COMMERCIALISATION FOR SUSTAINABILITY:

MICRO-FINANCE INSTITUTIONS IN HAITI

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Abstract

The present study looks at the growing presence of micro-finance institutions with commercial governance in the market of Port-au-Prince, Haiti. The aim is to conclude whether this process will increase the incidence of sustainable micro-finance institutions. Commercialisation encompasses both the entrance of commercially orientated financial institutions and the interest of non-governmental organisations to seek funds from private investors. The analysis compares data from three institutions within each of the two categories. The areas of evaluation are size and growth, risk, cost structure and efficiency, and profitability. The finding of this study is the apparent general superiority of commercially governed versus non-profit institutions when it comes to long-term sustainability.

Master's Thesis in International Economics
by Johan Dahlstrand

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I thank Professor Mats Lundahl, who supported me all along my Haitian experience.

I dedicate this thesis to Issa El Saieh, my helpful friend in Haiti.

1 INTRODUCTION

The present study will investigate the recent trend of governance transition of micro-finance institutions (MFIs), in the area of Port-au-Prince, Haiti. Governance refers to the ultimate institutional control, and therefore extends further than the term management, which does not consider ownership, here a central theoretical building block. The aim is to provide a quantitative and qualitative assessment of this process, from the point of view of risk and sustainability on the part of the lenders. The institutions considered are both non-profit Non-Governmental Organisations (NGOs) with foundation-based governance, and profit maximising, market-oriented, privately owned institutions. These two ownership structures will be compared in order to reveal similarities as well as dissimilarities. Conclusions will be drawn with respect to the long-term effects on the sustainability of the on-going market commercialisation. The period of investigation is 1998-2001, but at times the analysis will extend back to earlier years of the 1990s. The purpose is not to look at how it was, but rather at what to expect from the future, since what has taken place so far is only the beginning of a process.

2 OUTLINE

The *Background* section presents the how, when and where of micro-finance, as well as some data on Haiti. In the following section, *Objective*, the overriding question of the study is pinpointed. Thereafter, the *Limitations* of the purpose and scope of the research will be set out.

Before going into the *Theory* section a short summary will be made of earlier research under *Evidence*. With *Theory* explained, the *Methodology* of the analysis will be presented. The institutions studied are described under *The Sample*, followed by the actual *Analysis*. *Conclusions and Policy Implications* will end the study.

3 BACKGROUND

A discussion of the general background of development finance will serve to position micro-finance in space and time. Together with a general description of Haiti and its history, it will produce a backdrop for the entire study.

3.1 Credit

In Haiti, like in many other parts of the less developed world, the lack of access to capital of ordinary households has posed severe problems, labelled problems of poverty by Fass.[1] The constraints on the supply of capital have been manifold, partly as a result of market imperfections, such as agency problems and scale. Additionally, a lack of formal ownership rights of property severely limits the potential amount of capital in developing economies. This has been referred to as "*meta-rights*", "*access or rights to property rights*".[2]

Despite numerous setbacks and limited success, development aid has been disbursed for decades. Arguably, one of the reasons for this may be sought in its transformation. As one panacea for poverty reduction has failed, scholars and practitioners have always been ready to provide yet another one. Today, micro-credits are part of a more general trend, a bottom-up or grass-roots approach, which has taken over the lead from the top-down approach.

[1] Fass (1988), p. 291.
[2] De Soto (2000), p. 109.

3.1.1 Small Loans

Micro-credit may seem a new invention but to claim that would be to ignore history, as some scholars have recently pointed out. Looking into earlier periods of history may help us today, since the experience of what we presently refer to as micro-credits is limited to two decades. However, this connection with past phenomena is seldom made.

Small loans aimed at poor people were prominent in important parts of Europe from the early 18th century up to the 1950s.[3] The ruling elite saw it as an alternative to the costly aid that would otherwise have to be disbursed by the state, with the cost borne by the taxpayers. Besides the apparent resemblance of ideas to today's micro-finance, the institutional frameworks share common traits. In Ireland non-profit so-called loan funds had their heyday in the mid-19th century, with 300 funds managing approximately half a million outstanding loans.[4] What is remarkable is the endurance and robustness of the loan funds, surviving such macro-economic turbulence as emigration and famine of immense proportions. While the Irish loan funds may be compared to the NGOs of today, credit co-operatives were predominant in Germany. Like their Irish counterparts, these co-operatives were generally successful, soon to be replicated in other countries with varying degrees of success.[5] In contrast to the Irish loan funds, however, the German credit co-operatives survived the change of the economic environment by ultimately turning into commercial banks.[6]

3.1.2 Small Loans Reinvented

As a small informal experiment, the Bangladeshi professor Muhammad Yunus in 1976 started to give credit to people who needed it desperately but lacked formal assets that could be used as collateral in the regular credit market. Encouraged by the results he proceeded to fund the today world-famous Grameen Bank, the first contemporary micro-credit bank,[7] seven years later. [8] By inventing and implementing a new type of incentive structure for the borrowers as well as an extensive system of supervision, the bank has been able to ensure a high rate of loan recovery. The repayment rate has been the highest in the world, approximately 98 per cent.[9] Due to the success, different types of institutions in other parts of the globe, including Haiti, have wholly or partly replicated the methodology of the Grameen Bank.

3.1.2.1 The Nature of Micro-finance

The agency problems of asymmetric information and moral hazard have refrained commercial banks from dealing with borrowers from the lowest social strata in society. The Grameen Bank is trying to overcome these problems by its methodology. The concept of a bank going to the borrowers, instead of the other way around, is one of the features distinguishing it from "ordinary" institutions. This principle to a large extent applies also to the methods of the MFIs in the present study. For reasons of security, the branches generally handle the cash payments. In addition we find outsourcing of the entire cash payment procedure, also in this case as a result of the dangers of hold-ups and theft in such a poor country as Haiti. Regular visits to the business of the borrower are made, in order to get a better view of his or her prospects.

[3] Hollis & Sweetman (2001), p. 291.
[4] Hollis & Sweetman (1998), p. 1879.
[5] Hollis & Sweetman (1998), p. 1884.
[6] Hollis & Sweetman (1998), p. 1883.
[7] Semigovernmental, but autonomous.
[8] Karim & Osada (1998), p. 264.
[9] Karim & Osada (1998), p. 267.

Another part of the Grameen Bank philosophy is to reduce the costs of screening borrowers by giving loans to a homogeneous group of people, usually a group of five, and make all of them responsible for paying back. The loan is given to the group, which in turn distributes it, and collects interest and amortisation payments. Two to eight groups are organised into a centre, and about sixty centres form a branch.[10] Meetings of the group members, and of the heads of groups and centres at higher levels, are crucial when it comes to understanding the information flows and incentives that enable successful lending. This group-based, or village-based, lending is not what is considered here. Individual loans form the base for all the institutions in the analysis.

3.1.2.2 New Methods, New Problems

The micro-finance method imposes high costs on the lender. The high costs will in one way or another lead to high costs for the customers as well, except in cases where the loans are subsidised. In those cases it is better to talk about a combination of a grant and a loan. One way of tackling the issue of high costs has been to set up rules that ensure a healthy income and return on investment for the entrepreneur. Otherwise it may turn out that the MFI is the sole beneficiary of the entrepreneur's endeavour.

There are voices critical of micro-finance. In his book about the negative effects of informality faced by poor people in developing countries, de Soto depicts micro-finance as follows: "*…governments have supported micro-finance programmes to assist the sweatshops that are transforming residential areas into industrial zones throughout the world.*"[11] However, it deserves to be asked whether micro-finance programmes are the fundamental cause of this transformation, or if it is an expression of the early stage of industrialisation that these regions are experiencing?

3.1.2.3 Commercialisation

A trend among MFIs today is to commercialise operations. Basically this involves both non-banks and banks. The former are represented by an array of micro-credit lenders operating on a more or less idealistic and non-profit basis,[12] and the latter by commercial banks that until a few years ago were not interested in micro-credit lending. The growing interest of non-banks in turning into privately owned entities has several causes, all founded on the perception that micro-finance is sustainable and viable. Banks, on the other hand, are moving into the sector, thus adding to the commercialisation of the suppliers of micro-finance.

3.2 A Country Profile of Haiti

In 1492 Columbus discovered Hispaniola, the island that Haiti shares with the Dominican Republic.[13] After all the natives in what today is Haiti had fallen victim to European diseases and hard labour, the white rulers started importing slaves from Africa. In 1804 Haiti became the first Latin American country to gain independence.[14] Since then, the presidency of Haiti has been sought after with all means, bringing chaos and instability. An often-changing political minority has ruled and impoverished the many by violence and exploitation.

[10] Karim & Osada (1998), p. 265.
[11] De Soto (2000), p. 70.
[12] The NGOs analysed in this study do want to make profit, but only see it as a way to further expand their outreach and become independent of the benevolence of donors.
[13] Lundahl (1983), p. 51.
[14] Lundahl (1993), p. 187.

The fall of the Duvalier dictatorship in 1986 ended decades of ruthless plundering of the Haitian people. The consecutive presidents François Duvalier and his son Jean-Claude have served as touchstones when it has come to exemplifying kleptocracy.[15] Hundreds of millions of US dollars were channelled into the seemingly bottomless pockets of the ruling family. The last years of the 1980s, however, generated a great deal of optimism in Haiti. In 1990, Jean-Bertrand Aristide was elected President. The following year a military coup forced him into exile, which in turn called forth international criticism that in the end resulted in an embargo.[16] The Haitian economy came to a more or less complete halt.

In 1994, the president returned from exile backed by American military forces, effectively ending the putsch. As the president may not serve two consecutive terms, Aristide supported René Préval in the elections of 1995. In June 1997, the prime minister stepped down, with no replacement until an interim prime minister filled the political vacuum in March 1999. Aristide's *Fanmi Lavalas*[17] party officially won the parliamentary elections held in May the following year. However, the elections were rejected as unfair by the international community, which led to the blockade of foreign donor funds, a blockade that has not yet come to an end.[18] The presidential elections of November 2000 saw Aristide make a comeback as president, winning a landslide victory with 91.8 per cent of the votes.[19] The positive sentiment present from the fall of the Duvaliers to the military coup has not returned. Instead whatever social capital Haiti possessed has deteriorated.

To get a better understanding of the poor living conditions of the borrowers, some figures on the Haitian people deserve to be taken into consideration. *Nota bene*, all general data about Haiti have inherent faults caused by the environment. Thus, the figures below should be regarded as approximate levels. At any rate, the World Bank estimated gross national income per capita to be USD 480 in 2000.[20] Furthermore, average annual growth of gross domestic product per capita was considered by the World Bank to be –2.1 per cent throughout the 1980s, and the corresponding figure for the 1990s to be –2.7 per cent.

The literacy rate is very low, possibly as low as twenty per cent,[21] while the World Bank's estimate was less dramatic, at 50 per cent.[22] Many times adults are not even able to write their own name. This has prompted NGOs to provide literacy programmes, as well as incentives,[23] in order to tackle problems connected with reading and writing disabilities. According to the World Bank, life expectancy at birth is 53 years, with infant mortality a staggering 70 per 1,000 live births.[24]

3.2.1 Micro-credit in Haiti

In 1996, loans in the formal Haitian bank sector numbered close to 800, thirty per cent approximately of which were loans extended to the bank owners. Today the lack of capital has been aggravated as Central Bank bonds are offered at 24 per cent interest, thus draining

[15] Blomqvist & Lundahl (1999), p. 315.
[16] IMI.
[17] Creole for Water Fall Family.
[18] IMI.
[19] Electionworld.org.
[20] World Bank (2001).
[21] Jallot & Lesage (1995), p. 197.
[22] Considers the population being fifteen years of age or older, all according to World Bank (2001).
[23] A proven ability to write your own name is a condition attached to the acceptance of a second loan with FONKOZE, an NGO.
[24] World Bank (2001).

the market of capital. Furthermore, 40 per cent of the deposits have to stay with the Central Bank, without any interest.[25]

As early as in 1979, Fondation Haïtienne de Développement (FHD), an NGO with micro-credit operations, was established in Haiti. It deserves to be noted that there is no general definition of micro-credits. In this study, the notion refers more to the market segment of the credit and the lender-borrower relation, than to the conditions attached to the loans. Many of the MFIs in Haiti demand collateral of some sort, partially or completely covering the principal. This collateral may be in the form of physical assets (investments, inventory and private belongings), compulsory saving schemes or cash collateral (with or without interest).

