depending on the capability of the client, the seriousness and complexity of the problem, and the field officer's or institutional interest in the business.

(E) *Follow up stage* (READI, 1991). After the implementation of the selected solution, the field officer follows up to assess whether the solution has been effective in addressing the problem cause or opportunity constraint. If it comes out that the solution has not been effective, the field officer and the client may have to work back through the problem solving or opportunity identification process to establish where the deficiency lies, so that appropriate revisions can be taken. The failure of a chosen solution could result from the fact that the problem or opportunity was not defined correctly, the correct causes or constraints were not identified, the wrong solution was selected or the solution was not implemented correctly.

5.9 The monitoring officer

The building of a monitoring system is centred around the monitoring officer. A monitoring officer is responsible for identifying information needed by the institution, developing and managing data collection, analysing of collected data, and reporting to management with conclusions and recommendations. In the case of SFIs operating with several offices, the monitoring officer could also function as a mobile coordinator and communication channel between central office and the branches. Through these field visits the danger is also averted that the central office is losing touch with what is really happening in the field. In practice, most SFIs do not need a separate monitoring and evaluation unit staffed with extra personnel and a data collection team. Depending on the size of the institution and its operations, most of this work can be done by a single monitoring officer on a part-time or full-time basis in collaboration with the loan officers and their supervisors in the field.

When it is felt that a separate monitoring and evaluation unit is necessary, it should:

- ! *Be kept as small as possible.* Only relevant information should be kept and stored.

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- ! Provide services for all relevant working units dealing with the financial services, and not only for management. Staff should not work as supervisors but provide services to other people in the SFI.
- ! Not evaluate on its own the information on performance, but together with other working units.

Planning the work programme of the monitoring officer

The process of establishing objectives and indicators is an essential *first step* in designing a management-oriented monitoring system. It differs from the customary approach, which takes for granted that the first job of the monitoring officer is to "do a baseline survey" or "measure impact". Unless it can be made clear that there is a clear demand for such information, the monitoring officer is wasting time and institutional resources.

Initially, an appointed monitoring officer will be involved in promoting monitoring and evaluation activities in the institution. The officer must convince his colleagues in the institution that a well-conceived monitoring system will help them manage their operations more effectively and that the process of defining a unit's work programme helps them to clarify their role in the operational context.

Having classified these objectives, the management advised by the monitoring officer then need to select an appropriate indicator or set of indicators to measure the extent to which these objectives are met. The indicators may be measured numerically, for example in the case of measuring the outreach of the financial services by the number of credits disbursed. Alternatively, they may equally well be stated in terms of problems to be overcome, such as improved access to credit and savings for MSEs. Generally the number of indicators should be kept small.

Having identified suitable indicators, management and staff then set targets. The targets should be statements of results to be achieved and should ideally reflect all the objectives that have been identified. This is more difficult than it at first appears, and it is often only possible to set realistic targets after some experience is gained. To begin with, it is advisable to select only a small number of targets until staff become more confident. The targets must be measurable and verifiable. Often, a number of targets is set when the monitoring activities are designated. They usually include number of loans disbursed to and savings mobilized of small entrepreneurs or increase in geographical regions covered by the SFI. These targets can provide a good starting point often used to justify creation of the monitoring system. As the delivery of financial services is progressing, the situation changes and new factors enter into play causing management to review or add new targets. The setting of targets is, therefore, an on-going process which will involve reviews and updates at least on an annual basis.

Next, the monitoring officer should develop and discuss with the various technical officers, such as field supervisors and loan officers, a monitoring plan which will satisfy information needs at all levels. In addition to individual meetings, a brief workshop at the start of the monitoring activities is strongly advised to enable the monitoring officer and the technical officers to jointly ascertain:

- ! What are the objectives of each unit and officer within the context of the financial activities (quantified whenever possible);
- ! What would be suitable indicators to monitor progress toward achieving these objectives over time; and
- ! Who should be responsible for measuring the indicators, who will analyse the results, to whom will the findings be distributed, and when.

A *second step* in the work of the monitoring officer is to verify, summarise and disseminate the information flows from SFI staff and other institutions, and analyse the administrative files and records of the institution. The monitoring system is best established from the bottom up, starting with input monitoring. The main sources of information at this level are internal SFI reports, such as loan application reports, financial reports, progress reports, staffing and equipment summaries. It is sometimes thought that these reports are not part of the monitoring activities, when in fact they are the very first element to be put in place. At the next level in the hierarchy of objectives, the monitoring system keeps track of whether the inputs, once in place, are

effectively combined to provide the desired output, i.e. an efficient delivery of financial services. At this level, efficiency criteria have to be formulated.

As a *third step* the monitoring officer collects and analyses client data to supplement the available records and reports. Most of the information related to the client and their businesses is coming from the field staff's own monthly reports. Such reporting, once established does not need the intervention of the monitoring officer, except to combine the reports of the individual technical units into a consolidated report.

