International Enterprise for Development of Rural Micro Finance Services
(DRMFS-International)

Rural Micro Finance Support Project
(RMFSP)

A joint project in cooperation with
Bank Keshavarzi
Islamic Republic of Iran

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1. Project summary

The Rural Micro Finance Support Project, funded by IFAD from Italian supplementary fund resources, is a joint project of International Enterprise for Development of Rural Micro Finance Services (DRMFS-International), an international NGO, with Bank Keshavarzi (BK), the agricultural bank of the Islamic Republic of Iran. The overall **objective** of the project is to expand the microfinance services in poor and deprived regions of Iran by leveraging the resources and institutional capacity of BK in partnership with civil society organizations. The **core target group** are the rural poor in general, rural women and young adults (referred to as youth); in phase I women actually constituted 53% of the borrowers.

Based on the results of a socio-economic survey in some sample villages, which revealed that only 1.5% of women and young adults had access to bank credit, the project has been **implemented during Phase I in four provinces** (Ardebil, East Azerbaijan, West Azerbaijan, Kurdestan), with the assistance of four Iranian NGOs. DRMFS-International has provided technical assistance in the form of development services; BK has provided credit and supervision; the NGOs, without any experience in microfinance, have provided basic social mobilization and group guidance services. The NGO facilitators have resided in the respective provincial capitals; in the future, their function may be supplemented by local community facilitators, among them energetic young graduates found working as farmers in the villages.

BK has approved credit amounting to Rls 4.96 billion ($620,000) to 50 groups; actually disbursed were Rls 4.44 billion ($555,312)[1] to 48 groups, averaging Rls 103.33 per group with an average of 13.9 members, or **Rls 7.42 million ($939) per member**. BK also provides crop and livestock insurance. As the first annual instalment has not yet been due, the amount disbursed is equivalent to the amount of loans outstanding.

The groups have served as **channeling groups**, acting at the same time as **solidarity groups** of mostly 10-20 members who guarantee each others' loans; in line with its usual practice of securitization through third party guarantees, the bank has therefore waived physical collateral requirements. As channeling groups, they onlend to their members on the same terms at which they receive the loans; to-date there is no financial intermediation or transformation of size and duration by the groups. The group members receive loans up to Rls 8million (US$ 1000)[2], repayable in annual instalments, up to a maximum of 5 years. While there is some variation in loan terms, ranging from Rls 6-9 million and 1-5 years, there appears to be a tendency (at least in some areas) to standardized loans of Rls 8 million for 5 years, regardless of loan purpose, cash flow and repayment capacity. With start-up loan sizes in the meso- rather than microfinance range, the groups may be well-advised to request the listing of non-formal collateral as an internal back-up of their personal gurantees.

There is some variation in **lending rates** (ie, profit rates, interest rates). In Ardabil Province, the loans were granted at the usual agricultural lending rate of 13.5% effective p.a. In the Azerbaijan provinces, 75% of each loan were granted at a nominal rate of 13.5% p.a. and 25% at a rate of 4% p.a., averaging 11.125% effectively p.a. At an inflation rate of 17.5% during 2003, the real interest rate is thus negative, at –4.0% in Ardabil and –6.375% in Azerbaijan: hardly an inducement for a bank to vigorously expand lending.[3]

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[1] Calculated at the official exchange rate of Rls 7900 per US$, the respective figures would be US$627,848 and US$ 562,342.
[2] There may be minor deviations.
[3] The nominal interest rate of passbook savings is 7%. This leaves the bank with a positive spread: insufficient however to cover all its costs. Moreover, taking inflation at 17.5% during 2003 into consideration, the real interest rates for passbook savers is –10.5%, which means that savers loose one-tenth of the value of their savings every year due to inflation.

There is a **limited range of actual loan uses**. The loans have been used for a variety of purposes (eg, tailoring, capet-making, box-making, trading), but mainly for individual livestock projects, particularly sheep-raising, and dry-land agriculture. There are a few group projects, eg, for buying a tractor As group projects have proven elsewhere to be very risky, they whould be either discouraged, or at tightly supervised by the bank . They should be submitted to the bank's own scrutiny. Eg, tere is no justification under the project for a tractor loan to six relatives; such projects are financed through BK's regular instruments. An earlier, erroneous interpretation of solidarity group lending as lending for group projects has been corrected. Opportunities for other income-generating activities (IGA) in the villages visited in remote areas appear to be very limited.

All group members have to open **savings accounts**; but there are no mandatory savings. The group members have deposited a total of Rls 124.6 million ($15,770), or Rls 0.19 million ($24) per member, which is equivalent to 2.8% of the loans received. During the first year, they were deposited in interest-free Qarz-ol-Hasaneh accounts; but this is expected to be changed into interest-bearing accounts. Propensities to save vary considerably between the pilot project areas.

Credit is disbursed by the nearest BK branches, where the group members also open their savings accounts and repay their loans. However, during the pilot phase, loan decisions and loan supervision are carried out by the respective provincial offices of BK, which are far from the villages which all have been chosen from remote areas. As the project expands and turns into into regular operations, lending decisions, disbursement and monitoring will have to be brought together at branch level.

Actual accomplishments during phase I have exceeded project targets of 30 groups (*actually:* 48 groups) and loans disbursed of US$150,000 (*actually:* ($555,312) by a wide margin. **Outreach** (*actually:* 667 members) could easily have been larger, had the project not limited the number of groups in the larger villages to four or five.

Phase II has started on 5 July 2004, with an expected duration of 14 months. The main thrusts of the second phase are to consolidate the achievements of the first phase; to expand coverage to an additional 35 groups; and to test self-help groups (SHGs) owned and managed by local people, as an alternative to channeling groups. (PCR 2004)

2. Relevance of objectives, targeting and decision-making authority

The statement of objectives has three components: (a) the expansion of microfinance services in poor and deprived regions of Iran; (b) an orientation towards the rural poor in general, rural women and young adults as core target group; and (c) the leveraging of the resources and institutional capacity of BK in partnership with civil society organizations. As this is a pilot project, the statement of objectives has to be treated with some flexibility; it might need to be adjusted. Below are some implications of the statement *as is* that the project partners need to be aware of and that might require some adjustments in the project design:

- *Decision-making authority:* As BK provides the financial resources and institutional capacity and is expected to eventually fully take over the approach on a national scale, **BK is to be considered the ultimate decision-making authority** – in collaboration with DRMFS-Int. during the pilot phase. BK has recognized this and established a high-level task force headed by the Executive Director of Credit and Investment. Once implementation on a national scale is decided upon by BK, the project will have to be converted into its regular operational system, with the local branches as implementing units. Therefore, key elements of the approach need to be approved by the top management of the bank (ie, the Chairman of BK) from the

beginning: with national implementation in mind. This also requires a strengthening of the role of local branches in the project. Great care is to be taken that this is not going to be *just another project* lasting as long as its external support.

- *Self-targeting:* The core target group has been defined as the rural poor in general, rural women and young adults. On the basis of a participatory process which included among others local community members and decision-makers and NGOs, self-targeting was adopted as the mode of selection, with full authority of selection vested in the solidarity groups; they may thus **include near-poor or non-poor community members** who may wish to participate. BK and NGO staff may offer their advice; but given the fact that BK concludes its loan contracts with the individual members, it reserves of course the right of refusal, eg, for reasons of overindebtedness of the family of a loan applicant. The project has wisely accepted the principle of self-targeting, as this avoids social tension in the – sometimes very small – communities and recognizes the mission of BK as a general provider of financial services in rural areas. In fact, the inclusion of non-poor in Ardabil province has fostered the sharing of experience by the more enterprising members with the poorer members and at the same time increased bank confidence in the feasbility of solidarity group lending.

- *Target area:* Based on guiding criteria of the Ministry of Agriculture and the Planning & Management Organization, the project has focused on poor and deprived regions with a potential for agricultural development. In its first phase, it has selected predominantly remote and small villages. Thereby it has made its task difficult, for several reasons: (a) guidance and supervision of the groups, which are particularly important during the initial phase, are difficult at such distance; (b) given the undifferentiated economy of such villages and the lack of opportunities, the project fails to test the relevance of its approach for creating new income-generating activities (IGA) and generating income and employment on a larger scale; (c) it also unduly limits its own potential as a project to demonstrate to BK the feasibility of lending to hitherto neglected market segments. It is therefore suggested to **include high-potential villages**, in addition to villages from deprived areas, which normally have a low potential.

- *Women and young adults as a special market segment?* The project has a broad orientation to the rural poor, including explicitly women and young adults, with high rates of underemployment and unemployment. Both the social survey and the field visits have demonstrated that women and young adults, particularly young adult women, play a special role in these villages. There is considerable migration from the villages to the cities, which has resulted, in recent history, in an urbanization rate above 50%. Besides elderly couples, **it is young, mostly unmarried, women who are left behind: virtually all of them literate** with at least grade V elementary education, and many of them energetic and hard-working. This change in demographic structure is generally not recognized by BK, which continues lending mainly to farmers, ignoring young adult women. It is suggested to put special emphasis on access to finance for **young adult women and men as a new market segment** for BK.

- *Including rural towns?* The limited potential in villages and the limited success of BDS might lead to an expansion of the focus of BK and the project to rural towns, turning them into centers of growth and employment generation. Rural towns are the place where new opportunities evolve requiring finance and where additional opportunities may be more easily created, perhaps through BDS. Not all the poor in the village are entrepreneurs; and not all young men find work in Tehran. BK is already on the way of expanding into peri-urban areas and rural towns. An additional project **focus on rural towns** may support BK in its effort to finance employment opportunities which cannot easily be generated in villages, thereby promoting wage employment

opportunities for young adults from neighboring villages as an alternative to migration to Tehran.

- *Outreach at village level:* The project has initially limited the number of groups per village to about 4-5. In some smaller villages, this has resulted in near-total coverage, while in larger villages a major part of the population has been excluded. With little additional cost (in fact, at lower average transaction costs per group), the outreach of the project in larger villages could be increased substantially, without any restriciton on the number of groups.

- *Group projects*, promoted by many donors in many countries during the 1970s and 80s, have had a dismal record. There are exceptions, but they are rare. Most NGOs have learned from experience and ceased to promote group projects. Furthermore, solidarity group lending has sometimes been confused with group investments, as has been the case in this project in some areas. Group projects should only be financed under exceptional circumstances; they should be carefully monitored. In each case, they may be more appropriately financed through BK's regular instruments.

- *New business opportunities?* In many villages, particularly in remote areas, there is a dearth of business opportunities beyond livestock rearing and (mostly rainfed) agriculture. There is an urgent need for identifying and developing business opportunities, which is an extremely difficult task exceeding the mandate of a bank and the potential of a microfinance project. The problem cannot be solved by just allocating some additional project resources, and needs to be discussed in a wider context. The much-heralded donor support for *business development services (BDS)* has led to more attention at conferences than real success in the field. The issue of directly promoting new business opportunities in rural areas needs attention in Iran; but there is no easy solution applicable on a national scale. For DRMFS-International, the question whether, and how, to respond to that need.

- *Which focus for DRMFS-International?* Both microfinance and business identification & development demand a high level of expertise and full concentration. Historically, the emphasis in Iran has been on production, much less so on value addition through off-farm and non-farm activities with their usually far higher profit margins. DRMFS-International may be well advised to adhere to corporate clarity and fully concentrate on microfinance, seeking at the same partners who specialize on the promotion of income-generating activities and value addition through quality production, standardization, agricultural processing, packaging and marketing[4].

