Lessons learned

Community-based financial organizations

IFAD
Investing in rural people

Inclusive rural financial services

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These notes are ”living” documents and will be updated periodically based on new experiences and feedback. If you have any comments or suggestions, please contact the originators.

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List of acronyms

ASCA	accumulating savings and credit association
CBFO	community-based financial organization
CVECA	Caisses villageoises d'épargne et de credit autogérées (Self-managed Village Savings and Credit Institution)
CPM	country programme manager
MFI	microfinance institution
NGO	non-governmental organization
RFSP	Rural Financial Services Programme
SACCO	savings and credit cooperative organization
VSLA	village and savings loan association

Introduction

One of the main tools to alleviate poverty is creating access to financial services for people who are currently excluded from the financial system. Community-based financial organizations (CBFOs) are often the only institutions available to provide basic financial services to the rural poor, especially in remote areas with inadequate infrastructure.

CBFOs can be organized in many different ways. This knowledge document elaborates on the challenges of designing and implementing support for a CBFO. There are often many actors involved in the design, implementation, monitoring and financing of rural finance interventions. This is particularly the case with interventions to strengthen or upgrade CBFOs. Successful support to CBFOs is determined by the ability of rural finance practitioners to develop balanced partnerships based on trust and the acknowledgement of roles and functions of the many different actors involved. Moreover, interventions should be tailored to the local context and scale of implementation. A crucial issue to consider is a clear organizational structure in which costs and benefits are divided.

The development of such partnerships requires tailored process management and risk management, which need to be well defined and clarified among community organizations, formal financial service providers (FSPs), development partners and other stakeholders involved. Process leadership and steering must be clear for all partners involved.

Context and challenges

Financial interventions in decentralized village-based systems: CBFO

Every intervention is unique because every CBFO is unique. Each CBFO has its own actors, goals, needs, capacities and cultural context among many other factors. In addition, cultural and contextual factors must be considered before making decisions on what intervention suits the needs of the partners and what critical success factors need to be ensured. For example, does the legislative framework allow for a particular type of CBFO? Is the financial infrastructure sufficiently well developed to ensure that the CBFO can function properly? Does the type of CBFO that is envisioned by the practitioner actually fit the sector or the target group involved? What are the capacities of the project partners and what would be their capacity-building needs throughout the design process?

Designing the right intervention starts with considering the users and beneficiaries of financial services: the smallholder in remote areas who gains access to appropriate equipment to improve productivity on his or her farm, the processing company that can pre-finance raw materials or the trader who gains access to insurance. These target groups should be the primary focus of the intervention. It is easier to do so now as there is an increasing wealth of information on users and non-users of financial services and a growing understanding of the bottlenecks on the supply and the demand side of the market (Beck 2011). Understanding the users' needs can help determine the appropriate products, delivery methods, institutional set-ups and support structures, technologies and policies. The following user needs should be considered:

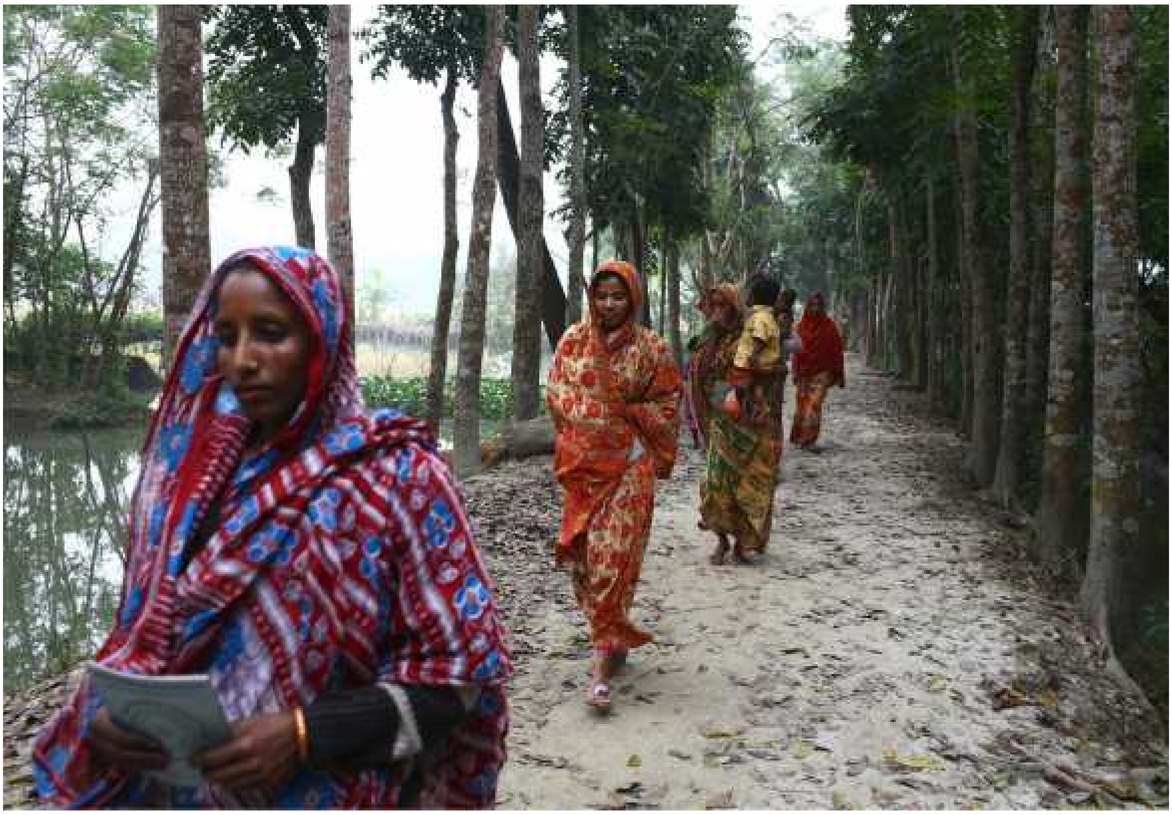
- **Financial literacy:** Raising the level of financial literacy is typically a primary need. This requires educating users on the benefits of financial products and developing the skill to compare and evaluate products to make sound financial decisions. This education also benefits the institution because when customers are better educated, it is easier to design products to meet their actual needs.

