**LESSONS IN DEVELOPMENT - THE AKRSP EXPERIENCE**

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# Micro-Finance

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# EXECUTIVE SUMMARY

**Introduction**

1. AKRSP has been a pioneer in the field of micro-finance and has managed one of the most successful micro-finance programmes in Pakistan. The micro finance sector is a rapidly growing sector in Pakistan and many of the existing NGOs have emulated the AKRSP model in designing and implementing key aspects of their micro-finance operations. However, the lessons from AKRSP's experience need to be properly assessed, synthesized and fully shared. The purpose of this study is to attempt an analysis of the lessons that can be learnt from AKRSP's rich and pioneering experience. In selecting areas for focus, the research team selected those issues that were of particular value for micro-finance practitioners and posed special challenges in the sector. Some of these issues include aspects such as the rationale and cost of including savings as part of the micro-finance operations, the credit operations and their evolution, impact of micro-finance on poverty reduction, sustainability of micro-finance operations and the lessons that can be learnt from the AKRSP's experience in establishing a micro-finance bank. Through a study of the AKRSP documentation and recording of the oral history of the programme in interviews with current and past staff members an attempt has been made to examine the rationale for the specific path that was adopted in the evolution of micro-finance thinking and operations at AKRSP. This particular analysis covers AKRSP's experience from 1982 to 2002.

2. AKRSP's microfinance programme was designed for an economy that was basically agrarian in which close to 90 percent of the population made its living from subsistence farming. AKRSP started its operations in an area with a poor natural resource base, rapid population growth, poor communication facilities, lack of employment opportunities and few banking facilities. Per capita income in 1982 was estimated to be $150 which was less than half the national average. Lack of credit facilities, high cost of transportation and inadequate distribution networks made it difficult for the average farmer to invest in technologies that would increase farm productivity. AKRSP's success lay in properly understanding this environment and designing a savings and credit program that catered to the needs of its target population. The essential features of the programme were low transactions cost for the client, catering for low volumes of savings and loans, catering to individual needs of security, liquidity and information about savings, personalized loan products and creating an institutional tier at the village level which helped to reduce its own transactions cost, convert low volumes to high volumes and enabled it to create social and financial collateral.

**Learning Lessons from the Past**

3. In the early years at AKRSP, it was repeatedly emphasized that AKRSP's VOs were patterned on the co-operatives of Raiffeisen in Germany and its model of rural development drew important lessons from development efforts implemented in Comilla (Bangladesh) and Daudzai (Pakistan). However, the lessons from these models and programmes were never

shared at AKRSP and the micro-finance component of these earlier models, if they had any, were never discussed at AKRSP. AKRSP did not come with a micro-finance blue-print and the micro-finance component in these programmes, if any, did not provide AKRSP any concrete lessons for replication. Thus in designing its micro finance component, AKRSP was not emulating a well defined programme which had been implemented elsewhere but was pursuing the simple objective of social organization that taught that capital formation was essential for rural development. AKRSP's micro finance experience was one that evolved as the programme progressed and there were few preconceived notions of how this might develop. There was also little examination of how AKRSP could learn from the experience of the early co-operatives or credit unions. AKRSP drew inspiration from these early efforts but never deeply examined how this intellectual heritage could be used to shape its own destiny. AKRSP's unbridled energy paid dividends in many areas of its work and allowed it to develop innovative and exciting models of village development. However, in some areas, particularly micro-finance, its refusal to draw lessons from the past stymied its growth, led to ad hocism and steered it in directions which did not contribute to its long term objectives

**AKRSP's Saving's Experience**

4. Savings was a key only component of the AKRSP model due to its basic premise that social capital, human capital development and capital formation constituted key elements for rural development. Even as AKRSP insisted upon savings and had put restrictions on what its clients could do with these savings, it did not itself have a clear idea of how these savings were to be used. The savings programme generated considerable interest among both men and women and, in fact, provided the main motivation for the first women's organizations established in the Northern Areas. AKRSP's savings programme provided the first opportunity to save with the formal sector and allowed its clients most of the attractive features of savings such as safety, regularity, convenience and access. AKRSP, after the initial years, also allowed the villagers to withdraw their savings and thus meet the high liquidity preference for households with vulnerable livelihoods. AKRSP's savings programme was important in that it demonstrated the significant potential of savings at the village level in an area which was considered well below the national income level. By the end of 2002, a total of Rs. 430 million had been generated by the Village and Women's Organizations as savings. The demonstrated potential for savings also opened the wide spectrum of financial autonomy and innovation at the village level through the internal lending mechanism and informal trading opportunities. Members of AKRSP's organisation have established independent savings programme and are fully aware of the opportunities of investment in the local financial markets.

**AKRSP's Credit Experience**

5. When AKRSP first initiated its operations it had not systematically planned a credit programme for its clients. AKRSP entered the credit market when it realised that its clients needed loans for investment purposes and that the loans available from the formal sector could not be easily tapped due to cumbersome disbursement procedures and high transactions costs.

AKRSP's credit chronology illustrates its dynamic and innovative nature. AKRSP has experimented with many types of different loan products since its inception in 1983. In designing its loan products, AKRSP appears to have struggled with balancing several different motivations. AKRSP developed a package of Village Banking which allowed the VOs and WOs to assume much of the responsibility for micro-level banking operations and laid the cornerstone for the financial autonomy which the VOs and WOs later wrested for themselves and initiated a programme of internal lending under which the members on lent their members money form their own savings on terms and conditions determined solely by them.

6. In 1996 AKRSP became mindful of financial sustainability and moved towards the identification of loan products with high returns which could justify the levying market interest rates. AKRSP acquired a more enterprise development orientation and tried to capitalise on off-farm opportunities through the introduction of a small enterprise development loan and a corporate credit programme. These were important products for AKRSP as it was trying to deepen an existing market in which possibilities of geographic expansion were limited due to the self-imposed delimitation of its area of operation. In the last few years, AKRSP has been particularly driven by its objective of developing high yielding products that would enhance its financial sustainability. This led to experimentation with products that had high risk and targeted a sector that has not been part of AKRSP's original target group. AKRSP learned important lessons from the introduction of these products. One of the most important lesson was that the skewed debt-equity ratio in the small enterprise loan was such that it was difficult for the borrower to service the loan. There was need for AKRSP to invest in equity rather than service a loan which it was beyond the capacity of the small business to repay.

7. In recent years, AKRSP has placed itself under enormous pressure to introduce products to increase its sustainability. In the process, AKRSP has been under pressure to expand its credit portfolio rapidly without proper appraisal procedures and has also experimented with poorly performing products, and those, that may not be entirely appropriate to its objectives of social and economic development. Some claim that this experimentation came at the cost of its members. The basic cornerstone of the lending policy was the use of collective savings as collateral. Many AKRSP clients lost their savings due to no fault of their own but simply because they had given surety for others. While, AKRSP has been very active in evaluating its loan products and quick to terminate poorly performing products and reviewing its internal policies and procedures, it has lost some of its early focus on the needs of its main target group and has deviated somewhat from its overall mandate of providing micro-finance services to the rural poor. This has happened even more after the establishment of the First Micro-Finance Bank as the main focus of the Bank is on urban areas and clients in main town centres.

8. Some assert that AKRSP's credit programme became a supply driven programme in some respects. Its policy of giving the VO and WO managers a commission of 2 to 3 percent for recovery of loans encouraged them to push for large amounts of loans on the recovery of which they would make a substantial commission. This combined with the system of VO banking in

which the VOs took the major decision about who would get the loans encouraged quick disbursements without proper appraisal and minimum supervision led to the increase in defaults against which collective savings were pledged and entailed huge losses for unsuspecting savers. AKRSP had successfully transferred the entire risk of its credit programme to the VO and WOS. Weary from this experience many VOs and WOs had branched off on their own and were running their own successful internal lending and savings programme. Thus when the First Micro-Finance Bank came along it became just another player on the scene and did not impact these organizations.