The *fourth step* is to identify problems encountered by the institution and conduct diagnostic studies bearing on these problems. Here, where the short term objectives is concerned and the relationship between the SFI's financial services and clients is to be monitored, the monitoring comes into its own. This is where the heart lies of the monitoring activities. Based on the information obtained through the follow-up visits, the monitoring officer assisted by the field officers is to take periodic soundings of the clients the institution and the community environment. They should observe whether and why changes do occur. The role of the monitoring officer refers the following three aspects:

- ! The monitoring officer should assess whether the intended client group is reached. Although an SFI might be very efficient, it has failed if it is not effective in reaching the type of clients it was aimed to serve.
- ! The monitoring officer focuses on the review of the quality of the SFI's financial decision making. First, the officer is to ascertain the extent to which the activities for which loans were issued are undertaken. Second, the officer is to verify whether clients did reach the projected levels of repayment. Third, the officer is to identify and contrast the characteristics of good payers and of defaulters, and of good loans and bad loans. The information should permit an assessment of the thoroughness and quality of the credit and savings services, including the institutional effectiveness in dealing with risk. Finally, the officer is to facilitate refinement of credit and savings criteria and product design.
- ! The monitoring officer is involved in the assessment whether the financial services were remunerative to the clients, their employees, and the community. The assessment should verify whether the social and economic situation of the businesses and community has been improved. Similarly, the officer should make assessments of the quality of the services of the SFI and their institutional setting. Furthermore, The monitoring officer must indicate what type of external factors may influence the SFI or its clients, and what their effects and impacts are.

Finally, in the *fifth step* the officer is to maintain in a retrievable format the various data series over time to facilitate later evaluations. At the same time, the monitoring officer must prepare formats that highlight the findings of various analyses and present a range of logical options which is required for adequate decision-making by management.

Presentation and communication

One of the main weaknesses of monitoring systems has been the lack of effective and timely communication of information to their users. A monitoring staff often invests much time and many resources to gather potentially relevant data. However, they also frequently fail to interpret and present the data in a form that will transmit their meaning to management. In these cases the monitoring staff may simple give interested parties a bulky laboriously prepared report which conceals rather than reveals its main message. As indicated, monitoring reports are needed on time and they should be concise, logical, comprehensive and contain recommendations. The following guidelines may help the monitoring officer in preparing reports (Frerks, 1990; Casley and Kumar, 1987; Rural Finance Facility, 1993):

- ! *Clarify the aim of the report.* Ascertain from management what they require in reports and ensure that what you are trying to transmit is what they actually need to be adequately informed or to formulate a decision.
- ! *Collect the information.* Observations and discussions are the main procedures for determining sources of information and obtaining the detail for analysis and presentation.
- ! *Prepare a suitable framework.* A suitable outline should be prepared before starting a

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- report. Try to reduce the mass of detail into clearly labelled and simple tables, and accompany tables invariably by explanatory text.
- ! *Collate the report.* The report can best be written under the following headings in this sequence: the subject or title, introduction, findings, conclusions and recommendations. When reports are extensive, start with an executive summary giving only the essential facts and recommendations for decision-making. Pay adequate attention to recommendations, preferably by identifying alternative courses of action. Credibility of findings is important. The likely accuracy of findings should always be indicated. In case findings run against current views or assumptions, they should be based on solid evidence. Unwelcome messages tend to be disbelieved or ignored. Try to be clear and brief.
- ! *Design presentations* specially for the targeted audience. Verbal communication is often more effective and efficient than written communication. The larger the "distance" from the SFI the less details and technical aspects are required. Instead the report should present main conclusions and options for decision-making. Presentations should always be timely. It may even be decided to present only part of the information or a summary if the main report could not be ready before the decisions are to be made. In case important new or unexpected findings are detected, reporting should be immediate, irrespective of the routine schedule.

Organizational aspects

The place, role and loyalties of a monitoring unit must be clear and righteous to SFI staff. It should not be seen as a shapeless data collection body set up to service a wide range of unspecified information needs for unidentified users. Ineffective performance by monitoring units is often the result of a lack of clear task setting which should have been established at the time of its creation. In some institutions, a monitoring officer is closely associated with the planning function and is given responsibilities for preparing new projects or writing project completion reports. While these are very valid functions, staff heavily involved in planning activities often may lack time, inclination or resources to contribute to the daily information needs of management.

To facilitate the monitoring process a system of time keeping can be used whereby time utilized for each and every task undertaken by staff members is recorded on time sheets. At the end of each month copies of the time sheet have to be handed to the monitoring staff for recording. The keeping of these time sheets is not a means of hindering or policing personnel but it should rather be looked upon as (Rural Finance Facility, 1993):

- ! The means of enabling the monitoring officer to assess how much time staff is spending on various aspects of their job.
- ! A means of identifying areas where field staff may be spending too much time, such as follow-up activities with particular entrepreneurs.
- ! A means of assisting staff in obtaining the optimum usage of their time.

Difficulties have also resulted from the lack of adequate differentiation between distinctive but overlapping functions of monitoring, supervision, and collection of statistics. The monitoring officer finds himself in the unsatisfactory position of having to define his own role. This task can bring him or her into conflict with other operational units, that is the very units it is supposed to be helping. At best, these units and especially the extension and the adaptive research staff, may treat the monitoring officer as someone having a rather irrelevant storage for historic statistics and reports of no direct use to them. Therefore, it is essential to clarify which monitoring and evaluation data and studies are intended to support staffmembers in their work and which for example are used for determining staff incentives. Every effort should be made to make the collection and use of monitoring and evaluation data as non-threatening as possible to staff (Frerks, et al., 1990). Staff should be kept informed as to what data is to be collected and how it will be used. Staff should be given the opportunity to review and comment on data and studies before they are finalized. If staff are involved in the design of studies and if they have the opportunity to comment on the results, they are much likely to cooperate in the design and implementation. Monitoring and evaluation should be based on a mutually agreed participatory approach by including all parties involved, be it that responsibilities in monitoring and evaluation have to be distinguished clearly. In both exercises one should try to build up the trust needed to carry out such activities. It is most desirable that the different levels of the management take a keen personal interest in the monitoring by asking questions, raising issues and giving feedback to information reported. They should encourage an open and objective attitude even when monitoring indicates failures or strikes a critical note.