- **Trust:** Overcoming mistrust is especially difficult in rural and farming communities. Institutions must be transparent. Trust is typically easier to establish in transaction services when customers can easily see their financial status, as in mobile phone banking.
- **Reaching the unbanked:** Products must be developed in a way that takes into account typical non-users, including the rural poor and farmers working with products that are difficult to finance, such as food crops for local markets, wild products and fishery products. Building strategic links among CBFOs, microfinance institutions (MFIs) and commercial banks can provide farmers access to a greater range of adapted financial services.
- **Proper supervision:** As regulation and supervision extend to non-bank segments of the financial system, it is important to take into account the need for the protection of different groups of users.

Moving forward

CBFOs can be a highly positive force in increasing agricultural productivity in Africa and in other parts of the developing world but interventions to set up, strengthen or upgrade CBFOs must be designed with careful consideration of the full range of factors that affect outcome, which include:

- having a clear idea of what the intervention should achieve and how this goal would meet the needs of the users of financial services
- seeking help when it is appropriate. The introduction of a second-tier organization can bring valuable knowledge and capacity but it may also bring unwanted interference and mistrust.



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Lessons learned

Strengths of CBFOs

Greater outreach: CBFOs are capable of achieving considerable outreach in remote areas at a relatively low cost compared to that of more formal financial institutions. Since they are in close proximity to their members, are self-managed and can already operate from a relatively limited membership base, they can be established in remote areas with low population density. As such, CBFOs allow practitioners to attract people who normally lack access to financial services and products. Once established, basic CBFOs (e.g. VSLAs) can operate with minimal external technical assistance. Reinvestment of local money increases local efficiency of capital and reduces the reliance on outside finance and handouts. The model allows for easy access to loans through nearby organizations that can decide on and grant them locally. Due to close relations within CBFOs, repayment rates tend to be high (see Box 1).

Box 1: Ophavela´s success in reaching remote rural areas

Ophavela is a local NGO founded by CARE during its rural finance project in Mozambique. Ophavela works in Nampula Province, which is one of the most productive regions of the country, but it has only primitive market systems. The area has recovered relatively quickly from war and natural disasters in terms of subsistence and traditional cash crops but input supply systems have been slower to restore themselves and only the most basic household commodities are to be found in this rural area. The rural Ophavela operations are relatively liquid but under-supplied with productive inputs, market opportunities and systems for a broader range of farm and semi-processed outputs.

Ophavela's services are appropriate to CARE's traditional rural target group because Ophavela sets up in rural areas savings and loan groups that are locally capitalized through savings and are managed by the members themselves. CARE's village savings and loan (VS&L) methodology has been tested and Ophavela implements it successfully. Services offered are *scaled to the capacity* of rural participants and the success rate is high, while the costs are very low. Ophavela's leadership is highly motivated and it continues to take a close interest in the NGO's progress to promote the success of the VS&L model and CARE's interest in its expansion.

While a strong sense of ownership might orient village salvings and loan associations (VSLAs) and their members towards the sustainable end, this cannot be assumed. If rules are out of alignment with standard village practices, some degree of institutional "devolution" or "entropy" is almost inevitable. It can be argued that relatively high education levels, combined with a significant level of social capital, increase the likelihood of institutional sustainability in the Ophavela group setting. Ophavela groups show a high degree of assiduity in record keeping and respect for procedures.