In short, we submit the following **recommendations to the task force** for consideration:

- Agreeing on BK as the ultimate decision-making body of the project, in joint consultantion with DRMFS
- Strengthening the decision-making and monitoring role of local branches, through which credit has been disbursed
- Including the poor, near-poor and non-poor through self-targeting
- Putting a special emphasis on young adult men and women as a promising market segment
- Shifting the emphasis during the initial years on larger, high-potential villages and inclujding villages from remote and deprived areas over time as BK capacities permit

[4] Eg, this is a field of expertise of the Common Fund for Commodities (CFC), a UN agency in Amsterdam, discussed in the forthcoming Proceedings of an International Expert Meeting on Finance for Small-Scale Commodity Processing: From Micro to Meso Finance, held on 9-11 November 2003 in Khartoum. Eligibility of funding by the CFC requires country membership.

- Adding rural towns with their demand for finance for new opportunities of income and employment generation, including employment for the poor from surrounding villages
- Lifting the restriction on the number of groups per villages, thereby increasing outreach and lowering average transaction costs per group
- Financing predominantly individual projects; group projects bear special risks of management and moral hazard and should be examined and monitored with great care
- Examining the feasibility of linkages with business development services (BDS), with the objective of promoting new business opportunities and value-adding off-farm and non-farm activities in villages and rural towns, particularly for young adult women and men
- Recognizing, and strengthening, the expertise of DRMFS-International in the field of microfinance, while seeking and promoting linkages with other agencies, specialized on microenterprise development and value addition.

3. Terms of financial contracts

3.1 Savings

The solidarity groups do not act in any way as financial intermediaries. They do not hold an account and do not build up any reserves for bad debts; nor do they generate loanable funds. This greatly simplifies the process of loan channeling and minimizes the need for training and supervision, as no book-keeping is required. At the same time, the lack of reserves constitutes a financial and social hazard as group members guarantee each others' loans; the default of one or two members might lead to a domino effect, with defaulting spreading to the other group members. The advantages and disadvantages of a lack of reserves held in group accounts should be further discussed with BK.

The group members are required to open individual savings accounts with a minimum opening balance of Rls 50,000; but it is not mandatory to maintain a minimum balance, nor are there any up-front or regular compulsory savings as a prerequisite for access to credit. Again, this greatly simplifies the process of loan channeling. However, savings are important and need to be encouraged: as a store of value for larger investments and other expenditures and for the accumulation of resources to cover the annual instalments on the loans. Savings from regular income should be accumulated to meet repayment obligations; this will avoid decapitalization, eg, by selling livestock at the time of repayment – a notion which does not seem to be widespread and should be propagated by project facilitators and bank staff.

The savings have been deposited in interest- or profit-free Qarz-ol-Hasaneh accounts. At an official inflation rate of 17.5% the depositors lose 17.5% (or more in terms of the real inflation rate) of the value of their savings every year. This may not pose much of a problem in those areas where savings are small, but far more so in areas, like Kordestan province, with a higher propensity to save, and perhaps in all areas once savings habits have been built. The overall effect of profit-free savings accounts on the propensity to save is negative; and it would be irresponsible to encourage group members to accumulate savings on a larger scale if these are eaten away by inflation.

In some areas people object against remunerations for savings deposits on religious grounds. Project facilitators and BK staff may point out (a) that the remuneration on savings is understood as a profit-sharing contract (mudarabah) and not as interest payment; and (b) that it is a necessary compensation for the loss of value due to inflation.

At the same time, one has to realize that any profit margin on savings further decreases the margin of the bank, which already lends at negative real terms. This needs further discussion

with BK in order to find a solution acceptable to both the bank and the group members. Note should be taken that preferences for savings withdrawable at any time vs. term savings may vary among members and preclude a single savings deposit scheme. It is also unlikely that poorer members will opt for long-term maturities.

We submit the following **recommendations** to the task force for consideration:

- Encouraging groups to build up a reserve fund for delayed payments and bad debts by deducting up-front a percentage of the loan amount The reserve fund may either be deposited in a profit-sharing bank account or used as an internal loan fund for small short-term loans. A member's payments into the fund will be refunded upon leaving the group after having settled all obligations. If the group is dissolved, the loan fund will be distributed among the members.
- Encouraging member savings in their personal accounts from regular income to build up resources for the repayment of annual instalments.
- Offering two options of profit-sharing (or interest-bearing) accounts: (a) savings accounts withdrawable at any time; (b) terms savings with maturities as desired by each member
- Examining the feasibility of offering special incentives for regular savings towards payment of annual instalments.

3.2 Credit

Size and maturity: Loans have been set at a maximum size of Rls 8m and a maximum maturity of 5 years. There has been a tendency towards standardized loans at these maximum terms, without taking into consideration loan purpose and cash flow. This may be convenient to the bank, which has largely worked through standardized loan products, but is not appropriate for the members. Particularly when loans are invested in innovative activities with a higher risk, the failure of a larger-size investment may financially incapacitate a member and make the member unbankable because of defaulting. In contrast, small short-term loans allow for experimentation without exposing the borrower unduly to big risks. Also, long-term loans may prevent rapid growth as the member may not be eligible for a new loan before the maturity date. In contrast, short-term repeat loans of increasing size and loan period allow for dynamic growth of investment and repayment capacity.

Instalment periods: Repayment has been in annual instalments, without the possibility of adjustment to the cash flow of investments. More flexibility may be needed. This can be achieved either through a differentiation of repayment schedules according to cash flow; or a savings scheme for the accumulation of resources for repayment.

Profit rates (interest rates): Profit rates should be unified, currently at 13.5%. Qarz al-Hasaneh loans, at 0% interest or an administrative charge of 4%[5], should be avoided, for two reasons: they create expectations which cannot be maintained for larger loans and in the long run; they lead to investments in activities with low or no profitability. Note should be taken that at loan charges of 13.5% and an inflation rate of 17.5%, the real interest rate is negative at –4%, which is generally considered as an impediment to growth and development. It is the function of the financial system to allocate scarce financial resources to the activities with the highest rates of return. This implies that, the higher the loan charges, the stronger the pressure of the borrower to invest in high-yielding activities. This means that, contrary to the good intensions of the government which subsidizes financial institutions, low lending rates are conducive to underdevelopment, rather than growth and development. This issue exceeds the scope of the project, but needs to be taken into consideration; to some

[5] In some project areas, 75% of each loan were granted at 13.5% and 25% at 4%, averaging 11.125% effectively p.a. At an inflation rate of 17.5% during 2003, the real rate is thus negative, at –6.375%.

extent it may explain why there is so little entrepreneurial spirit among the villagers, who may have been discouraged, rather than inspired, by a culture of subsidies.

We submit the following **recommendations** to the task force for consideration:

- Adjusting loan sizes and loan periods to the exigencies of each member's investment
- Offering small-size short-term repeat loans, with the possibility of increases in size and maturity depending on investment opportunities and repayment performance
- To minimize transaction costs, short-term loans may be automatically rolled over upon satisfactory repayment, with an optional increase of the loan amount up to ~30%.
- Examining the feasibility of instalment schedules adjusted to project cash flow or, alternatively, of a scheme of regular savings from investment income for the accumulation of resources to meet repayment obligations
- Handing over the repayment plan to the group leader, who will monitor the repayment and perhaps organize the transfer of payments from the members in the village to the branch
- Unifying lending charges at the usual 13.5%; avoid Qarz al-Hasaneh loans, which undermine sustainable access to rural finance
- Facilitating access of members with a satisfactory track record to individual loans for investments which exceed the scope of solidarity group credit.

3.3 Insurance and loan protection

Insurance:
BK offers crop and livestock insurance; but these have not always been included in the loan contracts with group members. Such insurance serves as a loan protection mechanism for all three parties involved: borrowers, groups and bank.

Collateral: In this project, group guarantees, referred to as chain guarantees, are used as a substitute for physical collateral. This is appropriate for the bank, as it has induced the bank to lend to a new market segment which may not otherwise have qualified for credit. Also, securitization of loans through personal guarantees is the rule rather than the exception in BK; in 2003-04, 96% of the number and 83% of the volume of all loans were disbursed with third party guarantees. However, ignoring collateral within the credit guarantee groups may be less appropriate, despite all the calls in the microfinance community for non-collateralized microlending. But with start-up loan sizes around US$1000 per member, these are meso- not microloans! The burden of joint and several liability among the members will be lessened considerably if the members list personal possessions (eg, a radio) as collateral they or members of their family possess, including the project as collateral (eg, sheep or turkeys). The listing of physical collateral and personal guarantees, in this case as non-formal security, has several advantages: (a) it emphasises the seriousness of the business and the commitment to repayment, which is particularly important in a culture of leniency and subsidization; (b) it lowers the level of joint and several liability of the members, which will become increasingly important as loan sizes and risks increase[6]; (c) it paves the way for the transition to direct access of members to credit from BK, particularly for projects exceeding the scope of group guarantees (with their inherent tendency toward mean loan sizes). This may have a side effect: teaching the bank how to assess the availability of collateral in rural households, which the bank has not been doing.

[6] Joint and several liability among farmers and microentrepreneurs was essential at the origin of credit cooperatives in Germany in the mid-19th century, but, as loan sizes gradually increased, turned out to be a major impediment to the growth of the movement. It was only when group liability was lifted and replaced by other forms of guarantee that credit cooperatives grew quickly, first into a national and then into a world-wide movement around 1900.

We submit the following **recommendations** to the task force for consideration:

- To automatically include crop and livestock insurance in loans with such purposes
- To include insurance premiums in the lending charges or interest rates (*as being done*)
- Facilitating the listing of non-formal collateral or additional personal guarantees as internal security within each group.

4. Strategies of expanding outreach and financial deepening in rural areas: channeling groups, self-help groups and community financial institutions

4.1 The international experience and the institutional framework in Iran

4.1.1 The international experience

A discussion of appropriate strategies for expanding and deepening rural financial services in Iran must take into account on the one hand the international experience, particularly during the last two decades, and on the other hand the institutional framework in Iran. While BK has participated in the international dialogue through its membership in such organizations as APRACA and NENARACA, it has experienced certain restrictions, to some extent due the Iraq-Iran war and the subsequent embargo. However, Iran, like every other country, is a unique case upon itself; and the international experience, no matter how important, cannot be mechanically applied by replicating models which have been successful elsewhere. No single model or approach is a panacea. Any approach taken therefore must be based on a participatory process of decision-making, starting in a given social, political and economic environment.

Channeling credit through solidarity groups, which have no other function than guaranteeing each others' loans, is a concept which has evolved in the 1970s. It has been used predominantly by agricultural development banks (AgDBs) in order to reach smaller farmers, expecting at the same time that transaction costs would be lowered and repayment rates increased. The record during the 1970s and into the 1980s has been dismal: mainly because AgDBs used subsidized donor and government funds, without a commercial interest of their own. Examples were pre-reform Bank Rakyat Indonesia and the Agricultural Development Bank of Nepal. As loans were not monitored and repayment was not enforced, collection rates were low, frequently hovering around 50%. Various methods were used by the banks to conceal the truth of poor performance.[7] NGOs have followed suit in large numbers, using donor funds with similar methods and similar results as the AgBanks. A special case has been the Grameen Bank, which has been far more successful in terms of social mobilization and loan monitoring as well as public relations, but has also used ingenious methods of concealing inadequate performance.[8] An important lesson has been that through credit channeling, new market segments may be reached, particularly among the poorer sections; but this has usually entailed(a) financially adequate loan terms, (b) effective monitoring and loan enforcement, and (c) some degree of institutional autonomy coupled with non-interference by the government.