**Does Micro-Finance Erode Social Organisation**

9. The question whether the inclusion of micro-finance eroded the collective spirit of cooperatives arises because of the tensions inherent in the collective community interest and the individual self-interest, AKRSP's policy of using the collective savings as collateral for individual default and the dichotomies implicit in its conception of the village organisation as a hybrid credit union. While one of the objectives of a credit union, like that of the VO, is to encourage its members to save and to obtain a reasonable rate of interest on these savings, there is another objective which can be construed as being directly in conflict with this objective which is to create sources of credit at a fair and reasonable rate. The lower the interest rate charged on credit, the lower the interest allowable on deposits. Furthermore, the manner in which AKRSP was using collective savings as a collateral for individual default not only had the potential of dividing the village organization but destroyed the VOs and WOs in many villages where individual default was realized through collective savings. In practice, some of the VOs later fell into disarray because collective savings was used to retire individual debt, members in-charge of savings either began to embezzle collective savings or provide cheap loans on a preferential basis to selected members. There was some concern within AKRSP that internal lending jeopardized the savings of the V/WO members and that defaults could erode the basis of social organization at the village level. Case studies conducted by AKRSP of model Village Organizations show that there is a rapid attrition in these organizations following problems of loan repayments.

10. While some assert that it is difficult to keep an organisation alive based on a savings programme alone. AKRSPs savings programme has acted as a cementing force. Women in the Northern Areas attach such a high value to savings alone that many of their organisations are not only alive but actively engaged in many activities as a result of their savings programme. Many women's organisations meet either weekly or monthly collect their savings and are running internal lending programmes with a part of their savings. In some cases they have hired male managers who help them manage their savings and credit programme for a small fee.

**AKRSP's record of Sustainability**

11. There is no evidence that AKRSP tried to pursue sustainability as a key aspect of its micro-finance programme in its first fourteen years. AKRSP initiated its micro-finance programme with the primary objective to mobilise people and better serve their micro-finance needs. Lack of AKRSP's quest for sustainability can also be attributed to availability of cheap donor funds, lack of staff orientation and absence of an overarching vision for the micro-finance programme. There was no information ever collected in its first decade and a half to estimate the cost of the savings or the credit programme. AKRSP's evolution and expansion is in sharp contrast with programmes like Kashf which begin with a clear analysis of how they could achieve sustainability. In Kashf, for instance, this analysis was undertaken for the branch level and it guided the operations of the NGO from the first day. The Field Management Unit of AKRSP which can be considered the equivalent of a branch was never regarded as a separate cost centre at AKRSP until after 1996. AKRSP could also have learnt from the experience of the Lachi Poverty Reduction Project which many years later tried to develop a sustainable model of micro-finance at the Union Council level and undertook a detailed analysis in this regard.

12. AKRSP staff first became mindful of sustainability issues when they attended the Boulder Course on micro-finance which radically transformed their thinking about the management of micro-finance at AKRSP. At this juncture AKRSP decided to reorient its operations and build a financially sustainable micro finance programme. The first step they took was to establish a separate micro finance section which employed specialised micro finance officers who took primary responsibility for delivering financial services out of AKRSP's Field Management Units. Day to day decision-making responsibility was decentralised further. Micro finance Officers in the field were given authority to sanction loans. The Micro finance programme costs, budget, and income were separated from the rest of AKRSP. Excess funds in various AKRSP accounts were allocated to the Micro Finance Programmes credit pool, and any funds from this pool in excess of the loan portfolio were invested with banks to earn a return. A manual of Credit Policies and Procedures and a monthly Credit Operations Report were established to improve the management of credit operations.

13. AKRSP's investment in micro-finance entailed a substantial investment in human resource development and in enhancing the financial management skills of men and women managing the savings and credit operations at the village level and the NGO level throughout its twenty years. AKRSP had also devised a very effective system of training at the grass roots level and from the outset focused on the training of a cadre of village activists in micro-finance operations, accounts and audits. One of AKRSPs' greatest achievement has been the awareness it has created about micro-finance operations and the possibilities of financial arbitrage.

**Lessons from AKRSP's Model of Institutional Development and Growth**

14. The concept of Village Organization Banking introduced by AKRSP was a novel concept in that it established a community owned and operated system of micro-finance at the grass-

roots level. Under the autonomy that was given to the VOs under this component, they determined the quantum of loan for each member and managed disbursements and recovery from individual members. The VOs demonstrated their competence to handle the entire loaning operation without reference to the regional office. This led to the expectation that somehow VOs would play a key role in the future management and ownership of the micro-finance portfolio of AKRSP. However, this operation also needed some form of regulation in view of the wide divergence in the manner in which some VOs were dealing with the disbursements of loans.

15. While it is very clear that there was strong support for the idea of formalizing AKRSP's micro-finance portfolio it is also very clear that the initial conception of this formalization was to make the VOs an integral part of the ownership and the management of the micro-finance operations. However, when AKRSP's decision to establish a bank was finally taken it was done without any role for the VOs. It was decided that AKRSP and AKFED would be the two main stakeholders in the First Micro Finance Bank (FMB). Thus the investment in the institutional growth of the VO as a financial intermediary was not capitalized upon and the opportunity to develop a truly village based system of banking with local ownership and management giving the VOs a role in their own destiny and linking them in a sustainable way with the formal sector was lost.

**AKRSPs Record of Changing Livelihoods through Micro-Finance ?**

16. It is difficult to answer the question regarding the impact of AKRSP's micro-finance programme and the extent to which it has enabled the transformation of livelihoods because of lack of empirical evidence. AKRSP has not undertaken credit utilization and impact studies on the basis that such studies are generally donor-driven and waste resources that could be productively used elsewhere. The average size of the loan was small and insufficient to transform livelihoods but was designed to deal with vulnerability and the small productive investments in the agriculture sector. A question that can be asked is if AKRSP by focusing on loan products designed for the low productivity agriculture sector limit its own impact. An informal assessment of credit utilization showed that AKRSP loans had helped in enterprise development, in providing loans for investments in the social sectors and housing and in reducing the vulnerability of poor households by helping them meet consumption needs. Women have particularly benefited from diverting loans for consumption purposes and from AKRSP's savings programme which has empowered them and has made them an owner of asset for the first time in their lives.

## A. Introduction

1. AKRSP has been a pioneer in the field of micro-finance and has managed one of the most successful micro-finance programmes in Pakistan. The micro finance sector is a rapidly growing sector in Pakistan and many of the existing NGOs have emulated the AKRSP model in designing and implementing key aspects of their micro-finance operations. However, the lessons from AKRSP's experience need to be properly assessed, synthesized and fully shared. The purpose of this study is to attempt an analysis of the lessons that can be learnt from AKRSP's rich and pioneering experience. In selecting areas for focus, the research team selected those issues that were of particular value for micro-finance practitioners and posed special challenges in the sector. Some of these issues include aspects such as the rationale and cost of including savings as part of the micro-finance operations, the credit operations and their evolution, impact of micro-finance on poverty reduction, sustainability of micro-finance operations and the lessons that can be learnt from the AKRSP's experience in establishing a micro-finance bank. Through a study of the AKRSP documentation and recording of the oral history of the programme in interviews with current and past staff members an attempt has been made to examine the rationale for the specific path that was adopted in the evolution of micro-finance thinking and operations at AKRSP. This particular analysis covers AKRSP's experience from 1982 to 2002.

2. AKRSP's microfinance programme was designed for an economy that was basically agrarian in which close to 90 percent of the population made its living from subsistence farming. AKRSP started its operations in an area with a poor natural resource base, rapid population growth, poor communication facilities, lack of employment opportunities and few banking facilities. Per capita income in 1982 was estimated to be $150 which was less than half the national average. Lack of credit facilities, high cost of transportation and inadequate distribution networks made it difficult for the average farmer to invest in technologies that would increase farm productivity. AKRSP's success lay in properly understanding this environment and designing a savings and credit program that catered to the needs of its target population. The essential features of the programme were low transactions cost for the client, catering for low volumes of savings and loans, catering to individual needs of security, liquidity and information about savings, personalized loan products and creating an institutional tier at the village level which helped to reduce its own transactions cost, convert low volumes to high volumes and enabled it to create social and financial collateral.

## B. Tracing the Roots of AKRSP's VO and Micro-Finance Model in Early Co-operative History.

3. The Asian Co-operative Movement was greatly influenced by Co-operative Development in Europe. AKRSP also derived inspiration of its VO model from the co-operative movement in Europe, particularly Raiffeisen in Germany and therefore it is relevant to begin with an understanding of this movement (Annex 1). There were considerable similarities in socio-

economic situations between Asia and Europe during the 18th and 19th century. The co-operative movement in Europe was an attempt to fight poverty and exploitation, by the working classes, farmers, artisans etc. supported by many social thinkers and reformers particularly due to the deteriorating socio-economic conditions of workers as a result of the industrial revolution[1].