Source: (Allan 2005)

Empowerment through group memberships: CBFOs commonly generate a strong sense of ownership among members. Due to the local character of the organizations, many of the members know their fellow villagers, local conditions and culture. Therefore, it is likely they will take a considerable interest in the CBFO. Groups often include and empower more marginalized individuals, for example, poor people or women (see Boxes 2 and 3). Furthermore, a high level of transparency is also created because all transactions are carried out in the presence of the members. CBFO membership is a powerful tool of social empowerment (IFAD 2007). Local ownership also enables group members to reject attempts by problematic individuals to join a CBFO. In-depth knowledge about the loan applicants helps members to make better decisions on whether an aspiring borrower is able to repay the loan according to the terms and conditions set by the group.

Box 2: Case of empowerment: Rural Financial Services Programme (RFSP), United Republic of Tanzania

One of the objectives of RFSP in the United Republic of Tanzania was to empower poor rural households to benefit from rural financial services. The programme has shown that, contrary to general assumptions, **poor households can save**, albeit in small amounts. In the case of the saving and credit cooperative organizations (SACCOs) in the Kindi area, savings have increased by around 185 per cent between 2004 and 2009; however, savings per member dropped by 16.5 per cent.The major reason for this decrease is related to the general decline in the coffee economy. What active poor people need is a safe place to save and an operating environment that guarantees sustainability of the institution.

The programme also showed that women who are exposed to group dynamics and encouraged to participate can **break socio-cultural barriers** to become active in the affairs of their SACCOs. During the programme´s evaluation study, researchers found a high rate of women's participation in leadership. Women have become more confident generally and about financial issues; they openly contribute ideas during meetings and participate effectively in SACCO matters. Women not only contributed to savings but also invested borrowed money in income-generating activities and helped ensure household productivity. For example, they helped pay for school fees and medical expenses.

Source: (Mlowe and Kaleshu 2009)

Possibility to link with the formal financial sector: The typical poor member of a remote CBFO is not an interesting customer for the formal financial sector. However, 20 to 30 individuals working as a group to establish mature savings operations is much more interesting to formal institutions, such as MFIs, banks or large credit unions because the group provides the economies of scale necessary to make service provision financially worthwhile. The typical CBFO becomes even more attractive to formal financial institutions if they are linked into a network of groups that can be serviced as one entity. For members of CBFOs, linkages to formal financial institutions can mean access to larger loans and other financial products and services; however, it is not advisable to require CBFOs to link with the formal financial sector (see Box 4).

Box 3: Men appreciate women's participation in savings groups

Membership in *Saving for Change* in Mali demonstrated to both fellow members and non-members that women are worthy of respect and consideration. Women's increased ability to manage family emergencies and general household responsibilities independently has led to **fewer conflicts** with men and this ability is appreciated by both genders. Some women also express the importance of increased **economic independence** from their husbands for protecting household assets from being spent poorly by men. Nevertheless, men themselves are highly supportive of the programme. Men see how *Saving for Change* **helps women meet their share of the household's economic burden** without requiring their assistance and they also appreciate their ability to manage their finances.

Source: (Bureau of Applied Research in Anthropology, University of Arizona 2010)

Box 4: Successful linkage to a commercial bank through mobile banking

The Rural Financial Services Programme (RFSP) in Mozambique promotes the establishment of accumulating savings and credit associations (ASCAs). Mozambique has more than 100,000 ASCAs, of which a large proportion struggles with the security of their savings. ASCA groups are composed of on average 12 members each, making savings accounts available and providing credit for their members on a weekly basis. These savings are stored in a wooden box in the house of one of the group leaders. This practice involves significant risks, such as theft, floods and fire. Partnering with commercial banks would provide more stability but the distance and time needed to reach them make this unfeasible for most groups.

The Bank of Mozambique has approved the license for the Mozambique Cellular Phone Company to start operating the mobile banking platform M-Kesh. A pilot project was designed involving the RFSP, the M-Kesh platform and the service provider, Ophavela. Preliminary results have been positive. Groups participating in the pilot project are now saving and providing credit to their members electronically. The money that was previously saved in the wooden boxes is now deposited at an M-Kesh agent and transferred to the groups' account, greatly improving the security of the groups' savings.

Nevertheless, there are some prevailing challenges, particularly those related to network quality and coverage in remote rural areas. Additionally, the type of cell phones used by group members do not function well with the M-Kesh platform.

Source: (Muhanj 2013)

Encourage savings culture: CBFOs are predominantly compulsory savings-based organizations. They can have a high impact by mobilizing savings and deposits from members for on-lending. Not only can this help encourage linkages with the formal financial sector but it is also important to encourage long-term sustainability, as shown in Box 5. Loans should only supplement internal savings and not be the major source in order to avoid dependence on commercial banks. Support institutions should capacitate MFIs on best practices in lending and management of loan portfolios to avoid occurrence of bad debts.

