# 6 Microfinance

Microfinance, broadly defined as the provision of financial services to low-income clients including the self-employed (Ledgerwood 1999), is recognized as a potentially powerful tool to promote economic growth, to reduce poverty, to support human development, and to improve the status of women (ADB 1998b). Providing the poor with financial services, especially credit, is a basic means of increasing their productivity and incomes (Gulli 1998). This chapter examines the need for microfinance in PDMCs and documents the current supply of microfinance. Current modalities, capacity and performance, and the viability and sustainability of microfinance schemes are investigated. Lessons learned from past experience are also summarized.

Microfinance in the Pacific islands is at an early stage of development. There are a limited number of institutions providing microfinance in both urban and rural areas, mostly relying on government and donor subsidies for survival. MFIs in the seven PDMCs reviewed have yet to achieve operational self-sufficiency. Nonetheless, they offer the possibility of access to financial services that can enable rural and poor urban people in PDMCs to save and borrow small amounts of money. MFIs are therefore critical to achieving rural and equitable urban development.

## DEMAND FOR MICROFINANCE SERVICES

ADB's *Pacific Strategy for the New Millennium* (ADB 2000, 20) notes that the "single biggest challenge is to generate wage-and income-earning opportunities for rapidly growing labor forces". The inability to generate enough formal and informal sector jobs and livelihood opportunities is beginning to show in the rising incidence of poverty, income inequality, and unemployment reported in the region (UNDP1999; ADB 2001b).

In the Fiji Islands in 1991, 25 percent of households were living below the poverty line, with half of all households receiving one-fifth of all income (UNDP and Government of Fiji 1997). Traditional safety nets and systems of exchange were no longer able to provide for the majority of rural households. Welfare organizations claim that the situation has worsened since 1991. In the Solomon Islands, a series of household income and expenditure surveys during the 1990s also revealed very marked inequality in household incomes, with less than 1 percent of Honiara households receiving 50 percent of total income (Government of Solomon Islands 1992). In Samoa, where an increasing number of households have less than one acre of land, there is growing concern over income inequality and a rising incidence of malnutrition, especially among children. In Tarawa, the main urban center of Kiribati, the findings of a 1996 survey of household incomes and expenditures revealed that many households lived in overcrowded conditions. Only 16 percent of the people surveyed had jobs, usually one per household, yet this was the main source of household income. A large proportion of cash income was spent on food, principally rice, fish, frozen meat, and sugar (Statistics Office 1996).

Job growth is continually outstripped by the demand for paid employment. Young people are particularly at risk of unemployment, and in some PDMCs, there are more than seven times as many young people seeking work each year as there are new jobs available (UNDP 1997). In the Fiji Islands in 1995, for example, only 1,100 jobs were available for 13,000 school-leavers. Demographic and economic trends suggest that the gap between the availability of and demand for formal sector employment is likely to grow in the coming years. In the light of this almost inevitable shortfall, it is necessary to stimulate the informal sectors in PDMCs to increase opportunities for self-employment.

Informal sectors include people in rural areas who are engaged in semi-subsistence production either for traditional exchange or for cash, and those people in urban areas who operate small-scale businesses or microenterprises. They are growing, as evidenced by the swelling number of market vendors and the growing numbers of peddlers and street hawkers in most PDMCs; and they are projected to grow further over the next decade. The challenge is to stimulate informal sectors by finding ways to increase productivity and opportunities to earn cash.

One important means of strengthening informal sectors is to meet their growing demand for microfinance. The access of poor and relatively low-income persons to formal financial services is very limited. For example, the Papua New Guinea Banking Corporation estimated in 1997 that only 30 per cent of the population held deposit accounts and less than 1 per cent had loans from commercial banks. In the Fiji Islands, it has been estimated that more than 83 percent of poor communities have no access to credit or savings facilities (UNDP and Government of Fiji 1997). It is likely that other PDMCs experience the same problems. Reliance must then be placed on family, friends, and moneylenders. By providing credit and savings facilities to individuals who do not have access to formal financial services, and by providing accompanying management, accounting and marketing skills, microfinance schemes can help people to meet their economic and social needs.

## SUPPLY OF MICROFINANCE SERVICES

Microfinance in the Pacific is at an embryonic stage. Current providers can be broadly classified into the three sectors shown in Table 6.1.

### Informal microfinance sector

This sector includes individuals or groups of people involved in collective savings and individual or collective lending practices, not registered or supervised by any

**Table 6.1**

**Current Providers of Microfinance**

| Informal | Semi-formal | Formal |
|---|---|---|
| Friends and relatives | Credit unions or savings and loan societies | Development banks |
| Unregistered moneylenders | Registered moneylenders or finance companies | Commercial banks |
| Self-help groups operating savings and loans schemes (e.g., workers/ employees, women and youth, villagers, sectoral groups such as farmers and fishermen, and church/religious groups) | NGOs implementing microfinance schemes | |
| | Registered village banks | |
| | Government agencies directly implementing microfinance schemes | |

regulatory body (UN-ESCAP 1997). Despite their diversity, they share some features:

(i) small-scale operations with limited sources of funds;
(ii) ease of entry, with no regulations to govern operations or other barriers to entry;
(iii) simple lending requirements and quick processing of loans;
(iv) limited geographical coverage;
(v) transactions at the community level; and
(vi) specific purposes, such as saving for Christmas expenses or paying school fees.

Generally, management capacity is limited. Informal financial systems are the most common source of credit for poor and disadvantaged people living in both urban and rural areas.