4. In the early years at AKRSP, it was repeatedly emphasized that AKRSP's VOs were patterned on the co-operatives of Raiffeisen in Germany and its model of rural development drew important lessons from development efforts implemented in Comilla (Bangladesh) and Daudzai (Pakistan). However, the lessons from these models and programmes were never shared at AKRSP and the micro-finance component of these earlier models, if they had any, were never discussed at AKRSP. AKRSP did not come with a micro-finance blue-print and the micro-finance component in these programmes, if any, did not provide AKRSP any concrete lessons for replication. Thus in designing its micro finance component, AKRSP was not emulating a well defined programme which had been implemented elsewhere but was pursuing the simple objective of social organization that taught that capital formation was essential for rural development. AKRSP's micro finance experience was one that evolved as the programme progressed and there were few preconceived notions of how this might develop. There was also little examination of how AKRSP could learn from the experience of the early co-operatives or credit unions. AKRSP drew inspiration from these early efforts but never deeply examined how this intellectual heritage could be used to shape its own destiny.

5. AKRSP has always prided itself in being innovative and not following a blue-print approach. While it is true that AKRSP's unbridled energy paid dividends in many areas of its work and allowed it to develop innovative and exciting models of village development. However, in some areas, particularly micro-finance, its refusal to draw lessons from the past stymied its growth, led to ad hocism and steered it in directions which did not contribute to its long term objectives. There was never any discussion at AKRSP about the outcome of Raiffeisen's co-operatives and whether they had a similar micro-finance component and, if so, what could be learnt from their experience. There was also virtually no examination of what was happening in the area of micro-finance in the 1980s elsewhere in the world and what current thinking existed in this field.

## C. What Lessons Can we Learn from AKRSP's Saving's Experience

6. Many NGOs which have entered the arena of micro-finance in Pakistan have done so primarily with a focus on loans and not on savings. The exception to this norm is generally those NGOs whose micro-finance programmes are patterned on the AKRSP model such as the rural support programmes. The question is why did AKRSP initiate a savings component as a

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[1] Co-operative Laws in Asia and the Pacific
by G.K. Sharma (pp.1-29)

critical part of its micro-finance and rural development model? In its very initial stage, AKRSP did not have a well established credit component as part of its early conception of what constituted a package of micro-finance services. In fact, when AKRSP first started its operations, loans were not part of its portfolio at all. At this stage, savings was the only component of the AKRSP model due to its basic premise that social capital, human capital development and capital formation constituted key elements for rural development. Its strategy for capital formation was to insist that its members save during their weekly Village Organisation meetings. While, there was no restriction on how much each member should save and savings was not compulsory in the sense that each member did not have to save each week if they had nothing to deposit. Even as AKRSP insisted upon savings and had put restrictions on what its clients could do with these savings, it did not itself have a clear idea of how these savings were to be used.

7. AKRSP stressed savings by Village and Women's Organizations (V/WOs) from the outset as an investment in social organization and to build the capital base that would enable investments in productive opportunities. The combination of equity capital and loan capital at the village level was expected to contribute significantly to a self-sustained development process. Many NGOs involved with micro-finance today are focusing on loans and have not been able to reorient their programmes in a manner which allows them to effectively utilise member's savings. This is an important issue for organizations wanting to capitalize on the opportunities made available by the Micro Finance Ordinance in Pakistan today as member's savings would allow them to build their own capital base and offer them the potential for transforming their operations into that of a formal sector bank. AKRSP began with a focus on savings and its principal advantage was that it came with a well developed strategy for social mobilization which made this possible. Even though the micro finance regulation in Pakistan is such that it does not allow an organization not registered under the banking ordinance to take savings deposits of members, AKRSP found a way around this obstacle by having the savings deposited in commercial banks in a joint account. Security of individual savings was preserved through a two-tier banking system under which individual savings were recorded in individual pass books issued to each member and the collective savings of the V/WOs were generally invested in commercial banks in high yielding term deposits. The profits earned on the collective savings were recorded on individual member's pass books on a pro-rata basis according to the savings held by each member. Originally V/WOs were not allowed to withdraw these deposits but in later years V/WOs were allowed to make withdrawals from their savings. Although in practice, commercial banks checked with AKRSP before allowing any organization access to their savings. Savings were generally invested in high-yielding long-term investments offered by the banks.

8. The savings programme generated considerable interest among both men and women and, in fact, provided the main motivation for the first women's organizations established in the Northern Areas. Given the past failures of rural organizations to preserve the equity of their members, the level of, and increases in, equity per member were regarded as impressive

in the first year of operations. At AKRSP, savings were a pre-requisite to the awarding of a Productive Physical Infrastructure [2](PPI) and this fact accounted for the high savings growth during the PPI work. Many organisations deposited the first PPI grant as part of the collective village savings. However, in most cases savings was considered an individual enterprise and people preferred o save their money in separate individual accounts. Savings continued to register rapid growth between 1983 and 1998 due to several reasons; AKRSP's savings programme entailed low transactions cost, it secured individual savings, and for many, provided the first opportunity to save with the formal sector. Savings also registered a rapid growth due to the fact that the rapid increase in the number of Village Organizations entailed a natural increase in savings due to the requirement of minimum savings to attract productive infrastructure investments, the policy to prevent withdrawals from savings and a favourable financial environment that encouraged savings through a high interest rates in the formal banking sector and availability of relatively inexpensive credit through AKRSP. Among many WO members, savings was claimed to be especially earmarked to cover future education expenses. It was generally held that AKRSP's savings programme allowed its clients most of the attractive features of savings such as safety, regularity, convenience and access. AKRSP, after the initial years, also allowed the villagers to withdraw their savings and thus meet the high liquidity preference for households with vulnerable livelihoods.

9. The Village Organization was conceived of as a social innovation that enabled access to micro-financial services to its members by taking collective responsibility for its members. Subsequently extending loans and recovery of loans was also added as an important part of the VO responsibility. Savings was visualized as a "common equity pool"[3] which would act as security against which VOs could borrow from outside agencies as land was considered inadequate as collateral and many people did not have title deeds to land in the Northern Areas. Thus savings was considered as the security which AKRSP used to underwrite loans from commercial banks to Village Organizations. VO savings were placed in accounts to which AKRSP was a co-signatory. The institutional innovation of the VO helped to reduce the transactions costs for farmers and for commercial banks as only one member was required to transact with the banks. The quantum of lending did not diminish as everyone had access to loans. The risk of default was covered by the common equity capital of residents of the same village. Mass default was prevented by making subsequent loans conditional on repayment of earlier ones. Increase in equity capital was motivated by linking VO's borrowing to its savings according to a pre-specified ratio.

10. While, there was a steadily growing number of formal sector banking institutions in the programme area, the outreach of formal sector banking institutions was limited to urban areas and households and businesses with the capacity for much larger savings. Commercial banks did not have mobile banking services and most villages were left still outside the reach of the

[2] This was not an initial requirement but was subsequently added due to the high demand and competition among VOs for PPIs.
[3] Page 40. First Annual Review. AKRSP 1983

formal banking sector institutions. By 2001, there were 28 branches of commercial banks and 21 branches of the Co-operative Bank in the Gilgit and Ghizer Districts. However, their coverage and outreach was restricted to the main towns. While the commercial banks have also been able to accumulate an impressive amount of deposits[4] these were in large measure generated from corporate and establishment accounts. A household survey[5] undertaken in AKRSP's programme area in Gilgit in 1989 showed that only 8 percent of the household savings were invested with the VO/WO, while 50 percent were with banks or post offices, 21 percent were as cash and 21 percent were given out as loans to others. However, AKRSP's savings programme met the needs of the rural poor households to save small amounts at regular intervals through the mechanism of the village and women's organizations. Thus while the commercial banks were able to attract the relatively larger accounts, AKRSP's savings programme helped attract the small savers.