Financial liberalisation in 1994 became a turning point in the history of Haitian micro-credits. The liberalisation included changes related to the Haitian monetary authorities, as well as abolishment of the interest rate ceiling of 22 per cent.[26] The interest rate liberalisation made it possible to set up sustainable operations, with interest and fees covering the high costs that the extension of micro-credits entails.

In Haiti, ownership commercialisation of MFIs refers to both NGO transformation and the growing interest among formal banks for that market. Successful transitions of institutions in other markets, among others in Bangladesh and Bolivia,[27] have spurred institutions in Haiti to move in this direction as well. However, as Barthélemy points out, Haiti has a fundamentally original social structure, making comparisons with other countries in Latin America, such as Bolivia, less convincing.[28] For this reason it is of interest to focus on MFIs in Port-au-Prince in order to draw the right policy implications for the specific Haitian economy.

4 OBJECTIVE

The overall purpose of the present study is to explore one of the most important trends of the Haitian credit market today. In particular, the study will explore possible outcomes and results of the important market transition of micro-finance. The question that this thesis will try to find an answer to is the following:

Will a transition to commercial governance of micro-finance institutions lead to increased institutional sustainability?

As was mentioned in the introduction, the term "governance" is used here to point out that the present essay does not refer to the narrow subject of internal management of MFIs, but rather to the external institutional control. This is important to note since the incentives of ownership are here regarded as a fundamental part of an incentive structure that determines the relative success of an institution in the long run. In other words, by "governance" is meant the ultimate control of the institution, the power that appoints the executive management of the institution. This, in turn, gives it the property to influence executive decisions relating to issues that determine profitability, and in the end institutional sustainability.

The "transition to commercial governance" is dual: both the transition of NGOs into entities with an ownership structure that includes private investors and the entry of commercial banks and other private financial institutions into micro-finance operations.

[25] Interview with Bernard de Brouwer, ACME, 12 October 2001.
[26] Boisson (1998).
[27] FONKOZE (2000), p. 14.
[28] Barthélemy (1989), p. 26.

By "institutional sustainability" is meant that the institution covers all its costs, and produces a long-term return on investors' funds that reflects the risk of the investment. In addition, this should be done without resorting to aid and donations, since these have turned out to be unpredictable and can hence not serve as the basis of a long-term strategy.

5 LIMITATIONS

Like any research project with limited resources the present study faced the problem of choosing between depth and width. One alternative was to make a broad survey of the effects of commercialisation by assembling bits and pieces of information all the way from the international markets to the outcome of the borrower's return on investment. This could be interesting, although primarily in an anecdotic sense. The lack of depth would not give the study mandate enough to enable it to convincingly propose any major trends.[29] In the present study the alternative approach is adopted. The focus is the specific issue of sustainability, or lack of it, on the part of the lenders at the retail level.

Arguably, the performance and outcome of the capital markets of a market economy will influence the economy as a whole. Since the majority of Haitians are effectively excluded from the ordinary banking system, one may assume that changes in the fundamentals of micro-lender behaviour would have effects on the economic development of Haiti. Scholars in other parts of the world have expected a perceptible macro-level influence of micro-finance activities.[30] For these reasons, a discussion of the trends in the governance of Haitian micro-finance seems to be of interest for anyone interested in the progress of Haiti. However, this study will only investigate the economic performance of credit suppliers, and no quantitative macroeconomic impact assessment of the consequences of this transition will be considered.

The criteria used to find appropriate institutions were twofold: they should have at least part of their operations in the region of Haiti referred to as "Ouest", which includes Port-au-Prince. Furthermore, the institutions should to some extent market individual loans.[31] These two criteria could be considered to go hand in hand, since an interviewee proposed that individual lending was not appropriate in rural Haiti. This had to do with the differences in social structure between the capital and the countryside.[32]

Savings may be just as important as credits to a micro-entrepreneur, but they may also be important in relation to the sustainability of the MFI.[33] Incorporating is a prerequisite for bank status. In turn, becoming a bank will make it possible to lend the deposits borrowers have with the bank. However, the effects of this fall outside the scope of the present study's analysis.

The time perspective presumably influences the result, i.e. what may be efficient in the short run may not be so in the long run, and vice versa. The form of governance suitable for MFIs in today's Haiti may well prove to be anachronistic in the, hopefully more developed, future

[29] Instead, to get a general insight into the impact of micro-finance on the production of the borrowers, Burstedt & Ek (1999) is recommended. Additionally, if the impact on borrowers of the commercialisation of MFIs is sought, Rhyne (2001) could be of interest.
[30] Karim & Osada (1998), p. 261.
[31] As defined in DAI/FINNET (December 2000).
[32] Interview with a representative of FONKOZE.
[33] Khandker (1996), p.105.

Haitian economy. Since we will look only at the recent past, and at today's trends, the applicability of the results produced here are limited to the near future.

The analysis will handle group aggregates, since some institutions were wary about sharing financial indicators with competitors. There is no reason to see this as an obstacle since the focus of this study is not specific organisations but categories of organisations.

6 EVIDENCE

At an early stage I looked into the work of others as sources of inspiration for this study. One of those is a report made by Swedish Development Advisers, prepared for International Finance Corporation (IFC).[34] Four years ago this company investigated extensively the micro-credit market of Port-au-Prince, as an input into the decision-making of the IFC. The latter was at the time interested in investing in the market for micro-finance in Haiti, together with some other institutions. Although the report does not convey a generally positive attitude towards further market growth in Port-au-Prince, the decision to proceed was taken. A joint-stock company was founded, MicroCrédit National (MCN).

There is also prior evidence to be found relating to the commercialisation of micro-credit in general and of certain markets in particular, outside Haiti. An example of the latter is a case study by Katsuma for the Japan International Cooperation Agency (JICA).[35] This looks at the successful partial spin-off of micro-credit lending PRODEM, Bolivia, that turned into the commercial bank of Banco Solidario (BancoSol).

6.1 Reasons for Haitian Private Banks to Enter the Micro-finance Market

The interviewees contributed different theories as to why the banks enter the market. According to Development Alternatives, Inc./Financial Services Network for Entrepreneurial Empowerment (DAI/FINNET) the commercial banks look for ways to lend their deposits. The methods used to do this vary, as we shall see later in the sample. A representative of one of the NGOs interviewed insisted that the commercial banks were not interested in micro-credits *per se*. The reason quoted was instead that the banks were drained of capital due to the possibilities to deposit in co-operatives handling micro-credits. To avoid this threat they have had to start their own micro-finance operations to attract deposits. However, this theory has not found any support. On the contrary, many facts point in other directions.

6.2 Reasons for a Haitian NGO to Commercialise

A Haitian NGO, Fondasyon Kole Zepòl[36] (FONKOZE), has been, and still is, actively working to spin off its micro-credit section.[37] Interviews with the NGO have provided the opportunity to learn the different reasons for engaging in such a transition, from an organisation actually in the process. FONKOZE works almost exclusively through group lending, but it emphasises that it is not a Grameen Bank replica.[38] Men are excluded from the micro-credit activities of FONKOZE and the foundation specifically aims at providing credit for *ti machann* (Creole for women street vendors).

[34] Swedish Development Advisers (1998).
[35] Katsuma (1997).
[36] Creole for shoulders together foundation.
[37] Thus, it is not a transition in the strict sense, where the foundation would incorporate.
[38] The reason it gives for engaging in group-based lending is that individual loans make less sense in the areas where the organisation conducts business, which to 85 per cent takes place in the provinces.

According to FONKOZE, there are three prime motives for this NGO to go through a costly commercial transition:[39]

- First, growth has been stymied by lack of capital. Evidence from countries such as Indonesia, Bolivia, Bangladesh and the Philippines points to commercialisation as a possible solution to this problem. For a time, FONKOZE has been engaged in raising capital for this purpose.

- Second, the need for a business environment is mentioned, as it is seen as the road to financial viability. A board with the desired expertise is thought to be part of the solution.

- Finally, this transition would enable new product development, since operating as a Haitian foundation limits the scope of operations. Acquiring bank status would definitely increase the possibilities for new product development for the institution. Primarily, FONKOZE would be able to use the savings of the depositors in their lending operations. The NGO has already initiated the process of obtaining bank status.

However, commercialisation could prove to entail additional costs to the direct costs with a transitional character. Besides these mostly administrative costs, there are also financial costs to keep in mind for the NGO considering incorporating. One of the advantages of being an NGO is the ability to attract donor funds, which is difficult for a privately owned institution. However, this advantage applies less today than a few years ago, since donations for Haiti have grown increasingly scarce. Logically, this ought to have further increased the pace of commercialisation in Haiti, since the NGOs become all the more anxious for further funds to increase operations at least *pari passu* with the market expansion. The interviews in Haiti corroborate this.

6.3 Emerging Institutional Problems of Commercialisation

Technically, the micro-finance part of FONKOZE will turn into a spin-off, creating a new institution: FONKOZE BANK. The ownership structure of this entity will ensure a major influence for the foundation, to prevent the micro-finance operations from experiencing "mission-drift" - drifting away from the more altruistic goals in favour of pecuniary ones as a consequence of commercially oriented governance. It is emphasised that the aim of this commercial transition is to reach more poor people, as FONKOZE sees the organisation as a people's movement and not a company. It is also stated that this self-image is its prime advantage.

However, at the same time as people within FONKOZE picture the employees as not primarily working with FONKOZE for the money, they are instituting a bonus system for the credit agents and/or branch managers. The most important criterion in this incentive programme will be portfolio performance. FONKOZE acknowledges that there is a danger that commercialisation will reduce the advantage it pictures itself as having. There is a risk that the incentives for the employees in the programme will bias the selection of borrowers in favour of safer and more profitable applicants. This is one way the new owner structure could influence the evolution and development of the institution's lending operations.

If this turns out to be closer to reality, FONKOZE will not be the only institution struggling with incompatible goals. As one publication noted: "*On the one hand, the NGOs seek solvent*

[39] Interview with Leigh Carter, FONKOZE USA, 6 November 2000.

shareholders based on commercial criteria. On the other hand they fear that a private shareholder will direct the institution's policies towards the main objective of increasing profits, thereby losing sight of the social development focus and ignoring the traditional target group."[40] The risk of "mission drift" was a common concern put forward by most NGOs. Representatives of DAI/FINNET believe that FONKOZE will stand the test and keep its principles despite this transition. The fact that it will keep its non-performers within the FONKOZE foundation is seen as a factor that will facilitate this.

7 THEORY

The relation between credit and development can be looked into from several angles and perspectives. In the present work the question asked is fundamentally related to the handling of credit, and how this affects development, i.e. how the framework within which credit is handled produces different outcomes when it is changed.

In Utopia and theory, funds flow from more developed countries to the less developed effortlessly, reaching the individuals making the best use of it. In the real world and practice, funds have to be channelled through institutions at different levels, to a varying degree ending up where it is meant to end up. The efficiency of these institutions will affect development, just like components in the great machinery of a developmental engine. As was explained under *Limitations*, the present study will look at the specific issue of governance of MFIs as a factor influencing the outcome of development finance, through its impact on sustainability of MFIs.