[7] Eg, injecting additional donor or government funds and calculating repayment of past loans in terms of the new portfolio size, which of course, arithmetically, yielded higher collection rates. Another widespread method has been the computation of *repayment rates* (100 – Amount Overdue/Amount of Loans Outstanding) instead of the much more sensitive, and usually much higher, *arrears ratio* (Amount Overdue/Amount outstanding).

[8] Until recently, the Grameen Bank mainly published figures on cumulative outreach and cumulative disbursement and calculated *repayment rates* on the basis of cumulative disbursements (rather than loans outstanding); such figures are grossly distorted if calculated on the basis of a rapidly growing portfolio. This method has been widely imitated by NGOs.

Fundamentals of sustainable rural finance: Meanwhile, increasing numbers of AgBanks and NGOs have learned that this is not the way of reaching large numbers of small farmers and the rural poor with adequate financial services in a sustainable way, which means in the long run. Due to the overall failure of donor- or government-driven directed credit, the emphasis in development policy has shifted to (rural) financial systems development and the building of self-reliant, sustainable institutions, including AgBanks, local rural banks and other MFIs[9]. Regardless of ownership, type of institution, rural or urban sphere of operation and target group, financial institutions in developing countries have to observe the fundamentals of sustainable rural finance (see Box 1) and accomplish the following:

- mobilize their own resources through savings
- have their loans repaid on time
- cover their costs from their operational income
- earn enough profits to offset the effects of inflation
- finance their expansion from their profits and savings mobilized.

Box 1: Fundamentals of sustainable rural finance
Sustainable financial institutions mobilize their own resources, provide financial services according to demand, cover their costs from their operational income, have their loans repaid, make a profit, and finance their expansion from deposits and retained earnings. *Resource mobilization* comprises equity, savings deposits, retained earnings and commercial borrowings, augmented by external resources such as soft loans and grants. Of these resources, three are fundamental to self-reliance and dynamic growth: savings deposits, equity and retained earnings from profits. *Financial services* comprise credit for various purposes and savings deposit facilities; they may further include money transfer, check clearing and insurance. Insurance may serve the triple function of borrower protection, loan protection and resource mobilization. *Sustainable institutions* need an appropriate legal status which authorizes them to carry out all these functions; and they need to be properly regulated and effectively supervised. *Interest rates* on savings and loans must be positive in real terms, providing adequate returns to savers and institutions. *Financial systems development* comprises processes of establishing a conducive regulatory environment (including a legal framework, prudential norms and effective supervision), an adequate infrastructure of viable small and large financial institutions, adequate demand-oriented financial products and good operational practices.
Adapted from: IFAD Rural Finance Policy

In addition to these fundamentals, a wealth of lessons have been taught by international experience. They are presented in a condensed form in Annex 1. However, any conclusions drawn must take into account the policy and institutional environment in Iran; no model that has been successful elsewhere can be mechanically replicated.

4.1.2 The institutional environment in Iran

Microfinance is poorly developed in Iran. There are a few small initiatives; sustainable microfinance institution-building has generally not been among their operational objectives. Major constraints have been a culture of subsidization inimical to cost-covering lending rates, far-reaching state control over the financial system, and a dearth of value-adding non-farm microenterprise opportunities in most of the 64,000 villages of Iran. NGOs are few and weak and have no experience in microfinance. Microfinance pilot initiativesare in their early stage, eg, those by the Ministry of Agriculture and by UNDP. (Annex 3)

The policy environment in Iran is characterized by government interference in the determination of interest rates, directed credit, and subsidization of interest rates, but at the same time by incipient liberalization and a decline of directed credit. This may open up new windows of opportunity, such as an emerging emphasis on women and youth (or young adults) without access to credit.

[9] Eg, MFIs registered under a special microfinance law or semiformal institutions with savings and crfedit activities in countries without a legal framework for small institutions.

4.2 Channeling groups

BK, as the most important and most prominent provider of small loans to farmers, is thus not fully autonomous and can only act within a given framework. Building autonomous local financial institutions has so far not been part of BK's mandate.
In this restrictive environment, DRMFS-International and BK have jointly decided to go beyond seasonal credit to farmers and expand BK's outreach to a broader segment of the rural population, among them women and youth, and a wide range of income-generating activities. The project partners chose solidarity groups as an instrument to overcome the lack of collateral and expand outreach. As most loans have been granted for five years and the first annual instalment has not yet been due, it is too early to judge the feasibility of the approach.

Loan channeling by BK to solidarity groups is an innovation in Iran; but it is fully within the mandate of BK. At the same, accepting mutual guarantees is fully within the operational experience of BK, which has been granting most of its loans on the basis of third party guarantees. On the whole, it must be considered a major accomplishment that BK has adopted loan channeling through solidarity groups as a new outreach strategy in a policy environment which is not conducive to innovations. **Further expansion may proceed in several *phases:***

- Expanding outreach in the pilot provinces to all villages, on the basis of operational plans of the branches and provincial directorates
- Testing solidarity group lending in pilot villages in other provinces
- Expanding outreach to all branches in all provinces.

Expanding outreach to all 1800 branches of BK is a gigantic program which can only be achieved over a longer time period, during which some *learning from experience* will be required. BK must ensure adequate monitoring and loan enforcement. Recent experience elsewhere, on which staff from BK and the project are in the process of collecting first-hand experience[10], has shown that this requires a full commitment from the executing institution, ie, BK. DRMFS-International will be more than fully occupied in this endeavor if it continues providing its services to BK. One of the core questions is to what extent NGOs have the capacity of providing social mobilization services and group guidance on a national scale in Iran; and to what extent such responsibilities may be developed within the BK branches. In either case, training of large numbers of staff will be required. **Further progress requires:**

- Creating the political will in BK to go ahead with loan channeling at full-force
- Strengthening the capacity of the steering committee by establishing a technical department with national outreach to the provincial offices and branches of BK
- Involving the branches not only in loan disbursement but also in loan decisions and monitoring
- Adjusting the approach based on the recommendations presented in chapter 3 above (ie, strenghtening the role of the groups) and on continual field experience
- Examining the feasibility of a stronger target group emphasis on women and young adults

[10] Particularly in India, where the National Bank for Agriculture and Rural Development (NABARD) has mobilized, since 1996 (after a four-year pilot project), more than one million self-help groups and facilitated their access to bank credit and deposit facilities. A decisive factor has been the personal commitment of the General manager and subsequent Chairman of the bank. Directing his staff "to either doing it well and full-force, or not at all," he established a Microcredit Innovations Department (MCID) and made the program the largest and perhaps most successful rural microfinance program in the developing world.

- Reexamining the roles of the project partners in social mobilization, group guidance, financial intermediation and loan monitoring – particularly of the branches and NGOs, with long-term sustainability of financial services on a national scale as an objective
- Establishing training courses within BK, based on the strategy chosen.

Using a term from the realm of agriculture, loan channeling through solidarity groups may be called a *minimum tillage instrument* in rural finance, ie, an instrument of great simplicity requiring far less preparation, social change and oversight than a full-fledged self-help group approach, and virtually no book-keeping by the group. There is a good chance that BK, with the initial assistance of DRMFS-International, will be able to successfully expand loan channeling on a national scale:

- Channeling groups may be considered a *minimum tillage instrument* in microfinance, well suited to the operational capacity of BK within the framework of a restrictive policy environment.

However great care has to be taken that the **mistakes made by many agricultural banks during the 1970s** are being avoided, among them:

- inadequate loan terms (too big, too long, lump sum repayment instead of regular instalments),
- inappropriate interest rates which failed to cover costs,
- lack of monitoring and supervision (many banks did not know what a payment was due),
- lack of insistence on full and timely repayment (both bank staff and farmers considered loans from government or donor resources as gifts);
- lack of staff and borrower incentives,
- lack of savings deposit services and lack of resource accumulation from savings, thus forcing the farmers to newly borrow every year instead of relying on his own savings.

4.3 Self-help groups

Financial self-help groups (SHGs) are local financial intermediaries, which mobilize their own resources from the members and and re-allocate them to the members, either by transforming them into loans (*credit groups*) or by accumulating them up to an agreed-upon date when they are distributed among the members (*savings groups*). They are normally led by a democratically elected committee.Proper SHGs are autonomous in selecting their members, examining loan applications, and determining loan terms including interest or profit sharing rates. They decide whether they charge high lending rates, thus opting for rapid growtt of their loan fund; or low lending rates, thus opting for cheap credit. Experience in Asia and Africa has shown that most indigenous SHGs opt for high lending rates and easy access to credit for high-yielding investments; whether would also apply to Iran remains to be seen. There are many different types and large numbers of financial SHGs in many countries, either of indigenous origin as part of the culture or more recently introduced. There are also many other types of SHGs, eg, water user associations, which may or may not have savings or credit as one of several purposes.

Size: SHGs may vary widely in size, They may be from small groups of a few members to large groups of several hundred. The difference to community financial institutions is that there may be several SHGs in one community and that they do not aspire to provide financial services to anyone in the community, but only to a select number of members according to its own membership criteria.

There are several *options of promoting SHGs* in Iran:

- Working with existing SHGs such as water user associations, strengthening their capacity as financial intermediaries
- Working with existing SHGs and linking them to banks such as BK
- Establishing new SHGs, with access to BK as a refinancing institution
- Transforming channeling groups into SHGs.

Which approach is chosen, and whether it is applied on a local or national scale, depends on the decision in a participatory process. In each case, a considerable amount of technical assistance will be required. Worldwide there is an enormous body of experience of SHG promotion. India and Indonesia are the two countries with the deepest experience in linking banks and SHGs.

There are several *elements of SHGs* that may be adopted by the solidarity groups in the project. This would give the groups a choice whether they want to remain channeling groups or gradually transform into genuine SHGs. Alternatively, new groups may be established as SHGs, which tend to be larger than channeling groups, with elements like the following:

- Agreement on membership criteria (including women's, men's or mixed group)
- Adoption of a charter or bye-laws
- Election of a leadership committee of chairperson, secretary and treasurer
- Agreement on meeting schedule
- Keeping of records of meetings
- Membership fee in the form of a share of identical size as the group's social capital
- Regular savings to build up an internal loan fund
- Lending to members from internal resources
- Determining their own loan terms (interest or profit rates, maturities, instalment schedules, penalties) for loans from internal resources
- Credit worthiness examination of internal or channeled loans or both, either by the SHG as a whole or by an elected credit committee
- Collateral and collateral substitutes
- Financial intermediation of loans provided by BK to the SHG, which may be transformed into loans with different profit rates, maturities and repayment schedules
- Adoption of book-keeping and an annual income statement and balance sheet (Annex 2)
- Reporting to, and supervision by, BK branch or provincial office (see Annex 2)
- Membership in a network or association of SHGs (to be formed in due course).

The establishment of SHGs requires a major effort, including an executing agency with sufficient resources over a long period of time and a comprensive system of guidance and training. A decision would have to be taken whether SHGs will be established on a limited scale in a given area or national-wide.

The existing channeling groups have adopted some elements of SHGs, such as a leadership committee of chairperson and secretary-treasurer; and they are supposed to meet regularly which they do monthly or weekly, but only during the off-season. Given the lack of genuine financial activities of their own, it appears that there is little urgency in meeting regularly and keeping records.

The volume of guidance and training for channeling groups depends on the number of SHG elements to be incorporated. It is likely that the task of training and guiding groups with major elements of SHGs would exceed the capacity of BK branches, requiring instead a massive input by NGOs. Preparing civil society organizations without prior experience in microfinance for such a task would be a major undertaking.