It is difficult to determine precisely the level of informal financial sector activity, since it is not captured in official statistics. Suffice it to say that the "rich variety" of informal saving and borrowing mechanisms is of great practical importance and is well integrated into rural and urban life

(Hughes 1998). Informal financial services operate outside the structure of government regulation and supervision, although, with the exception of unregistered moneylenders in countries where legislation governing moneylending exists, their activities are legal. The services of informal providers vary, with some intermediaries extending only credit, others only savings, while most extend both credit and savings.

Informal financial systems thrive because they offer quick, convenient, and affordable ways of accessing credit and saving money, compared to formal financial institutions. They address the need for "quick money" to meet traditional obligations such as funerals, birthdays, weddings, school fees, and pressures to meet traditional and family obligations, for which many people have to borrow. Informal financial providers include friends and relatives, unregistered moneylenders, and self-help groups, commonly referred to as savings and loans clubs.

**Friends and Relatives.** The most common sources of informal credit are friends and relatives. This is akin to *kerekere* in Fiji; *bubuti* in Kiribati; *wantok* in Solomon Islands, Vanuatu, and Papua New Guinea; and *fa'aSamoa* in Samoa. A person may not be required to pay back in cash, but would be obliged to reciprocate in other forms; this is consistent with the cultural reciprocity that is well entrenched in the Pacific region.

**Unregistered moneylenders.** These are the usual source of "quick credit". They generally operate outside the law and often charge high rates of interest. In Tonga and Samoa, finance companies approximate the role of moneylenders, but these companies are required to obtain business licenses. In Vanuatu and PNG, moneylending activity is not regulated, but individuals or companies engaging in moneylending are required to secure a business license.

**Self-Help Groups**. Within communities and work environments, a wide range of self-help groups operates savings and loan schemes. Some offer only loans, others only savings, but the majority offer both. These self-help groups include women's groups, youth groups, farmers and other sectoral groups, employee/staff associations, and church or religious groups. Most self-help groups maintain savings accounts in commercial banks, often held as a group account; one member or the treasurer of the group keeps individual savings records.[8] Self-help groups are widespread in Tonga, active in Fiji and Kiribati, and apparently less active in other PDMCs.

Institutions in the informal sector provide only a limited outreach, as they serve only members or a specific community. The loan amounts are limited and the timing of loans is inflexible, as collecting loans or funds only takes place when there is a person available to do so. There is also a risk of loss of investment or savings of members due to mismanagement of funds.

## Semiformal Financial Sector

The semiformal financial sector consists of individuals or institutions whose financial activities are licensed and supervised by government agencies, but who are not regulated by banking authorities. It includes credit unions or savings and loan societies, registered moneylenders, small-scale finance companies, NGOs implementing microfinance schemes, village banks, and government agencies involved in microfinance activities. The institutions in this sector are either governed by specific legislation (credit unions, savings and loan societies, village banks, and moneylenders), or are licensed or registered under an Act of Parliament (finance companies extending small-scale loans), or by municipal or town councils. NGOs implementing microfinance schemes in the Fiji Islands, Samoa, Solomon Islands, and Tonga are registered by an Act of Parliament, while NGOs in Kiribati are registered with the municipal or town councils. NGOs in PNG have to secure a license to operate.

**Credit Unions**. The most common and longstanding semiformal financial intermediaries are credit unions. The

---

8 In Samoa, a review of one bank's accounts, requested by the Central Bank, found 9,000 group accounts, most of which were held by self-help groups; there are probably similar numbers of accounts in other banks in Samoa.

credit union movement in the Fiji Islands dates back to the enactment of the Credit Union Act in 1954. Samoa passed similar legislation in 1960, PNG in 1962, the Solomon Islands in 1968, Tonga in 1977, Kiribati in 1990, and Vanuatu in 1999. In each country, an apex body for credit unions or savings and loans societies, referred to as the Credit Union League, has been established to supervise and monitor member credit unions. The unions are self-financing organizations composed of groups of people (members) united by a "common bond" of association. They are primarily organized to aid collective saving by encouraging thrift among members, and to provide members with credit for both productive and provident purposes. Both community-based credit unions and employee-based credit unions operate in urban and periurban areas of PDMCs. In some remote rural areas, access to financial services is possible only through credit unions. Credit union members in urban areas are mainly workers from government and private companies. In rural areas, members include salary- and wage-earning workers, such as teachers and hotel workers; farmers; fishers; and women, church, and youth groups.

The number of credit unions has dwindled over the years because of mismanagement, but efforts are now being made to strengthen them. There are more than 600 credit unions in the seven PDMCs, about one third of them active (Table 6.2).

**Finance companies and registered moneylenders.** These are also semiformal financial intermediaries. They include village banks (in Kiribati), Five Star Finance Co. Ltd. (in Tonga), Co-operative Savings and Loans Society Ltd. (in Melanesia), and registered moneylenders (in Vanuatu). Where there is no legislation on moneylending, as in Samoa, Solomon Islands, and Tonga, finance companies approximate the role of moneylenders. In the Fiji Islands and Kiribati, moneylenders are regulated pursuant to the provisions of the Moneylending Act, and in PNG, moneylenders are required to secure a license. Vanuatu is drafting legislation on moneylending.