Box 5: Savings and credit cooperative organizations (SACCOs) in the Kindi area

At the start of the RFSP in the United Republic of Tanzania, one of the objectives was to develop a sustainable rural financial network infrastructure capable of linking CBFOs to commercial banks. With the support of RFSP, SACCOs in the Kindi area linked up with CRDB Bank, National Microfinance Bank, Kilimanjaro Cooperative Bank and the Savings and Credit Cooperative Union League of Tanzania where the SACCOs could receive training, deposit unused savings and invest in shares.

However, during the programme, it was concluded that promoting business linkages between SACCOs and commercial banks should not be the main priority of the programme. It was deemed more appropriate to allow such linkages to grow naturally, in line with the growth of a SACCO's maturity, entrepreneurial capacities and credit appetite. This had not been the case for most SACCOs in the Kindi area.

Therefore, the success of the SACCOs in Kindi should primarily be measured by the extent to which the SACCOs have been able to mobilize savings and deposits from members for on-lending. In order to encourage long-term sustainability, loans have supplemented internal savings but they have not been the major source of loanable funds. This has prevented SACCOs in the Kindi area from becoming totally dependent on commercial banks for their financial requirements.

Source: (Mlowe and Kaleshu 2009)

Weaknesses of CBFOs

Limited ability to generate a big pool of savings: CBFOs often operate in remote regions, have a relatively small membership and have a very limited savings capacity. As a result, savings generated by CBFOs are small, which constrains their capacity to finance anything other than micro or small business and/or consumption activities.

Sustainability is not guaranteed for external funded groups: CBFOs that receive external credit from governments or donors often fail (Ritchie 2007; Rosenburg 2009). Poorly planned and executed, externally funded CBFOs often risk attracting a non-socially cohesive membership whose sole purpose is to access "free money" rather than to encourage members to save and build the group up over time. Even if savings are compulsory, members are likely to view these CBFOs as a way to access loans rather than an opportunity to build a savings habit, which would be beneficial to both the members and the group to ensure liquidity and sustainability. A rapid expansion strategy by the government or donors can exacerbate these challenges, undermining the quality and sustainability of the CBFO sector in a country (see Box 6).

Box 6: Own savings versus external funds from donors or governments

Murray and Rosenberg (2006) reviewed numerous CBFO projects with community-managed loan funds from 1990 to 2005. They observed that a CBFO´s success is strongly linked to the source of funding. CBFOs that were financed through an early injection of external funds from donors or governments often failed in providing sustainable financial services to its members. Therefore, this model of support is never a prudent gamble, especially in rural areas.

In contrast, CBFOs are often more successful when loans are financed by members' own savings, with moderate use of external funds after the group has built a solid track record of lending and recovering its own savings. In linkage banking models, certain ratios of total volume of group deposits and loans from the formal lender to the CBFO are applied (usually 1:2 – 1:4).

Performance results are more mixed when CBFOs start by collecting and then lending members' own savings but subsequently receive large-scale external funding from commercial banks.

Sources: (Murray and Rosenberg 2006; Ritchie 2007)

Need for thorough technical assistance and monitoring: Project implementation staff and support organizations often lack adequate technical skills to carry out high-quality capacity-building in organizational development. Such capacity-building is much needed since many rural CBFOs lack the capabilities for efficient and effective savings and loan management. In many cases, failure of CBFOs can be traced back to unqualified service providers that have not been properly screened and trained before being given technical assistance assignments (Ritchie 2007). Therefore, setting up and supporting CBFOs require strong technical assistance and training at the beginning of the programme to ensure that these financial organizations are provided with the right tools to manage themselves and become sustainable institutions. Furthermore, CBFOs require close monitoring and oversight of procedures for at least two to three years after their establishment to help them become sustainable.

Murray and Rosenberg (2006) stress a need for continued technical support beyond the inception stage. This support does not entail the continued involvement of donors or CBFO promotion agencies but can instead come from member-owned federations or other domestic support structures, such as an apex organization. However, such structures also require long-term support to mature and become sustainable (Ritchie 2007) (see Box 7).

Box 7: Caisses Villageoises d'Epargne et de Crédit Autogérées (CVECAs): technical assistance and monitoring in Africa

The strategy of the Centre International de Développement et de Recherche (CIDR) for CVECAs (Self-managed Village Savings and Credit Institutions) includes the development of second-tier organizations: technical service providers (and groups of *caisses* that negotiate bank refinancing. The CVECAs sign annual contracts with the service provider to provide technical support and conflict-resolution services. A peer review of this model conducted in 2003 found that establishing these external services has been a long and difficult but necessary process. An important lesson learned was that the contractual nature of the link between CVECAs and technical service providers does not always guarantee the authority of service providers when problems are detected, even though bank refinancing was made conditional to CVECAs having such contractual relationships.