11. It is generally asserted by empirical studies that the rate of return offered on deposits is not as influential a consideration in the decision to save as other factors listed above[6], especially for the savers at the lower end of the spectrum. The fact that the money is earning some nominal return while being stored safely, and is accessible in one form or another, is good enough for the typical saver. However, AKRSP's experience with savings shows that the rate of return on savings does matter and influenced the growth and trends in savings and once the financial environment changed it significantly affected savings. There was a rapid decline in the rate of growth of savings between 1998 and 1999 and an overall decline in savings between 1999 and 2000. A major challenge to savings mobilization was the low real and perceived returns being earned on savings under the then prevailing financial conditions in the country. High inflation, constant devaluation, declining deposit rates and economic instability compelled people towards greater present consumption. As commercial banks lowered their rates on variable-rate term deposits, V/WO members argued that their expected returns from savings deposited in banks were decreasing while AKRSP was increasing its Group Loan rates. The use of savings for generating greater returns was more likely to be practiced by more mature V/WOs where members were able to calculate their returns and compare them with other market options available. The question that was frequently asked was whether it wouldn't be better for the VO to just use its own savings rather than take a loan from AKRSP. In response, many Village Organizations initiated the practice of internal lending, as a result of the lowering of interest rates offered by banks and the increase in service charges by AKRSP on different loan products. These V/WOs started withdrawing their savings from banks and using them for on- lending purposes. This practice was most widespread in the Gilgit region and in particular in Hunza where trading opportunities with China made off-farm and trade options more attractive. This practice grew rapidly between 1996 and 2000 and it is estimated that a total of Rs. 71 million was being used for lending to members internally by the V/WOs. In

[4] Just three of the banks with the largest outreach in the Northern Areas i.e National Bank , Habib Bank and the Co-operative Bank indicated total deposits of Rs 2.6 billion.
[5] M.H. Khan. 1989.
[6] Von Pischke, J.D. startegies for Improving AKRSP Savings and credit operations. AKRSP 1998.

1998, these issues presented a real challenge in the management of the Group Loan (V/WOCP) portfolio.

12. AKRSP's savings programme was important in that it demonstrated the significant potential of savings at the village level in an area which was considered well below the national income level. By the end of 2002, a total of Rs. 430 million had been generated by the Village and Women's Organizations as savings and Rs 200 million had been extended as credit. By the end of 2002, cumulative credit of more than Rs 1.7 billion had been provided in about 600,000 lending operations since the initiation of the credit program in 1983[7]. The demonstrated potential for savings also opened the wide spectrum of financial autonomy and innovation at the village level through the internal lending mechanism and informal trading opportunities.

13. The use of savings to promote empowerment in the AKRSP approach was given considerably more importance than the financial factors for savings discussed above. Indeed for women savings provided the first opportunity for owning an asset. This approach can explain much about the way AKRSP's savings programme developed. Savings in AKRSP's conception was an extremely important tool for social intermediation and developing the grass roots capacity for self-help[8]. Some felt that there was too much emphasis in the AKRSP approach on savings as a tool for social cohesion and felt that AKRSP should consider developing a savings strategy which graduated from savings as a means of empowerment to a demand-driven financial service approach in which individual financial needs were targeted. It was said that this would represent a major philosophical shift in the organization, requiring a new way of looking at the rationale behind savings and the reasons for promoting savings[9].

14. There was some ambiguity at the start as to whether AKRSP's original objective of generating a collective capital base implied that the savings were to be used for collective development initiatives with these funds. Even though AKRSP harboured this notion initially through its conception of the long-term comprehensive village development plan[10], the practical difficulty of implementing this idea did not develop much further and community members did not have a common vision on the allocation and use of savings. In the beginning attempts by the villagers to use collective savings for entrepreneurial activity were discouraged especially the setting up of shops. The Third Quarterly Progress Report from 1983 stressed that "attempts were being made to make VOs understand the real use and purpose of equity capital i.e. to attract capital for promotion of agricultural activities because it is in agriculture that the well being of majority lies and not in shop-keeping."[11] The idea of collective village development planning and implementation through collective loans did not get off the ground

[7] Performance Indicators Report: January-December 2002. Report No 6. Pakistan Micro Finance Network.
[8] L. Bennet et al. Ownership and Sustainability: Lessons on Group-Based Financial services from South Asia" Journal of International Development, 8 (2); pp. 271-288.
[9] Fourth Evaluation of AKRSP. World Bank. 2001.
[10] Third quarterly report August to October 1983 AKRSP.
[11] Page 16. Third Quarterly Progress Report. August – October 1983. AKRSP

because individual farmers did not have a common perception about village development and considered this an individual sphere of activity. The actual outcome of the savings process has thus been collective only in promoting solidarity and empowerment, and only in managing the risk of credit given to individual members. The agglomeration of village savings for use in VO Banking or Group Loans as they were later called also allowed the use of individual savings for collective purposes.

15. In 1991, the thinking at AKRSP was that the "villagers had gained tremendous experience and have also generated a large amount of capital. The objective was to ensure village autonomy in development finance as the formal credit structure is unlikely to revise its rules, procedures and attitudes towards the small farmers. If the small farmers are to access credit for agricultural needs, as well as for other purposes, in a sustainable manner, then they will have to use their capital to create and manage their own financial institutions. This is the only way to ensure autonomy in development finance and to preserve the sovereignty of the village level participatory institutions in Northern Pakistan."[12] Sadly this vision was never discussed with villagers to assess their views about it and no attempt was made to asses its feasibility or oeprationalise it.

16. Where is the savings program today? The VOs continue with their savings with or without AKRSP. Some VOs and WOs also lost much of their savings as a result of AKRSP's policy to deduct loan defaults from collective savings which villagers had pledged in order to access the group loans. AKRSP was not very mindful of the fact that within the same organisation the borrowers may have been different from the savers and often were. Many of the VOs and WOs have learnt from this experience and have stopped borrowing from AKRSP and only lend money from their internal lending programme. Other organisations have stopped given out loan altogether and focus only on savings. The main thin is that the savings programme continues unharnessed and unabated. AKRSP in one sense has lost control of the savings programme and has unleashed an energy which is now being guided by the villagers themselves.

17. What has happened to these savings after the establishment of the First Micro Finance Bank (FMFB)? While the villager's are still saving through the VOs, it is unclear how effectively the FMFB will be able to generate and collect savings from the Northern Areas. The FMB currently has five branches in the Northern Areas and 2 in Chitral. The potential opportunity of using the member's savings as equity capital for the bank or to buy the members an ownership in the First Micro Finance Bank was never assessed or used. The conception of the bank as something which would emerge from the grass roots and be a natural progression of the savings programme was severed by the decision to generate equity capital from other sources to establish the Bank. It is another matter on how this could have been achieved and whether the members would have agreed to this option. The option was never fully explored. It is unlikely that the VOs and WOs would even have invested in the bank had they been given a choice

[12] Shoaib Sultan Khan, Hussain Wali Khan, Khaleel tetlay and Mutabiat Shah. Village Organisation Banking: A Status Report as of December 1990.

especially in view of the projections of its sustainability. The FMFB has to compete with other banks to attract member savings. Villagers have become very smart in assessing rates of return on savings and carefully consider their options. Interviews with both men and women reveal an incredible knowledge about the rates of return that they can earn from different banks and VOs and WO savings are invested with a wide range of banks in the north. The fact that the FMFB has to struggle for attracting the VOs and WOs savings is a testament to the autonomy and empowerment the savings programme has imparted to the people of the Northern Areas. This might perhaps be AKRSP's greatest contribution.

18. Some attribute AKRSP's success in persuading a large number of people to save with the VOs and WOs as a phenomenon peculiar to its perception as an Ismailiya Organisation. The large differential in savings growth between the Ismali and non-Ismaili areas in the Northern Areas and Chitral is pointed to in support of this contention. While it is true that the greatest development in terms of savings and the internal lending programme happened in upper Hunza which is completely Ismaili, it is also true that it is upper Hunza which offers the greatest potential in terms of trade with China and tourism. Regardless this point of how an organisation is perceived locally is important because it implies that other organisations encouraging savings among its members may not be as successful and in fact some of the other RSPS have not been very successful in generating savings and no other NGO is pursuing savings as vigourously as AKRSP did or had the success of AKRSP in this regard.

19. Some of the key lessons that can be highlighted from AKRSP's experience of savings include the following;

- A well developed social mobilization strategy is required to mobilize savings of the scale that was made possible by AKRSP.
- It is possible to develop an effective model of generating savings from the rural poor.
- A two-tiered savings system is required to preserve the distinction between individual and collective savings.
- Savings provides an effective entry-point for organising women and generating savings from them and can be an important means of empowerment for women.
- The key preferences of clients should be kept in mind while shaping the features of a savings programme such as safety, liquidity, returns and cost.
- The returns on savings are an important feature of the savings programme and strongly influence the motivation and trend in savings.

- Members will capitalize on the opportunities for financial arbitrage and develop strategies which will help them take advantage of these opportunities in their financial decisions.

- AKRSP's use of savings as a tool for social cohesion kept it from developing innovative savings product and there was virtually no change in the savings product offered by AKRSP's portfolio in the last twenty years.

- A well conceptualised savings programme with a clear vision about its future allows the development of institutional arrangements that can help support this vision.