A substantial number of lending transactions takes place through finance companies. For example, a finance company in Vanuatu disbursed total loans to the amount of Vt10 million within six months and boasted a total membership of 1,400. A

**Table 6.2**

**Existing and Dormant Credit Unions/Savings and Loan Societies [a]**

| Country | Active | Dormant | Total |
|---|---|---|---|
| Fiji Islands | 52 | 15 | 67 |
| Kiribati | 60 | 70 | 130 |
| Papua New Guinea | 21 | 76 | 97 |
| Samoa | 20 | 55 | 75 |
| Solomon Islands | | | |
| Credit Unions | 36 | 128 | 164 |
| Savings Clubs | 6 | 15 | 21 |
| Tonga | 23 | 46 | 69 |
| Vanuatu | 6 | 45 | 51 |
| Total | 224 | 450 | 674 |
| Credit Unions | 218 | 435 | 653 |
| Savings Clubs | 6 | 15 | 21 |

a. In some PDMCs, data on dormant credit unions are not available. For these countries, data are estimated by subtracting the existing number of credit unions compared to the year with the highest number of registered credit unions.
Sources: Credit Union League or Credit union; ILO 1999.

finance company in Tonga had weekly loan releases between T$30,000 to T$40,000 and estimated having 400 regular customers, mostly from Government offices. Tonga has the highest number of registered small-scale finance companies (around 300), and Kiribati has the lowest number of registered moneylenders (11, of which eight are registered with Tenaina Urban Council and three with Betio Town Council).

Though finance companies usually charge higher interest rates than banks, their quick service is highly valued. Many people prefer to borrow from finance companies and moneylenders because of the relative ease in accessing credit. Collateral requirements are relatively easy to comply with and take the form of household assets, salary or bank deposits, or traditional items such as fine mats (in Tonga and Samoa) and *tabua*, or whales teeth (in Fiji Islands). A one-page application suffices for paperwork, and funds are normally released in an hour or two. Some finance companies also operate through a network of agents, usually staff in government and private companies.

**NGOs**. In PDMCs, the involvement of NGOs is limited. At present, there are only 11 NGOs undertaking various microfinance schemes in the seven PDMCs.

**Village banks.** These exist only in Kiribati. The Government launched the Village Bank program in June 1995 in support of its development policy—*kamaeroan te i-Kiribati*, which literally means "the improvement of the living standards of i-Kiribati"—and in response to the demand for microcredit, especially in the outer islands. The Government allotted a total of A$450,000 from the Kiribati National Development Fund to establish 182 village banks nationwide, covering 23 of 24 inhabited islands, including South and North Tarawa. The Rural Planning Unit of the Ministry of Home Affairs and Rural Development, through its cadre of Island Project Officers based in each island, is responsible for overseeing the implementation of the Program.

Village banks are the most common sources of credit, especially in the outer islands. They are owned and managed by village people through a village committee, with minimal supervision by the Government. Village banks provide loans to members at a reasonable rate of interest not exceeding 10 percent per year for a maximum term of eight months, though the term is sometimes reduced to one month. They do not accept savings from their members. The Village Bank Act of 1998 regulates the Village Banks, requiring them all to be registered.

**Government agencies.** There has been increasing interest in, and support by, governments for microfinance. Government agencies either directly operate or coordinate microfinance schemes in all PDMCs except Samoa and Tonga (Table 6.3). Funds for government-initiated microfinance schemes are either provided by governments themselves or by donor agencies, notably New Zealand Overseas Development Assistance (NZODA) and the United Nations Development Programme (UNDP). The governments of Samoa and Tonga have both been involved in microfinance schemes. With the exception of the Women's Grants Scheme in PNG, started in 1988, government microfinance schemes are relatively new.

**Table 6.3**

**Government Agencies' Current Involvement in Microfinance**

| Country | Government Agency Directly Implementing Microfinance Program | Government Agency Coordinating Microfinance Program | Title of Microfinance Program | Modality |
|---|---|---|---|---|
| **Fiji Islands** | Department for Women and Culture | | Women's Social and Economic Development Program (WOSED) | Grameen Bank Replication (Modified) |
| | | Microfinance Unit, Ministry of Commerce, Business Development and Investment | Fiji Microfinance Program | Grameen Bank Replication (Modified) |
| **Kiribati** | None | Rural Planning Unit, Ministry of Home Affairs and Rural Development | Village bank Program | Village Bank Individual lending (Modified) |
| **PNG** | None | Women's Division, Department of Religion, Women's Affairs and Youth | Women's Grant Scheme | Wholesale lending to provincial associations |
| **Samoa** | None | None | | |
| **Solomon Islands** | None | Women's Development Division of the Ministry of Youths, Women and Sports | Solomon Islands Microfinance Scheme for Women (SIMIWODS) | Grameen Bank Replication (Modified) |
| **Tonga** | None | None | | |
| **Vanuatu** | Department of Culture, Religion, Women's Affairs and Archives | None | Vanuatu Women's Development Scheme (VANWODS) | Grameen Bank Replication |

Sources: Credit Union Leagues & Credit Union Registrars, project implementers and relevant reports

They were introduced in the middle of the 1990s, mostly as pilot programs that were later expanded.

The Government of the Fiji Islands has given the most substantive support in facilitating the development and growth of microfinance. A National Microfinance Conference has been conducted, with participation by Government representatives, NGOs, donor agencies, microfinance practitioners, staff of the University of the South Pacific, and resource persons from well-known MFIs such as the Grameen Bank, the Foundation of Development Corporation, and the Asian Development Centre. A draft National Action Plan on Microfinance resulted, which outlined strategies to promote awareness and understanding of microfinance, and to improve the access of the poor and disadvantaged to financially viable and sustainable financial services. A Microfinance Unit within the Ministry of Finance was established (recently transferred to the Ministry of Commerce, Business Development and Investment), with F$3 million in funding from the Government. The unit is currently pilot-testing a microfinance scheme through the provision of grants to the Fiji Council of Social Services, an apex organization of NGOs, which in turn on-lends to target clients.