In addition, the service providers are small and isolated, sometimes leading to a lack of dynamism. Many are in need of technical assistance themselves. As a result, CIDR created entities at the national level to ensure technical quality of the entire network. The national level's role included the development of a common charter of best practices to clarify and harmonize the practices and obligations of service providers and to ensure that internal controls are in place to resolve crises. Despite the weaknesses of many service providers, experience has shown that they need to be strengthened rather than replaced because national-level entities cannot achieve economies of scale in sparsely populated rural areas alone. It also lacks the capacity to provide adequate follow-up of individual CVECAs.

Source: Ritchie 2007

Vulnerability to elite capture: Since CBFOs are often established in villages with a strong hierarchical structure and power relationships, they are vulnerable to elite capture. Given the attraction of accessing "free money", local elites (e.g. village chiefs or large-scale farmers) are often tempted to take over CBFOs for their own interests, while neglecting the interests of members (see Box 8). In extreme cases, this could even lead to the collapse of the CBFO and the loss of members' savings. In order to prevent elite capture, CBFOs have to design and implement governance structures that do not allow the elite to take control of the CBFO board.

Box 8: Reforming CBFOs to prevent elite capture

The mid-term review of the Sri Lankan North-East Irrigated Agriculture Project revealed that the irrigation infrastructure **improvements were benefiting only the most advantaged people** in the community because the poor have no irrigated land and they farm dry uplands, which are far less productive. In addition, the war caused a great number of widows, many of whom have no secure source of income. As a result of these findings, the Women's Rural Development Societies (WRDS),which can can have as many as 100 members, have been reorganized as a bottom-up governance structure.

WRDS members form groups of five to seven members and elect a chairwoman and treasurer. The chairwomen of these groups form the executive committee (EC) of the WRDS and the treasurers form the credit committee (CC). This structure **avoids elite capture**, which was found in many groups with a large membership, and **gives voice to the poorest and most vulnerable** because each small group has representation on the EC and CC.

Source: (Ritchie 2007)

Lack of management skills and weak governance: CBFOs need willing leaders with governance and management skills. However, it is often difficult to find such people in rural areas. These challenges are pronounced in an externally funded CBFO, which may become too reliant on outside technical assistance, and thus prevent the transferral of relevant financial management knowledge and skills. Fostering management skills takes time and requires people who are committed to champion the group development process. In addition, there is also a need for a system of checks and balances to control governance and management. When questions of ownership and accountability over the funds remain unclear, the CBFO has no incentive to properly manage them (Ritchie 2007) (see Box 9).

Box 9: The issue of ownership of loan funds

In some programmes sponsored by the World Bank, CBFO members were confused about the ownership of the loan funds. Local governments (e.g. municipalities) were involved in the supervision, monitoring, facilitation and technical assistance of the CBFOs. Most members, as well as the local governments, did not fully understand that the government's role was to support and protect the groups and not to own the funds. Thus, incentives were lacking for strong stewardship of the loan funds by CBFOs. There was also confusion among NGO service providers, many of whom were unclear about the ownership of the funds.

In contrast, ownership of the loan funds in other CBFOs was clear. In the Sri Lankan town of Gemidiriya, the village company owns the revolving loan fund and delegates the management to the Village Savings and Credit Organization (VSCO). This agreement is recorded in a Memorandum of Understanding between the two parties and two members of the company's board of directors sit on the VSCO's decision-making committee, ensuring the interests of the company. In Andhra Pradesh,India, the World Bank's revolving loan fund (RLF) is owned by self-help group (SHG) district-level federations and lent through a clearly defined set of rules: first to a lower tier of federation and then to individual SHGs, which lend to members.

Source: (Ritchie 2007)

Restricted range of products and services: While only a small share of the rural population needs credit, virtually every rural household has a need to save. Savings enable rural households to better manage seasonal income (e.g. seasonal crops) and expenditure fluctuations (e.g. school fees), accumulate funds for major life events (e.g. weddings or funerals) and build assets. They provide an important safety net against unforeseen events such as illness and bad harvests (GIZ 2011).

However, there are trade-offs between desired product features. Experience shows that low-income savers are more concerned about accessibility, security and liquidity than with returns (CGAP 2010). Most CBFOs can fulfil the basic needs of rural households by offering savings services; but the range of loan services that rural CBFOs can provide is constrained by their limited ability to mobilize savings, their physical remoteness and the lack of skilled personnel to understand more complex loan products (see Box 10).

Box 10: Saving groups have best access to low-income rural areas

"Savings groups have been able to attract members across a broader social and geographical spectrum than other types of financial service providers … and [they] exclude very few people, except the destitute, for whom livelihood provisioning is a more appropriate intervention. The experience of organizations with the longest track records in promoting this approach confirms this suggestion. Most large, multi-sector NGOs that promote savings groups do so because they offer the best blend of flexible, broad-based financial services, consistent with being able to reach the rural and urban poor through self-financing services" (Alan and Panetta 2010).