### D. What Lessons Can be Learnt from AKRSP's Credit Experience

20. When AKRSP first initiated its operations it had not systematically planned a credit programme for its clients. AKRSP entered the credit market when it realised that its clients needed loans for agricultural production and investments. Addressing itself to this need, AKRSP in its Third Quarterly Progress Report stated that, "in order to enable the VOs to undertake development projects, AKRSP has decided that it will help arrange loans from commercial banks. Such loans will also partially help to satisfy the expectation of VOs for further help once the first PPI has been completed". However, the existing supply of credit from the formal sector banks could not be easily tapped due to high transactions costs, minimum loan size, cumbersome disbursement procedures and lengthy processing periods. Thus while the formal financial sector disbursed a large amount of loan, only a relatively small segment of the population was reached by this sector. It was instructive to note that when AKRSP initiated its operations an interest free production loan scheme was available from the commercial sector which entitled small holders to a loan of Rs. 6000 per crop. However, not a single such loan had been advanced to the potential 28,000 farm households in the Gilgit region due to the difficulty to access these loans and the small size of loan required by the people in the Northern Areas. There has been rapid growth in AKRSP's credit disbursements from Rs 1 million in 1983 to a high of Rs 276 million in 1997 and Rs 175 million in 2002. There has been a gradual decline in credit disbursements partly due to reduced demand and partly due to AKRSP's attempt to reduce its portfolio at risk. The reduction in demand was due in part to the increasing tendency of internal lending. In 2000, at least one-third of the V/WO had been provided loans through internal lending.

21. AKRSP first ventured into offering loans to its clients through the intervention of established formal banking sector institutions as it had made no provision for a revolving fund for credit from its own sources and had not developed a policy on interest rates either. In early 1983, AKRSP embarked upon a loaning programme with the approval of its Board of Directors and the availability of a sum of Rs 200,000 from the Habib Bank Limited from its interest free production loan portfolio on the surety of AKRSP. In February 1983, AKRSP extended its first fertiliser loan to 46 VOs. The average loan size per borrower was only Rs 174 and the total loan amount disbursed was Rs 621,086. In 1984 AKRSP provided medium term

credit through the National Development Finance Corporation (NDFC) which provided a soft loan of Rs 5 million to AKRSP. Since then, AKRSP donors have also provided grant funds for credit in the shape of a revolving fund. This early success of AKRSP acting as a social intermediary for whole sale commercial credit and its quick disbursement of this credit was a path breaking development and was later emulated by many other banks such as the First Women's Bank, the Khyber Bank, the Khushali Bank, etc.

22. AKRSP's credit chronology illustrates its dynamic and innovative nature. AKRSP has experimented with many types of different loan products since its inception in 1983. In designing its loan products, AKRSP appears to have struggled with balancing several different motivations. Chronologically, its main motivation at first was to try and address the needs of the small farmer through short-term and medium-term loans which were initially extended from anywhere between 12 to 60 months. The utilisation of the medium-term loans indicates that except for loans utilised for agricultural machinery, a period of 12 months was sufficient for medium-term loans and that even people who had taken loans for five years for land development generally exceeded their targets within two years. As such the medium-term loan was discontinued.

**Table 1: AKRSP's Savings and Loan Products 1982 – 2001**

| Financial Product | Year introduced | Year withdrawn | Reason to withdraw | Interest rate (f) flat, (d) decl. balance |
|---|---|---|---|---|
| Community savings | 1982 | | | |
| Short term loans | 1983 | 1999 | | 0 |
| Medium term loans | 1984 | 1999 | | 8% |
| Village Banking or Group loans to VOs (V/WOCP) | 1989 | | | 15% |
| Enterprise credit loans ECP | 1992 | | | 16%, raised to 24% in 1998 |
| Corporate Credit loans | 1996 | 1999 | | |
| Business Committee loans | 2000 | | | |

23. AKRSP realised that some progressive VOs were experimenting with a village credit system that met not only the agricultural needs of its members but also other credit requirements. AKRSP also noted that the credit needs of the VO did not exceed the current volume of its savings in 1989. Therefore, under the guidance of Dr. Akhter Hameed Khan, AKRSP tried to use the institutional devise of the VO for the introduction of Village Organisation Banking in 1989. The VO banking idea marks an important conceptual beginning in AKRSP thinking about the VO's role. Although, the manner in which AKRSP's short-term and medium-term credit operated it was the VO which had primarily shouldered the responsibility of the management and disbursement of its loans. AKRSP soon realised that it was the VO which had

determined the quantum of loan for each member, managed disbursements and recovered the loan from individual members. It was felt, therefore, that the VO had proved its competence in handling the entire loan operations without reference to the Regional Programme Office of AKRSP. The only function that the RPOs and the SO were performing was monitoring and account keeping. As a consequence, AKRSP developed a package of Village Banking under which an amount equivalent to VO savings was advanced to VOs for onward loaning to members. The VO savings was invested in Deposit Certificates and other high interest bearing accounts held jointly in the name of the VO concerned and AKRSP.[13] The VO paid a 7 percent interest rate[14] as service charge on the money advanced and the VO was asked to charge 15 percent to individual member's which was equivalent to the profits VO members were earning on their savings at that time. In addition, AKRSP developed guidelines and provided training to VO representatives. Later the VO Banking was renamed Group Loans due to reservations by the State Bank on terming this activity VO Banking. However, some of the problems with internal lending pointed to the need for some sort of supervision and regulation of the programme.

**Box 1: Issues and Problems with VO Banking**

- VO capital was instantly disbursed and there was little element of planning.
- The equity element was often ignored.
- Variability in service charges that were being levied.
- In some VOs the Credit Committee established to oversee the loan disbursements and recoveries was by-passed.
- VO accounts and records were not being maintained in some VOs.
- Lack of clarity regarding the recovery of the capital, its additional and renewal.
- Loans were given for commercial purposes often for use outside the village.
- No reserve funds were maintained to meet unforeseen losses and contingencies.
- Loans were given for 12 months which did not allow for a high turn-over.
- AKRSP relaxed its requirement for recovering the VO capital at the end of twelve months and only service charges were paid to AKRSP at the end of twelve months which meant that AKRSP did not know what was going on within the VO.[15]

24. The year 1996 marked the start of a new period for AKRSP in which it became mindful of financial sustainability and moved towards the identification of loan products with high returns which could justify the levying market interest rates. AKRSP acquired a more enterprise development orientation and tried to capitalise on off-farm opportunities through the introduction of a small enterprise development loan and a corporate credit programme. These were important products for AKRSP as it was trying to deepen an existing market in which possibilities of geographic expansion were limited due to the self-imposed delimitation

[13] AKRSP had the authority to draw the money unilaterally to satisfy VO default.
[14] Equivalent to the interest earned on PLS account.
[15] However, this was later modified and AKRSP once again levied the requirement that the capital should be recovered after twelve months along with the interest payments.

of its area of operation. [16] In the last few years, AKRSP has been particularly driven by its objective of developing high yielding products that would enhance its financial sustainability. This led to experimentation with products that had high risk and targeted a sector that has not been part of AKRSP's original target group. AKRSP learned important lessons from the introduction of these products. One of the most important lesson was that the skewed debt-equity ratio in the small enterprise loan was such that it was difficult for the borrower to service the loan. There was need for AKRSP to invest in equity rather than service a loan which it was beyond the capacity of the small business to repay. AKRSP had no policy for equity investments. This was a critical finding for AKRSP as the product which was projected to make its micro-finance operations sustainable was the enterprise development loans and not group-loans. In the feasibility projections prepared for the new bank the fastest growing product form which the profits were projected to be derived were the SME loans. Thus it has grave implications for micro finance that the potential for this product appeared limited in the Northern Areas.

25. In recent years, AKRSP has placed itself under enormous pressure to introduce products to increase its sustainability. In the process, AKRSP has been under pressure to expand its credit portfolio rapidly without proper appraisal procedures and has also experimented with poorly performing products, and those, that may not be entirely appropriate to its objectives of social and economic development. While, AKRSP has been very active in evaluating its loan products and quick to terminate poorly performing products and reviewing its internal policies and procedures, it has lost some of its early focus on the needs of its main target group and has deviated somewhat from its overall mandate of providing micro-finance services to the rural poor. This has happened even more after the establishment of the First Micro-Finance Bank as the main focus of the Bank is on urban areas.