More recently, in September 2000, the PNG Cabinet approved a Microfinance and Employment Policy whose objective is to provide sustainable microfinance services to viable formal and informal enterprises and savings services to the general population. Achieving this objective will involve capacity building of MFIs through a Microfinance Competence Center; the development, testing and implementation of new savings and loan products and delivery methods; and the provision of a Revolving Finance Facility. This initiative is supported by an ADB loan approved in October 2000.

## Formal Financial Sector

The formal financial sector comprises financial institutions that are chartered by government and are subject to banking regulations and supervision, mostly development banks and commercial banks.

**Commercial banks.** Most poor and disadvantaged people have limited access to financial services from commercial banks in PDMCs. Commercial banks extend personal loans to those with regular sources of income and those who are able to comply with security and other banking requirements. They also offer savings services targeted primarily at wage and salary earners. Banks are oriented toward providing large loans, which are beyond the absorptive capacity of poor borrowers. Banks' paper requirements are often too complicated for poor borrowers, who typically have low levels of education. Mostly, banks perceive poor people and microentrepreneurs to be too high a risk, and too costly to serve because of the small loan size and their inability to meet security requirements. With their offices and branches concentrated in urban and periurban areas and the bigger islands, most commercial banks have limited outreach.

**Development banks.** These may extend microloans, either as part of their regular lending activity or through a special window with funding from donor agencies. Otherwise, their services may be inaccessible to the majority of disadvantaged people, because the usual banking requirements concerning collateral are enforced and because a substantial amount of paperwork is involved. The size of their loans is usually also beyond the absorptive capacity of low-income earners.

## PERFORMANCE OF SELECTED MICROFINANCE INSTITUTIONS

Microfinance providers or institutions (MFIs) adopt various modalities or methodologies: (i) individual lending; (ii) Grameen-style solidarity lending and its derivatives; (iii) village banking; (iv) revolving loan funds; and (v) savings and loan associations (Table 6.4).

### Geographical and Client Coverage

Credit unions, widely present in both urban and rural areas, have the widest geographical and client coverage (Table 6.5). They are often the only source of financial services to people in remote areas. They had 109,578 members at the height of the movement's popularity. With the decline of the movement in the 1990s, membership has dropped dramatically, although the exact figure cannot be determined. The two largest PDMCs have the most members.

The village banks in Kiribati are effectively nationwide. Development banks have also endeavored to expand their geographical outreach to rural areas and outer islands in the seven PDMCs, in keeping with their mandate to contribute to the development of rural areas. However, they have been constrained by the considerable cost of delivering financial services to rural areas, and have had to rely on donor funding or government subsidies to continue operations. The microloan schemes of development banks in Samoa, Solomon Islands, and Tonga have been terminated because funds have been exhausted. FDB's scheme is still operating with bilateral donor funds.

Microfinance schemes implemented by NGOs and government agencies have limited geographical coverage. Most of them are concentrated in urban and periurban areas and are mostly pilot projects with limited funds. The Women's Social and Economic Development Program (WOSED) in the Fiji Islands is an exception, and has been able to expand its outreach to rural areas, because it has a network of staff and because the operational costs are subsidized from the regular budget operation. It is clear that geographical outreach for NGOs is dependent on the availability of funds. Given donors' limited financial assistance, schemes usually cover only the urban and periurban areas; expanding their outreach to rural areas would be too costly.

NGOs with long-running microfinance schemes, such as Liklik Dinau Abitore Trust (LLDAT) in PNG and the Tonga National Youth Council (TNYC), have reached more clients than NGOs with newer microfinance activities, such as Young Women's Christian Association (YWCA) in Solomon Islands, Social and Economic Equity for the Disadvantaged (SEED) Foundation in Fiji Islands, and Women in Business Foundation (WIBF) in Samoa. Except for TNYC, which targets youth groups, the NGOs target mainly disadvantaged women.

NGOs that replicate the Grameen Bank model utilize means tests to screen potential members. Loans are small and

**Table 6.4**

## Modalities/Methodologies Adopted by Existing Microfinance Providers/Institutions

| Principals/ MFIs | Individual Lending | Grameen – style Solidarity Group Lending | Village Banking | Revolving Loan Funds | Savings and Loan Associations |
|---|---|---|---|---|---|
| Existing MFIs | Development banks offering microloans (FDB, TDB, SDB, SIDB) | Fiji: Dept. for Women & Culture/ WOSED & SEED Foundation PNG: Liklik Dinau Abitore Trust Fund Samoa: WIBF Solomon Is.: YWCA/ SIMIWODS Vanuatu: Dept. of Culture, Religion, Women's Affairs and Archives/ VANWODS | Kiribati: village banks | Tonga: TNYC | In Fiji Islands, Kiribati, Samoa, Solomon Islands, Vanuatu: Credit unions In PNG: Savings and loan societies In Fiji Islands: UNDP/ SMILE initiated savings and loan Scheme |
| Clients | Individual | Individual, through groups | Individual, through village banks | Groups | Individual, through credit union or SLS |
| Credit officers' relation to client | Close, with individualized attention | Very close, through weekly/ fortnightly meeting | Distant, focus on committee members | Distant, focus on group officers | Distant, focus on officers of committees |
| Loan Approval | Based on analysis of project viability and client's capacity to repay Centralized loan approval | Group involved in loan appraisal and approval | Committee-appraised loan applications & loans approved by members | Appraised and approved by agent/ TNYC | Appraised and approved by credit committees |