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Conclusions

The objective dealt with in this guide, is to provide a systematic framework of questions and indicators for the building of a monitoring system. The monitoring system is to ensure a continual supply of reliable basic data and information at all levels relevant to the institution. Progress monitoring, effect monitoring, impact evaluation and occasional research are activities which all need to be considered by SFIs delivering credit and savings services. An SFI may improve its performance by building an information system on these concepts, at the same time focusing at the level of the clients, the institution and the community. The information provided by the monitoring system should ultimately lead to increased productivity, reduced operational costs and more effective client services.

Particularly, it is felt that SFIs need to pay more attention to their financial and operational performance. Institutional weaknesses are becoming manifest in their management capacity, the understanding of business concepts, defining client groups, self-assessment, integration of small enterprise support with other development work, and a lack of attention to the economic environment. Only by operating a well-functioning monitoring system an institution will be able to make a start in reducing these weaknesses. The monitoring system can contribute to an overall improvement of the SFI's technical, administrative, and business know-how so that they can provide well-organized and effective services to small entrepreneurs. While it is often felt that monitoring systems are too economic, delivering financial services is in fact a very economic matter. By including effect monitoring and impact evaluation, however, the monitoring system is also paying attention to the broader social and political issues of interest to the institution. Still, SFIs have little guidance to determine what levels of performance may be considered as standard. Clearly, a need exists for developing local standards for these type of institutions active in providing on-going and sustainable financial services to the poor.

Besides their financial and operational performance, SFIs should not loose sight of their economic and political environment. It is broadly recognized that changes in the financial market development and government policies are key indicators in assessing an SFI's success. In the end, this success is not measured by the number of loans that has been made or the amount of dollars that have reached the pockets of poor entrepreneurs, but by the number of entrepreneurs that have gained permanent access to more formal credit and savings services. Funding agencies and development institutions cannot solve many problems directly, but can help create the conditions under which financial institutions become more interested in small entrepreneurs. Increased attention of financial institutions can lead to improved permanent access to formal financial services for these groups. It is hoped that this guide will increase the awareness among people of the requirements and consequences it takes of operating in the financial marketplace.

Unfortunately, few SFIs are carefully monitoring their efforts. At best, monitoring and evaluation practices consist of a few midterm and end-of-project studies, leaving critical and valuable information for improvement often buried in office files. This absence of monitoring and evaluation may stem from limited financial resources, the perceived high cost of a monitoring system, and concern that outcomes will be unflattering. To overcome these constraints, ways should be explored of integrating monitoring and evaluation into continual staff activities and streamlining data requirements wherever possible.

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Staff participation in the monitoring and evaluation activities is considered crucial to successful implementation. SFI staff need to collect, process, and present data on their operations and the people they try to reach. It has been emphasized that monitoring and evaluation results can be used by the institution both to understand and to improve the financial services. The challenge is to utilize these systems and to begin producing data and analysis that can enable institutions to understand better the relationship between their financial services and clients.

Based on the guidelines presented the SFI may decide to formulate an action plan and timetable in order to set up or improve its monitoring system. This first start could include the setting of some clear measurable goals with appropriate strategies to achieve these goals; listing the key tasks which must be performed to enable the strategies to occur; setting a clear timetable for this action; and describing how to monitor, evaluate and feedback to form new strategies if needed. As the SFI continues to gain experience and grow, and as the context in which the SFI operates continues to change, the monitoring plan must be periodically revised to remain an effective management tool.

Drawing conclusions from the information produced by the monitoring system requires careful analysis if financial products and services, client groups or delivery techniques are to be changed effectively. Especially, one has to be careful not to interpret financial indicators in isolation. Insightful comments from outsiders and frequent discussions with SFI staff can help most institutions to improve their operations. Only in this way a monitoring system will enable the SFI to increase professionalism, provide better services to micro and small entrepreneurs and ultimately contribute to improved living and working conditions of the poor.

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Annexes

Annex A:

Criteria for SFIs delivering financial services

Small entrepreneurs need flexibility and discretion to respond to continually changing and often highly localized circumstances, and require permanent access to stable institutions capable of executing essential banking functions. SFIs should decide whether credit and savings services is really what the client group seeks, and whether the SFI itself can fulfil the requirements of providing financial services to the poor. This annex formulates a set of basic criteria for SFIs which should ensure an effective delivery of financial services to MSEs. In the case an SFI desires greater involvement in financial services, it might pay to think a little more like a banker by reducing costs and increasing efficiency. At least people within SFIs must seek to professionalize and to avoid wasting precious resources or upsetting functioning markets. They need to institutionalize the financial discipline that they seek to instill in their clients. The following example of criteria has been adopted from SATE, Community Based Enterprises, Jamaica, (1991).