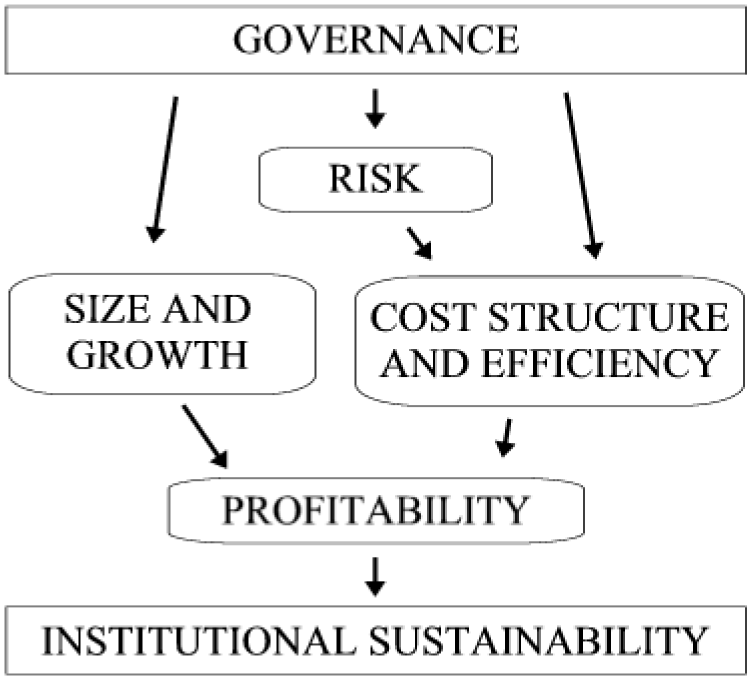
The general reasoning of the present study as to how the specific type of governance affects institutional sustainability will present this study's conceptual framework. Subsequently, different forms of governance will be considered. These will produce explanations and reasons for the present study's assumptions, thus providing a starting point.

7.1 From Governance to Institutional Sustainability

A general theoretical framework through which the specific form of governance affects institutional sustainability is displayed in Figure A below. This framework will guide the comparative analysis.

[40] FONDESIF/GTZ (2001), p. 8.

Figure A



It is here assumed that the specific type of governance will directly affect size and growth, as well as risk and issues related to cost structure and efficiency. While risk influences costs, the other two factors directly affect the profitability of the financial institution considered. Institutional sustainability is then determined by this profitability.

7.1.1 Size and Growth

It is important to have a minimum loan volume, since credit institutions typically have fixed costs that have to be covered. In other words, the market is characterised by certain economies of scale. However, large operations demand major financial backing, or access to large quantities of capital. *Ceteris paribus*, a large organisation will demand large investments in assets. Further, it is important that the MFI can rely on accurate and timely disbursement of these resources, so that planning and action in accordance to the plans are possible.

7.1.2 Risk

Managing credit risk is essential for the institutional sustainability of institutions extending credit, both short-term and long-term. Handling risk is an integral part of the function, or business idea, of these organisations.

Informal money-lenders and lending arrangements have played an important role in the extension of credit to poor people in Haiti.[41] Despite the extremely harsh business environment and economic conditions they have prevailed, typically without resorting to

[41] Lundahl (1979), pp. 511-535.

collateral and other tools to secure loans.[42] This has been possible due to the accurate knowledge that these money-lenders possess about the people that they extend credit to. This in turn is a result of the close relationship that lenders and borrowers typically have.

Whether secured or unsecured, loan extension demands collecting information about the potential borrower applying for loans. However, this information will not be comprehensive; the borrower will have more knowledge about his possibilities to pay interest and repay the loan than the lender. What we have is a situation with asymmetric information. Akerlof has depicted some of the problems that such an anomaly may cause in a market.[43] His term "lemons" would in the case of the present study be borrowers without good business prospects, who are given loans because the lender has acquired insufficient information or disinformation. In a situation where an MFI does not have the ability to screen and monitor borrowers, it will attract all the "lemons", as these people will not be able to acquire credit elsewhere. Therefore, it is essential for the MFI to be able to assemble and process information about potential borrowers properly. Thus, to have a good knowledge of the local market is a strong comparative advantage.[44]

7.1.3 Cost Structure

However, governance does not influence costs only through the level of risk, but also through the cost level in general. The reduction of risk is often obtained only at the expense of higher administration costs. However, it is important to remember that the MFIs have to strike a balance between minimising risks of lending, and minimising the costs of minimising the same risks.

7.2 Theories of Governance and Optimum

The choice of governance in the upper part of Figure A will influence all the other components through the interconnections illustrated. No other component of the model is independent of this first component, including institutional sustainability. This is the point of departure of the present study.

First, the deficiencies related to State control of institutions handling developmental finance are considered. A commercial and profit-oriented method is then compared with alternative, albeit also non-governmental, methods. Based on history and prior evidence from various parts of the world, the present study will consider, *a priori*, government interference related to the distribution of credit as inferior to non-governmental governance. This leaves the relative performance of commercial MFIs versus NGOs to be investigated in the comparative analysis.

7.2.1 Fallacies of the State

The advantage of an NGO over a parastatal development bank lies in its inherent flexibility in structure and methods. Both when it comes to determining and adapting to the demands and needs of the borrowers, light-footed NGOs are superior. Furthermore, an NGO may build on local customs of how credit is extended, and thus work through the existing social structure (solidarity and sanctions), something that is not easily replaced by using collateral.[45]

[42] Lundahl (1979), p. 523.
[43] Akerlof (1984), pp. 7-22.
[44] Lundahl (1979), p. 548.
[45] Adams & Fitchett (1992), p. 81.

The superiority of private alternatives over public ones has also been documented. The commercial bank is referred to as more decentralised and local, in refinancing as well as in decision-making. The borrower selection process will benefit efficiency in the short run and sustainability in the long run. The state-driven development banks are instead characterised by centralisation. The dependence of developing countries on foreign funds with specific targets adds heavily to the extensive overhead costs, making concessionary loans expensive.[46] This criticism also applies to the NGOs in the present study, although more so a few years ago, according to several interviewees. The number of grants has decreased considerably with the increasing political problems in Haiti.

7.2.2 Is Commercialisation Optimal?

Observing the developed world of today, taking into account the evolution of financial intermediation in history,[47] a commercial alternative is usually taken to be optimal. Instead, the present work concentrates on evaluating whether commercial governance is superior to the non-profit alternative also in the underdeveloped frame of Haiti. Meanwhile, it could be that the specific cultural and economic features of the borrowers in Port-au-Prince make it even more preferable, relatively to developed economies, to conduct micro-finance operations in a commercial context.

As has already been mentioned, concerns of "mission-drift" due to profit-seeking investors were widespread in the field. They are also found in literature on the subject of commercialisation and MFIs. However, the literature also points out that a competitive environment is a fundamental characteristic of a micro-finance market with business-orientated MFIs.[48] Furthermore, it is said that "*commercialization and competition go hand in hand, one spurring the other.*"[49] From an economic viewpoint, one expects this competition to ensure that MFIs will respond to their clients' needs, so that their current and potential clients do not opt for a competitor. For the same reason, these commercial MFIs would be in a constant process to streamline operations and lower cost, in order to be able to offer micro-credit at increasingly favourable terms, to even more micro-entrepreneurs.

Therefore, one would be at fault to suggest that commercialisation of micro-finance gives private investors a tool to extort the poor masses. On the contrary, competition generated by commercialisation will ensure that borrowers will be able to acquire credit that reflects the true costs of the loan extended, with these costs declining as the MFIs are forced to become increasingly efficient.

In some micro-finance markets, a deterioration of portfolio quality has followed on increased competition, as these markets have become saturated.[50] However, as private investors are concerned about the long-term profitability of their investments, their presence in the governance of MFIs will ensure that the latter attempt to minimise risk.

For the NGO, changing from being a foundation to a private company is also a requirement in order to obtain a bank status. Turning into a bank will give an institution the legal status necessary to be able to lend money from deposits, already used by customers as a way to earn

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[46] Adams et al. (1984), p.102.
[47] Hollis & Sweetman (1998), p. 1883.
[48] CGAP (2001), p. 2.
[49] CGAP (2001), p. 9.
[50] CGAP (2001), p. 9.

interest on money saved for emergencies. This is yet another important step on the road to financial independence.[51]

8 METHODOLOGY

A comparative analysis will form the basis for the evaluation of the long-term changes in performance and sustainability of micro-finance operations in Haiti that commercialisation produces. This will be achieved by comparing the performances of commercially governed micro-credit operations with those of NGOs. To this end I will use theories and guidelines, some of which are found in thorough guides for technical analysis of specialised credit institutions, such as those developed by the Inter-American Development Bank (IDB)[52] and The Consultative Group to Assist the Poorest (CGAP).[53] Due to the varying quality and focus of the material obtained, the approach is necessarily selective.

Due to the difficulty of obtaining large amounts of financial data, the analysis will not only consist of quantitative measures and remarks but also of qualitative findings. For example, inherent institutional differences that are not covered by the literature obtained, but possibly producing differences in performance, will be acknowledged and accounted for.

9 THE SAMPLE

The institutions analysed in this study are Association pour la Coopération avec la Micro Entreprise (ACME), Groupe Technologie Intermédiaire d'Haïti (GTIH), Initiative Développement (ID), Banque de L'Union Haïtienne (BUH), MicroCrédit National (MCN) and Société Générale Solidaire (SOGESOL). None of the six MFIs provide micro-credit for consumption; they only extend credit for investment of some sort.

Representatives of three more institutions of interest for the analysis were interviewed but inability, and/or reluctance, to share financial data made it necessary to exclude them from the analysis. One possible reason for secrecy could be the on-going consolidation process, which at least one of these institutions was experiencing first-hand during the time of the field study.

The first and most obvious way to categorise the MFIs is by adhering to the legal definitions of the institutions. This approach could easily be challenged by other, more comprehensive, methods. During the course of the study in the field it became apparent that many NGOs used both techniques and mindsets that are typically considered commercial or businesslike. This is an important issue to settle, and it was emphasised by Robert Dressen of DAI/FINNET. For this reason a set of questions was used during the interviews with representatives of the MFIs in the present study, in order to reveal the true level of commercial thinking. The answers suggested that there was a wide array of thinking in the NGO camp. But at the end of the day, with all business behaviour considered, the difference in structures of pecuniary incentives persists, and so do the differences in governance and in the way capital is exchanged with the outside world. For that reason the study follows the definition of the law and of ownership.

Although all the institutions in the study work with the poorer part of society it deserves to be noted that they serve different social strata. In that sense they do not always compete but rather complement each other.

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51 Khandker (1996), p.105.
52 IDB (1995).
53 CGAP (1999).

9.1 Compiling Data

The different systems of interest, fees and other loan conditions among the MFIs display a high degree of complexity. For that reason, the study will not compare interest rates directly, but rather look at the aggregate financial figures. Due to the lack of financial data, the numbers have been both interpolated and extrapolated to enable comparisons and industry averages. This underlines the tentative nature of the results.

Due to the design of the collection of data, hard decisions had to be made regarding the choice of statistics. One of those concerned disparity in time between the same MFI's most current figures. In order to create meaningful ratios and to minimise biases, time consistency between the figures analysed was given priority over the use of the most recent data. Thus, intra-firm consistency in time was prioritised over inter-firm time consistency. The disadvantages of this procedure should not be overemphasised since the length of time the different MFIs have been in business varies, from several years to less than one.[54]

The financial information received was mostly denominated in the local currency, the Gourde.[55] Thus, all other figures were transformed to Gourde equivalents to enable comparisons.

9.2 The Commercial Entities

The three commercial institutions in this survey are Banque de L'Union Haïtienne (BUH), MicroCrédit National (MCN) and Société Générale Solidaire (SOGESOL). Together, arguably, they form something like the front of the commercial initiatives in the market. Being commercial, they all differ in several ways. In fact, only one of the three, the BUH, possesses bank status.

In the interpretation of the analysis it should be taken into account that the figures for privately owned entities will partly reflect the performance of young organisations.

9.2.1 Banque de L'Union Haïtienne (BUH)

The BUH is a major commercial bank having added micro-credits to its product portfolio, calling it *kredi popilè* (Creole for "popular credit"). The product was introduced in 1997 with the aim of reaching small businesses. To get a better profile of the market segment of micro-credit borrowers it deserves to be noted that the BUH extends between Gds 5,000 and Gds 50,000 to first-time borrowers, and the basic loan never exceeds Gds 75,000. A new product for high performing clients has recently been introduced, with loans ranging between Gds 100,000 and Gds 150,000. The BUH also has a school fee loan, at the beginning of semesters. The bank does not use compulsory savings schemes.

The branch network and the human resources of the BUH are considered by the manager to be the key components of the bank's prosperity. Micro-finance has been added to its existing network, and the knowledge base related to credit was in place already before offering the micro-products. At the moment, the BUH sees profitability as more important than growth. This is a feature that distinguishes it from more recently started commercial MFIs.