- ➢ We are therefore reluctant to recommend a full-fledged SHG approach, but to proceed cautiously.

- The channeling approach appears to be the most effective one in terms of outreach to poorer segments of the rural population, particularly young adults.
- It is also fully within the mandate and capacity of BK to lend through solidarity groups.
- SHGs may be promoted on a selective scale in villages where channeling groups show initiative of their own and actively demand their conversion into SHGs with financial activities of their own.

4.4 Community financial institutions (*Deh banks*)

There are two major types of community financial institutions, frequently referred to as community banks or village banks (an improper terms if they have no legal banking status):

- institutions owned by the community as a corporate body
- institutions owned by a majority of community members as individual shareholders.

Institutions owned by individual community members would mobilize their share capital (or social capital) either through single shares of equal size, with equal voting rights of all members (like cooperative societies); or through multiple shares, with different voting rights according to the number of shares (a distinction may be made between voting and non-voting shares). Institutions based on single shares would normally rely on savings as the main source of loanable funds; there would be no dividends. In institutions based on multiple shares, the share capital may be the major source of loanable funds. Part of the profit would be divided as dividends among the shareholders, the remaining part would be allocated to retained earnings as a major source of loanable funds. All major elements of SHGs presented in chapter 4.3 apply to community institutions; the only major difference is size. Several small villages may join together to form a single institution.

In contrast to a national bank like BK, community financial institutions form part of a decentralized financial sector. Depending on the legal framework of a country, such institutions may belong to the informal, semiformal or formal financial sector. If newly introduced in a country, they start informal; if successful, they may form an association and perhaps a central fund and initiate a policy dialogue on the enactment of an appropriate law of rural banks, community banks or microfinance institutions. A major technical assistance input would be required to establish such a system. It is not evident that civil society organizations exist in Iran with the capacity of installing a network of community financial institutions. In some of the larger villages, we have encountered an active interest in self-managed and (partially) self-financed Deh banks. Smaller villages suggested to form a Deh Bank comprising several villages.

We propose that,

- The feasibility of promoting either type of community institution needs thorough discussion with BK and policy makers as well as sponsoring organizations such as UNDP.
- In a longer-term perspective, community financial institutions might eventually evolve out of the merger of successful channeling groups and SHGs.
- A major emphasis on the establishment of Deh banks in the framework of RMFSP would be premature in phase II.

5. Conclusions and recommendations

Two factors have to be taken into consideration in deciding on the most effective strategy of RMFSP within the framework of its resources:

i. on the side of *weaknesses and constraints:* the lack of a conducive policy environment and the lack of experience in sustainable microfinance among governmental and non-governmental organizations in Iran;
ii. on the side of *strengths and opportunities* the capacity and willingness of Bank Keshavarzi to expand financial services from its own resources to new market segments in rural areas through mutual guarantee groups, particularly young adult men and women.

We therefore recommend to DRMFS-International for the second phase of RMFSP:

- To focus on the upscaling of loan channeling by BK through solidarity groups based on mutual guarantees by gradually expanding outreach on a national scale – a focus which is likely to extent into a third phase
- To generate the political will in BK to adopt loan channeling through solidarity groups as a regular instrument for reaching previously unbanked people in rural areas
- To put special emphasis on young adult men and women, without excluding other rural people willing to join solidarity groups
- To provide loans predominantly for individual activities and only under special circumstances for well-prepared and well-monitored group projects
- To relax restrictions on loan purposes, with the objective of diversifying the income-generating activities in the villages and financing the most profitable ones.
- To assist BK in building the capacity of its training system for solidarity group lending on a national scale
- To cautiously strengthen self-help group elements in the groups, particularly participation in decision making, the group's role in creditworthiness examination, and the building of group funds from savings for internal lending operations.
- To postpone the promotion of full-fledged self-help groups to a later phase when there is sufficient demand from solidarity groups to be upgraded to SHGs or from communities to establish new SHGs
- Establish a special technical unit in BK to lend operational support to the existing task force;
- Develop capacity in BK (rather than in NGOs) to provide social mobilization services for the establishment and monitoring of channeling groups, a task for which NGOs do not exist in adequate numbers and quality
- To develop DMRFS into a full-fledged professional micro-finance promotion agency in Iran
- To communicate and cooperate with other agencies[11], with the objective of exchanging experience and harmonizing approaches.

6. Postscript: Recommendations for exposure training abroad

Decision-makers in BK and RMFSP project staff could greatly benefit from exposure training abroad. Two countries are recommended, each with a particular focus:

- **Banking with self-help groups:** Linking one Million Self-Help Groups to Banks – NABARD's SHG Banking Program in India (*Annex 4*)

- **Agricultural bank reform:** Bank Rakyat Indonesia (BRI), Microbanking Division: an Asian flagship of agricultural bank reform (*Annex 5*)

[11] Eg, UNDP (Mr. Farzin), MoA (Ms. Mafie)

Annex 1:

Lessons taught by international experience: What matters in development finance?

The old vs. the new world of development finance: In an increasing number of countries, there have been notable changes to varying degrees from the old world of directed credit to a new world of sustainable institution building. In this new world, governments make determined efforts to create conducive policy environments:

- with new legal forms for local financial institutions,
- deregulated interest rates, and
- prudential regulation and supervision of financial institutions,
- paralleled by a deregulation of foreign exchange and the trade regime.

Responding to the demands of their customers, institutions undergo reform and provide an array of savings and credit products for a wide range of income-generating activities, thereby generating the loanable funds and the profits needed for expansion. Many agricultural and rural banks, cooperatives and other MFIs have learned to manage their risks. The transition from the old to the new world of development finance, as described in Table 1, is a challenging framework to any institution and donor agency aiming at sustainable development.

Table 1: From the old world of directed credit to the new world of sustainable financial institutions

	The old world of directed credit	***The new world of institution-building***
Policy environment	Financial repression	Prudential deregulation, fin. system dev
Legal framework	Lack of private local R/MFIs	New legal forms for local R/MFs
Develop't approach	Supply-driven	Demand-driven
Institutional focus	Monopoly institutions	Various competing financial institutions
Clients perceived as:	Beneficiaries	Customers
Selection of clients	Targeting by donors and governments	Self-selection
Outreach	Limited outreach to groups	Potentially all segments of the economy
Incentives	Perverse: leading to fund misallocation	Efficient allocation of funds
Non-formal FIs	Millions of informal MFIs ignored	Opportunities for mainstreaming
Semiformal FIs/NGO	No standards, no deposit mobilization	Conversion to deposit-taking formal FIs
Financial coops	Unsupervised, ruined by governments	Self-reliance; low costs, expansion
AgDBs	Lack of viability and outreach	Reforms towards autonomy, viability
Rural banks (RBs)	Lack of opportunities for private RBs	Legal framework for private RBs
Regulation and supervision (R&S)	Coops, MFIs, AgDBs unsupervised; donors keep distressed institutions alive	MF units in CBs; regulation of RBs/ MFIs; closing of distressed FIs
Commercial banks	Unable to lend to a variety of sectors	Some outreach to commodity producers and microentrepreneurs
Agricultural finance	Lack of self-financing; restricted credit according to government directions	Self-financing from savings; external financing for profitable investments
Commodity finance	Restricted to production of selected crops	Available for profitable production, processing, trade
Remote and marginal areas	Futile attempts of donors to drive ill-suited MFIs into remote areas	Self-managed savings-based SHGs and cooperatives operating at low cost
Individual and group technologies:	Rigid replications without growth of outreach and sustainability	Both can be profitable and reach microentrepreneurs and the poor
Non-financial services	Maximalist approach without cost coverage undermines FIs	Provided by SHGs, other agencies, FI subsidiaries; balance of objectives
Targeting	Undermines outreach and viability	Differentiated financial products
Linking banks and SHGs/MFIs (LBS)	Lack of healthy banks with a mandate to be of service	Spectacular increase in outreach to the poor; profitable if interest rates are free

Interlinked schemes	Lack of institutional sustainability	Ltd.success under controlled conditions
Self-reliance	NGOs, AgDBs barred from deposit-taking; donor and gov. dependency	Self-financing through deposits and profits; institutional autonomy
Sustainability	Donors, gov. fail to insist on perform-ance standards and sustainability	Increasing numbers of self-sustaining institutions of any type and ownership
Access to financial services	No access of many poor and non-poor to savings, credit, insurance	Sustainable access of the poor as users and owners of R/MF institutions

The transition to a new world of finance, as promising as it looks, has only just started. Neither does it cover all developing countries; not does it cover all institutions and spheres of the economy in those countries where it has commenced. In most countries, the situation is highly complex and full of contradictions, for example:

- failing and prospering institutions may exist side by side;
- governments pass laws on market-driven institutions, yet continue subsidizing the interest rates of others;
- agricultural development banks and commercial banks – facing high minimum reserve requirements and high T-bill rates and plagued by weak lending technologies - may produce huge amounts of excess liquidity, yet the government borrows money from international donors and increases its external debts.

What matters in development finance? Despite promising beginnings, rural areas and agricultural finance have been least touched by these changes. A wealth of lessons on what matters in rural and microfinance has been taught by international experience, but not always learned by donors and governments. The lessons are complex and are presented below in a condensed form. A more elaborate presentation is available upon request.

What matters to the poor:

- *First of all, client experience matters.* Clients have experienced in projects that credit can make them poorer or richer
- *The poor themselves matter … and so do the non-poor.* Their autonomy in self-selection, instead of targeting, should be respected, also on separate vs. mixed institutions of women and men
- *Access to savings and credit matters* – far more than interest rates.
- *Rural enterprise viability matters* and is mutually reinforcing with the viability of rural financial institutions.
- *Household portfolio diversification matters*; but group enterprises have usually failed.

What matters in terms of origin, history and culture:

- *Informal finance matters,* particularly in the form of self-help groups (SHGs). Upgrading and mainstreaming through networking and linking them to banks are two ways in which donors can support expansion of outreach and financial deepening.
- *History matters.* MFIs in Europe, since 1720, have started from informal beginnings and evolved, through appropriate regulation and supervision, to cooperative banks and savings banks. Microfinance is not a poor solution for poor countries!
- *Crisis matters.* Financial innovations typically emerge in response to crisis.
- *Development matters:* Microfinance is no panacea; it requires a climate of broader development to be fully effective
- *Culture matters,* in numerous different ways. Eg, development from above, through the established authorities, is more effective in hierarchical or closed societies; development from below, through participatory processes, is more effective in segmentary or open societies.

What matters at the level of financial systems:

- *The political will matters:* The development of adequate financial services for all segments of the population requires first of all the political will to promote sustainable financial institutions without government interference in interest rate determination and lending decisions
- *Financial systems matter.* Governments and donors can contribute to that evolution, but only in a long-range perspective and in a coordinated and goal-oriented manner.
- *Financial sector policy matters,* particularly interest rate deregulation and non-interference by government.
- *The legal framework matters.* Appropriate legal forms allow people to establish their own financial institutions in private, cooperative or community ownership.
- *Capital matters,* but external resources should be mainly used in bridging temporary shortages in funds
- *Savings matter,* as a service to the poor and as a source of loanable funds.
- *Financial intermediation matters:* savings-first for low-yielding activities; and credit-first for high-yielding activities - depending on the rate of return.
- *Interest rates on deposits matter*, preventing the erosion of capital
- *Interest rates on loans matter*, covering all costs.
- *Institutions matter* (projects don't), providing continuity and efficiency. Donors must abstain from perverse incentives which enable institutions to maintain unviable operations.
- *Competition matters*, entailing institutional diversity and pressures to perform.
- *Prudential regulation and supervision matter*, requiring the political will and institutional capacity to enforce standards in rural banks, SACCOs, AgDBs, other R/MFIs.
- *Knowledge matters.* Effective knowledge management Is urgently needed.