Higher interest rates compared with those of formal financial institutions: CBFOs often charge higher interest rates than commercial FSPs. It is expected that, since the amounts loaned are small, the high interest rates would encourage short-term borrowing, which would result in high repayment rates because borrowers would not want to accumulate high interest fees on longer loans. However, it has been found that high interest rates discourage poorer members of CBFOs from taking such loans. In the absence of other external cash inflows to repay high interest loans, members who take high interest loans for consumption can end up poorer at the end of the business cycle.

Box 11: Turning data into information for decision-making

According to research by Ferguson & Co. (2005), CBFOs are able to keep records but they cannot convert data into useful information for decision-making. Even though their basic records were sufficient, only a fraction had a good understanding of their financial status. This led to the false presumption among members that savings were secure when this was not the case. Furthermore, training of CBFO members does not necessarily lead to better financial management capacities of CBFO boards. The findings showed that the financial management systems used were too complex for the skill levels of members and, thus, require simplification.

Lack of financial management capacity: Many CBFOs are managed by members who have little or no financial management skills (see Boxes 11 and 12) but such members volunteer their time on a pro bono basis. Although these forms of modest financial management – often organized in small groups for internal logics – is sufficient to facilitate basic service provision of CBFOs, larger CBFOs that offer more complex products need an officer or board member with sufficient capacity to handle the financial management of CBFO funds. This often means that CBFOs need to pay for these services. Nevertheless, most CBFOs cannot afford to hire qualified people, resulting in mismanagement of CBFO funds and compromising the CBFO's accountability (Jazayeri 2005).

Box 12: Experiences from Indonesian's Agricultural Development Projects (ADPs)

In Indonesia, the ADPs invested significant resources to establish financial systems for revolving loan funds. Although management of CBFOs was given financial training, many were unable to interpret financial reports generated by these systems. Due to the limited capacity of the CBFOs to execute the work, reporting by consultants and facilitators was needed. This meant that financial management knowledge was not transferred to CBFO managers who would need these skills in the future. These findings indicate that financial management systems were too complex. Simple systems are needed to ensure local management and sustainability of groups.

Source: (Ritchie 2007)

Follow-up and strategic recommendations

Recommendations for project design and implementation

This section details different support services that can be provided to existing CBFOs. A key issue to consider is how to fund these interventions. Some governments are reluctant to finance these activities with debt, instead preferring to use the funds for investments in infrastructure and agricultural inputs. Therefore, the CPM will have to make a strong case in support of these activities. Some suggestions include:

- emphasize the role that access to financial services plays in lifting rural people out of poverty
- prepare a joint IFAD/government request to other donors for funding
- request grant funding from IFAD's own internal resources to support CBFOs.

What to include in project design and implementation

Finance a market survey: Finance a basic market survey to assess the informal and formal supply of financial services available. This will help IFAD to understand:

- whether there is enough need and demand to run a sustainable CBFO
- what type of project support is needed by CBFOs
- what types of products and services are needed by the rural households.

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India - Andhra Pradesh Participatory Tribal Development Project

There is no need to establish a new system if:

- there are other FSPs operating in the target area that provide appropriate products and services to the target clients or
- these services could be expanded to include IFAD target clients.

If the survey establishes that there is sufficient underlying demand and no alternative system is available, the proposal for an informal system should proceed through the project design cycle. Assess the current informal credit system and support linkages with the formal financial sector. Although the informal financial system can work successfully parallel to the formal sector, efforts should be made to link the two together. Such a connection enables clients of the decentralized system to access a greater range of services than would otherwise be the case.

Box 13: Strategic recommendations from IFAD's appraisal report on Zambia's Rural Finance Programme

- Flexibility: CBFOs should have sufficient freedom to develop and apply their own methodologies and approaches. Given the wide variety of models in use, IFAD should encourage NGO MFIs to build upon their experiences rather than imposing a single uniform approach.
- Focus on women: Women's requirements for financial services include an emphasis on savings, ease of access (in terms of distance to the meeting place and length of meetings) and participation in decision-making processes.
- Focus on the low-income population: Allow low-income households to form the large majority of members served. Although this will result in lower amounts involved in savings and credit operations, outreach will be enhanced.
- Outreach in remote areas: CBFOs have an advantage over conventional microfinance operators in rural areas because they operate in very close proximity to their members and also are almost entirely independent from the mainstream financial system.
- Financial services to individuals: Only group members will be the recipients of the financial services. Group members provide guarantees for the other members' loans and ensure repayment.
- Avoid long-term external dependence: While initial external support in training and advisory services is required, all interventions should aim at the establishment of CBFOs that will be operationally independent within one or two years after their establishment.
- Promote financial linkages: As the next step in the development path, efforts should be made to link mature CBFOs with viable, formal financial operators that can provide more flexible savings facilities and larger, medium-term loans in rural areas.