According to a representative of the bank, a balance sheet for the micro-credit section could not be produced since these operations were integrated into the balance sheet of the BUH

[54] The problem of inflation has not been taken into account.
[55] USD 1≈Gds 25, as of October 2001 (Gds=Gourdes).

group. A profit and loss statement was obtained, however. Furthermore, the BUH is in the process of being acquired by Société Générale de Bank (SOGEBANK)[56] and for that reason the BUH does not make any projections at this stage.

9.2.2 MicroCrédit National (MCN)

The MCN is a private joint stock finance company that was started in November 1999. One of the major Haitian banks, UNIBANK,[57] owns the MCN together with the IFC, Internationale Micro Investitionen (IMI), the Financierings-Maatschappij voor Ontwikkelingslanden (FMO)[58] and the International Cooperation and Development Fund (ICDF).[59] Unlike the BUH, the MCN does not have bank status. However, the MCN does not see any problems with not being able to hold deposits, as there are such possibilities within UNIBANK.

Entrepreneurs who do not qualify for a loan in the regular banking system are given a first time loan ranging from Gds 1,000 to Gds 150,000. The estimated median for first time borrowers is Gds 25,000 to Gds 35,000. The loans are categorised into *Mini* (Gds 1,000-15,000), *Micro* (Gds 15,000-100,000) and *Petit* (exceeding Gds 100,000). No cash collateral is required when taking these loans, but the business must have been running for at least six months. However, the MCN funds new businesses too, but through a product called *Crédit Investissement*.

When asked what is the key component for the prosperity of the MCN its officials pointed to the institutional set-up or structure, and the human capital. The company has been subject to technical assistance from the renowned German consultancy firm Internationale Projekt Consult (IPC), one of the owners of the IMI above. This was part of the agreement between the different investors to start MCN.

Growth was seen as more important than profitability for the time being, since the institution is relatively young. Making profit is more of a long-term aim.

9.2.3 Société Générale Solidaire (SOGESOL)

SOGESOL is a subsidiary of SOGEBANK, which manages the bank's micro-credit portfolio like a service company. Formally it is a public limited company, and like the MCN it does not have bank status. At the time of writing, SOGEBANK was in the process of acquiring the smaller BUH.

SOGESOL targets all urban micro-entrepreneurs between 21 and 55 years of age working within the commercial, service or production sectors. It does not have any compulsory saving schemes and does not require cash collateral on the part of the borrower when giving loans. However, it demands a full guarantee for the loan, which may be anything from machinery and inventory to personal belongings. The business funded must have been operating for at least one year. The size of a first time loan is in the interval of Gds 2,000 to Gds 15,000, with an average of Gds 7,500.

Rapidity in the service is what SOGESOL puts forward as its key competitive advantage.

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[56] SOGEBANK is the largest commercial bank in Haiti.
[57] The bank holds a forty per cent stake in the company.
[58] The Dutch government development agency.
[59] A Taiwanese fund.

The institution began its operations as late as in November 2000. The company is concerned with both profitability and growth, but due to its short history growth is considered more important at the moment. There is a bonus system related to performance in place for the credit officers, besides a fixed salary.

During one and a half years, SOGESOL received funds from the IDB covering technical assistance. It no longer receives any such aid; today SOGESOL pays the outside external technicians working there. These include technicians from ACCION International. The majority ownership is held by SOGEBANK, with ACCION Gateway Fund, Profund[60] and local Haitian investors holding the rest.[61]

Important to note is the fact that service charges and other fees constitute the revenue of SOGESOL. The portfolio that it manages is owned by SOGEBANK. Therefore, the revenue and costs that SOGESOL displays may diverge from those it would have if it were the owner.

9.3 The NGOs

Three NGOs will be analysed in this study, since the other organisations interviewed could not produce the relevant information needed to be included. The institutions of interest in the analysis are Association pour la Coopération avec la Micro Entreprise (ACME), Groupe Technologie Intermédiaire d'Haïti (GTIH) and Initiative Développement (ID). Although all the institutions present a commitment to helping the needing masses of Haiti, they do not share the same view of how this is best accomplished.

Generally speaking, these three NGOs have been active for a longer period of time in micro-finance activities than the three commercial MFIs in the analysis. Some of these institutions also had other programmes to support the poor prior to their micro-finance endeavours, many of which are still in operation.[62] Therefore one could argue that they have a wider knowledge of the conditions of the poor of Haiti, giving them at least a temporary competitive lead over the privately owned MFIs.

9.3.1 Association pour la Coopération avec la Micro Entreprise (ACME)

ACME is the only of the three NGOs that works exclusively with micro-finance. The programme was established in 1997 and focuses on the urban area of Port-au-Prince. First time borrowers may get loans starting at Gds 2,000, and the maximum loan is Gds 50,000 for old clients. The aim is to reach a middle segment of the informal business sector.[63] With some exceptions, the borrower has to be in business already with a fixed locality. There are no compulsory saving schemes. The loan may not exceed forty per cent of the present capital, with repayments being neither larger than the expected monthly income increase nor thirty per cent of the monthly income before the interest payments of the potential loan have been subtracted.

A proposal by one of the bigger Haitian commercial banks, Capital Bank, to buy ACME was turned down. The reason stated for this was the fear that ACME would become just another commercial bank. Profitability is one of the goals, but so is reaching the market below the segment of the commercial banks. ACME's desire to become incorporated shows its

[60] Supports the growth of regulated financial intermediaries serving Latin American micro-enterprise markets.
[61] ACCION International (2000).
[62] Referred to as "*credit plus*" approaches in Karim & Osada (1998), p. 257.
[63] Businesses in the upper ten per cent, as well as the lower twenty per cent, of the informal business sector are excluded.

management's faith in the dual mission. ACME is actively searching for both international and local investors in order to increase its capital, although the risk of "mission drift" is apparent. The problem is that purely commercial investors are not interested because of the size of the investment, which is too small to be profitable. The donor side, on the other hand, has "given up", according to the founder of ACME. The issue of turning ACME into a full-fledged bank is seen to entail too high a cost, related to the extensive informational interaction with the Central Bank required.

In the beginning, the United States Agency for International Development (USAID) supported ACME through the programme of Projet pour la Relance de l'Economie en Transition (PRET) by covering fifty per cent of its losses. Today PRET and USAID's FINNET programme provide technical assistance in management information systems and strategic planning. The United Nations' Development Programme (UNDP) provides assistance with bookkeeping and internal control, through MicroStart. Furthermore, ACME has bank guarantees with both the Soros Foundation and Deutsche Bank, lowering the costs of refinancing.

9.3.2 Groupe Technologie Intermédiaire d'Haïti (GTIH)

The GTIH is engaged in infrastructure projects in poor neighbourhoods and operates micro-finance. The micro-credit activity started in 1995. The target group of the GTIH consists of people from the informal sector not eligible for loans in ordinary banks. Loans are offered to activities related to both commerce and production, but even credits to agriculture are under consideration for the future. The minimum loan of Gds 5,000 effectively excludes the lowest social strata. The maximum loan, given only to customers with at least three prior loans, is fixed at Gds 40,000.[64] Loans are conditioned on the provision of a guarantor with an income and a security deposit of ten per cent of the loan is required. The GTIH recognises that resorting to the judicial system has never produced any result for the organisation in cases of delinquent loans. Having guarantors to the loans serves more as a means to get a closer contact and knowledge about the clients than anything else.

Asked about whether the GTIH sees its borrowers primarily as customers or beneficiaries the respondent chose the former description. Also, the MFI has an incentive system for its credit officers, with bonuses attached to performance. The GTIH sees the bonus system as the most effective tool to keep operations sound. It envisages financial equilibrium and profitability as the only realistic alternative. As an NGO, the GTIH has no access to financial markets as of today, but hopes are attached to a programme designed to deal with this issue. The two reasons given for the desire to commercialise operations are on the one hand a reduction of the cost of capital, and on the other hand social improvement for the poor.

Unlike the other MFIs in the analysis, the GTIH operates from a single branch. Not having a branch network severely restricts the possibilities to reach some categories of borrowers. Craftsmen and farmers, for example, cannot leave their work for travelling without a serious reduction in revenue-generating production.

In the end most of the financial and business figures that the GTIH could produce were from 1999, up to two years older than the most current data provided by other organisations in the analysis. However, the problem is not that alarming, taking into account that the GTIH has been in business since 1995. This should be compared with two of the three commercial

[64] The minimum and maximum amounts here relate to the situation on 30 September 2001.

entities launching their operations as late as 1999 and 2000, respectively. Furthermore, the size of the loan portfolio as of 30 September 2001 had not changed significantly compared with the one of 30 September 1999. The institution does not technically separate earlier earnings/losses from donations, which adds to the difficulty of analysis.

9.3.3 Initiative Développement (ID)
The ID operates within three areas of development and relief support: health, education and micro-finance. The micro-finance programme was started in November 1998 and is only intended to operate in Port-au-Prince. The borrowers are people in great financial distress living in St Martin, a shantytown in the capital. First time loans range between Gds 1,000 and Gds 1,500, a relatively low segment of the market.

The ID is not trying to raise commercial capital, as it sees dangers related to commercialisation of micro-finance. The institution actively aims to serve the poorest and most vulnerable, an aim that it does not see as compatible with a commercial transition. The ID does not see itself as ever becoming economically sustainable, as it needs subsidies to stay financially viable. It views its borrowers primarily as beneficiaries and not as customers, distinguishing it from the other institutions surveyed.

Borrowers are required to have a guarantor and an up-and-running business. Commonly, the borrower has a one-person business, e.g. a *ti machann* selling off the street. The ID subjects its clients to a compulsory savings scheme as a means to further secure its portfolio. These deposits are interest free.

9.4 Co-operatives
Besides the commercial entities and the NGOs, the micro-credit sector contains a number of co-operatives. These co-operatives were not considered, as they have not been involved in the formal commercial transition in Haiti. Meanwhile, they will most likely experience some effects of the market transformation. It is important to stress the importance of these same institutions as they represent a considerable share of the market. The competitiveness of the co-operatives was acknowledged several times during the interviews with their competitors. In many cases, this competitiveness was referred to more as high-risk pyramid games than healthy operations based on lowest cost. The comment refers to the high interest rates on the deposits that they market, where up to ten per cent per month is offered, in order to attract customers. A representative of the Banque Haïtienne de Développement (BHD) estimated that there are approximately 1,500 co-operatives in Haiti, with an aggregate number of members of one and a half to two million. The BHD has bank status and operates on a profit basis, but is owned by a majority of co-operatives.

9.5 Competition
No MFI considered the market demand for micro-finance in Port-au-Prince as saturated. Thus, competition has still to become a major issue, or as one representative of an NGO said: "*[competition] is a new phenomenon, but we do not step on each others' toes*". As to the future, many MFIs seem to expect harder competition. One indication that competition is on the rise has to do with the increasing number of people comparing conditions of different MFIs before choosing one, according to the organisations. Considering the complex system of different types of interest rates, fees and compulsory savings programmes etc., one may doubt the short-term results of this competition for the, many times illiterate, borrowers. Competition in this form - "shopping around" - was downplayed by one of the MFIs.

According to this source, the borrowers are personally attached to their MFI, and will therefore not hastily change from one MFI to another.

Evidence from micro-finance markets outside Haiti tells of increasing competition as the number of institutions operating in the same geographical area increases. The outcome may be negative for the market as a whole if competition turns "unhealthy"; market saturation together with a need to continue increasing loan portfolios. In this situation, even the operations of institutions committed to sustainability may be negatively effected.[65]

Competition in the labour market for micro-finance professionals, such as credit officers, was sometimes referred to as on the rise. This should not be too surprising since the few that have the possibility to acquire an education often were said to emigrate, to the detriment of Haiti.[66] If the growth of demand exceeds the growth of supply, basic economics tell us that wages should increase, *ceteris paribus*. This is perhaps a point to keep in mind, when technical assistants paid for by donors become scarcer and the founders, typically working on a more or less voluntary basis, step down. Haitians with a higher education can demand high wages due to their scarcity, and there was no indication that this would change in the near future. An example of the competition for sought-after Haitian expertise, as well as of the management transition from foreign to Haitian, happened at the time of the study. During this period, the managing director of the BUH micro-credit operations became the managing director of ACME. Meanwhile, another MFI had been interested in hiring the same professional.