cont. next page

**Table 6.4** (cont)

**Modalities/Methodologies Adopted by Existing Microfinance Providers/Institutions**

| Principals/ MFIs | Individual Lending | Grameen – style Solidarity Group Lending | Village Banking | Revolving Loan Funds | Savings and Loan Associations |
|---|---|---|---|---|---|
| Loan Characteristics | Loans usually large & beyond the absorptive capacity of the poor Stringent loan requirements and procedures Longer loan processing Loans geared more for small-scale enterprises | Small loans taking into account paying capacity of clients Simplified requirements and streamlined procedures Loans mainly for income generating projects | Small loans Minimal loan requirements Loan disbursement depends on availability of funds Loan for productive or provident purposes | Group loan based on criteria Endorsement from umbrella organization Loan strictly for income generating activities | Loan size varies based on certain percentage of savings Simple loan requirements Fast disbursement of loan Loan for productive and provident purposes |
| Guarantees | Collateral and/or co-signers | Mutual guarantee of group/ center members (in some cases group guarantee not enforced) | Easy to comply with collateral, at times not required -village pressure | Peer pressure Endorsement by umbrella organization | Collateral required most of the times but easy to comply with Peer pressure |
| Savings | Not essential | Key part of methodology | Not essential | Not required | Fundamental principle—save before borrow |

Sources: Credit Union Leagues & Credit Union Registrar, project implementers, and relevant reports.

**Table 6.5**
**Geographical Outreach of Selected Microfinance Institutions**

| Microfinance Institutions | Country | Name of Microfinance Project | Geographical Coverage |
|---|---|---|---|
| 1. Credit Unions | Fiji Islands | Credit Union | Key urban areas: Suva, Nadi, Lautoka, Singatoka, Labasa; and rural areas of Vatukula, Nmosi, Ovalau, Bua, and Taveuni |
| | Kiribati | Credit Union | 18 out of 23 inhabited islands |
| | PNG | Savings and Loans Association | 8 out of 17 regions nationwide |
| | Samoa | Credit Union | Upolu and Savaii (two largest islands) |
| | Solomon Islands | Credit Union | Central, Guadalcanal, Honiara, Isabel, Makira, Malaita, Temotu, Western, and Choseui |
| | Tonga | Credit Union | Three main islands: Tongatapu, Vavau, and Ha'apai |
| | Vanuatu | Credit Union | Port Vila, Pentecost, Ambae, Maewo, and Ambrym |
| 2. NGOs<br>a. Replicating Grameen Bank | | | |
| LLDAT | PNG | LLDAT Trust Fund | Four districts of Eastern Highland Provinces [a] |
| YMCA | Solomon Islands | Solomon Islands Microfinance Scheme for Women (SIMIWODS) | Two low-income settlements in Honiara: Lord Howe and White River Settlements |
| SEED | Fiji Islands | SEED Foundation Microfinance Scheme | Five squatter areas in greater Suva: Tacirua, Saika, Naiyala, Namadi, Wailea; and three low-income communities in suburb of Suva: Kinoya, Bagasau, and Valelevu |

cont. next page

**Table 6.5 (cont.)**
**Geographical Outreach of Selected Microfinance Institutions**

| Microfinance Institutions | Country | Name of Microfinance Project | Geographical Coverage |
|---|---|---|---|
| Fiji Council of Social Services | Fiji Islands | Microfinance Scheme of National Microfinance Unit | Drekena Village is Rewa (pilot site); other sites identified for expansion |
| Women in Business Foundation | Samoa | WIBF/UNDP Microenterprise Financing & Savings | Island of Savaii |
| b. Operating Revolving Fund TNYC | Tonga | TNYC Credit Scheme | Tongatapu, Ha'apai, and Vavau |
| 3. Village Bank | Kiribati | Village Bank Program | 182 wards covering 23 islands |
| 4. Development Banks | Fiji Islands | New Zealand Loan Scheme | Nationwide |
| | Samoa | IFAD Pilot Credit Fund | Urban and mainly rural areas |
| | Solomon Islands | Women's Credit Scheme | Honiara and Guadalcanal |
| | Tonga | Outer Islands Credit Project | Major islands except Tongatapu |
| | | NZODA Outer Island Rev. Fund and Women's Dev. | Major island groups except Tongatapu |
| 5. Government agencies Dept. for Women & Culture | Fiji Islands | Women's Social & Eco. Dev. (WOSED) | Caukadrove, Bua, Macuata, Central & Western Divisions |
| Dept. for Culture, Religion, Women's Affairs & Archives | Vanuatu | Vanautu Women's Dev. Scheme | Low-income communities in Port Vila |
| 6. UNDP/SMILE Program | Fiji Islands | Enterprise-based and community-based S&L | Greater Suva area (14 factories; three low-income communities; two religious groups) |

a. As of December 1999 for Goroka and Kainatu branches
Sources: Credit Union Leagues & Credit Union Registrar, project implementers and relevant reports

within the absorptive capacity of poor clients, requirements are simple, and services are rendered quickly and at the community level. Peer guarantee is used as a substitute for collateral. Loans are short-term and are renewed or increased based on repayment records. Clients are characterized by low levels of education and no formal employment outside the home. They are mostly women with very limited entrepreneurial skills and experience, who want to earn money to augment meager household incomes. Access to credit is more important than the rate of interest, as shown by the experiences of Fiji Islands' SEED Foundation and Women's Social and Economic Development Program (WOSED), Solomon Islands Microfinance Scheme For Women (SIMIWODS), and Vanuatu Women's Development Scheme (VANWODS), which all charge interest higher than 10 percent per year. Clients are willing to save small amounts of money when the motivation and convenient and affordable savings mechanisms are present. The client outreach of NGOs' microfinance schemes is limited by funding, by civil unrest (in Solomon Islands), by slow training processes and by the low educational level of clients.