What matters at the level of institutions:

- *Institutional reform matters:* There are striking cases of reform of very different types of institutions, with great benefit to the poor, leaving no excuse for continual support to unviable institutions.
- *Ownership and institutional autonomy matter;* but management autonomy in terms of customer selection and loan decisions may be more important than ownership
- *Viability, efficiency, sustainability and self-reliance matter.* Donors should support domestic resource mobilization, cost-effectiveness, and profitability.
- *Saver and borrower outreach matter,* which is compatible with sustainability.
- *Sustainable outreach to marginal rural areas* requires support for the primacy of savings and self-financing; and of member-owned SHGs operating at low costs.
- *Lending technology matters* – and should not be a matter of ideology: *g*roup technologies for the very poor; Individual technologies for *graduating* to larger loans .
- *MFI portfolio diversification matters* as a risk management strategy.
- *Good practices matter, not <u>best</u> practices,* which lead to inappropriate replications.
- *Institutional size matters.* There is no *best practice* in terms of size, both small and large institutions can be feasible.
- *Profits matter,* as a source of capital and a major determinant of growth of outreach.
- *Incentives matter, as* a major determinant of quality of performance and profits.
- *Repayment matters.* Many institutions now know how to reach repayment near 100%.
- *Financial products and delivery systems matter:* demand-oriented and cost-effective.
- *Loan protection matters.* Insurance is a service, but also part of loan protection.

Annex 2:
Model balance sheet and income & expenditure statement for SHGs

Balance sheet of SHG *Date of balance sheet: _____*

		Rls.			*Rls.*
	Assets:			**Liabilities:**	
	Cash at hand			Member savings: Regular savings Voluntary savings	
	Bank deposits			Bank loan outstanding	
	Total net loans outstanding to members:			Other borrowings outstanding	
	from internal funds			***Total liabilities:***	
	from bank borrowings			**Equity:**	
	Net fixed assets			Share capital	
	Other assets			Retained earnings:	
				from previous years	
				… from current year	
				Grants:	
				from previous years	
				from current year	
				Total Equity	
	Total assets			***Total Liabilities and Equity***	

Income and Expenditure Statement of SHG

	Income	*Rls.*
	Interest received:	
	from bank account	
	from loans to members	
	Income from penalties	
	Other income	
	Total Income:	
	Expenditure	
	Interest expenses	
	Administrative expenses:	
	Honorarium to office-bearers (if any) (incl. transportation paid by SHG)	
	Honorarium to external book-keeper	
	Auditing fees	
	Other payments to guiding organizations	
	Stationery, loan documentation, etc.	
	Other expenditures	
	Loan losses	
	Total expenditure:	
	Profit/(Loss):	

Proposed system of auditing and reporting:

1. **Preparation of balance sheets and profit & loss statements:**
   - by SHGs with the assistance of their respective guiding organizations
   - to be reported to bank branch

2. **Auditing of SHG balance sheet and profit & loss statements:**
   - by bank branch or provincial office of BK

3. **Reporting of SHG key balance sheet and performance data to BK:**
   - by bank branch or provincial office of BK

4. **Key data to be reported:**
   - Total assets of SHG
   - Total net loans outstanding to members
   - Total bank loan outstanding to SHG
   - Return on assets (ROA) of SHG (*Profit/Total Assets*)
   - Nonperforming assets (NPL) of SHG (overdue more than 6 or 12 months?)

Identification codes for SHG reporting:
(Assign code numbers for the following:)
Province: ___
District: ___
Village: ___
SHG: ___

BK branch: ___

Annex 3:

Microfinance in Iran

Microfinance is poorly developed in Iran. There are a few small initiatives; sustainable microfinance institution-building has generally not been among their operational objectives. Major constraints have been a culture of subsidization inimical to cost-covering lending rates, far-reaching state control over the financial system, and a dearth of value-adding non-farm microenterprise opportunities in most of the 64,000 villages of Iran.

Informal finance is reportedly widespread, but there is little information. It appears to be largely limited to small-scale short-term loans by relatives and friends, frequently just for a few days; for emergency loans there is no other alternative. Local traders may provide advances, with the expected crop serving as nonformal collateral.

Among informal institutions are Emdad Committees and local funds, the later under the name of Qard-ol-Hassaneh Funds as financial self-help groups, frequently established by members from their locality of origin. Loans are given mainly to member, mostly in cities, but occasionally to people from their home village. These loans are supposed to be interest-free, as the term Qard-ol-Hassaneh implies; but this does not always seem to be case. We heard of annual interest rates up to 22% or approximately 5% in real terms, which is negligible compared to informal lending rates in other developing countries.

Among the informal institutions on an SHG basis with a potential of developing financial services on an institutional basis are water user associations, which are indigenous to Iran and have a long history.

In provincial centers, there are small community-owned semi-formal financial institutions, also referred to as Quarz Al Hassanah Funds, which may be similar to the savings funds in many European countries in the 18th and 19th century from which savings banks at an earlier stage of their evolution.

In a non-representative survey in villages in four provinces in northern Iran, 22% of repondents reported that they received credit from informal sources (compared to 36% from formal sources, mainly Bank Keshavarzi), mostly friends and relatives. Other sources were Emdad Committees, Qard-ol-Hassaneh Funds and local traders. There may be considerable regional variation; eg, Qard-ol-Hassaneh Funds were found to be quite popular in East Azerbaijan. (Rashidi & Azadi 2004: 10)

There is a small number of NGOs in Iran, which are increasingly given national and international attention as civil society organizations; but they are not active in microfinance. (Namazi 2000). An exception is DRMFS-International in Tehran, recently established by B. Mansuri on behalf of IJO and funded by IFAD, which has initiated a Rural Micro Finance Support Project (RMFSP). In cooperation with Bank Keshavarzi, solidarity groups are being established on pilot base for channeling credit; in a second phase, they may either continue as channeling groups or evolve into SHGs and community-based financial institutions (*Deh banks*). Further details are given in Annex 8).

Recently UNDP has targeted some 400 women-headed poor households with microcredit in southeast Iran and subsequently, through its Lazoor Project in Damavand, helped to establish self-help groups (SHGs) referred to as community-based funds in some six villages. In cooperation with provincial governments, the project is now entering into a phase of upscaling in six subdistricts in six different provinces, targeting about 1-2000 families in each. It is hoped that provincial governments will eventually expand the initiative at their own. SHGs of about 20 members mobilize their own resources savings through regular compulsory savings. They receive capacity-building and skill training as well as capital

injections of about $2-3000 as a revolving fund. The groups help their members to identify investments. Members receive loans of $2-300 for 4-8 months, which they repay in regular instalments. A fee of 5-7% is deducted up-front without any additional profit-sharing or interest. This is equivalent to an effective annual interest rate around 24%, which is considered inadequate for institutional growth and sustainability.

In the framework of its telefood program, the FAO has provided a dozen grants of $10,000 each to groups of 10-25 people for starting individual or joint microprojects, reportedly with good results. Institution-building is not the objective. Projects are identified and monitored in cooperation with the provincial extension services. Examples of investments are mushroom growing, jam and pickle production, dual-purpose ponds for irrigation and trout raising, honeybee-keeping and cereal packaging.

During a recent mission Unido identified a good potential for bamboo cultivation and associated microenterprise processing in northern Iran.

Since 2000, the Ministry of Agriculture, through its Rural Women Affairs Office, has piloted the establishment of Microcredit Funds for Rural Women in the form of savings and credit SHGs. Until 2003, 33 funds were established in 10 provinces. Among the objectives are women's empowerment, skill development, self-reliance through savings promotion and microcredit for small projects – all geared to income and employment generation. Institutional sustainability has remained a major challenge. (Mafie 2003)

Bank Keshavarzi may be considered the major provider of agricultural microcredit, comprising loans predominantly to small farmers below $ 1000. BK handles three microcredit projects for women on behalf of government agencies, all of them profit-free Qard-ol-Hassanah loans: (i) Hazrat Zeinab-e-Kobra Scheme with loans to 62,632 borrowers since 1994, which provides loans of Rls 3-5m to women; in 2003-04 Rls 27bn were disbursed to 10,151 women. (ii) In 2000, Rls 130bn were disbursed through the Iran Scheme to some 66,724 women, approx. 67% for microenterprise activities and the rest for consumer credit. (iii) Credit was also disbursed to carpet-weaving microenterprises of women. None of these has an institution-building component. In addition, credit to rural women is being disbursed through cooperatives. Since 2002 the bank has also provided Rls 1429bn for the employment or self-employment of unemployed male and female youth in villages and small towns.

BK has recently established a Women's Saving Fund of Rls 1bn ($120,000), funded by BK (75%) and several foundations (25%), which is expected to promote women's SHGs in cooperation with the IFAD-supported Rural Micro Finance Support Project of DRMFS-International. (Tehrani 2003)

HDS
Tehran, September 2004

Annex 4:

Linking one Million Self-Help Groups to Banks: NABARD SHG Banking Program in India

By H. D. Seibel
2004

SHG banking, the developing worlds largest program of banking with the poor: India has a highly differentiated rural financial sector, comprising some 50,000 bank branches and 92,000 cooperatives. Yet, the poorest 200 million and some 180 million of the rural near-poor are largely barred from formal rural finance. To cut across access barriers, NABARD, a rural apex bank, has made a bold move by promoting self-help groups (SHGs) as informal financial intermediaries, which mobilize their own resources and are refinanced by banks. During 1996-2004, *SHG banking* in India has grown to the developing world's largest microfinance program for the rural poor, comprising around one million SHGs with a total of 15 million self-selected members, 90% of them women, credit-linked to some 31,000 bank branches and cooperative societies.

SHG banking found highly profitable to the banks: SHG banking has proven to be a highly successful social proposition to the poor, facilitating NGOs and GOs, and bankers; but is it also a commercial proposition as a prerequisite of sustainability? An indicative, non-representative study of bank transaction costs (TC) in 2002, using both average and marginal cost analysis, found that social mobilization costs were largely **externalised to non-governmental and governmental organizations** at yet to be studied social mobilization and SHG maintenance costs, and direct bank TC were moderate. At repayment rates reportedly in the upper 90s percentage range, SHG banking was found highly profitable by the banks.

Transaction costs (TC) of SHGs and members, including real costs and opportunity costs, were found to be minimal. Annual TC of SHGs amount to US$27 per group or 1.22% of loans outstanding to members (averaging US$ 2,230), comprising 51% real costs and 49% opportunity costs. Existing TC, particularly opportunity costs, are more than offset by indirect and intangible benefits. Annual direct transaction costs of SHG members were found to amount to US$3.50 or 2.3% of loans outstanding (averaging US$148), which are almost fully opportunity costs.

Implications for NABARD:
TC of SHGs and members were generally found to be low so that immediate intervention is not required. Most banks require SHGs to come to the bank, rather than taking the bank to the SHGs: an issue for the shaping of a demand-oriented banking culture in the framework of rural and agricultural bank reform.

Recommendations: As both internal resources and bank loans continue growing, so does the need for adequate training, control and supervision. We therefore recommend to NABARD:

- to facilitate the annual auditing and reporting of key balance sheet and performance data of SHGs
- To improve the quality of financial management and supervision by facilitating adequate training of book-writers and auditors.