9.6 Accounting

When it comes to accounting, the institutions display extremely divergent levels of professionalism and ambition. The whole range of MFIs, from institutions swiftly producing detailed figures to others scribbling down a few rounded aggregates, are working side by side in the market.

In the analysis, any extra interest payments due to late repayments are merged with interest received in time accordance to the contract. Also, the dates that correspond to the data and indicators used are attached as footnotes.

According to the IDB, consumer prices have developed as displayed in Table A below.[67]

Table A

Consumer Prices Development (in per cent)					
Year(s)	1991-1995	1996-2000	1999	2000	2001
Change	26.0*	14.7*	8.7	13.7	17.0**
* average annual change; ** forecast					

As a proxy for inflation, the development of consumer prices the last years tells us that we should be cautious when evaluating past financial figures denominated in Gourdes. This is important as the analysis of the present study does not adjust the financial figures to account for inflation.

65 Karim & Osada (1998), p. 283-284.
66 At times referred to as "brain-drain".
67 IDB (2001).

10 ANALYSIS

The analysis is structured into four different areas of major importance: size and growth, risk, cost structure and efficiency, and last but by no means least, profitability. The general theoretical framework of how a specific form of governance affects the institutional sustainability was illustrated in Figure A above. According to this framework, these four areas of interest should be regarded as the core issues of this paper, since they determine the long-term institutional sustainability.

Reaching a large portfolio size is important for sustainable operations, with revenue covering expenses. Growth of the same portfolio is vital for further expansion of operations, once costs have been covered. Keeping risks of the credit extension under control is essential if operations are to remain healthy and it influences sustainability through costs to the MFI. In the end, the main factor influencing sustainability is profitability. These four areas will be considered one at a time, in order of influence. Starting out with size and growth, the analysis will go on to consider risk, before looking at cost and efficiency, while ending with profitability.

10.1 Size and Growth

A certain critical mass of customers and loan volume is a prerequisite for attaining sustainability. However, deficient credit management may well compound problems in a situation where the aim is expansion in order to reach the critical mass.

Figure B

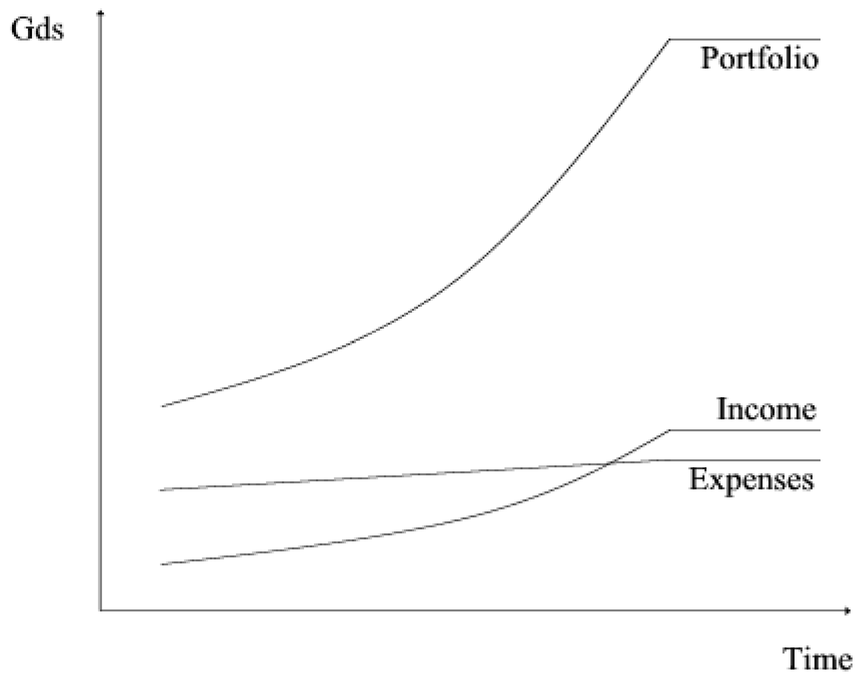

Figure B[68] gives an idea of how portfolio growth may lead to profitability. In this case of a well-managed MFI, the expanding portfolio enables income eventually to surpass expenses.

10.1.1 Portfolios

Sustainable micro-finance operations are commonly associated with portfolios that contain a minimum amount of about 5,000 borrowers.[69] Of the six institutions in the sample, none had reached this level. A commercial MFI had the portfolio with the largest number of loans of all six institutions, allegedly 4,000. The group average of the three commercial MFIs[70] was 2,426, while the corresponding figure for the group of NGOs[71] was 1,300, or about 54 per cent of the former group's figure. *Ceteris paribus*, this points to an advantage for the commercial MFIs.

Also when looking at the volume of the portfolios, the commercial MFIs show a strength in term of size. The average portfolio size of the three commercial MFIs[72] was Gds 54,844,319, as opposed to a volume of Gds 8,148,641 for the NGO group.[73] The latter average is not even fifteen per cent of the former.

Accordingly, almost all the institutions interviewed during the research in the field expressed a wish to expand their outreach. The fact that the volume of operations was emphasised so strongly does not necessarily mean that viability and sustainability are overlooked, as was explained above. Generally, growth was viewed as a prerequisite for self-sufficiency.

Studies of more mature micro-finance markets have proven that the growth of non-profit MFIs has been negatively affected by the presence of commercial alternatives.[74] The NGOs in Haiti could therefore expect to experience such a development in the medium to long term.

At the moment, growth seems to be sustained at high levels, at least for some MFIs. A representative of one of the NGOs reported that during November and December 2001, the portfolio increased by 25 per cent.

10.1.2 The Market

The micro-credit market for Haiti as a whole has experienced a rapid growth in terms of actors. Swedish Development Advisers (1998) estimated the average annual rate of growth of MFIs to twenty per cent during the period from the late 1980s to the late 1990s. A similar explosion in the number of MFIs has taken place in Port-au-Prince. Between 1993 and 1997, the number increased from less than ten to thirty institutions, and the number of borrowers from somewhere in the hundreds to between 15,000 to 25,000. In 1996 alone, there were eight new MFIs entering this market.[75]

More recently, the presence of growth in the market may be exemplified by the development in 2000, drawn from data provided by DAI/FINNET.[76] According to their figures, the growth

[68] Based on the idea of the figure displayed on page 2 in IDB (1995).
[69] Swedish Development Advisers (1998), p. 12.
[70] Data corresponding to three different dates during the period from 31 December 2000 to 30 September 2001.
[71] Data corresponding to three different dates during the period from 30 September 1999 to 30 September 2001.
[72] Data corresponding to three different dates during the period from 31 December 2000 to 30 September 2001.
[73] Data corresponding to three different dates during the period from 30 September 1999 to 30 September 2001.
[74] Karim & Osada (1998), p. 283.
[75] Swedish Development Advisers (1998), pp. 7 and 11.
[76] DAI/FINNET (December 1999), DAI/FINNET (July 2000) and DAI/FINNET (December 2000), Table 1 in each "database".

of the total market portfolio in 2000 was 27.6 per cent for the first six months, and 21.7 per cent for the last. The data are unadjusted for the growing number of MFIs that were recorded by DAI/FINNET.[77] This should not pose any great problem, since the actual total number of MFIs undoubtedly grew during the same period. Knowing the integrity of DAI/FINNET, these figures most likely indicate the evolution of the size of the market.

10.1.3 Limits on Demand

The general sentiment in the market is that there is still a huge potential that remains untapped. However, it is important to define what is meant by the potential market: is it the number of people that would like to receive a loan, or the people eligible for a micro-credit without having one? The latter would then refer to the people that have not received a loan because of supply bottlenecks, or because they are ignorant as to the possibility. This is of interest to institutions with sustainability as a goal. Thus, this is the definition that will be used here.

In developed countries not all people would be considered apt at being self-employed.[78] There is no reason to see why this should not apply to the case of Haiti as well. The idea of lending money right and left would not help anyone, especially not the borrower. Not only is the use of capital inefficient, but it also gives the wrong signal to the borrower about his investment plans. Ultimately, failure to repay the debt will exclude the borrower from loans in the future. Even if the borrower gained the entrepreneurial ability to manage a loan in the future, he would not be considered, due to his history of default.

10.1.3.1 Market Size

In 1998, Swedish Development Advisers estimated the market portfolio of Port-au-Prince to be approximately Gds 195 million to Gds 200 million for the 15,000 to 25,000 borrowers that the thirty MFIs served at the time.[79]

According to DAI/FINNET, in December 2000 there were 61,560 micro-loans in all of Haiti, aggregating data from 101 of the most important MFIs.[80] Seventeen of the 101 organisations extended individual loans, and out of these seventeen MFIs, thirteen carried out operations in Port-au-Prince. If considering MFIs of any lending methodology operating in the capital, the share rises to 53 out of the 101 organisations.

10.1.3.2 Estimations of Demand

The problems for any estimation of the demand for micro-credit in Haiti begin at a very basic level, namely to get a robust figure as to the amount of people living in both Port-au-Prince and the provinces. The urbanisation process and birth rates have been, and still are, high, making it difficult to obtain up-to-date figures. However, when considering the whole country of Haiti it was estimated in 2000 to have a population of eight million.[81] One should also take into account that its average annual growth 1994-2000 was 2.1 per cent, which was higher than the average low-income country.[82] A few years back, Port-au-Prince alone was estimated

[77] For the two periods, the amount of organisations that DAI/FINNET registered grew at a rate of 14.5 per cent and 6.3 per cent, respectively.
[78] This has been brought up before, for example by Karim & Osada (1998), p. 284.
[79] Swedish Development Advisers (1998), p. 7 and 11.
[80] DAI/FINNET (December 2000), Table 1.
[81] World Bank (2001).
[82] World Bank (2001).

to have 1.6 million inhabitants,[83] due to a high natural population growth, but even more to in-migration. From 1950 to 1988, its size increased from 140,000 to 1,550,000.[84]

Because of the difficulties of performing statistical work in Haiti there are no solid figures of how many willing and eligible micro-borrowers there are in the Haitian capital, or in the provinces. Despite the adversities, however, some estimates have been produced.

The report of Swedish Development Advisers, published in 1998, contains such estimates. The report contains some interesting figures, by way of comparison of other economies on a similar level as Haiti. The report estimates that at the time there were approximately 150,000 to 200,000 micro-enterprises in the Port-au-Prince area. Further it states that 40,000 to 55,000 of these enterprises were, as it were, ”permanent”, and 50,000 to 70,000 “semi-permanent” (described in terms resembling those of the *ti machann* used in this study). Still, only about 35,000 to 40,000 of the micro-enterprises in Port-au-Prince area would be eligible for micro-credits.[85] This was then compared to the estimate of the number of borrowers that they had at the time. The estimates ranged from 17,000 to 25,000, or more or less half the market demand being met. Considering the huge importance of the capital in Haiti, the 35,000 to 40,000 eligible borrowers in Port-au-Prince may be put in relation to the December 2000 figures presented above of 61,560 micro-loans for the whole of Haiti.

All interviewees in this study made a remark on the Herculean, if not impossible, task of trying to produce a good estimate of the size of the market. Nevertheless, estimations were in some cases produced when asked for. Representatives of DAI/FINNET thought that there was a minimum of 300,000 individuals in Haiti eligible for micro-credit. In relation to their December 2000 figure of 61,560 borrowers, this means that the supply at most meets about twenty per cent of the demand. According to a manager at the BUH, the MFIs of Port-au-Prince was not even servicing one-fifth of the market. The same rough estimate for the provinces was considered even lower, about ten to fifteen per cent.

Perhaps the most interesting finding is that nowhere has any indication of market saturation been communicated, neither in the field nor in the surveys. On the contrary, demand is seen as outweighing supply both in the capital and in the provinces. However, the MCN did point out that the excess demand showed signs of decreasing in the provinces.