Source: (Based on IFAD 2007).

Support capacity-building: Allocate funds to train staff of the CBFO, primarily in accounting and bookkeeping, credit analysis and loan collection. Training should enable (usually part-time) staff to perform their basic duties of running the CBFO. Such training should be supported by on-the-job learning, capacity-building and follow-up training courses on financial management.

Training the management in good governance procedures is vital, particularly on how to avoid elite capture. This training should focus on their duties and responsibilities, what they should look out for and the relationship between staff and management.

CBFOs need built-in incentives to keep management staff in their position; otherwise, after acquiring good capacity and skills from the training, they will leave the CBFO to look for better paying opportunities.

Provide research and technical assistance to develop the financial product and service portfolio: Keep operations simple. The CBFO's remoteness, limited income potential and lack of managerial capacity already make operations complex. This rule applies to the design of the financial products as well.

Initially, the CBFO should be limited to mobilizing savings and, after a pool of funds has been developed, short-term loans. Once it is sufficiently mature, some types of CBFO can offer loans of varying maturities and time deposits. If the methodology supported has a security safe – e.g. FSAs or Caisse Villageoises d'Epargne et de Crédit Autogérées (CVECAs, Self-managed Village Savings and Credidt Institutions and Credit Bank) – they can undertake safekeeping services for a fee.

Given the important role of savings for the sustainability of CBFOs, technical assistance is particularly useful for developing new savings products and delivery channels to reach poorer clients. Once there is better credit capacity, technical assistance can also develop systems and expertise to safely lend funds that have been received as deposits, for example, to establish systems for assessment, monitoring and collection in case of non-performance.

Improve management information systems (MISs): Fund the design and installation of an appropriate MIS and offer technical support to use it. Establishing an easy-to-use, cost-effective MIS is critical to the management of a CBFO and to transparent reporting. Before computerizing MIS, CPMs should verify that the CBFO is capable of supporting such a system.

Provide ongoing support and supervision: Ongoing supervision and support are necessary for most types of CBFOs. One approach is using loan officers and/or field agents for ongoing monitoring and oversight services. They collect data, provide follow-up training and help avoid fraud and elite capture.

Assessment of, and technical support to, regulatory and oversight entities: When working with local cooperatives and credit unions, the CPM should review the strengths and weaknesses of the regulating body. This analysis should identify whether:

- the supervising entity is willing and able to take on a supervisory role over the project's financial partners if they receive a modest amount of funding and technical support
- compliance by CBFOs with the regulatory requirements will not be overly burdensome and will be a clear benefit to the proposed CBFOs.

If the regulator meets the needs of the CBFO, the CPM should request that IFAD provide technical assistance and support to the regulator. In most cases, assistance should be in the form of technical training of inspectors, office equipment needed to support supervision of CBFOs and transportation subsidies to reach remote CBFOs.

Support provision of independent audits: For larger decentralized CBFOs, the ideal scenario is to identify and train local auditors to perform annual audits of CBFOs on a fee basis. These firms then provide an independent review of the performance of the CBFO directly to the general assembly. Challenges include whether these auditors are available and affordable, and whether the long-term investment required for underpinning such an approach can be obtained. In addition, the CPM should ensure that reviews are proportionate to the actual size of the CBFO.