Annex 5:

Bank Rakyat Indonesia (BRI), Microbanking Division:
an Asian flagship of agricultural bank reform
By H. D. Seibel
2004

Reform by deregulation: Until 1983, interest rates in Indonesia were regulated, the financial sector was dominated by state banks, century-old BRI was the main provider of agricultural credit, heavily subsidized. When oil prices dropped and GDP fell, the government offered the bank two options: *close it or reform it*. In 1983, interest rates were fully deregulated, and BRI was placed under new management, which decided to commercialise the 3,000-plus rural outlets (*unit desa*, established at sub-district level) of hitherto subsidized credit into self-sustaining profit centres.

Product development: With technical assistance from the Harvard Institute for International Development, the bank calculated microsavings and microcredit transaction costs and carefully crafted two new commercial products. One was a scheme of voluntary savings withdrawable at any time with a lottery component, SIMPEDES, which proved to be immensely attractive and at the same time served as an instrument of resource mobilization at village level. The other one was a non-targeted credit scheme, KUPEDES, open to all and for any purpose, the only credit product offered by the units. Its features included simple procedures, short maturities, regular monthly instalments mainly from non-agricultural income, flexible collateral requirements and collateral-free microloans, incentives for timely repayment, repeat loans contingent upon successful repayment of previous loans, and market rates of interest amounting to 2% flat per month (equal to an effective rate of 44% p.a., minus 11% for timely repayment = 33% p.a.) to cover all costs and risks.

Reform continued – reorganization of BRI: The financial crisis of 1997/98 would have wiped out BRI had it not been for its microfinance operations. During the crisis year, 1998, when state banks went technically bankrupt, the units yielded consolidated profits of $94m and produced excess liquidity of $1.43bn. In response, BRI was reorganized in 1998 into three divisions: a Corporate Banking Division for loans above Rp 3 billion ($300,000 at the Oct. 1988 exchange rate), a Retail Banking Division with 323 branches which offer savings deposit services, provide loans on commercial terms from Rp 25 million to Rp 3 billion ($2,500-$300,000) and handle the remaining subsidized targeted credit programs; and a Microbanking Division, with 4,185 outlets (2,566 village units, 1,220 peri-urban units, and 379 village posts), with loans from $5 to $2,500 and unrestricted savings services.

Outreach: From the inception of the reformed scheme in 2/1984 until 6/2003, a total of 31.5m loans were made. As of 6/2003, it served 3.0m borrowers; loans outstanding amounted to Rp. 13.18tr (US$1.6bn; or $527 per borrower). The number of savings accounts had grown to 29.2m, amounting to Rs. 24.68tr ($3.0bn; or $102 per account). In 2000, there were about 6,000 formal and 48,000 semiformal microfinance outlets in Indonesia, serving some 45 million depositors and 32 million borrowers; the BRI units accounted for 74% of microsavings balances and 39% of microloans outstanding (ADB 2003).[12]

Performance history: SIMPEDES, voluntary savings withdrawable at any time, with a lottery component, proved to be most attractive savings product, outperforming all others by

[12] Outside the formal and semiformal sector are some 800,000 channeling groups and the ubiquitous *arisan*, a grassroots institution of most of the poor as well as the non-poor. Despite the extraordinarily high level of institutional differentiation, some 50% of rural households are reported to remain without access to formal and semiformal finance.

a wide margin. By December 1989, BRI had broken even in terms of resource mobilization: fully mobilizing its loanable funds through village-level savings, and generating excess resources thereafter. BRI's self-reliance in terms of fund mobilization, together with its profitability, has created the material base for its autonomy and freedom from political interference which has so severely afflicted other state banks.

The BRI units reached their break-even point eighteen months after the inception of their reform, generating Rp 9.8bn ($8.7m) in profits. For the period 2/1984-6/2003, the long-term loss ratio (total overdue ≥1 day, including amounts written off, divided by total which has fallen due during that period) was 1.62%; for the period 1-12/2002, the 12-month loss ratio was 1.55%. Since 1994, return on assets (ROA) has been consistently around 5%-6%. ROA stood at 6.4% in 12/2002 and 5.4% in 6/2003. Profits at unit level amounted to $177m in 1996, $94m in 1998, $167m in 1999, $119m in 2000, $129m in 2001, $186m in 2002 and $89m during the first half of 2003[13]. After 20 years, there is still no sign of the often-quoted iron law in microfinance of an increase in defaults and a fall in profits over time.

The BRI units have a highly efficient MIS, which provide instant information on a daily basis. The data are forwarded to the head office where they are compiled and published on a monthly basis. The table below summarizes some of these data and may serve as a model to other banks.

Agricultural finance: Under the subsidized BIMAS program handled by the units until 1983, an average of $101m was lent over a 14-year period, part of which flowed into non-agricultural activities. Under BRI's nonsubsidized KUPEDES scheme, about 20% of loans are directly invested in agriculture, that was $384m (out of total disbursements of $1.92bn) in 1996; and $338 of loans outstanding (out of a total of $1.60bn) as of 6/2003.

Strong microfinance units in a weak bank: BRI is generally renowned as the bank which revolutionized rural microfinance, correctly so. The microbanking division is indeed highly profitable, and its outreach is vast; but it is only one of three divisions, accounting for 34% of total assets, 31% of loans outstanding and 41% of deposits in 2001. However, the bank as a whole had accumulated losses in 1999, 2000 and 2001 of US$3.98bn, 2.81bn and 2.51bn, respectively. The units have cross-subsidized the bank in two ways: through the continual transfer of profits from the units to the consolidated bank; and through the siphoning off of savings mobilized at village level to the branches.

The challenge of success: how to recycle savings at village level: The units' success in savings mobilization has created a new problem: recycling the savings within the village economy vs. siphoning them off. Since 1989, the units have produced excess liquidity, for the past ten years consistently above US$1bn per year. These levels have been highest during the crisis years 1998 and 1999, with $1.43bn and $1.56bn, respectively – at a time when donors rushed to Indonesia to provide fresh credit lines, thereby further raising the country's mountain of external debts. The units are required to place their excess liquidity with the BRI branch system; net placements amounted to $1,60bn in 1999, $1.24bn in 2000 and $1.23bn in 2001 (Hiemann 2003:83). With its individual lending technology and no outreach mechanism to villages beyond the subdistrict towns, BRI has not been able to recycle the savings mobilized locally, despite an unmet demand for credit (presumably by about 50 % of the rural population, among them the poor and the near-poor).

Lessons learned: Several lessons can be drawn from the experience of the BRI Microbanking Division:

- Financial sector policies work and are conducive to financial innovations.

[13] Consolidated profits before tax reported by the bank as a whole were Rp1,545bn, or $187m, during the first half of 2003; ie, about half that amount was earned by the units.

- With attractive savings and credit products, appropriate staff incentives, and an effective system of internal regulation and supervision, rural microfinance can be highly profitable.
- The poor and near-poor can save; and rural financial institutions can mobilize their savings cost-effectively.
- If financial services are offered without a credit bias, the demand for savings deposit services effectively exceeds the demand for credit by a wide margin.
- Incentives for timely repayment work.
- Outreach of a financial institution to vast numbers of low-income people is compatible with viability, self-reliance and financial self-sufficiency.
- Average transaction costs can be lowered, and both the profitability of a financial institution and the volume of loanable funds can be increased, by catering for both the poor and the non-poor with their demands for widely differing deposit and loan sizes.

Sharing experience: Within a six-year period,1984-89, the BRI unit system became a model case in Asia of the transformation of an unsustainable program of an ailing AgDB into a network of viable and self-sufficient financial intermediaries with ever-increasing outreach and financial resources, competing successfully with a wide array of other local financial institutions. There is no doubt in BRI, which went public in October 2003, what the answer should be to the question, *Agricultural Development Banks: Close Them or Reform Them?* [14] It is this experience which BRI is prepared to share with others through an institutionalised exposure visit and training program.[15]

[14] This is an astonishing development, in which the microfinance units played a decisive role. With total equity at US$ -3.65bn, the bank was technically bankrupt in 1999. In 2000, a new management took over, and the government injected some US$ 3bn. The corporate market was all but abandoned, and the bank now focuses fully on the micro, retail and SME markets. This resulted in a turn-around of the bank, which was internationally rated as BBB in 2001 (a better risk than the country at C). This new policy has been so successful that Moody's assigned a B3 rating to BRI (9/2003); and the bank is now traded at the stock market.

[15] International Visitor Program SBU Micro Banking, BRI, Jakarta. Fax 62-21-2511644, 2513013; ivp@bri.co.id, , ivpbri@cbn.net.id.

Table 2. Performance data of BRI units, 1984-6/2003

Year	*Savings deposits*		*Loans outstanding*						
	No. of accounts	*Amount in billion Rp*	*No. of accounts*	*Amount in billion Rp*	*Savings to loan ratio*	** Excess liquidity in bn US$*	*12-month loss ratio*	*Arrears ratio***	*Return on assets*
1984	2,655	42.2	640,746	111.1	38%	(0.06)	1,0%	5.4%	n.a.
1985	36,563	84.9	1,034,532	229.0	37%	(0.13)	1,8%	2.1%	n.a.
1986	418,945	175.8	1,231,723	334,3	53%	(0.10)	2,7%	4.5%	n.a.
1987	4,183,983	287.5	1,314,780	429,6	67%	(0.09)	3,0%	5.8%	n.a.
1988	4,998,038	493.0	1,386,035	542,3	91%	(0.03)	4,6%	7.4%	n.a.
1989	6,261,988	959.1	1,643,980	846,5	113%	0.06	2,3%	5.4%	n.a.
1990	7,262,509	1,694.8	1,893,138	1,381,8	123%	0.16	2,0%	4.1%	3.0%
1991	8,587,872	2,540.5	1,837,549	1,455,7	174%	0.54	4,9%	8.6%	2.7%
1992	9,953,294	3,399.1	1,831,732	1,648,5	206%	0.85	3,4%	9.1%	2.6%
1993	11,431,078	4,325.2	1,895,965	1,957,4	221%	1.13	2,2%	6.5%	3.3%
1994	13,066,854	5,231.9	2,053,919	2,458,1	213%	1.26	0,7%	4.5%	5.1%
1995	14,482,763	6,015.7	2,263,767	3,191,2	188%	1.24	1,1%	3.5%	6.5%
1996	16,147,260	7,091.7	2,488,135	4,076,2	174%	1.29	1,6%	3.7%	5.7%
1997	18,143,316	8,836.5	2,615,679	4,685,4	189%	1.14	2,2%	4.7%	4.7%
1998	21,698,594	16,146.0	2,457,652	4,696.8	344%	1.43	1,94%	5.7%	4.9%
1999	24,235,889	17,061.4	2,473,923	5,956.5	286%	1.56	1.72%	3.1%	6.1%
2000	25,823,228	19,114.8	2,715,609	7,827.3	244%	1.17	1.11%	2.5%	5.7%
2001	27,045,184	21,990.6	2,790,192	9,873.1	223%	1.17	0.53%	2.2%	5.8%
2002	28,262,073	23,480.4	3,056,103	12,010.8	195%	1.28	1.66%	1.6%	6.4%
6/2003	29,201,210	24,683.1	3,028,633	13,175.0	187%	1.39	1.83%	2.2%	5.4%

Source: Laporan Statistik BRI Unit, June 2003

* Calculated by the author on the basis of year-end exchange rates.