10.1.4 What the Analysis Tells Us about Size and Growth

The group specific averages are summarised in Table B below.

Table B

Portfolio size (group averages)		
	Commercial MFIs	NGOs
Number of loans outstanding	2,426	1,300
Total volume (in Gourdes)	54,844,319	8,148,641

There are some findings of the present section that are especially noteworthy:

[83] Swedish Development Advisers (1998), p. 12.
[84] De Soto (2000), p. 79.
[85] Swedish Development Advisers (1998), p. 12.

- The group of commercial MFIs outperformed the NGOs as a group, by exceeding them in both number of loans and sheer size of the average portfolio.

- The commercial MFIs more rapidly reach the quantity that is required for attaining sustainable operations, due to their strong financial backing. At the same time the competing NGOs are involved in a constant struggle to reach the fund size necessary to expand at that same pace.

- The absence of significant signs of market saturation means possibilities for further portfolio growth, at least for the MFIs with the resources available to do it. However, it is necessary to sound a cautious note here since estimations of market demand have been revised upwards with the passing of time.

Throughout this first section of the analysis, growth has meant growing with the aim to keep operations sound. By including only borrowers with healthy businesses and projects, risk is kept on a reasonable level, in order to have low lending costs. As has already been emphasised, risk plays an important factor in the development of sustainability.

10.2 Risk

There are different kinds of risks for credit institutions. In developing countries like Haiti, country risk is an important factor besides the ubiquitous risk of the lending portfolio. How the latter is managed is of utmost importance regardless of whether the credit market in question is in London, Santiago de Chile or Port-au-Prince.

There are many factors that influence portfolio risk, some of which will be analysed here. *Ceteris paribus*, a higher risk will generate higher costs.

10.2.1 Country Risk

In credit markets of developing countries, like those of developed countries, the mere physical survival on the part of the borrower does not allow us to conclude that lending has been successful. It is very important for the MFI to be able to cover its refinancing costs and pay a reasonable dividend. It is essential to meet debt and equity obligations to keep and improve the terms upon which it capitalises operations.

When asked what was seen as the largest threat to their organisation, all institutions mentioned the political and economic situation in the country. Political deficiencies and lack of justice have paralysed Haiti economically and socially.

10.2.2 Portfolio Risk

One of the functions of DAI/FINNET is to fill the void created by the absence of a public informal credit bureau. As part of this work, the organisation manages a blacklist of about 4,000 names, which eight MFIs share and contribute to. The names represent borrowers that have not fulfilled their contractual obligations. The mere existence of a blacklist provides incentives not to fail on repayment. One NGO mentioned that it conducted meetings before engaging the judicial system when a customer has failed on repayment. This action is taken about two months after default on debt obligations. The meeting is in fact a negotiation, as going to court will automatically put the person on the blacklist.

10.2.2.1 Portfolio at Risk
The portfolio at risk, defined as "*the total outstanding principal balance of all loans that have any payment in arrears as a percentage of the outstanding principal portfolio*",[86] is a widely used indicator among the MFIs. The indicator may be refined taking into consideration loans in arrears with different lengths and intervals of time. Unfortunately for this analysis, there is no uniform system whereby all would use the same lengths and intervals. However, there are some figures that, according to the criteria used for compiling data in the present study, can be used in the analysis.

For arrears of thirty days or less, the commercial MFIs had an average of 2.9 per cent of their portfolio at risk.[87] The NGO equivalent was 8.3 per cent on average, or three times as much.[88] Looking at the opposite time interval, more than thirty days, the commercial group showed a portfolio at risk ratio of 1.0 per cent, on average.[89] The corresponding average for the NGOs was 13.2 per cent, or about thirteen times as much.[90]

At first glance, the figures from the operations of the commercial MFIs seem very competitive, but they exclude one of the commercial MFIs, an outlier, because of a lack of data. When calculating an average for arrears of more than ninety days, the picture becomes more balanced. Adding this last commercial institution produces an average of 9.9 per cent.[91] The average for the group of NGOs is 10.0 per cent, or slightly above the average of the commercial MFIs.[92]

The performance of the two commercial entities that are not outliers is interesting. Both these two outperform all the others significantly, for every time interval in the sample. When it comes to portfolio risk, the commercially owned institutions generally have a lower level than the NGOs.

10.2.2.2 Loan Loss Provisions
Loan loss provisions refer to funds set aside to match loan losses of the present portfolio that will occur in the future. This is important for the basic long-term health of loan extension. All six institutions enclosed at least one indicator of their loan loss provision.[93]

All three commercial MFIs had a general loss provision for the loan portfolio as a whole, averaging 2.3 per cent. No such provision was recorded in the group of NGOs. In at least four MFI cases,[94] perhaps five, loans with arrears surpassing sixty days were backed by loan loss provisions of fifty per cent. The most precautious MFI provisioned for the full value of a loan when more than ninety days had gone. This was one of the commercial entities. For the most cautious NGO it took another thirty days to write off the value in its entirety.

[86] IDB (1995), p. 10.
[87] Two institutions produced data here, which related to the dates of 31 December 2000 and 31 August 2001.
[88] Two institutions produced data here, which related to the time periods of 1 July 2000 to 30 June 2001, and 2000.
[89] Two institutions produced data here, which related to the dates of 31 December 2000 and 31 August 2001.
[90] Two institutions produced data here, which related to the time period of 1 July 2000 to 30 June 2001, and the date 30 September 1999.
[91] Data for the three commercial MFIs relates to dates between 31 December 2000 and 30 September 2001.
[92] Two institutions produced data here, which related to the time period of 1 July 2000 to 30 June 2001, and the date 30 September 2001.
[93] Data for the three commercial MFIs relates to dates between 31 December 2000 and 30 September 2001. Data from the three NGOs relates to the date of 30 September 1999, and the two time periods the year 2000 and 1 July 2000 to 30 June 2001.
[94] Two from each group.

Interestingly, the commercial MFI having the highest portfolio at risk above turned out to be the least cautious of the three institutions in its group, at all levels, when provisioning for loan losses.

10.2.3 Loan Conditions to Reduce Risk

The MFIs levy formal fees for late payment, to persuade borrowers to pay their dues in time and thereby lower the portfolio risk. These fees are but a piece in the incentive structure that the MFIs create in order to improve repayment.

Loans in developed credit markets often require more than the verbal assurances of the borrower to respect contractual agreements. In Haiti, the same complements are present, although they may serve the lender in a somewhat different manner.

10.2.3.1 Collateral

From the beginning one of the most characteristic features of micro-credits has been to provide loans without the need for collateral such as private possessions. Their most important contribution to development finance has probably been to provide alternative ways of building incentives for repayment. The Grameen Bank has displayed remarkable loan recovery rates[95] with its group lending, without resorting to collateral.[96] Generally, this is taken as an indication of the strength of this alternative incentive structure.

Different types of collateral were widely used among both the NGOs and the commercial MFIs. However, considering the methodology of micro-finance, one should not overemphasize the benefit of requiring collateral as a means to lower the risk exposure of the portfolio. During the course of the study, MFIs often criticised the Haitian judicial system by referring to its inefficiency making cash collateral and compulsory savings schemes the only efficient types of collateral. On the other hand, the practice of demanding collateral as a written obligation could possibly be a necessary adaptation to the specific environment of Haiti. Unfortunately, the present essay cannot discern the mechanics of this.

10.2.3.2 Guarantors

Several of the MFIs, both NGOs and commercial MFIs, demand a guarantor with proven income when extending micro-credits.[97] This is yet another reason to ask if there is really a case for connecting these MFIs with the ideas of the Grameen Bank. Considering the failing judicial system, the rationale behind guarantors demands may well be questioned. One reason given pointed to the need of getting more information about the loan applicant. Meeting a third party could serve this need by providing a different view of the potential borrower.

10.2.4 Sectors

The loans may be divided into three categories in terms of the character of the business the loans serve: commercial, services and production. Agriculture is not of interest in this study since we look primarily at the metropolitan area of Port-au-Prince. Borrowers falling under the category of commercial loans, commonly street vendors, are by far the largest recipient group. The trend is towards increasing the share of commercial loans, as they perform better. An NGO not considered here had a share of value-adding activity loans of about sixty per

[95] Wahid (1994), p. 1.
[96] Karim & Osada (1998), p. 264.
[97] Or even two guarantors.

cent before the military coup in 1991. Today the same institution extends ninety per cent of its credits for commercial use, to people buying and selling.[98]

One of the NGOs considered in the analysis has seen the production loan part of the portfolio decrease from close to nineteen per cent in 1996, to slightly above eleven per cent in 1999. Political strife since the return of constitutional order in 1995 is blamed for this development. Generally, among the operational problems cited in connection with manufacturing in Haiti since 1991 is failing electricity, which was repeatedly experienced firsthand in the field.

At the same time, the gross margin for street vendors is about ten per cent while that for a bakery is approximately forty per cent, as told by a credit co-ordinator with one of the commercial institutions.[99] To investigate the consequences for Haiti should be important, but it will not be attempted here.

Ceteris paribus, a larger share of loans to commercial activities should indicate a lower portfolio risk. At the same time it should be considered if there exist any benefits of diversification by extending credit to a multitude of business sectors in society.

The pattern of distribution between commerce, production and services showed both similarities and dissimilarities between the two groups. The commerce sector had similar shares in both groups: the average for the three commercial MFIs [100] was 86 per cent while that of the NGOs [101] was 85 per cent. Meanwhile, there were significant differences in proportions between the two sectors of production and service. The average for the commercial MFIs was three and ten per cent going to production and service sector loans, respectively. A more or less opposite situation was found among the NGOs. They had an average of thirteen per cent of their loans going to production-related businesses, and two per cent to service sector activities. The pattern was consistent within each group.

The level of diversity between the two sectors appears to be similar, according to the figures calculated above. However, having a non-negligible share of loans going to investments in production-related activities might be risky for the NGOs. On the other hand, one could argue that on a national scale there is a need to support businesses engaged in production. Even though these are more prone to founder, the pay-off in work generation and return on investment if successful may be much larger. This phenomenon is not confined to developing countries, but applies to developed economies as well.

10.2.5 Gender

The preponderance of women in micro-finance may have different causes. In many cases it is a well thought-out policy in order to empower women. The Grameen Bank has aimed especially at women, and as a result 94 per cent of its members are female.[102] There even exist MFIs that extend loans exclusively to women. A Haitian example is the NGO Fond Haïtien l'Aide à la Femme (FHAF).

[98] Marketing to a great extent imported products.
[99] The margin of commercial activities varies much. Vendors pooling resources and sending someone abroad, e.g. Panama, to buy articles in bulk, such as clothes and shoes, could reach gross margins as high as forty per cent. It should also be noted that some people conduct other businesses at the side, e.g. a hairdresser (services) importing and selling clothes (commercial).
[100] Data for the three commercial MFIs relates to dates between 31 December 2000 and 30 September 2001.
[101] Data for the three NGOs relates to dates between 30 September 1999 and 30 September 2001.
[102] Karim & Osada (1998), p. 264.

FONKOZE changed to this micro-credit strategy after having started without any discrimination. According to its representatives, the reason was connected to perceived effects on the demand side. Basically, the money earned from investing borrowed funds was put to better use when women were in charge of the money.

On average, the three commercial MFIs in the sample had 55 per cent female borrowers.[103] The corresponding average for the NGOs was 76 per cent.[104] Apparently, the sample as a whole matches the global pattern of female dominance at the receiving end of micro-credits. Only one of the six organisations, a commercial MFI, showed a bias towards male borrowers, but all commercial lenders had smaller proportions of female borrowers than any of the three NGOs. Arguably, the three NGOs seem to have a stronger tendency to favour women in the selection of borrowers. Alternatively, a higher proportion of women applying to NGOs could cause the differences. There are no facts readily available to support such a proposition, however.

No conclusion could be drawn about how this might affect risk. One could argue that having a more balanced distribution between the sexes might serve as a form of diversification *per se*. In that case, the result of the analysis would be to the advantage of the commercial MFIs. However, no theory or evidence was found regarding this matter.

10.2.6 Liquidity

Strains on liquidity may have several causes. A central factor is the dimension of time; an otherwise healthy business may founder due to poor cash-flow management.