The following set of criteria can be formulated for SFIs for delivering effective financial services to MSEs:

- ! **The SFI has a positive net worth;** that is, its total assets must exceed its total indebtedness. the SFI's net worth will define its borrowing capacity as total loan commitments and, in this case, will be limited to 2,5 times its net worth.
- ! **The SFI is well managed.** It must therefore have a qualified manager and qualified support staff. The job description of each member of staff must be clearly stated and there must be an institutional chart to define the inter-relationship among staff members. Overall, the SFI should have the management capability of outlining and implementing strategies to deal with any problem that may arise.
- ! **The SFI has the ability to mobilize savings and be able to return them when this is required by the client.** This ability is measured by the presence of a properly trained accounting staff and computerized support systems. This staff should have the ability to specify at any time the total amount of money deposited by the client.
- ! **The SFI has the ability to appraise loans.** The ability is measured by the number of officers trained in project appraisal including project documentation.
- ! **The SFI has the ability to properly supervise loans** not only to ensure implementation but to assist in the collection process. This ability is measured by the number of officers assigned to project supervision. An officer may provide both appraisal and supervisory functions or the function may be differentiated and assigned to specialists.
- ! **The SFI has the ability to collect loans** on a timely basis and to make remittances to funding institutions providing loans. This ability is measured by the presence of a properly trained accounting staff. This staff should have the ability to send out invoices on time, to monitor payments and to alert the field officers of problem cases.
- ! **The SFI has the ability of making periodic reports detailing the performance of its portfolio,** paying particular attention to the delinquency problem.
- ! **The SFI is establishing a reserve fund** for loans whose recovery is doubtful in an amount equivalent to 2% of the outstanding balance of its loan portfolio.
- ! **The SFI possesses the necessary physical facilities and equipment** to properly conduct its operations.

Annex B:

Credit risk management

SFIs are attracted to credit disbursement because they aim at supporting small entrepreneurs by using financial instruments. But often little attention is paid to the fact that disbursing credit also means creating debt for the ones who receive the loans (Adams and Von Pischke, 1992). Providing credit is equivalent to requesting the client groups to accept to engage in financial obligations. These financial obligations entail risks which clients may not have sufficiently considered or may even be unnecessary to take. For this reason, SFIs must develop borrower selection techniques that weed out entrepreneurs who will not be able or willing to repay their loans. This Annex describes the different aspects that are often considered by loan officers in selecting creditworthy small entrepreneurs. The Annex describes the assessment of credit risk based on the four C's and P.A.R.T.S. of credit. Loan officers often keep these aspects in mind and apply it in specific circumstances by addressing a set of questions on each of the relevant aspects. This Annex is based on FACET and MDF (1992) and Rural Finance Facility (1993).

1. The four C's of credit

There are four main considerations to be taken into account when considering a loan application of small entrepreneurs. These are Character, Capability, Capital and Conditions. Together these are known as the four C's of credit.

Character

The assessment of the Character of the entrepreneur deals with the following aspects:

- ! Integrity and honesty
- ! Temperament, courage, inflexibility, gambling, etc.
- ! Knowledge of human character
- ! Record as a borrower, if previously money is borrowed.

In microenterprise lending Character assessment is often the only means by which borrowers can be assessed. On the issue of Character, a loan officer needs to collect information on the following questions:

- 9 Can you trust this person to mean what he or she says, to do what he or she says and to deliver what he or she says? Has he or she done so in the past? Why do you think he or she will do so in the future?

Capability

The assessment of the Capability of the entrepreneur emphasizes the following aspects:

- ! Technical know-how on its own is not sufficient
- ! A borrower requires financial judgement as well as management ability.

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The borrower will probably have little experience in finance and management and this will entail a certain amount of training, for example regarding simple book-keeping, marketing and preparation of a cash-flow statement.

On the issue of Capability, a loan officer needs to collect information on the following questions:

- 9 Can he or she do the job? Is he or she able to organize and manage the business? And if he or she can't, could he or she employ someone who could or is additional training available to improve his capabilities? Has he or she proved to be able to do the job in the past? Can you assume he or she will continue to do so in the future?

Capital

Capital refers to the monetary backing which provides the measure of the amount which may be borrowed whilst Character and Capability earn the right to credit.

In those cases where little Capital is available, Character and Capability will be the main yardstick by which we may measure the amount that may be borrowed.

On the issue of Capital, a loan officer needs to collect information based on the following questions:

- 9 What is the entrepreneur putting into the business? How much finance is he or she providing? What knowledge, experience, technical expertise, and goodwill is he or she putting into the business? Does he or she have the concept or idea? Can he or she deliver the right people to work with him? In other words, what is his commitment?
- 9 Who else is involved in financing the business? Has the borrower tried elsewhere? If other sources are more appropriate, why has he or she not tried to get funding there (or why has he or she not been successful)? Are we the right source of funding for this business?

Conditions

The assessment of the Conditions of the entrepreneur deals with the following aspects:

- 9 Technical conditions: has the borrower sufficient expertise to make a success?
- 9 Economic conditions: is there a demand within the entrepreneur's area to make the business viable?
- 9 Knowledge: does the entrepreneur have a thorough knowledge of (sub)sector, locality and clientele?

2. The P.A.R.T.S. of credit

So much for the big four C's. If we have them sorted out, then we can begin to work on the rest, the details, or P.A.R.T.S. of credit:

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P = Purpose

9 What does he or she really want the money for? Exactly?

A = Amount

9 What does he or she really need to borrow? (Remember, people often underestimate what they really need and get into trouble later on when the cash flow turns negative). What will he or she do if?

R = Repayment

9 You want your money back from a profitable business, when is that going to happen? How is that going to happen?

T = Terms

9 Specifically, what is he or she willing to do and what are you willing to do to close this loan? What is the basis for the loan agreement?