26. There has been a marked difference in the rate of growth of different loan products. Part of this difference can be attributed to the difference in the features of the loans and partly due to an internal policy that prefers group loans to individual loans and stipulates that a ratio of 70: 30 be maintained between the two types of loans. The group loans reduce the transactions cost of AKRSP, place a higher transaction's cost on the members, carry greater risk for members who are net savers but have a service charge of between 15% to 18%[17] and are cheaper than the Individual Loans. The individual loans place a higher transactions cost on AKRSP, are riskier as they are not collateralized but are higher yielding as AKRSP levies a service charge of 24%. The ratio of group loans to individual loans stood at 76:24 in 2000. An analysis of the cumulative loans disbursed in the three regions shows a marked difference in the proportion of the two types of loans. At one stage the proportion of Individual loans in Baltistan were as high as 62% as a result of the runaway expansion of the individual loan

[16] A suggestion by AKRSP staff in the mid 1990s that AKRSP should consider expanding to areas outside the Northern Areas was considered premature and ignored.
[17] AKRSP's service charge is 15% but the V/WOs on lend at around 18%.

portfolio in Baltistan District between 1996-1998. Subsequently there was a high default rate in Individual Loans and in Baltistan large amounts had to be written off.

27. AKRSP's policy on interest rates was not very well considered at the start of its operations. Even in 1983, interest free loans were not considered best practice in rural finance. Yet AKRSP began with a policy of a zero interest rate and only slowly graduated to a policy of charging market rates. The policy on interest rates in the beginning was patterned on the formal sector policy of providing interest free agricultural production loans and was partly based on the belief that poor farmers would not have the capacity to pay market rates. Later AKRSP decided to impose a 10 percent per annum service charge, starting with the marketing loans. This policy coincided with the abolition of the interest free production loans by the government. The first medium-term loans were given on very soft-terms i.e. 5 percent per annum. However, the service charge on these loans has been progressively increased to the market level and in 1989 varied from a minimum of 10 percent to a maximum of 15 percent. AKRSP first began charging market rates of interest in 1992 when it felt it had developed a loan product which was appropriate for the commercially oriented investor and justified the levying of market rates. In its first decade of operation, there was not much notion at AKRSP that interest rates should be based on a careful analysis of delivery costs, recovery rates or sustainability of its micro-finance operations. In this AKRSP acted very much with a rural development orientation and not as a financial institution with sustainability as its objective.

28. AKRSP's policy on collateral has been very instructive and other organisations can learn from its experience. AKRSP realised that using land as collateral was not possible in the Northern Areas due to the limited availability of land titles. However, AKRSP also realised that even if land deeds had been available it would have been difficult to use them as collateral as this would have enhanced the transactions cost of processing loans without adding much value and, in case of default, enforcement of repayment through recourse to formal mechanisms, in case of default, would have been difficult and would have eroded the spirit of trust and partnership on which AKRSP's approach was premised. Therefore, AKRSP did not demand collateral for short-term loans. For marketing loans a 100 percent cash collateral was required. In case of medium-term loans which were given for a period greater than 12 months, the VO had to furnish 30 percent cash collateral. It notionally treated this savings as collateral for loans. In the case of default this collective savings was used collateral which presented a huge problem to the savings and credit programme as the savings belonged to one set of people and the loans had been taken by another.[18] The basic cornerstone of the lending policy was the sue of collective savings as collateral. This policy can be questioned on ethical grounds as many AKRSP clients lost their savings due to no fault of their own but simply because they had given surety for others.

29. As a result of its collateral policy in which its loans were completely covered, AKRSP's overall record of repayment has been excellent. The program has disbursed Rs 1.7 billion in

[18] Page 40. Third Quarterly Progress Report August- October 1983.

different types of loan products between 1983 and 2002 and has recovered 99% of this amount. There is a marked regional difference in the pattern of repayments by region and gender. In 1999 Chitral had the smallest percentage of overdue loans at the end of December 2000 as its overdue loans stood at 18% of total outstanding loans, followed by Gilgit District at 24%, and Baltistan with 48% of its loans overdue had the worst record. Women appeared to be much better at timely repayments and in each region the amount of loans overdue by Women's Organizations were much lower when compared with loans borrowed by men. An analysis of the credit portfolio of AKRSP reveals that there has not been a marked change in the amount of loan overdue at the end of each financial period in the last six years. The credit portfolio at risk showed an increase in each region at the beginning of 2000. However, the overall portfolio at risk has declined due to the policy of writing off bad loans at the Core office.

30. Some assert that AKRSP's credit programme became a supply driven programme in some respects. Its policy of giving the VO and WO managers a commission of 2 to 3 percent for recovery of loans encouraged them to push for large amounts of loans on the recovery of which they would make a substantial commission. This combined with the system of VO banking in which the VOs took the major decision about who would get the loans encouraged quick disbursements without proper appraisal and minimum supervision led to the increase in defaults against which collective savings were pledged and entailed huge losses for unsuspecting savers. AKRSP had successfully transferred the entire risk of its credit programme to the VO and WOS. Weary from this experience many VOs and WOs had branched off on their own and were running their own successful internal lending and savings programme. Thus when the First Micro-Finance Bank came along it became just another player on the scene and did not impact these organizations.

31. The following key lessons emerge from AKRSP's credit operations;

- Product development needs to be closely aligned and balanced with the various objectives of the organization such as meeting the needs of the target group, efficiency and financial sustainability.
- Interest rate policy needs to be carefully considered from the outset focusing on sustainability rather than based on notions of the borrower's capacity to repay.
- Policy of collateral should be developed in a manner which helps to retain the advantages of micro-finance without eroding the social basis on which micro-finance lending is provided.
- Local capacity of VOs can be built to undertake on-lending operations by managing, disbursing and putting a system for recovery in place with proper guidelines, supervision and training,
- Autonomous operations of VOs in micro-finance operations needs to be balanced with some form of regulation to ensure transparency, equity, efficiency and cost recovery.
- The debt-equity ratio in small enterprise loans needs to be balanced in a manner that allows the borrower to service the loan properly.

- Policy of paying commission to local agents for loan recovery needs to be watched so that it does not encourage a supply driven approach to credit.

**E. Did AKRSP by Inclusion of Micro-Finance as a Key Part of its Activities Promote an Unsustainable Model of Community Mobilisation and Organisation ?**

32. Did AKRSP's savings programme achieve its initial objective of social mobilization? At the group level, AKRSP's experience demonstrated that saving, through the V/WO can provide a community with a sense of empowerment due to its ability to generate large sums of money from its own sources. However, the sustainability of the savings and credit programme is inextricably linked to the sustainability of the Village and Women's Organizations. AKRSP has been finding it difficult to sustain these organizations in the absence of significant village level activity and investment. The most active phase of a VO's existence is during the construction of the Productive Physical Infrastructure scheme. AKRSP has been hard pressed to find ways to keep the organisations active. From time to time, opportunities such as those presented by the implementation of the physical works under the Khushal Pakistan Programme and others provided a brief spurt of activity and interest. Some assert that it is difficult to keep an organisation alive based on a savings programme alone. While this may be generally true it is not true of many women's organisations. Women in the Northern Areas attach such a high value to savings alone that many of their organisations are not only alive but actively engaged in many activities as a result of their savings programme. Many women's organisations meet either weekly or monthly collect their savings and are running internal lending programmes with a part of their savings. In some cases they have hired male managers who help them manage their savings and credit programme for a small fee.

33. The question whether the inclusion of micro-finance eroded the collective spirit of cooperatives arises because of the tensions inherent in the collective community interest and the individual self-interest, AKRSP's policy of using the collective savings as collateral for individual default and the dichotomies implicit in its conception of the village organisation as a hybrid credit union. While one of the objectives of a credit union, like that of the VO, is to encourage its members to save and to obtain a reasonable rate of interest on these savings (promotion of thrift), there is another objective which can be construed as being directly in conflict with this objective which is to create sources of credit at a fair and reasonable rate. The lower the interest rate charged on credit, the lower the interest allowable on deposits. Furthermore, the manner in which AKRSP was using collective savings as a collateral for individual default not only had the potential of dividing the village organization but destroyed the VOs and WOs in many villages where individual default was realized through collective savings. In practice, some of the VOs later fell into disarray because collective savings was used to retire individual debt, members in-charge of savings either began to embezzle collective savings or provide cheap loans on a preferential basis to selected members.