For banks, liquidity involves a time horizon asymmetry between assets and liabilities. Much simplified, a bank has relatively long-term assets in the form of the loan portfolio, and short-term liabilities in the form of deposits in the bank. If for some reason there is a drastic decrease in the deposits, i.e. a bank-run, the bank will not be able to provide the liquidity needed. The reason is that the assets it possesses will not be returned in the short term. Damage is primarily inflicted on the bank and its owners, and on the depositors. This is the situation of the BUH, but to some degree also of the other two MFIs, since they are dependent on refinancing from their respective owners.[105]

For the NGOs, liquidity problems have been related to their specific structure of capital inflows and outflows. The inflows are in the form of repayments and interest payments from the borrowers, as well as disbursements of loans the NGO takes and the grants it receives. The outflows are disbursements to borrowers and repayments of, and interest payments on, the NGO's own borrowing. Adding to these outflows are expenses related to operations, to keep the business running.

It is essential for the MFI to possess the knowledge and tools to calculate the magnitude and timing of its cash flows. Also, the external actors involved in the cash flows must behave according to the contract. Alternatively, the deviation from contract of these actors must be readily calculable and taken into account by the MFI. Large and unpredictable irregularities may in this context turn out to be fatal.

[103] Data for the three commercial MFIs relates to dates between 31 December 2000 and 30 September 2001.
[104] Data for the three NGOs relates to the two dates of 30 June 2001 and 30 September 2001.
[105] To a large degree, these owners are major Haitian banks.

The commercial MFIs had never experienced any problems with liquidity. The portfolio managers only had to ask for more funds when they needed them.

The picture was somewhat different for the NGOs. One of them expressed that they were operating in a situation where they found themselves with a constant strain on liquidity. The management of their cash flow was not negligible. Until then, they had managed through manual procedures, but recognized that with better management they could make better use of their funds. Another NGO told of a minor incident, where funds from the EU were delayed for several months. In that situation, they had had to borrow money for two weeks to manage. The damage to the lending operation was not considered that important; about thirty loans were postponed for one week. Of course, this could possibly have caused severe difficulties for borrowers that were expecting disbursement.

10.2.7 Double Borrowing

Divergent opinions were raised over the incidence of "double borrowing", i.e. whether it was common that people covertly had loans in different MFIs at the same time. One NGO thought it would make more sense to talk about triple borrowing. At the other end, another NGO said it was quite rare, adding that ninety per cent on the blacklist are not engaged in such activities. An NGO not in the sample exposed the fallacies of the list, by giving an example where the same person had appeared in half a dozen places on the blacklist before being noticed. The problem is connected to problems of identifying the potential borrower, as many Haitians have the same name. In this situation it is important to have good operational practices that minimise risks. One of the commercial entities explained the strict procedures employed if there was any doubt as to the true identity of the applicant. If the person appeared on the list and claimed innocence, the borrower had to come back with a written verification of this, from the notifying MFI.

There could be many reasons for borrowing covertly from different MFIs. It could form part of a well-thought out plan to take the money and run. It could also be the result of a desperate attempt to try to repay a loan at one MFI with a loan from another MFI. This could possibly go on for some time if not revealed and stopped. The incidence of this phenomenon in the sample has not been quantified, but remarks made during interviews point to a heterogeneous pattern. Differences in operational procedures or in knowledge about the respective clienteles could be among the causes for any such disparate results. However, no clear division distinguishing one group from the other was found.

10.2.8 ***Devaluation of the Currency***

The depreciation of the Haitian currency, the Gourde, against the US dollar has accelerated during the last few years. This poses problems for MFIs that lend in Gourdes and refinance their operations in US dollars. The problem is accentuated if it is difficult to evaluate the currency fluctuations over time, making both appropriate devaluation provisions and interest rate fixing difficult to determine. This question was not brought up explicitly, but one NGO spoke of the dilemma. It did not have any such provisions for devaluations of the Gourde against the US dollar. The possibility that other MFIs were exposed to such risks has not been investigated.

10.2.9 What the Analysis Tells Us about Risk

Tables C to F display a summary of the comparative figures related to risk.

Table C

Portfolio at risk (group averages in per cent)		
Days in arrear	Commercial MFIs	NGOs
< 30	2.9*	8.3
> 30	1.0*	13.2
> 90	9.9	10.0
*excluding outlier		

Table D

General loan loss provision (group averages in per cent)	
Commercial MFIs	NGOs
2.3	-

Table E

Loan distribution by sector (group averages in per cent)		
Sector	Commercial MFIs	NGOs
Commerce	86	85
Production	3	13
Services	10	2

Table F

Loan distribution by gender (group averages in per cent)		
Gender	Commercial MFIs	NGOs
Female	55	76
Male	45	24

The following are the most important findings of this last section:

- When it comes to portfolio at risk, the commercial MFIs outperform the NGOs even when the outlying commercial MFI that has a higher risk exposure is taken into consideration.

- There are signs of a systemic pattern towards risk, with bad repayment rates and low loan provisioning hand in hand, as well as good repayment rates and high loan provisioning.

- NGOs are engaged to a higher degree in production-related businesses, which tends to increase their risk exposure.

- There are not many signs that liquidity was a problem in any of the two sub-samples. However, while only one NGO told of any incident related to liquidity, NGOs that did not have computerised systems of cash flows were under constant strain to manage daily operations with manual practices.

Keeping risk low is essential if costs are to be kept under control. While costs caused by risk are important there are other costs as well to consider in an analysis like the present one.

10.3 Cost Structure and Efficiency

Important costs to any MFI are costs related to staff and branch network. These costs are further linked to the efficiency and size of the MFI, and for these reasons it is of interest to include them in the present section.

10.3.1 Staff

The quality of the personnel at any bank could be considered one of the most important aspects of its business. Employees incur costs, e.g. salaries, for the organisation, but they are essential for generating new business to the institution. The income of the MFIs consists primarily of interest payments, as well as of accompanying fees of different types. Having fewer persons working[106] will surely lower personnel costs in the income statement. For example, if the MFI has a large portfolio per employee, or credit officer, this could be the result of a highly efficient staff, but few employees could also mean that the portfolio is poorly managed. A portfolio that is not taken due care of in the short run will produce problems in the long run, if not earlier. The decrease in personnel costs will in this case result in higher costs in other parts of the organisation, as the lending operations are left to deteriorate. Insufficient attention to screening and follow-up due to a too heavy workload should compound the problems related to adverse selection when it comes to borrowers. In addition to outright default, an increasing amount of late payments would put strain on liquidity and in the end lower profits and sustainability. Thus, the possibilities of expanding and reaching more entrepreneurs would diminish and the performing borrowers of the MFI could see their credit source vanish.

10.3.1.1 Headcount

The commercial MFIs turned out to have a considerably larger workforce than the NGOs. The average number of employees was 41 for the former group of institutions[107] and 16 for the latter group[108], 38 per cent of the figure of the commercial entities. The first group had an average of 20 credit officers, while the NGOs had 7, i.e. two-thirds less.[109] This reflects the larger resources supporting the commercial MFIs relative to the NGOs.

10.3.1.2 Economies of Scale

The ratios of credit officers to total staff, 0.48 for commercial MFIs and 0.44 for the NGOs,[110] do not display any major differences between the groups. This could indicate that large-scale economies concerning employees that are not credit officers, such as support staff and management, are not present. However, the very recent start-up of two of the three commercial MFIs[111] could prove this conclusion to be premature. Most obvious, the amount of staff employed at headquarters even from the start of the organisation could be set with a vast future network in mind. This would increase the ratio of credit officers to total staff as the network expands. More or less the same could be said substituting the branch for the network.

10.3.1.3 Credit Officer Workload and Efficiency

In order to get a better picture as to the reasons for the large differences in quantity of staff, a look at data per working unit, or employee, is warranted. The average number of borrowers managed by a credit officer and the outstanding portfolio per credit officer are proxies of the level of work and responsibility attached to core business personnel.

[106] This refers to staff getting a salary from the MFI. This is important to stress as NGOs, and privately owned MFIs during start-up, many times take use of volunteers and staff, such as technical assistants, paid by international organisations.
[107] Three different dates ranging from 31 December 2000 to 30 September 2001.
[108] Three different dates ranging from 31 December 2000 to 30 September 2001.
[109] Three different dates ranging from 30 September 1999 to 30 June 2001.
[110] GTIH was excluded due to its two figures relating to different dates.
[111] Late 1999 and late 2000, respectively.

The number of loans per credit officer is one approximation used here. The average of the three commercial MFIs was 127 loans.[112] The corresponding figure for the NGOs proved to be 178 loans,[113] almost forty per cent more than for the former group. Thus, according to this measure, credit officers working with NGOs on average had a heavier workload than their peers in the commercial MFIs. Likewise, this could mean that the officers within the NGOs do not give as much attention to their portfolio as the commercial MFIs. In any case, the discrepancy indicates that the level of responsibility is more important for the average credit officer within the group of NGOs. It deserves to be noted that for the commercial banks the deviation around their mean was wide. The group actually contained the lowest as well as the highest number for the six institutions: 47 and 222, respectively.

Figures showing the outstanding portfolio per credit officer were also calculated. The commercial MFIs had an average of Gds 2,886,518 in outstanding portfolio per credit officer,[114] and the equivalent number for the NGOs was Gds 922,513.[115] This demonstrates that although the amount of loans was lower for the typical officer in the commercial MFIs, the sizes of the loans they actually had were more important. Bigger loans, from the point of view of the institution, mean more responsibility and logically should demand more work. However, smaller loans are more time-consuming as they tend to be connected to borrowers with a shorter, or no, credit history. At the same time, the NGOs have been in business one year longer than the commercial MFIs, on average. This lends less support to the idea that the NGOs have clients with shorter credit histories. These inconsistencies make it difficult to give a definite explanation of workload and efficiency, without having additional information.

10.3.1.4 Cost Cutting Activities

To meet the requirement of sound operations with low costs, the idea of sharing professional staff among different organisations has been brought up. ACME would like to have an internal control manager but could not meet the costs of having someone working full-time. Some kind of semi-outsourcing, where ACME could share this functionary with other MFIs, is seen as a possible solution.

10.3.1.5 Efficiency Enhancing Activities

Most of the organisations already had or were going to implement incentive programmes for their employees. Credit officers, credit co-ordinators and branch managers were, or would become, the beneficiaries of these bonuses. Incentives programmes serve as solutions of the principal-agent problem. When the work of key personnel is directly non-observable, a bonus system may be attached to results, such as portfolio performance. Knowing this, the agent will do his best, contributing to a high level of productivity for the organisation as a whole.

10.3.2 Branches and Regions

The commercial institutions also turned out to have a greater number of branches in their networks.[116] In total, they had on average 7.3 branches throughout Haiti. The NGO equivalent was two, both in the capital. The 7.3 branch average of the privately owned MFIs was equally distributed between Port-au-Prince and the provinces. If the BUH is a Goliath in this matter, with fourteen branches, the GTIH certainly stands out as a David, with its single branch.

[112] Three different dates ranging from 31 December 2000 to 30 September 2001.
[113] Three different dates ranging from 30 September 1999 to 30 September 2001.
[114] Three different dates ranging from 31 December 2000 to 30 September 2001.
[115] Three different dates ranging from 30 September 1999 to 30 September 2001.
[116] All figures here relate to the situation at the end of September 2001.

Having a vast network entails both benefits in terms of catchment area, and higher operational costs[117] in terms of administration, management information services, transport and communication. For the BUH, the fact that micro-credit merely constitutes an additional product for the already existing BUH network to market, should show up in the BUH having lower marginal costs connected to geographical expansion, relatively to its competitors. This would then constitute a competitive advantage for the BUH. Given the early stage in which the other two commercial MFIs are found, as well as their plans and the resources they possess, their current networks are of less interest. The patterns of distribution between the capital and the provinces of these first branches are of some interest, however. While the MCN has an overweight of branches in the provinces,[118] the opposite is the case for SOGESOL.[119] Whether this has any short-term or long-term effects is difficult to predict.