S = Security

9 Of course, we don't want anything to go wrong. But ... if it does, how is the SFI going to get its money back? What does the borrower put up against the loan (and is it really worth everything he/she says it is)?

Finally, remember that Collateral:

- ! Never makes a good loan
- ! Is no substitute for Character and Capacity; and
- ! It is a bad policy to make a loan if the only source of repayment is the sale of the Collateral.

In the micro and small enterprise sector the pledging of Collateral should be looked upon as a token of seriousness by the borrower.

3. Main considerations

In the assessment of the borrower the main considerations to be taken into account are:

- ! Can and will the borrower repay the loan?
- ! In principle the loan should be repaid from the normal course of business, i.e. earnings. It is important that the client makes the asset work which (s)he acquired with the loan, in order to be able to repay the loan. If not there would be reason to doubt the wisdom of the loan:

**Can the business generate sufficient cash
in order to meet its repayments?**

Annex C:

Delinquency management

Delinquency management refers to the ability of a financial institution to minimize the risks of late and non-payment and subsequently to maintain the quality of its portfolio high. The immediate objective of this Annex is to provide additional strategies and guidelines for SFIs to improve the quality and recovery of their loans. The overall objective of the guidelines is to protect SFI's portfolio thereby protecting the ability of the institution to continue to provide financial services to small entrepreneurs. The Annex is based on the materials developed by Katherine Stearns (1991b); Women's World Banking (1991); Rural Finance Facility (1993) for part 1, but particularly part 2A and 2B; and Graddy and Spencer (1990). The first part of the Annex addresses general strategies for delinquency management. In the second part more specific guidelines are provided for loan officers who have to deal with clients not able or willing to repay their loans.

1. Strategies for Delinquency Management

- ! *Establish a target level of acceptable delinquency based on a thorough understanding of the costs and effects of delinquency on the institution. New SFIs should create an image and philosophy that convinces staff and clients that delinquency is not acceptable. SFIs with existing delinquency problems should set realistic but demanding goals for progressively reducing delinquency to an acceptable level.*
- ! *Accept that most delinquency is caused not by bad borrowers, but by credit institutions that have not implemented an effective credit methodology. Develop borrower selection techniques that weed out entrepreneurs with bad intentions or bad reputations, and make sure that loan sizes and terms do not make repayment difficult. Entrepreneurs should receive an individual repayment plan as part of the loan contract with clearly specified due dates and amounts.*
- ! *Develop a portfolio information system that enables field workers to conduct effective and timely follow-up of loans and to manage their portfolios efficiently. Similarly, it must enable management to conduct timely and useful analysis of portfolio quality, determine trends in the portfolio over time, and identify possible causes of delinquency.*
- ! *The key to dealing with a problem loan, and preventing it from being a loss, is to take prompt action with accurate information. At the first sign of delinquency, immediately the SFI should determine the reason of not complying with the loan agreement and begin to put increased pressure on clients to repay. This can take the form of more frequent visits by the loan officer or the supervisor, or visits by a collection agent. Many institutions also send out warning letters to clients, requesting that they present themselves immediately to the office for payment and often threatening with legal action. It is important never to give the client a feeling that he or she is just one of many delinquent accounts, and to try eliciting some degree of cooperation from the client. The guidelines and procedures for handling problems should be established before lending operations begin, so that when the situation arises no time is wasted.*

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- ! *Develop a plan of action in cooperation with the borrower* to service the loan in the future. Reschedule loans if the situation warrants. If the loan officer determines that late payment is due to causes outside the control of the entrepreneur, it can be recommended that the loans be rescheduled. Loans should be rescheduled only when late payments are due to unexpected circumstances faced by the business. If loans are rescheduled when this remedy is not warranted, the SFI will simply be prolonging the time before the loan will be declared a loss.
- ! Ensure that, from the borrowers' perspective, the benefits of on-time repayment and costs of late repayment far outweigh the benefits of late repayment and costs of on-time repayments. *Include an incentive for timely repayment* in the interest rate calculation, for example by charging 10 percent of total interest paid back at the end of the lending period. Alternatively, a system can be established of penalties or higher interest rate for overdue payments. Penalties are normally calculated as an increase of the interest rate on the remaining balance for each month during which payments are in delinquency. At the same time, an incentive system may be established for staff that uses both financial and non-financial incentives to encourage on-time repayment.
- ! *Double the collection efforts.* Be firm but positive when making collections from the clients. Do not treat defaults on the first loan payment as a routine matter.
- ! *Initially avoid threatening statements* to the client. However, if the client does not respond to requests threaten to call on guarantors.
- ! If business performance is being affected by management or technical problems, the SFI can *provide assistance to the business* to correct the problems. Assistance might be provided by the loan officer as one-to-one counselling, the client can be required to participate in further SFI training programmes, or the SFI can refer the client to other institutions providing technical and management assistance.
- ! *Initiate legal action to seize collateral.* It is important that the SFI be serious about using the collateral and requesting guarantors to pay to cover delinquencies and defaults. If the SFI accepts collateral and co-signers, and then does not follow through by seizing and liquidating collateral or calling on co-signers, the SFI will lose credibility and gain the reputation of being "soft" on loan repayment.
- ! If the SFI has received authorization from clients to use their savings as collateral, it is important to actually *withdraw money from the clients' savings accounts* (if existing) to cover late payments.
- ! *Establish prudent loan loss reserve and write-off policies* that prepare the institutions for such write-offs. Ensure that income and assets are accurately reflected in the financial statements. At some point, collection efforts by either the SFI or another agent will no longer be cost-effective. Collection of bad debts can be costly and time-consuming for the SFI. The SFI is spending money to try to recover a loan. If it has not adequately covered the possibility of loan default through sufficient guarantees or savings, all efforts to recover a loan in delinquency may be in vain. When all means of recovery have been exhausted, the SFI needs to know when to accept losses, and write off irrecoverable loans.