34. There was some concern within AKRSP that internal lending jeopardized the savings of the V/WO members and that defaults could erode the basis of social organization at the village

level. The social dynamics of each village are different but because of the close personal relations it maybe difficult for members to refuse the use of their savings to members whom they have known all their lives. Furthermore, in some villages, a disturbing trend which emerged was that a few powerful borrowers dominated decision-making and could jeopardize the savings of the V/WO members. Apart from the concern for protecting the small savers, AKRSP assessed that many of the organizations did not have the requisite financial management capacity to be able to mange an effective internal lending program. There is also evidence that some of the organizations are under pressure due to internal conflict and dissension. It is estimated that around 8 percent of the Village and Women's Organizations are under social stress because of internal conflict. Moreover, there are also likely to be a growing number of organizations that are unable to deal with the conflicts that may arise as a result of the high risk activities of internal lending that they are engaged in. Case studies conducted by AKRSP of model Village Organizations show that there is a rapid attrition in these organizations following problems of loan repayments.

35. Could AKRSP have learnt any lessons about this issue from the early co-operative history. There are important aspects in which AKRSP's micro-finance programme was similar to the early co-operatives and equally important aspects in which it was dissimilar. For example, if one examines some of the rules drafted by the Third Co-operative Congress held in London in April 1832 which represents the first attempt in the systematic self-regulation of co-operatives one can make a comparison with AKRSP. This congress decided that "it was universally understood that the grand ultimate object of all co-operative societies whether engaged in trading, manufacturing or agricultural pursuits, was community on land. It is interesting to look at some of these rules and compare them with AKRSP's savings and credit model that was designed 150 years later;

**Box 2: Comparison Between the Third Co-operative Congress and AKRSP**

| Third Co-operative Congress (1832) | Aga Khan Rural Support Programme (1982) |
|---|---|
| A weekly subscription, either in money, goods or labour from a penny to any other amount agreed upon, is indispensably necessary to be continued from year to year, until a capital sufficient to accomplish the object of the society be accumulated. | Weekly savings no matter how small which in the initial phase had to be accumulated to achieve the objectives of the VO. |
| It is the unanimous decision of the delegates here assembled, that the capital accumulated by such associations should be rendered indivisible, | The savings were initially treated as indivisible and no withdrawals were allowed even though members were given individual passbooks for recording individual savings. |
| It is deemed more especially essential in all | There was no credit component in the VO |

| | |
|---|---|
| the trading transactions of co-operative societies that credit shall be neither taken nor given as deviation from this important principle has been the sole cause of the destruction of so many previous societies. | model when it first emerged at AKRSP but very quickly loans were included as a key aspect of AKRSP's model of rural development. |

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**Aga Khan Rural Support Programme (1982)**

- Weekly savings no matter how small which in the initial phase had to be accumulated to achieve the objectives of the VO.
- The savings were initially treated as indivisible and no withdrawals were allowed even though members were given individual passbooks for recording individual savings.
- There was no credit component in the VO model when it first emerged at AKRSP but very quickly loans were included as a key aspect of AKRSP's model of rural development.

36. Many of AKRSP's village organizations began operating like credit unions upon the initiation of their internal lending activities in the late 1990s. These VOs fall fairly neatly into the definition of credit unions[19] as they offer loans to their members out of the pool of savings that are built up by the members themselves. The seeds of this were laid by the savings programme and the introduction of the Village Organisation Banking model in 1989 which gave greater autonomy to the VO and provided them a model that eventually led them to use their own funds to initiate their internal lending programme. The VO began using their own funds when they found loans from AKRSP too expensive and once their own savings invested with commercial banks stopped earning high returns.

### F. Did AKRSP Pursue Sustainability as a Key Aspect of its Micro-Finance Programme?

[19] Berthoud and Hinton (1989).

37. In answering this question, it is useful to divide AKRSP's micro-finance history into two distinct phases; 1982 to 1996 and post 1996. There is no evidence that AKRSP tried to pursue sustainability as a key aspect of its micro-finance programme in its first fourteen years. AKRSP initiated its micro-finance programme with the primary objective to mobilise people and better serve their micro-finance needs. Sustainability was not a factor in this equation. There was no information ever collected in its first decade and a half to estimate the cost of the savings or the credit programme. AKRSP's evolution and expansion is in sharp contrast with programmes like Kashf which begin with a clear analysis of how they could achieve sustainability. In Kashf, for instance, this analysis was undertaken for the branch level and it guided the operations of the NGO from the first day. The Field Management Unit of AKRSP which can be considered the equivalent of a branch was never regarded as a separate cost centre at AKRSP until after 1996. AKRSP could also have learnt from the experience of the Lachi Poverty Reduction Project which many years later tried to develop a sustainable model of micro-finance at the Union Council level and undertook a detailed analysis in this regard. A comparison of these two models with AKRSP shows the extent to which sustainability was disregarded at AKRSP.

**Table 2: Comparative Analysis of AKRSP's Model of Sustainability with Other NGOS**

| Programme Features | Kashf | Lachi Poverty Reduction Project | AKRSP |
|---|---|---|---|
| Geographical Focus | Urban and peri-urban areas. | Rural | Rural |
| Model of sustainability | The NGO has developed a model under which sustainability is being pursued at the branch level. | The project has developed a model of micro-credit that it hopes to make sustainable at the union council level. | 1982-1996: No model<br><br>1996: 2003: Focused on FMU for performance evaluation purposes but no calculations of sustainability. |
| Break even point or sustainability defined as the branch being able to meet its own costs. | For achieving break even or sustainability at branch level Kashf needs 1100 borrowers per branch. | For achieving break even, the project team estimates that they will need to disburse a minimum of Rs 6.5 million per union council to around 1200 borrowers[20]. | No cost calculations for FMU level sustainability.<br><br>Estimated that AKRSP's operations could not be sustainable if they only operated in the Northern Areas and |

[20] An average loan of Rs 5,400 per borrower.

| | | | |
|---|---|---|---|
| | | | Chitral. |
| Achievement | Of its 16 branches, 10 were currently sustainable and the rest were expected to become sustainable by June 2003 | By the end of March 2002, the project had disbursed Rs 4 million to 820 households in Shakardara Union Council | Sustainability was never achieved. |
| Policy on sustainability | Branches are closed if they do not reach break even within a specified period. | No specified policy | No policy of closure |

38. AKRSP staff first became mindful of sustainability issues when they attended the Boulder Course on micro-finance which radically transformed their thinking about the management of micro-finance at AKRSP. At this juncture AKRSP decided to reorient its operations and build a financially sustainable micro finance programme. The first step they took was to establish a separate micro finance section which employed specialised micro finance officers who took primary responsibility for delivering financial services out of AKRSP's Field Management Units. Day to day decision-making responsibility was decentralised further. Micro finance Officers in the field were given authority to sanction loans. The Micro finance programme costs, budget, and income were separated from the rest of AKRSP. Excess funds in various AKRSP accounts were allocated to the Micro Finance Programmes credit pool, and any funds from this pool in excess of the loan portfolio were invested with banks to earn a return. A manual of Credit Policies and Procedures and a monthly Credit Operations Report were established to improve the management of credit operations.

39. Although, AKRSP's operating cost ratio did not change significantly between 1995 and 2000, there has been a significant change in the income and operating costs of AKRSP. The increase in income from service charges increased almost five-fold between 1995 and 2000. This increase is explained by the increase in the interest rates, improved loan recovery performance and the increase in loan volumes in the intervening period. However, the most significant increase has come from the income from investments. There was no income being generated from investments in 1995. However, by the end of 2000 AKRSP improved its fund management by investing its idle funds in high yielding returns.

40. In the same period, AKRSP strengthened its Micro Finance Section with the addition of Micro Finance Officers at the field level from 6 in 1995 to 31 by the end of 2000. In addition, a Loan Portfolio Auditor, a Financial Analyst, and a Systems Analyst were added to its Core Staff. AKRSP also created a separate cost center for the Micro Finance Program and all direct and indirect costs were charged to the Micro finance Program in an attempt to estimate the real costs of the program and help it in its move towards financial sustainability. As a result, the operating costs of the Micro finance Program increased from Rs 2.8 million in 1995 to Rs 19.41 million in 2000. However, AKRSP's micro-finance programme did not achieve sustainability

and the feasibility for the FMFB projected that AKRSP could not achieve sustainability if it continued to operate only within the Northern Areas and Chitral and that sustainability considerations required expansion into other areas of Pakistan.