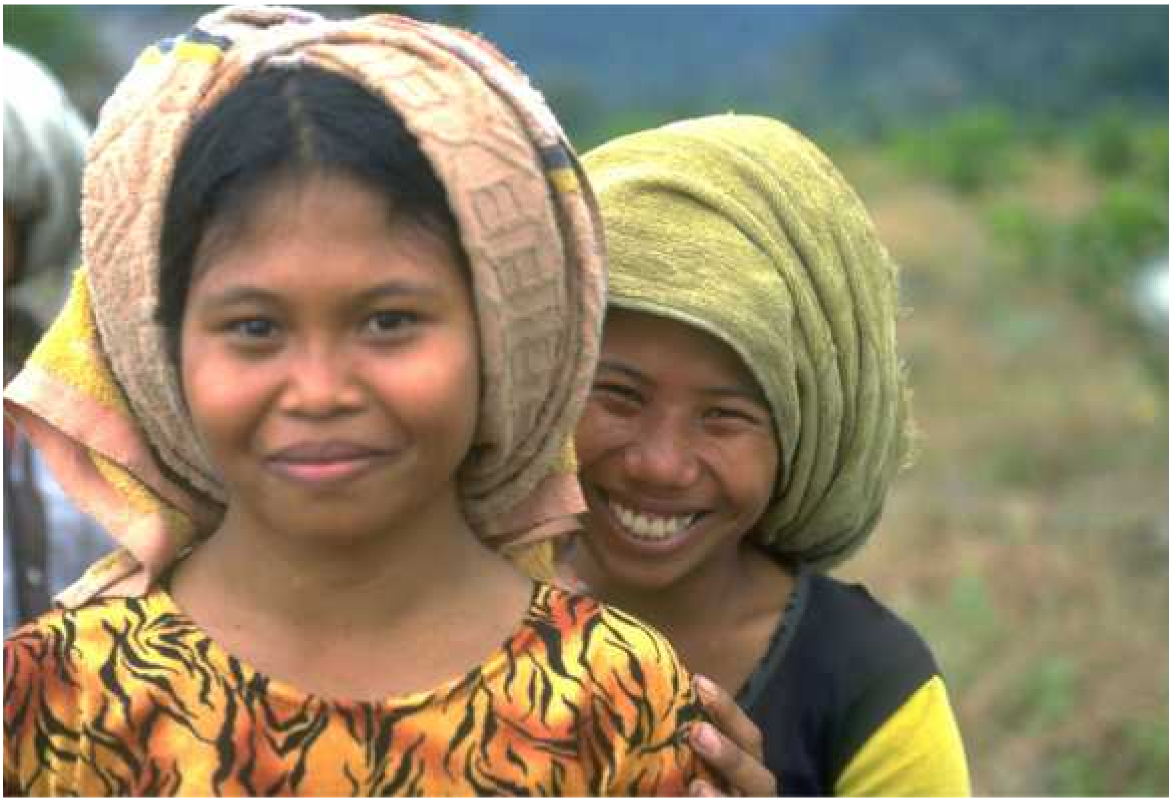
Fund exchange programmes between CBFOs**:** Field visits between rural-based CBFOs can be an extremely useful training tool. Instead of external experts explaining to the officers of individual CBFOs how to run their groups, groups of officers exchanging experiences and sharing problems has proven an effective way of increasing the skill sets of individual office holders in a participatory and user-friendly manner.

Link CBFOs **to a second-tier structure:** Most CBFO models require long-term technical assistance, which is often expensive. At the design stage, CPMs should finance a successor entity to provide ongoing support after the project closes. This will improve sustainability of CBFOs beyond the project horizon, allowing necessary support functions to be carried out by the second-tier organization.

In most cases, this successor organization will be either an apex organization, a federation of similar CBFOs, an MFI or an NGO with technical expertise. Affiliation with commercial banks is also possible, as shown with the Indian SHGs. The successor organization should provide regular monitoring and oversight through periodic visits, provide technical advice on product development and management and governance issues, systematically review the books and records of CBFOs, and attend their annual general meetings.

Develop an effective monitoring and evaluation system (M&E) for rural-based CBFOs: An effective M&E system needs to be built at the project design stage. This M&E system should enable the organization and IFAD to track all pertinent monitoring statistics, as well as any impact and gender metrics that are deemed necessary. At all levels, these statistics must be treated as a management tool rather than just being collected passively. They should be analysed on a trend basis. Feedback should be provided to the various implementing levels to help improve overall performance.

Use performance-based agreements for project implementation: Performance-based agreements (PBAs) contain the targets, the key performance indicators (KPIs) and the baseline information to be collected for successful project implementation. These data enable IFAD and the project monitoring unit to monitor performance, identify problems at an early stage and propose remedial action, where necessary. If the project contractor is chronically in default of the guidelines without providing a valid reason, funding should be stopped and consideration given to closing down the project before any deposits might be lost.



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What to exclude in project design and implementation

IFAD should be careful about certain types of support to CBFOs.

IFAD should be careful with making credit lines directly available for on-lending: IFAD's CPMs and PDTs may be put under pressure to provide quick access to external credit to help the CBFO grow faster. This pressure must be resisted. Experience has shown that premature access to external credit often damages CBFOs since it weakens the incentive for members to save, skews the institution's emphasis in favour of borrowers rather than savers and leads to weakened credit analysis and neglected loan recovery. Only when funds are well managed can they provide a real incentive to increase savings, reduce delinquency and increase membership. To achieve this, the instrument must be properly designed and credit delivered in a timely manner. Projects should aim to have a high proportion of the credit portfolio funded by savings.

Limit outside management: CBFOs should be community-owned and -managed; having external professionals undertake these CBFO management tasks undermines community ownership. It also damages its sustainability. And yet, in the early stages, groups do need help; therefore, support should take the form of mentoring and capacity-building. Some limited gaps may need to be externally filled where high-level professional expertise is not readily available. However, this support should be limited to second-tier organizations.

Avoid supply-driven policies: CBFOs must not be pressured to absorb large amounts of technical assistance and support that they cannot realistically absorb to ensure that donors' disbursement requirements are met.

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