** Total payments overdue one day or more in % of total loans outstanding, excluding loans written off.

Annex 6 Field notes: Bank Keshavarzi, Orumiye, West Azerbaijan

RURAL MICRO FINANCE SUPPORT PROJECT (RMFSP)
Bank Keshavarzi branch questionnaire

BK Provincial Directorate, West Azerbaijan:
Mr. Golchin, GM
Abbas Nejat, Senior expert
5 September 2004-09-05

Population: 1.2m, population density 72/km²
36 districts, 109 subdistricts
Number of permanently settled villages: 2600 active; 1100 largely deserted or not permanently settled
Number of cities: 56 (40 big, 16 medium)
Annual rainfall 3-400mm
(Source: Statistical Report West Azerbaijan 2001)

BK: 60 branches: 14 branches in Orumiye, 29 in cities, 17 in rural towns.
There is at least one branch in each district except one).
There are BK branches in 26 out of 109 subdistricts.
Average number of villages per branch: 43

The DRMFS project:
2 branches involved
11 groups were established or contacted; 9 groups from 2 villages received credit
2 groups from a third village were not prepared to accept credit: for religious reasons (as Sunni Muslims) and lack of familiarity with group formation.
9 groups with 82 members, 7.5 on average
82 members received a loan
Total investment: Rls 820,000 ($100,000)
10% were contributed by the borrowers, 90% by the bank.
Rls 738m were disbursed in loans by BK, identically Rls 9m per member.
All loans were given to individuals for individual projects
Loan uses: agriculture, livestock, agricultural machinery, cement brick-making, shops

Potential for expansion of project (to up to 2600 villages):
More than 60% over 10 years -

- If financial resources, training and extension services are provided, this can be achieved with the existing staff.

To-date, the **extension service** has not been involved in the project.

Potential of expansion into rural towns and cities:
Main emphasis on villages; but the approach can also be applied to rural towns and cities.
Suggestions of GM of provincial directorate:
If financial resources are provided, encourage joint projects (like tractor purchase, deep wells, agricultural industries, non-farm projects), managed by small common-interest groups. Will these not run into the same problems as the cooperatives did, from which BK has moved away? GM: not if these are small common-interest groups. Cooperatives are too large (from 7 to 2000 members), they are not harmonized, members are not personally involved in cooperative projects.

BK Orumiye central branch

Head of credit section: Ghasem Barzah *(very well informed, all figures readily available)* *5 Sept. 2004*
Head of financial section: Reza Framarzi

Province	West Azerbaijan
District	Orumiye town and district
Total population of district	800,000, 50% in the city and 50% rural
Town & name of branch	Orumiye central branch
Date of opening of branch office	Since the beginning of the bank, since 2001 in new premises
Operates in how many villages Operates in how many rural towns	600 0
Economic opportunities in villages	Agriculture, orchards, livestock, rural industries (carpet-making)
Economic opportunities in Orumiye city	Commerce, industries (eg, cold-storage), microenterprises (food processing and packaging…)
No. of staff of branch	44
No. of staff in credit	12 (5 field staff who go out to villages)
Days/week in the field per officer	4
Activities in the field	Project assessment, supervision, guidance
Staff involved in collection	5
Number of deposit accounts	43,340
% of deposit accounts in villages	70%
Total amount of deposits	89.11bn (15% current acc't; 22% interest-free; 11% short-term; 52% long-term = 100%)
% of amount in villages	60-70%
Total number of loan accounts	9,000
Gross amount outstanding 3/2004	268bn (23bn overdue); 70% of that is mandatory credit
No. of loans disbursed	2002: 3919; 2003: 2351 (loan to sugar factory, which gives advances to farmers); 2004/May: 767
Amount disbursed	2002: 130.25bn; 2003: 135.55bn (loan to sugar factory: 28bn working capital); 2004/May: 50.61bn
Collection rate	86% (100% from sugar factory); 23bn overdue (mainly mandatory credit)
Solidarity groups:	
Number of groups	Originally all groups were under this branch, since July all re-assigned to another branch which is closer to the target area
Total no. of groups with credit	9
Total no. of members with credit	82
Total amount disbursed to groups	720m
Smallest individual loan Biggest individual loan	Equal amounts, because their activities are the same or similar; testing equal-size loans; this is a minimum loan size
Loan period	5 years
Installment schedule	Annual repayment
Profit rate charged	25% of loan 4%; 75% at 13.5; mean 11.125%
Individual activities financed	79 cow-raising for dairy; 1 modernizing a shop; 1 huller; 1 cement brick-making
Group projects financed	None
Who assessed the projects?	BK experts
Which criteria were used?	Location, fin. appraisal, residency - excluding applicants!
# of savings acc'ts of group members	All
Amount deposited	Rls 6m
Profit (interest) rate on deposits	0% (amounts were small); will change to 7% 1yr, 13.5% 3 years, 5 yrs 17.5% in phase II, newly approved by CBI)
Advantages of channeling facilities to solidarity groups	1 person represents the group in loan negotiations and collection, lowers TC (shifts TC to group representative)
Disadvantages, problems	None
Suggestions for improvement:	Increase number of villages and groups, which will increase the amounts outstanding; for non-agricultural investments in industries & services (particularly during the off-season)
Should the group project be expanded? To how many groups?	In 10 years all the villages and 60% of eligible rural people can be reached; may form 100 groups per year; *will take the bank to the people*

BK Branch of Shoadu, 2nd branch in Orumiye

Name of director of credit: Mr. Afshar (transferred to this branch 4m ago) *Date: 5 Sept. 2004*

New branch, opened in Dec. 2003

Province	West Azerbaijan
Districts covered	Silvavana and Somay Bradost
Total population in area of operation	70,000
Town & name of branch	Orumiye, Branch of Shoadu (2nd branch of Orumiye)
Date of opening of branch office	2003
Operates in how many villages Operates in how many rural towns	300 1
Economic opportunities in villages	Dryland and irrigated farming, animal husbandry, orchards, handicrafts (carpet-weaving)
Economic opportunities in rural towns	Trading, services
No. of staff of branch	10 (10% female)
No. of credit staff	4; 2 of them field staff visiting villages; + one loan collector
Days/week in the field per officer	2-3 per week
Activities in the field	CreditLoan appraisal, client study, supervision of long-term loans, guidance
Number of deposit accounts	35,000
% of deposit accounts in villages	70%
Total amount of deposits	12bn
% of amount in villages	80% (taken to the bank)
Total number of credit accounts	600 (new branch, established 1 year ago; 290 accounts transferred, 310 newly opened)
No. of loans disbursed in 2003-04	600
Amount disbursed in 2003-04	15bn (in 9 months)
Collection rate	84%
Solidarity groups:	
Number of groups	82 groups, **transferred from 1st branch (*see above*)**
Total no. of groups with credit	
Total no. of members with credit	
Total amount disbursed to groups	
Smallest individual loan Biggest individual loan	
Loan period	
Installment schedule	
Profit rate charged	
Individual activities financed	
No and type of group projects	
Who examined creditworthiness?	
Which criteria were used?	
# of savings acc'ts of group members	
Amount deposited	
Profit (interest) rate on deposits	
Advantages of channeling facilities to solidarity groups	Transferred 4m ago
Disadvantages, problems	
Suggestions for improvement:	
Should the group project be expanded? To how many groups?	80% of total area in 10 years = 240 villages, Potential: 200 groups per year, 2000 in 10 years
Notes:	

Annex 7: Field notes: Solidarity groups in West Azerbaijan

RURAL MICRO FINANCE SUPPORT PROJECT (RMFSP)
Group questionnaire

Village : Gojar, Silvana District, Orumiye Province, West Azerbaijan
Population : 7-800, in 140 households
Estimated number of BK borrowers: 10 big farmers with collatal (loan sizes ~Rls 3m in 1998)
Last loan received: 6 years ago
Number of groups in the village: 7.
Group capacity : 7 existing+ 15 additional = 22 groups

6 Sept. 2004

Group 4		
1. Village	*Gojar, Silvana District*	
2. Name of group	**Group 4, chairman: Mr. Mohammadi**	
3. Date of establishment Date of credit disbursement	10/2003 11/2003	
4. Established on the basis of previous groups? Relatives? Friends?	Relatives and neigbors	
5. Number of members 6. Number female	7 1 (35, married)	
7. How did you decide who should be a member?	Facilitator (from NGO) explained the advantages of the group, advertised, invited, selected according to capability	
8. Officers 9. How did you decide on the officers?	(X) Chairperson; (X) Secretary-treasurer Literacy	
10. Charter?	Yes with the assistance of the facilitator	
11. Meeting schedule	Weekly during off-season; no meetings during season	
12. Date of last meeting 13. Topics discussed:	2m ago, June 2004 Taking loan, exchange of views on how to stock and market their products; discuss problems: lending rate too high, installments (prefer grace period or small initial installments) Animal diseases, how to refer to the veterinarian	
14. Minutes kept? 15. Any other books or records kept?	Yes Chairman may deposit savings for members	
16. Date of credit disbursement to members	11/2003	
17. Amount per member	6.6m	
18. Sufficient? Suggested amount?	14m (to buy a cow or more sheep)	
19. Total loan period	5 years	
20. Appropriate? Suggested period?	7-8 years	
21. Instalment schedule	Years	
22. Appropriate? Suggested schedule?	Smaller installments during first 2 years	
23. Activities of individual members financed	7 members purchased 2 cows each **(all insured)**, kept near the house, more profitable than sheep; produce dairy for consumption and sale; monthly income ~Rls 300,000	
24. Any group projects financed?	No	
25. How did you decide on loan amounts, loan periods, repayment schedule, activities financed?	Determined by BK	
26. Additional investment opportunities of members	Livestock, farm mechanization; canal irrigation	
26A. Opportunities for young men **("Lack of capital is the main problem of young people here.")**	Most young men stay in the village, unemployed; opportunities: Stores, cement brick-making, metal works, carpentry, other non-agric activities, carpet-weaving;	
26B. Opportunities for young women ("Women are very hard-working")	(Marriage age 15) Tailoring, embroidery, Carpet-weaving, dairy-making,	

27. How many families (of those present) had had a loan before from BK? 28. From other banks? 29. From other sources?	7 present, only one had a loan; other had no information about BK, problem of guarantee; no land certificate (divided into small plots) 0 0	
30. All members opened savings accounts? 31. How many newly?	Yes, Qard al-Hassanh, will be changed to profit-sharing Opened another account to deposit their 10% share of investment, received 90% from the bank; withdrew the whole amount All but one	
	Economies of scope: bank will offer additional services	
32. Amounts deposited?	Rls 50,000 each to open the account. Balances now: Rls 900,000; 2m; 50,000; 0; 1m Some have substantial savings at home Taking is interest is haram	
33. Any group savings? 34. Where held?	None;	
Group functions	Chairman collects savings and deposits them on their behalf in BK	
35. Would you be interested to establish a group fund or Deh bank from own savings (for loans to members?	Yes, strongly interested, on the condition that they will get loans from their Deh bank But our capital is limited, we would still need capital for our Deh bank, eg, from BK or other sources	
36. From an initial share contribution? Rls?	Yes, different numbers of shares	
37. From regular monthly savings? Rls? Irregular savings?	Yes Yes	
38. Comments, suggestions	Loan size according to project (expenditure) size. Many **restrictions on loan uses**, such as passenger cars, barber shop, second-hand machinery Land-ownership as a condition for a loan; the landless want loans to offer services to farmers, eg, tractor services	