Particularly with *group-based financial services* delinquency is a very delicate matter. When delinquency occurs it is crucial to take prompt action with accurate information. The success of a group lending model is based on the group's strong belief that repayment is important and on the effectiveness of peer pressure. Because no group member can receive a new loan until all have repaid their old loans, and all members are responsible for any member's defaults, pressure is exerted on late payers by borrowers who have repaid their loans and want new ones. However, when repayment begins to be perceived as unimportant, the group-based lending model "tilts". As their peers stop repaying, members perceive repayment as a foolish choice because they (1) will not receive more loans anyway, (2) will be held responsible for their peers' defaults regardless, (3) will lose access to the capital they currently have if they repay, and (4) will not be subject to the group's displeasure if they do not repay (since defaults are becoming the norm). Therefore, it is very important that the project is carefully set up, taking into account the

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17. If a decision cannot be made, consult your colleagues in the field or contact your loan supervisor.
18. Stick to your word even if you have to confess to your colleagues that you have overstepped the mark.
19. We make all mistakes on occasions. This is never held against you. In fact one can often learn a great deal through mistakes. However mistakes should not be hidden. Also it generally makes the problem bigger.
20. Do not take your problems home. As long as you did your best today this will not be necessary.
21. Do not discuss the affairs of one entrepreneur with another.
22. Do not hesitate to praise an entrepreneur if he or she has achieved something.
23. Do not get too involved in entrepreneur's personal or business affairs. Your function is that of lender and counsellor.
24. Keep appointments punctually. Ask entrepreneurs to make appointments for their convenience.
25. Maintain a better service than others, but do not overservice. The exceptions you create for one entrepreneur might lead to dissatisfaction with others.
26. Avoid the "take it or leave it" attitude, try to convince the entrepreneur what is best for him or her, in your opinion.

2B. Delinquency management: some general "Do's and Don'ts" in handling delinquency

"Do's"

1. Try to put a clear case to the credit committee.
2. Be honest with entrepreneurs and spell out arrangements clearly; limits, repayments and security arrangements as well as interest rates, should be clearly understood and agreed by all entrepreneurs.
3. Take a critical view of your reports and see how they can be improved.
4. Be a good listener. Let the entrepreneurs talk.
5. Remember that for some people it may be embarrassing to ask for a loan. Help them to feel at ease when they approach you.
6. Make a point of visiting the businesses of the entrepreneurs.
7. Get to know how their business functions, from whom they buy, to whom they sell.
8. Find out as much as possible about the businesses entrepreneurs are engaged in.
9. Remember management are there to help you and advise. Help them to be of assistance of you.

"Don'ts"

1. Don't interrupt entrepreneurs when they are stating their case.

2. Don't be discourteous, even when you have reason to doubt their statement.
3. Don't become too excited during discussions.
4. Don't pretend to know much and give wrong advice as a result. Try to be frank about the entrepreneurs' businesses.
5. Don't too proud to enlist the assistance of you colleagues.
6. Don't be ambiguous in your statements. Management must rely on what you say.
7. Don't hide behind management when a decision unfavourable to entrepreneurs must be given. Speak for all of the SFI.
8. Don't try to hide mistakes or important information about problems with businesses. Early and frank advice can save money and a lot of concern.
9. Don't make promises which are unable to be kept.

Annex D:

Formulating performance indicators, the case of Women's World Banking

This case emphasizes the importance of planning for the SFI, as well as the formulation of performance indicators for its programmes. They are used to increase the focus on key measures for achieving operating self-sufficiency, strategic alliances, and larger impact. They are also important funding vehicles, as they formulate a clear strategy with programme and financing plans for the SFI. The case is adapted from Women's World Banking.

Women's World Banking (WWB) is a global not-for-profit financial institution to advance and promote the full economic participation of women, and encompasses now a network of 47 affiliates in 36 countries of Africa, Asia, Latin America, Europe, and North America. This unique global network of affiliates dealing with enterprise development, credit, and economic participation of poor women, has served over the past 12 years more than 500,000 microenterprise clients, the vast majority being women who had no previous access to formal financial institutions. The WWB's network is strongly involved in building businesslike SFIs, delivering efficient microenterprise credit and savings operations, and building cost-effective training and technical assistance.

Each affiliate sets its objectives and means to maximize institutional strength and impact and related WWB inputs in Partnership Agreements and Action Programmes, using affiliate assessments and business plans as starting points. The Partnerships Agreements will be flexible, subject to modification based upon mutual agreement as situation evolve. The joint three-year Action Programmes will provide the basis for WWB's brokering, of affiliate capitalization, leveraged credit lines, and institutional development programmes.

The Partnerships Agreements and Action Programmes are used to increase the affiliates' focus on key measures for achieving operating self-sufficiency, strategic alliances, and major impact. They are also important funding vehicles, as they formulate a clear strategy with programme and financing plans for the SFI. The next table presents an outline of the targets, objectives and financial projections that are formulated by an WWB affiliate.