Government agencies replicating the Grameen Bank model are gradually expanding their outreach to disadvantaged women. WOSED, under the Fiji Islands Department of Women and Culture, has gained a total outreach of 534 clients since it was pilot-tested in April 1993, while VANWODS has served a total of 405 disadvantaged women in Port Vila since it started in 1996.

## Institutional Capacity

Most MFIs have limited institutional capacity for expansion and sustainability, as they have weak governance structures, inadequate staffing, and no business plan. This situation results partly from the lack of training in microfinance, and is being remedied to some extent through the UNDP Pacific Sustainable Microfinance and Livelihoods Through Empowerment (SMILE) Program, which has assisted WOSED, SIMIWODS, VANWODS, SEED Foundation, and WIBF in preparing their viability plans. Grameen Bank replicators do not necessarily share the same institutional weaknesses, because of the varying technical support of donor agencies. This is especially true for those with full-time microfinance specialists like LLDAT, VANWODS and SIMIWODS.

Credit unions and Grameen Bank replicators like Liklik Dinau Abitore Trust and SEED Foundation focus only on microfinance, whereas some other MFIs administer other projects and programs. This can lead to a lack of focus that adversely affects the performance of microfinance schemes. For example, although TNYC and WIBF have staff assigned to microfinance projects, they administer other projects as well and their resources, time and focus are consequently dissipated. Government agencies also carry out other programs while implementing microfinance schemes. Development banks do not treat microfinance schemes separately from regular banking services, and the staff are responsible for the delivery of all these services as well as microfinance.

Because they are at an early stage of development, most MFIs in PDMCs need technical assistance to strengthen their institutional capacity to deliver efficient ongoing microfinance services. Several MFIs have expressed this need for technical assistance, including the Microfinance Unit in the Fiji Islands, the Village Bank Program in Kiribati, TNYC, and most development banks operating microfinance schemes.

Credit unions in villages with few educated people have problems maintaining good financial records. Boards of directors for credit unions and for credit union leagues also do not have sufficient financial management capability to make sound financial decisions. There is a high turnover of officers and a shortage of full-time staff is a perennial problem that constrains service delivery, especially field visits to affiliated members. The leagues also face financial constraints, some receiving minimal support from government.

Most MFIs, except those receiving technical assistance, have no accurate management information systems. Even those receiving technical assistance have difficulty in producing timely reports. Some credit unions do not regularly submit reports to their credit union leagues, which is why data are not available to assess the various microfinance schemes. Some leagues, for lack of manpower and technical capability, are not able to use the data in making decisions, addressing problems and issues, or assessing the accountability of credit unions. Village banks in Kiribati encounter the same problem: even when monthly progress reports have been regularly submitted by the Island Project Officers to the Rural Planning Office or the Ministry of Home Affairs, which oversees the village banks, the data are collated but not analyzed or used to make decisions or address problems.

### Financial Self-Sufficiency

The review of selected MFIs in the seven PDMCs established that not one has yet achieved financial self-sufficiency. This is certainly partly because the MFIs are in the early stages of development, where the operational costs of delivering microfinance services far exceed incomes. Experience in other developing countries shows that operational efficiency can be achieved in three to seven years and financial self-sufficiency (costs equal income) within five to ten years (Committee of Donor Agencies 1995). Achieving self-sufficiency will probably take longer in PDMCs. VANWODS posted a 46 percent operating self-sufficiency rate, WOSED posted 13 percent, while LLDAT fared better with 18.2 percent. The TDB Outer Island Project registered 22.3 percent (McGuire 1996). However, these rates fall well below the standard of 100 percent.

The failure to achieve financial viability makes MFIs heavily dependent on government subsidies and donor assistance, both financial and technical. Credit unions tend to show a greater degree of self-reliance, because they are able to lower their costs of operations by using the volunteer services of members, and are also able to mobilize members' savings. Nonetheless, no MFI has yet demonstrated financial viability. Measures to increase revenue and reduce costs need to be adopted to hasten the achievement of self-sufficiency. These should include charging higher interest rates: many MFIs, particularly credit unions, are charging interest rates equivalent to only 1 percent per month on a declining balance.

Grameen Bank replicators tend to charge higher interest rates and have better portfolio quality than other MFIs. VANWODS has an exemplary record, with consistent 100 percent repayment over more than four years. Similarly, SIMIWODS posted a high repayment rate of 96 percent. Other schemes have lower repayment rates: SEED at 86 percent, WOSED at 83 percent, WIBF at 80 percent, and LLDAT at 71.1 percent (in 1998). The International Fund for Agricultural Development project executed by the Development Bank of Samoa has the lowest at 65 percent.

### Networking

Networking among MFIs within countries and within the region has been minimal. To date, there has been only one regional microfinance conference sponsored by NZODA in 1995, followed by a microfinance conference in the Fiji Islands, and microfinance workshops conducted by Pacific SMILE in Solomon Islands, Samoa, Fiji Islands, and Vanuatu. SMILE has established linkages with various MFIs in the Pacific, particularly schemes that are funded by UNDP such as VANWODS, SIMIWODS, SEED Foundation, and WIBF. Close coordination also exists between WOSED and SMILE, with technical assistance provided upon request. Linkages have also been established with Vanuatu's village bank program and TNYC, where assistance has been sought from SMILE to evaluate the schemes. Some MFIs indicate that they do not know where to seek advice concerning microfinance.