Group 3		
1. Village	*Gojar, Silvana District*	
2. Name of group	**Group 3, chairman: Mr. Saadat**	
3. Date of establishment	10/2004	
4. Established on the basis of previous groups? Relatives? Friends?	Relatives and friends	
5. Number of members 6. Number female	10 0	
7. How did you decide who should be a member?	NGO facilitator encouraged them, voluntary membership	
8. Officers 9. How did you decide on the officers?	(X) Chairperson; (X) Secretary-treasurer: both well-known, by consent (not vote)	
10. Charter?	yes	
11. Meeting schedule	Weekly during off-season, no meetings during season	
12. Date of last meeting 13. Topics discussed:	June2004 How to get the resources to repay the loan, repay on time so that we can get another loan (before having repaid the loan, but for another activity).Alternatively, a borrower may repay early and receive a bigger loan	
14. Minutes kept? 15. Any other books or records kept?	Yes No	
16. Date of credit disbursement to members	11/2003, one month after group formation	
17. Amount per member	Rls 10m	
18. Sufficient? Suggested amount?	No, needed 20-30m (see 23)	
18A **Project impact**	***Made people think about investment opportunities***	

19. Total loan period	5 years	
20. Appropriate? Suggested period?	Too short, 7-8 years	
21. Instalment schedule	Yearly	
22. Appropriate? Suggested schedule?	Instalment period should be after harvest	
23. Activities of individual members financed	Two cows each	
24. Any group projects financed? Activities?	None	
25. How did you decide on loan amounts, loan periods, repayment schedule, activities financed?	Facilitator explained, decided by the bank	
26. Additional investment opportunities of members	Passenger car, metal workshop, harvester, truck, repair shop, telephone taxi	
27. How many families had had a loan before from BK? 28. From other banks? 29. From other sources?	0 0 Neighbors, relatives (~Rlsm, 2-3m; interest-free), reciprocity-based	
30. All members opened savings accounts? 31. How many newly?	Yes + an additional account to deposit their share. Bank paid loan in cash 0	
32. Amounts deposited?	5m per member on average	
33. Any group savings? 34. Where held?	None	
35. Would you be interested to establish a group fund from own resources (for loans to members?	Yes, we would have direct access to services without having to spend money on going to the city. Find the best location Preference: one Deh bank for the whole village incl.youth & children Rural residents should be shareholders Other financial institutions should help capitalize the Deh bank and provide guidance and training	
36. From an initial share contribution? Rls?	Yes. Gvt. organizations can deposit their funds here instead of going to the city	
37. From (regular monthly savings? Rls?	Yes	
38. Existing funds or FIs in the village?	None, no Qard al-Hassaneh	
39. Comments, suggestions	Increase credit volume, drop credit use restrictions	
40. No. of groups in the village	7	

RURAL MICRO FINANCE SUPPORT PROJECT (RMFSP)
Group questionnaire

Village : Basrik, Silvana District, Orumiye Province, West Azerbaijan
Very remote, far up In the mountains, at the end of a steep and narrow gravel road
Population : 120, in 18 households
Estimated number of BK borrowers (before advent of the project):0
Last loan received: None ever
Most of the families are here only part of the year, live and work in the city
Number of solidarity groups in the village: 2
None received credit:
(a) Both refused to obtain credit for religious reasons (haram according to the Sunni Mullah)
(b) no potential, far from the market, unable to invest a loan profitably;
(c) most are only seasonally in the village.

Ahmad Yasini, group leader
The groups have never really functioned and have ceased to exist.

Village wrongly selected (on the ground of having been selected as part of the survey!)

Main activities: sheep raising and season labor in the city.
No opportunities, no suggestions.
Women are not part of the discussion,
NGO did talk to the women; milk not sufficient for yoghurt, cheese or butter production. Rlls 10m would be too big a risk; small loans for dairy-making are not available. Conditions are too harsh for productive investments…

Village : Dobareh, Silvana District, Orumiye Province, West Azerbaijan
Good access, on a tarred road
Population : 300, in 44 households
Estimated number of BK borrowers (before advent of the project): 15
Last loan received: 10
Did not take further loans because the interest rate was high.
2 groups in the village, originally 3, one was closed because they were too poor and could not accept the risk of defaulting.
Total number of members: 24 (21 men, 3 women)
Women were sceptical, wanted first to see how risk sharing functioned
Group potential in the village: 5 (NGO: 10-15)

7 Sept. 2004

Group 8		
39. Village	***Dobareh***	
40. Name of group	8	
41. Date of establishment Date of credit disbursement	10/2003 11/2003	
42. Established on the basis of previous groups? Relatives? Friends?	R1latives, neighbors, friends	
43. Number of members 44. Number female	12 1	
45. How did you decide who should be a member?	Voluntary, anyone could join	
46. Officers 47. How did you decide on the officers?	Chairperson, Secretary-treasurer Consensus, according to ability, knowledge, literacy	
48. Charter?	Yes	
49. Meeting schedule Why weekly	Weekly during winter and spring (nothing better to do during winter) Once during summer season Recommended by facilitator	
50. Date of last meeting 51. Topics discussed Do facilitators participate:	Last Friday Loan repayment: repay on time in order to be eligible for another loan Occasionally (not in the last meeting; last time 2m ago) Discussed and adopted crop and livestock insurance	
52. Minutes kept? 53. Any other books or records kept?	Yes	
54. Date of credit disbursement to members	Nov.2003	
55. Amount per member	Rls 9m	
56. Sufficient? Suggested amount?	No, required 30m	
57. Total loan period	5 years	
58. Appropriate? Suggested period?	No, 7 years	
59. Instalment schedule	Yearly	
60. Appropriate? Suggested schedule?		
61. Activities of individual members financed	1 goat raising (20 goats), 9 cow-raising (2 cows) 1 cement blocks production	
62. Any group projects financed?	No	
63. How did you decide on loan amounts, loan periods, repayment schedule?	Terms determined by BK	
64. Additional investment opportunities of members	Additional livestock, expand activities; we have time to produce, pick-up truck	
26A. Opportunities for young men	30 young men unemployed: livestock, carpet-making, fish-farming, shops, shops and inns for tourists Prefer separate groups for youth: mixed groups of men and women	

26B. Opportunities for young women ("Women are very hard-working")	20 young women unemployed (get married at 18-20): tailoring, embroidery, carpet-weaving, dairy products Prefer mixed groups because they are all relatives and friends; separate women's groups for female activities; 1-2 men should be members to support us	
65. How many families (of those present) had had a loan before from BK? 66. From other banks? 67. From other sources?		
68. All members opened savings accounts? 69. How many newly?	Yes All	
70. Amounts deposited?		
71. Any group savings? 72. Where held?	No	
Group functions	Discuss group role in negotiating for loan, preparing loan documentation, discuss production and marketing problems, discuss prices. Contract was signed here in the village	
73. Would you be interested to establish a group fund or Deh bank from own savings (for loans to members?	Village too small, 2-3 villages nearby would have to join together	
74. From an initial share contribution? Rls?	…	
75. From regular monthly savings? Rls? Irregular savings?	…	
76. Comments, suggestions	There is a lot of potential, all we need is credit. Credit should not be limited to certain activities Women want credit for tailoring and other non-farm activities **Why not go ahead and establish another group? Conditions are very favorable, the women and the bank are ready to go ahead. Neighboring villages are interested to form groups – one of the impacts of the project**	

Annex 8: Field notes: A women's NGO

Women's Society Against Environmental Pollution
A member-based civil society organization, Orumiye, West Azerbaijan
Ms. Mahdiyeh Mostafapoorshad, Executive Secretary
Tel.: 0441-3456067, 0914-4416174
5 Sept. 2004

Qualification of staff members:
ExecSecr: B.A. in computer sciences and statistics; 8 years experience in teaching at the University and in health organizations
Other staff: environment, nursing, construction engineering, teaching, natural resources, one new part-time employee works as an accountant to keep the NGO's accounts.

Established 1995
Inititiave taken by Ms. Mahdiyeh, the ExecSecr
Objectives: battling environmental pollution
Activities:
(1) preserve the lake
(2) teach people to clean their environment
(3) train people to use compost as a natural fertilizer
(4) train people to plant trees
(5) Recyce glass
(6) coordinate activities of NGOs

Personnel:
Membership: 498 members, mostly students and women
Board members: 7
Staff: 15 full-time employees (female)
Administrative staff: 2
Professional staff: 13
Sources of funds:
60 pay an annual membership fee of Rls 30,000 (Rls 1.8m per year)
Support by board members
Project funds from various sources
Projects:
Preservation of salt lake: UNDP ($2000 for 3 years)
Initiate digging of canals by gvt and private agencies (from their own resources) to bring water into the lake to prevent drying out (against some farmer resistance because of deviation of water)
Tree planting (greening of the environment) MoA (Rls 6m)
Plants received from MoNatural Resources distributed among residents of Orumeye
Composting: Environmental organization (Rls 6m)
Initiate pilot training and supervision of ~100 residents by gvt agencies in Orumiye to use nature waste
Participatory management for NGOs, a workshop: Provincial gvt. (Rls 27m)
Job creation: Provincial government (Rls 250,000 for training over 6m), since 2000
Identify unemployed young women (22-35 old); link with Women and Youth Committee of Provincial gvt. to provide a grant to establish some 32 women's registered societies (under societies law) and 5 cooperatives with a total of 522 members for tailoring, household services, handicrafts, university graduates
Rural finance: DRMFS/IFAD (Rls 22m)

DRMFS/IFAD project:
No of staff involved: 4 part-time facilitators (trained by DRMFS)
Staff worked full-time for 3 months in the selection of target group; helped establish 12 groups, now part-time

Training needs of NGO staff: group formation, demonstrate successful projects to facilitators; methods of training rural people;

- train facilitators and groups members jointly in the village ("on the job", as part of the social mobilization process)

Content of training:

advantages of groups (helps members to achieve their goals in shorter time, cooperation, harmonization of thoughs and interests, help each other, coordinate their potential)

Progress and upgrading of living standards due to access to finance

Training needs outside IFAD project: survey methods; editing of newsletter, methods of project appraisal and preparation of studies

Solidarity groups:

9 groups which received credit, 82 members, 19 are women whose husband, father or brother is a group member (traditionally group participation is for men only)

all in mixed groups; no separate women's groups

Best groups are family groups (husband, wife, brothers, sisters, parents, children)

Reasons why 3 groups (out of 12) did not receive credit:

objected against credit for relilgious reasons (*haram)*; many households are only seasonally in the village and thus not eligible for credit

Training needs of group members: see above, no additional suggestions

Potential of groups as SHGs: Channeling or self-help groups?

Establishing 200,000 solidarity groups in 64,000 villages (three groups per village on average), or 100,000 groups in 32 villages, is a huge job.

Where is the potential (and vested interest) in Iran to establish them as, or convert them into, SHGs?

(330 NGOs for environmental concerns; many other NGOs exist in Iran, none specialized on rural or microfinance)

Ideal number of members per group: 7-10 (cohesion and control are easier, can harmonize and cooperate better, have common interests – such as family groups)

100,000 SHGs (3 on average in half the villages, ie, in 32,000) : total outreach one million:

- Bank expert and NGO agree to concentrate on channeling groups.

NGOs can help the bank to identify and establish the groups

Does the NGO have the capacity of establishing SHGs? Not without extensive additional training.

Would rural people accept the concept of SHG with its own loan fund and financial management, and would they be able and willing to develop the SHG capacity? They are not familiar with the concept, would need training. It is not evident that there would be much interest.

BK expert: The capacity for genuine SHG formation does (not yet) exist in the villages.

- The rural people are interested in channeling groups with a group representative who transacts on their behalf.

IGA opportunities: Rural people have more experience in agriculture and animal husbandry. There are problems with diversification! There are even some problems with animal husbandry.

Suggestions to improve the project: establish more groups and more flexibility for larger loans for good investment opportunities (economies of scale), more staff training.