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Table: Partnership Agreements: Planning and Targeting SFI's Performance

<p>I. Institutional financial targets</p> <p><i>Capital base</i></p> <ol style="list-style-type: none"> 1. Percentage of growth in, and targeted size of, capital base 2. Expected sources of new capital: <ul style="list-style-type: none"> ! Percentage of local capital, such as membership fees, local fundraising, allocation of revenues) ! Percentage of external capital funding partners 3. Expected uses of capital: <ul style="list-style-type: none"> ! Percentage invested in financial instruments ! Percentage put at risk in lending programmes <p><i>Sustainability</i></p> <ol style="list-style-type: none"> 4. Percentage of self-sufficiency <ul style="list-style-type: none"> ! Operational self-sufficiency <ul style="list-style-type: none"> ! savings and credit training ! for overall institution ! Financial self-sufficiency <ul style="list-style-type: none"> ! savings and credit training ! for overall institution <p><i>Effectiveness</i></p> <ol style="list-style-type: none"> 5. Cost-effectiveness of credit service delivery: <ul style="list-style-type: none"> ! Cost per loan ! Cost per dollar lent ! Number of loans per loan officer ! Amounts lent per loan officer 6. Cost-effectiveness of training service delivery <ul style="list-style-type: none"> ! Cost per individual trained ! Number of clients per training officer 7. Number of permanent, paid staff <p><i>Revenue</i></p> <ol style="list-style-type: none"> 8. Expected/average interest rate to be charged on: <ul style="list-style-type: none"> ! First-time loans, and percentage of portfolio ! Repeat loans, and percentage of portfolio 9. Expected fee structure for services per programme 	<p>II. Institutional management targets</p> <ol style="list-style-type: none"> 1. Establish strategic and business plan for x number of years 2. Establish appropriate accounting system <p>III. Programme financial targets</p> <ol style="list-style-type: none"> 1. Total no. of persons receiving credit per year 2. Total no. of loans disbursed per year: <ul style="list-style-type: none"> ! Loans to new borrowers ! Loans to clients having received previous loans 3. Total amount of loans disbursed per year: <ul style="list-style-type: none"> ! Loans to new borrowers ! Loans to clients having received previous loans 4. Outstanding portfolio at end-of-year 5. Average terms of loans in months 6. Portfolio quality <ul style="list-style-type: none"> ! Repayment rate ! Portfolio at risk 7. Total no. of savings depositors received per year 8. Total amount of savings deposits received per year 9. Balance held in savings at end-of-year 10. Total number of individuals trained 11. Expected fee structure for services <p>III. SFI impact objectives, strategies, and targets for three years period.</p> <ol style="list-style-type: none"> 1. Client and broad impact objectives (for period or per year) 2. Client and broad impact strategies (for period or per year) 3. Client and broad impact targets (for period or per year), for example: <ul style="list-style-type: none"> ! Establish a client impact evaluation system ! Impact on government policies ! Impact on bank policies ! Joint action with other SFIs ! Hosting of participation in WWB programme <p>IV. SFI financial projections, 3 years period</p> <ol style="list-style-type: none"> 1. Profit and loss statement 2. Balance sheet and income statement 3. Financial profile
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Annex E:

General performance indicators of NGOs

This is an example of the criteria that can be formulated for evaluating the general performance of NGOs. In the Annex the overall performance of NGOs is rated by distinguishing three sets of criteria: service delivery, participation and empowerment, and the wider impacts of the organization. The measures are adapted from: Thomas F. Carroll, Intermediary NGOs, "The Supporting Link in Grassroots Development", Kumarian Press, 1992.

The formulated criteria reflect the main goals of the NGOs themselves, and could be seen as the evolutionary sequences in the development of NGOs. The dominant philosophy of the NGO community has undergone evolutionary changes. The early work of local development organizations was predominantly in the relief and welfare tradition, concerned with the supply of basic necessities, first social services and later economic help. This is presented by the first set of criteria: the delivering of development services to the poor, the isolated and the disadvantaged. NGO performance is measured as it is traditionally viewed, representing the more short-term dimension of performance. Concern with participation and empowerment followed, as is indicated by the second set of criteria that represents a more indirect and complex dimension of performance, reflecting the process-oriented approach. The third set of indicators, which looks at the wider impacts of the organization, grew out of the recent interest in trying to ascertain how the recognized effects of NGOs could be expanded and linked to macrolevel. The aim of increasing the awareness among development organizations of the context have only recently begun to develop within the NGO community.

A. Service delivery

1. *Beneficiary needs and livelihood.*
 - a. Services or products are of the type and quality that meet the needs of the beneficiaries; evidence of satisfaction.
 - b. Potential to enhance living levels; independent judgement of evaluators, taking into account exogenous factors.
2. *Efficiency*
 - a. Supply of service distributed in a timely manner.
 - b. Share of target population actually reached by service.
 - c. Estimate of cost-effectiveness, where applicable and available.
3. *Sustainability*
 - a. Position on continuum between routine replacement of public services and complementarity to public services.
 - b. Evidence that along with service, skill transfer or experiential learning is taking place.
4. *Linkages*
 - a. NGO has developed linkages to financial, technical, and political resource centres.
 - b. NGO has achieved influence over elements of service system not covered by projects.