## EXPERIENCES AND LESSONS IN MICROFINANCE

Microfinance is surrounded by myth. Some of the most common beliefs are shown, and dispelled, in Table 6.6. The general truths—that microentrepeneurs are knowledgeable, creditworthy people with viable projects, that the poor do save, that microfinance interest rates can and should reflect operating costs, and that care must be taken in packaging credit with other services—apply in the Pacific Islands.

**Table 6.6**

**Common Myths and Realities about Microfinance**

| MYTH | REALITY |
|---|---|
| Microentrepreneurs need to be cared for because they are poor. | Microentrepreneurs are knowledgeable about doing business in their local economy. They often have years of experience in their trade, working with dedication and determination. Belief in the intelligence and business knowledge of clients is critical. |
| Microenterprises are redundant activities that should be replaced by larger businesses employing many people. | While often marginal, microenterprises are viable, locally important activities that should be upgraded. These small-scale economic activities are valid business activities to be taken seriously. |
| Interest rates to the poor need to be subsidized. | Microfinance rates of interest must reflect operating costs to achieve sustainability. Organizations making large numbers of small loans will have high transaction costs and thus need to charge interest rates that are higher than commercial rates. However, microfinance rates are still significantly lower than those charged by moneylenders and other sources from which the poor borrow. |
| Credit alone is useless. It must be packaged with training, marketing, technology, and other services. | Although programs that package credit with other services may seem ideal, they require large subsidies and have proven to be largely unsustainable. The minimalist approach used by the Grameen Bank and many others has shown that clients can use credit in small amounts to start or improve the profitability of their microenterprises. Providing marketing and many other types of services is worthwhile, but best managed separately. |
| The poor cannot be trusted with credit. The consumption needs of the poor are so pressing that any loan will find its way quickly to consumption. | The high repayment rate of millions of microfinance clients is empirical proof that the poor are creditworthy. |
| The poor are unable to save. | The high rate of savings reported by many microfinance organizations demonstrates that the poor can value savings as much as credit. |
| Poverty has crippling effects rendering the poor unable to improve their condition. | The remarkable success of institutions lending to more than 10 million clients around the world, the vast majority of whom are below the official poverty line (usually defined by caloric intake), proves beyond doubt the ability of the poor to improve their lives with their own ingenuity and drive. |

Source: UNDP and Citicorp Foundation 1997.

Specific lessons learned from experience with microfinance schemes in the Pacific, typically involving loan amounts in the range of US$50 to US$500, are summarized below. [9]

- MFIs often lack the institutional capacity, management expertise, and resources to operate sustainable schemes. Microfinance schemes therefore should be carefully designed, and all essential elements for successful implementation considered. Expert technical assistance is essential.
- Microfinance schemes should be tailored to meet the financial needs of potential clients, while retaining a focus on viability. These needs may extend beyond income-generating activities/enterprises to encompass social purposes.
- Some microfinance schemes are not compatible with the local culture. Many schemes, especially those targeting women and the poor, are undermined by the lack of support from men, other family members, or local elites, who feel that they have been excluded from the scheme. Therefore, a thorough study of the local situation must be carried out to assess the suitability and acceptance of the scheme. Participatory appraisal approaches should be adopted.
- Schemes that charge relatively low interest rates and do not require compulsory savings generally do not foster a sense of sacrifice and ownership, and tend to lead to poor repayment rates and eventual depletion of the lending capital. Compulsory savings, even in small amounts, should be required where feasible.
- Many schemes do not carry out a realistic assessment of the income generation potential in a particular locality before implementation. This has been the reason for failure of many outer island and rural village schemes, where the population is small (about 100 to 200 people) and where there is little or no regular source of income. There is a need to conduct a market assessment to identify viable projects.

[9] These lessons were drawn mainly from Liew 1997 and validated during fieldwork.

- Credit alone is not sufficient to ensure that borrowers succeed in their income-generating projects. There is a need for a comprehensive package of support services, including business skills training and on-demand advisory support services. More deliberate, officially sanctioned, and reliable linkages between credit schemes and other development services are important to ensuring the sustainability and pertinence of microlending schemes for the poor.
- The "copy cat" syndrome is very prevalent in most Pacific communities. Coming up with a good moneymaking idea is extremely difficult, especially in small islands and the rural areas; but experience elsewhere shows that successful repeat borrowers more frequently invest in another new activity rather than expanding an existing one. The reason for this is that in small communities, the potential for expansion is very limited and there is more potential for doing something new. A continuous injection of new ideas, of making and doing something different, is important. In many cases such new ideas will come from outside.
- These lessons were drawn mainly from Liew 1997 and validated during fieldwork. There are no national and regional networks of microcredit programs that distill the wealth of knowledge and systematically share it among microcredit practitioners. Consequently, every new scheme struggles on its own, making the same mistakes as other schemes. Networking and information sharing should be strengthened and a mechanism such as a national or regional association of microfinance practitioners set up.
- Many microfinance schemes fizzle out because of lower-cost competition from grant-in-aid programs implemented in the same location. Having a national policy on microfinance and more careful planning and location of projects would avoid such unnecessary and unproductive competition and duplication.
- Little effort has been made to build capacity at the community level and to use community-based organizations to manage microfinance schemes. The prevailing attitude among government officials is that grassroots organizations are made up largely of poorly educated and rural people who cannot handle microfinance schemes. However, several

schemes that are managed entirely by local communities have worked well. Some have shown great creativity and responsibility in coming up with sound solutions to their problems. Such initiatives should be encouraged.