The approach of the three NGOs seems to be local, with presence only in the metropolitan area of Port-au-Prince. When seen against their aspirations to expand outside the capital this could indicate that they are short of the resources necessary for such an expansion. It could, however, also derive from a cautious attitude, where the consolidation of existing business is prioritised. A combination of the two is also possible.

10.3.3 Loan Sizes

By way of definition, micro-credit has partly to do with the fact that the loans are smaller than "ordinary" loans, destined for the formal business sector. From a strict business perspective, the size of micro-credits entails both benefits and costs. The costs are high relatively to the size of the loan, but the small size also creates a whole new segment in the credit market.

As to the amounts disbursed, the two groupings share the same average when it comes to minimum amounts, but differ widely in terms of ceilings. The minimum average was Gds 2,667.[120] The average maximum that the commercial MFIs offered was Gds 287,500.[121] The corresponding figure for the NGOs was Gds 45,000, which is less than one-sixth of the average of the other group.[122] While the numbers for the NGOs were similar in size, this was not the case for the commercial MFIs. However, the figures of the commercial group were higher than the corresponding figures for the NGOs, causing less doubt as to the pattern. Meanwhile, if the common minimum loan level is taken into consideration, this would not by itself mean that the two groups serve different markets. The privately owned sector is in addition open for borrowers with demands for larger loans. Thus, the argument that commercial institutions are *only* interested in upper-tier informal borrowers is not completely true.

Justification for such an argument may instead be found when comparing the actual outstanding average loans of the respective portfolios. The commercial MFIs have an average of Gds 24,074 for the average loan in the portfolios, while the equivalent for the NGOs is Gds 4,903. The fact that the former figure is close to five times larger than the latter points to a major difference between the market segments within which the two groups operate.

[117] Karim & Osada (1998), p. 278.
[118] Four in the provinces and one in Port-au-Prince.
[119] None in the provinces and three in Port-au-Prince.
[120] Data for the three commercial MFIs relate to dates between 31 December 2000 and 30 September 2001. The dates for the three NGOs were 30 June 2001 and 30 September 2001.
[121] Two institutions produced data here, which related to the dates of 31 December 2000 and 30 September 2001.
[122] Two institutions produced data here, which related to the dates of 30 June 2001 and 30 September 2001.

Although the costs may not diverge, *ceteris paribus*, larger loan sizes should create higher revenue. The commercial MFIs would, in this respect, have a higher profitability, i.e. they are more sustainable at the margin. One of the NGOs expressed a wish to increase its loan ceiling. According to this MFI, it was too costly to lose the most profitable borrowers, as these advanced upwards economically. This problem of "dropping out" has also been documented in micro-finance markets elsewhere.[123]

An attempt by Lapenu and Zeller[124] to observe micro-finance institutions globally came up with an average outstanding loan size of less than Gds 7,500.[125] Furthermore, these authors point out that MFIs using the method of individual lending have a higher average in order to compensate for the generally lower staff productivity associated with extending this kind of micro-credit.[126] In the present study, the commercial MFIs follow this global pattern as a group, while the NGOs do not.

10.3.4 Costs of Borrowed Funds and Hidden Economic Costs

Costs of borrowed funds will not be treated as such since it proved to be somewhat out of this paper's reach to calculate these costs in a consistent manner. Nevertheless, some aspects of hidden costs and the difficulties in relation to these costs will be considered.

Micro-credits are reported to remedy some of the faults inherent to earlier approaches to credit extension in developing countries. As the interest rises for this form of credit extension, the market actors receive support in different forms. Outright grants, donations in-kind, concessionary loans, technical assistance, service provisions and credit guarantees are all contributions from a world better off. Not only the NGOs receive such aid but the commercial MFIs do so as well, to some degree.

The most transparent type of support, the grant, does not pose a problem for cost evaluations, at least not when it is recorded and separated from other equity/net assets. However, this is not true for all the MFIs in the sample. Additionally, it matters if the recipient receives support according to his needs or someone else, typically the donor, determines the content of the grant. The question then arises whether the support should be valued according to its market price, the cost incurred by the donor, the net value to the recipient, or any other valuation method.

The presence of hidden economic costs in the financial statements of the organisations analysed here should not be underestimated. The reader should bear this in mind when observing the financial performances of the respective groups below. The examples of hidden economic costs are numerous and varied, and they tend to occur across the board. As a matter of fact, only two NGOs reported any figures related to subsidies/donations in their profit and loss statement. Only one of the NGOs analysed here had any subsidies/donations singled out in the balance sheet. Although receiving only a small fraction of the support that NGOs are receiving, the commercial MFIs are not totally devoid of it. Usually this is related to technical assistance from foreign consultants and services provided by institutions like DAI/FINNET.

[123] Karim & Osada (1998), p. 262.
[124] Lapenu & Zeller (2002), p. 95.
[125] When using the rate 1 USD = Gds 25.
[126] Lapenu & Zeller (2002), p. 100.

10.3.5 What the Analysis Tells Us about Cost Structure and Efficiency

In order to swiftly recapitulate the important figures of this section, Tables G to J are inserted.

Table G

Headcount (group averages)		
	Commercial MFIs	NGOs
Total employees	41	16
Credit officers	20	7
Credit officers / total employees	0.48	0.44

Table H

Credit officer efficiency (group averages)		
Per credit officer	Commercial MFIs	NGOs
Loans	127	178
Outstanding portfolio (in Gds)	2,886,518	922,513

Table I

Branch network (group averages)		
Number of branches	Commercial MFIs	NGOs
In Port-au-Prince	3.7	2
Outside Port-au-Prince	3.7	-

Table J

Loan sizes (group averages)		
Loans	Commercial MFIs	NGOs
Minimum amount disbursed	2,667	2,667
Maximum amount disbursed	287,500	45,000
Average outstanding	24,074	4,903

A shorter recapitulation of this section's main points gives us the following:

- The larger number of borrowers per credit officer may indicate that the NGOs are more cost efficient. Meanwhile, one has to keep in mind that most likely it means a higher level of risk for the loan portfolio, as less attention will be given to each loan.

- Undoubtedly, the wider branch networks and reach outside of Port-au-Prince entails larger costs for the commercial MFIs. However, having a large number of staff and branches will enable them to expand operations further and more rapidly.

- The larger maximum loan amounts disbursed and average outstanding loan amounts by the commercial MFIs, as well as their credit officers' larger average portfolio, point to cost efficiency on their part.

The first three sections have in different ways dealt with the one factor that determines sustainability, namely profitability.

10.4 Profitability

The notion of non-profit NGOs should not be taken literally. They are not privately owned companies with the aim of generating as much future dividend as possible to their owners, but they all share the aspiration of covering their costs. To avoid continuing losses means independence, and, equally important, being able to reach even more people. Only one of the NGOs believes it will probably never reach economic sustainability, taking into account the goal of the organisation.

Two out of the three commercial MFIs stated that they made profits.[127] There was no commercial group member who accounted for any donor support. This adds to the uncertainty with respect to the profitability of these institutions. One of the three NGOs claimed it made profits,[128] but no organisation in this group had a profit that was larger than the revenue grants received. Thus, at most one of the NGOs was financially viable, and none of them were self-sufficient.

The pattern where the profit disappears once grants and donations are excluded is documented in other parts of the world as well. The Grameen Bank showed a profit every year between 1987 and 1993, except in 1992, for exceptional reasons. When excluding revenue grants, however, the Bangladeshi bank incurred losses during the whole period.[129]

11 CONCLUSIONS AND POLICY IMPLICATIONS

The basic question that this paper set out to find an answer to has been the following:

Will a transition to commercial governance of micro-finance institutions lead to increased institutional sustainability?

The present analysis has produced some interesting results regarding the differences in performance between the two groups of NGOs on the one hand, and commercial MFIs on the other.

A precondition for sustainability is that a critical mass in terms of loan volume is reached. As none of the MFIs in the analysis had reached the minimum level considered to be sustainable in the long run, growth should be a concern for all of them. The abundance of eligible entrepreneurs with an interest in acquiring a loan produces possibilities for any MFI with the ability to expand its business. Essential for such an expansion is proper access to large amounts of funds. In this perspective, the heavy financial support commercial MFIs receive gives these institutions a major advantage over the financially strained NGOs. This has shown up already in portfolio size, where the group of commercial MFIs comes out on top, despite the recent market entrance of two of the three MFIs.

The commercial MFIs outperform the NGOs when it comes to risk as well. They have a lower risk exposure and a more cautious attitude towards risk. The lending operations of the NGOs showed signs of having a higher level of risk than the commercial MFIs. This should affect

[127] Due to the short period of time that SOGESOL has been operating, their figures used here correspond to the double of the six months 1 March 2001 to 31 August 2001. Data for the other two institutions relate to the year 2000 and the period from 1 October 2000 to 30 September 2001, respectively.
[128] Data for the three NGOs relate to the year 2000, as well as the periods 1 July 2000 to 30 June 2001 and 1 October 1998 to 30 September 1999.
[129] Karim & Osada (1998), p. 278.

the sustainability of the NGOs in relation to that of the commercial MFIs negatively, through higher costs.

The analysis fails to produce a straightforward picture of the situation when looking at costs and efficiency. According to the figures one might argue that the NGOs are more cost efficient. It may also be argued that the same figures are part of the picture of commercial MFIs being more aware and cautious of risk. However, most probably, the figures for the commercial MFIs are spurious in that they correspond to the mere beginning of a massive expansion of operations. One must not forget the very short length of time in the market of two of the three commercial MFIs. Undoubtedly, the larger loans disbursed and managed by the commercial MFIs, which produce the larger portfolios at the staff level, give this group of institutions an advantage.

Finally, the commercial MFIs turned out to possess a greater ability to avoid losses, although one may not exclude the presence of hidden costs in the balance sheets of these three institutions. However, taking all six institutions' donations and grants into full consideration would most likely further strengthen this finding. The fact that one of the NGOs openly admitted that as an institution it would probably never reach profitability adds to the poor outlook of the future of NGOs as a group, taking into account that grants have become scarce.

In the light of the findings of the present study, the on-going process of commercialisation of the MFIs in Port-au-Prince should be viewed as conducive for institutional sustainability among these MFIs.

However, commercialisation of NGOs and entry of new commercial MFIs in the market will probably not be enough to ensure long-term sustainability as the market matures. Mergers and acquisitions among MFIs are most likely needed, in order to attain a sustainable scale of business. An especially benign development would be mergers and acquisitions between NGOs and commercial MFIs.[130] The extensive knowledge of the needs of their customer base makes NGOs a suitable partner for incipient commercial MFIs. The latter, on the other hand, will provide the sound governance and management that the NGOs need in order to ensure long-term sustainability.

[130] Lapenu & Zeller (2002), p.103, believe NGOs may improve their governance and performance by observing commercial MFIs.

ABBREVIATIONS

ACME	Association pour la Coopération avec la Micro Entreprise
BHD	Banque Haïtienne de Développement
BUH	Banque de L'Union Haïtienne
CGAP	Consultative Group to Assist the Poorest
DAI/FINNET	Development Alternatives, Inc./Financial Services Network for Entrepreneurial Empowerment
FHAF	Fond Haïtien l'Aide à la Femme
FHD	Fondation Haïtienne de Développement
FMO	Financierings-Maatschappij voor Ontwikkelingslanden
FONDESIF/GTZ	Fondo de Desarrollo del Sistema Financiero y de Apoyo al Sector Productivo/Deutsche Gesellschaft für Technische Zusammenarbeit
FONKOZE	Fondasyon Kole Zepòl
Gds	Gourdes (the national currency of Haiti)
GTIH	Groupe Technologie Intermédiaire d'Haïti
ICDF	International Cooperation and Development Fund
ID	Initiative Développement
IDB	Inter-American Development Bank
IFC	International Finance Corporation
IMI	Internationale Micro Investitionen
IPC	Internationale Projekt Consult
MCN	MicroCrédit National
MFI	Micro-finance institution
NGO	Non-governmental organisation
PRET	Projet pour la Relance de l'Economie en Transition
SIDA	Swedish International Development Cooperation Agency
SOGEBANK	Société Générale de Bank
SOGESOL	Société Générale Solidaire
USAID	United States Agency for International Development
USD	United States dollars

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