B. Poverty reach

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1. *Poverty level*
 - a. Average level of beneficiaries within the income distribution spectrum (ex ante).
 - b. Share of landless, women within beneficiary groups.
 2. *Benefit distribution*
 - a. Relative equity of benefit distribution within the beneficiary groups, or relative degree of access to project benefits.
- C. Participation**
1. *Initial decisions*
 - a. Degree of beneficiary participation in project identification and design; availability of mechanisms to facilitate such involvement.
 2. *Implementation*
 - a. Opportunities for consultation or for shared decision making during operation phase.
 3. *Accountability*
 - a. Degree of representation of participants and leaders.
 - b. Member/beneficiaries have access to records, information.
 4. *Resource mobilization*
 - a. Beneficiary contributions (labour and materials) to projects.
 - b. Relative equity of sharing labour and other costs within group.
- D. Group capacity building**
1. *Group creation*
 - a. Promotion of group formation whether at the base or intermediary (membership) level.
 2. *Capacity growth in resource management*
 - a. Evidence that group is learning to cooperate in effective management of common resources or collective tasks.
 - b. Reinforcement of system of rewards and sanctions for compliance with group norms.
 3. *Capacity growth in claim-making*
 - a. Growth in ability of goal articulation, conflict resolution.
 - b. Leadership development to deal effectively with outside world (mobilization, bargaining).
 4. *Weaning, graduation*
 - a. Progress towards greater degree of independence and autonomy.
 - b. Progress towards acquisition of linkages to public or private services/resources after

termination of projects.

E. Innovation

1. *Technical*
 - a. Emergence of new or improved techniques that have potential for diffusion.
2. *Institutional*
 - a. Development of more effective institutional approaches, training, extension methods, group processes of possible wider application.

F. Policy reach

1. *Horizontal effects*
 - a. Evidence of reaching a significant number or "minimum mass" of beneficiaries, directly or indirectly.
 - b. Evidence of coalition building, networking, or cloning buy the NGO.
2. *Regional*
 - a. Effects on regional economy attributable to NGO work.
 - b. Spillovers from exclusively clientele to wider circle.
3. *Vertical influence*
 - a. Creation of new federative or associative structures.
 - b. Influence on public-sector institutions to improve quality of services.
 - c. Increase in public awareness of client problems and policy options.
4. *Macropolicy*
 - a. Legislative changes and other shifts in government procedures in relation to NGO's clientele.
 - b. Mobilization or redirection of public-sector resources more favourable to beneficiaries.

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Annex F:

Useful addresses

To obtain more background material with regard to monitoring and evaluation, the following organizations may be contacted for purchasing copies of publications on monitoring and evaluation as, for example, mentioned in the bibliography:

ACCION International
Publications Dept.
130 Prospect Street
Cambridge, MA 02139
USA

The FIT Programme
4, route des Morrillons
CH-1211, Geneva 22
Switzerland

GATE
P.O. Box 5180
Dag-Hammarskjöld-Weg 1-2
D-65726 Eschborn
Federal Republic of Germany

GEMINI, PACT, SEEP Network,
and Women's World Banking
c/o PACT Publications, Inc.
777 United Nations Plaza
New York, NY 10017
USA

ILO Publications
International Labour Office
4, route des Morrillons
CH-1211, Geneva 22
Switzerland

OXFAM
OXFAM Publishing
274 Banbury Road
Oxford OX2 7DZ
UK

READI Project
c/o POET
Sedom Industrial Complex
P.O. Box 292
Blantyre
Malawi

The Netherlands Ministry of Foreign Affairs
DGIS
Operations Review Unit
P.O. Box 20061
2500 EB The Hague
The Netherlands

The World Bank
World Bank Publications
P.O. Box 7247-8619
Philadelphia, PA 19170-8619
USA

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**Enterprise and Cooperative Development Department
Poverty-oriented Banking**

Working papers

N° 1	1994	D. Gentil & al.	Banquiers ambulants et opération 71 au Togo et au Bénin
N° 2	1994	B. Balkenhol and E.H. Gueye	Tontines and the banking system - Is there a case for building linkages?
N° 3	1995	Douato A. Soedjede	Mécanismes de collecte de l'épargne et de financement de l'entrepreneuriat informel et formel par les banquiers ambulants au Togo
N° 4	1994	M.A. Adechoubou and S.N. Tomety	Les banquiers ambulants au Bénin
N° 5	1994	B. Hane and M.L. Gaye	Les pratiques du marché parallèle du crédit au Sénégal - Leçons pour le système bancaire
N° 6	1994	I. Ba	PME et institutions financières islamiques
N° 7	1994	B. Balkenhol and Ch. Lecointre	Pratiques bancaires dans les opérations de crédit avec les petites et moyennes entreprises en Afrique de l'Ouest
N° 8	1994	I.F. Camara	Structures mutualistes d'épargne et de crédit dans l'Union Monétaire Ouest-Africaine (UMOA)
N° 9	1995	B. Wesselink	Monitoring guidelines for semi-formal financial institutions active in small enterprise finance

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N° 10	1995	J. Poyo	Expansion of rural financial services: The development of a community-based rural credit union network in the Dominican Republic (1984-1993)
N° 11	1995	J.P. Krahn and R.H. Schmidt	On the theory of credit cooperatives: Equity and onlending in a multi-tier system — A concept paper
N° 12	1995	D.W. Adams	Using credit unions as conduits for micro-enterprise lending: Latin-American insights
N° 13	1995	M. Lamberte	Credit unions as channels of micro-credit lines: The Philippine case
N° 14	1995	K.J. Morris	The effects of using credit unions as onlending agents for external lines of credit: The experience of the International Credit Union Movement