- Most PDMCs do not have NGOs with the staff, experience, or resources to manage a microfinance scheme. As a result, some schemes are implemented through government departments, such as women's affairs and rural development departments. However, these departments are often also inadequately staffed and resourced; the staff members operating the schemes sometimes become over-authoritarian and preoccupied with loan collection instead of helping the beneficiaries to better manage their finances and livelihood projects. NGOs should be encouraged to participate in microfinance and, whenever possible, governments should eventually pass on the scheme to them if there is corresponding capacity building provided within the scheme.
- Most donor funds for microfinance are channeled through governments and follow established accounting and disbursement procedures, generating much paperwork and a trail of approvals. Although this is good for accountability, many schemes pass these bureaucratic requirements on to the borrowers, who have to fill in many forms, wait long periods of time for approvals, and sign legal documents giving the State the right to prosecute if they default on a loan. Streamlining of procedures and release of funds is needed, subject to full assessment of profitability.
- People in positions of influence often do not attach much importance to micro-finance schemes, mainly because they involve relatively small amounts of money, are largely grassroots-oriented, and target primarily women and the poor. They are not as glamorous as large development banking and investment financing schemes, which attract political support. Serious government support is vital for microfinance to flourish and to benefit the large majority of the poor.
- Most microfinance schemes utilize very low interest rates that are often set quite arbitrarily. Where schemes are donor funded, seed capital is often considered to be "free" money.

However, the poor are able and willing to pay market rates of interest as long as they get good, quick service. Donor funds could be well spent on training and capacity building for MFIs. Borrowing from commercial banks should be explored, where costs can be passed on to the borrowers.

## THE FEASIBILITY OF MICROFINANCE IN SMALL PACIFIC ECONOMIES

In making an assessment of the feasibility of microfinance in selected PDMCs, the central question is: "Do the conditions in PDMCs warrant the development of sustainable microfinance systems that can provide efficient and responsive services to the majority of low-income households?" The answer to this question requires an examination of the following: (i) the achievements of microfinance in the Pacific; (ii) factors contributing to sustainable microfinance; (iii) factors hindering sustainable microfinance; and (iv) the preconditions for sustainable microfinance.

### Achievements

Microfinance has helped clients develop good savings habits, shattering the myth that the poor are unable to save and that the cultural environment in the Pacific is not conducive to cash saving. The accumulated savings of clients of schemes such as LLDAT, WOSED, SIMIWODS, and VANWODS and of credit unions demonstrate that low-income households can save small amounts of money on a regular basis. The high repayment rates registered by Grameen Bank replicators such as VANWODS (100 percent loan repayment) and SIMIWODS (96 percent) demonstrate that the poor, especially women, can be creditworthy.

MFIs have also enhanced the process of broadening and deepening rural financial markets, helping successful clients to earn income and to invest in improved nutrition, housing and household assets, education, and health care for the family. They have also enabled clients to gain experience in managing microenterprises.

## Contributing Factors

The growing support of development agencies and governments aids the development of sustainable microfinance in PDMCs through the provision of technical assistance. The increased participation of institutions in microfinance, and especially the emergence of new institutions like NGOs, is gradually building the institutional capability to deliver microfinance services. The liberalized policy on interest rates being adopted by PDMCs also enables MFIs to charge interest rates that will help to cover their operational costs, while meeting the huge unsatisfied demand for microfinance services.

## Hindering Factors

On the other hand, MFIs must contend with the high cost of delivering services, especially to people in rural areas and outer islands. Small and highly dispersed populations make it difficult to obtain a critical mass of clients. Some MFIs have poor loan repayment performances. The lack of self-sufficiency, limited institutional capacity, inadequate financial resources to expand outreach, and lack of policy and legal frameworks all constrain the sustainability of MFIs. Other conditions, such as weak support services for business development, poor market linkages and extension, limited cash income opportunities (especially in rural and remote areas), and limited entrepreneurial skills of clients, also act as constraints to MFIs' viability.

## Preconditions for Successful Microfinance

The constraints that small size imposes on the viability of MFIs are less severe for the larger PDMCs (Fiji Islands, PNG, and Solomon Islands); but in general, viability depends on five factors:

(i) the availability of cash income opportunities in rural areas;
(ii) the strength of the commitment of MFIs to outreach and sustainability;
(iii) the long-term commitment of governments and donor

agencies to provide financial and technical assistance to MFIs for institution strengthening, and funds for administrative costs and related support services;

(iv) the provision of a policy and legislative environment that is conducive to facilitating the growth of microfinance; and

(v) improved viability through the provision of support services, especially in microenterprise development and management and social mobilization.

Achieving self-sufficiency for MFIs in the Pacific is a longer-term proposition than the five to ten years in the Guiding Principles agreed to by donor agencies, because of the need to build the infrastructure for markets to develop and for cash income opportunities in rural areas to increase. There is no one best model for microfinance in PDMCs, given the differences in population density, infrastructure and other factors. Whatever modality is adopted, practice should be informed by the lessons outlined above.

**Box 6.1**

**Best Practice for Microfinance**

Market rates of interest should be charged to clients to ensure sustainability of microfinance schemes. Compulsory saving through such schemes helps to inculcate good savings habits and to improve loan repayment performance. Peer pressure through solidarity groups fosters group accountability and responsibility and results in high rates of loan repayment; in particular, mobilizing women into groups deepens their commitment to microfinance schemes.

Measures must be taken to ensure the efficient operation of microfinance schemes, including training of microfinance specialists and provision of technical advice at both management and staff levels.

Microfinance schemes need a policy, legal, and regulatory environment conducive to facilitating their growth.