41. It would be fair to recognise that AKRSP's investment in micro-finance entailed a substantial investment in human resource development and in enhancing the financial management skills of men and women managing the savings and credit operations at the village level and the NGO level throughout its twenty years. AKRSP had also devised a very effective system of training at the grass roots level and from the outset focused on the training of a cadre of village activists in micro-finance operations, accounts and audits. One of AKRSPs' greatest achievement has been the awareness it has created about micro-finance operations and the possibilities of financial arbitrage. By the year 2000, AKRSP had a professional staff strength of 63 in its Micro Finance Section including 9 staff members in the Core Office. Each Micro-Finance Officer was responsible for overseeing the accounts of 70 organizations on average. This staff was supported by 178 Village Accountants (FA) charged with the responsibility of auditing the accounts of Village and Women's Organizations for a fee of Rs 300 per organization on a six-monthly basis. One FA was on average supervising 21 Village and Women's Organizations. The team of Field Accountants included 23 women accountants. Each organization had a Manager for maintaining the books and record keeping of village accounts. Where it was not possible to find a literate women, men were nominated by the women to manage their accounts.

42. The question is why did AKRSP not worry about sustainability in its early years. There are several answers to this question. There are virtually no barriers to entry in the field of micro-finance in Pakistan. The Micro-Finance Ordinance does not apply to NGOs. Thus there is no training required, no regulation and no experience required for some one wanting to enter the micro-finance arena. An NGO may get staff with no previous experience in micro-finance and hence no orientation towards sustainability or even understanding of how this is to be achieved. As such, the direction which an organization takes does not often depend upon an overall vision for the institution but individual proclivities. Furthermore, when AKRSP started its operations, donor funding was readily available at zero percent interest rate for financing its credit operations. AKRSP eventually put all the grants it had received as revolving credit funds into one high yield account which it used to finance its micro-finance operations. An organisation which has a financial self-sufficiency ratio of over 300 percent is not going to be overly concerned about sustainability at the field level. Does this imply that cheap donor funds actually impeded the quest for financial sustainability at AKRSP in its first decade and a half ?

43. Just prior to its decision to separate its micro-finance operations in preparation of the establishment of the First Micro-Finance Bank, AKRSP's Subsidy Dependence Index was estimated to be around a negative 130 percent. This favourable ratio was due to the fact that AKRSP was using its own funds for its credit programme and could borrow at concessional rates

of 6 percent from the Pakistan Poverty Alleviation Fund. Furthermore, AKRSP's income from its investments provided the major source of funds. Its operating cost ratio was 4.6 percent and its operating self-sufficiency ratio was estimated to be as high as 300 percent due to the large amount of income it earned from its other investments. AKRSP realised that its scale was not increasing and its client base was not increasing neither were volumes. AKRSP believes that with the creation of the FMB it can eventually make its operations sustainable. It plans to cross-subsidise and use the profits from its urban branches to sustain rural areas. The shareholders of the FMB are not pushing for a profit for the first five years and this gives the FMB some breathing space.

44. AKRSP's credit operations are not directly comparable with most Micro finance NGOs operating in Pakistan[21] due to the very small size of their loan portfolios compared to AKRSP, different implementation methodologies and the limited time for which they have been in existence. However, a comparison of AKRSP with other NGOs in the Micro Finance Group indicate an overall favourable picture of AKRSP's micro finance programme. AKRSP's financial self-sufficiency ratio is the highest in the Group due to its large volume of loans and income from other investments. AKRSP's operating cost ratio is among the lowest, but this is due to its large volume of performing assets that may have reached a saturation point while the volume of loans may be growing for other NGOs relative to their costs. Returns on performing assets indicated that while AKRSP was not earning as high a return as some of the other NGOs like Kashf (17%), OPP (19%) or DAMEN (24%), it was earning 15% which was the average return.

## G. Lessons from AKRSP's Model of Institutional Development and Growth

45. The policy environment for micro-finance underwent rapid change as a result of the promulgation of the Micro Finance Ordinance in 2001. The enforcement of this Ordinance has opened up new opportunities and challenges for the micro-finance sector in Pakistan. The main benefit from registering as a bank is that the organization would be allowed to take deposits and use its funds, an advantage that was denied to AKRSP due to the restrictions on NGOs on taking deposits. As a result an NGO's decision to transform itself into a bank is inextricably linked to its savings potential and the cost-efficacy of the model it can develop to generate savings. However, this decision has to be taken very carefully as the prudential regulations impose a high cost on the establishment of a bank by requiring a heavy equity investment and its requirement of regular audits, branch features, security arrangements, etc. In AKRSP's case, the startling fact is that the savings of AKRSPs VOs and WOs were not automatically saved with the First Micro Finance Bank as most were tied in long term government bonds and could not be liquidated. The FMB will be unable to draw upon what was -presumed to be one of its principal advantages – the savings of its clients and will have to begin the long arduous journey of raising a savings base all over again.

[21] NRSP comes closest to AKRSP in terms of the maturity of its micro finance program but the Micro Finance Group's Performance Indicators Report for 2000 does not give figures for NRSP.

46. While AKRSP has always been very mindful of an exit strategy it has not successfully been able to evolve such a strategy. Encouraged by donors, AKRSP was constantly pressed into thinking about its future institutional growth. It was felt that "an overarching principle for AKRSP to adopt was to ensure the long-term sustainability of its initiatives and to transfer some of its functions to successor institutions.[22] It was felt that one function which could be shifted was the credit and banking operations of AKRSP. However, there was not enough thought on how this could be achieved. While there had been a prolific increase in the number of V/W Organisations, the long-term growth and development of these organisations was always a question mark. Furthermore, even though there was considerable debate on the formalization of the VOs and the benefits and advantages that would accrue from registering them as formal entities, this discussion never really got off the ground. Regardless of these discussions, one of the most significant aspects that emerges from AKRSP's experience with the community based approach to micro-finance was the institutional development that took place at the village level.

47. The concept of Village Organization Banking introduced by AKRSP was a novel concept in that it established a community owned and operated system of micro-finance at the grass-roots level. Under the autonomy that was given to the VOs under this component, they determined the quantum of loan for each member and managed disbursements and recovery from individual members. The VO had the freedom to set their own service charge rates, although AKRSP recommended that 24% per annum be charged. In 1989 data from 24 VOBs in the Gilgit region indicated that there was a wide range of service charges actually levied ranging from a minimum of 8% to a maximum of 20% with an average of 14.5%.[23] The VOs demonstrated their competence to handle the entire loaning operation without reference to the regional office. This led to the expectation that somehow VOs would play a key role in the future management and ownership of the micro-finance portfolio of AKRSP. However, this operation also needed some form of regulation in view of the wide divergence in the manner in which some VOs were dealing with the disbursements of loans. Furthermore, the villagers demonstrated capacity to generate large savings had also led to the expectation that the villagers would have a stake in the institutional development and formalization of the micro-finance programme.

48. In the thinking that emerged around 1989 it was felt that there was need for the formation of a sustainable banking system as a continuation of the present credit and savings program[24] and that the VO would have some a critical role in it. The objective of which would be to maintain the sanctity of the VOs while being intrinsic to the grass-root developments of the whole region. This view was expressed within AKRSP by the Finance Manager who stated

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[22] Page 7. A Strategic Review of AKRSP's Micro Finance Programme by Khaleel Tetlay and Mutabiat Shah AKRSP. July 1991.
[23] P.46. . A Staretgic Review of AKRSP's Micro Finance Programme by Khalil Tetlay and Mutabiat Shah. July 1991.
[24] Du Marchie Sarvaas, E.C:: Creating a sustainable savings and credit facility in the Northern regions of Pakistan, 1991. p. 26.

clearly that "one of the long-term objectives of AKRSP was to establish a financial institution which should be subsequently owned, operated, managed and funded by the villagers of the Northern Areas of Pakistan on a self-supporting and self-sustaining basis."[25] While the Finance Manager admitted that a charter did not currently exist but the proposed bank was expected to take the "form of a public company with its shareholding restricted to AKRSP and its member VOs and AKRSP's share would eventually be taken up by VOs so that the ownership could eventually be transferred to these VOs." This thinking was echoed in the report prepared by a team of consultants[26] at the end of the same year and they also noted a "strong desire for a member-owned bank that would responsively finance economic activities and operate conveniently located depository facilities." The Houghton group recommended that VO members must buy ownership of the financial institution and over time, through increased ownership earn a larger voice in its management. This team recommended that a permanent and self-sustaining Investment Organization (IO) should be established as a separately incorporated institution or a separately managed window of AKRSP, primarily to serve VOs. It was recommended that this IO should be operationally distinct from the non-financial parts of AKRSP's programmes. It was felt that the VOs must put shares into the IO earning a stake in its management and VO shareholders should assume eventual management control of the IO. While this proposal established the principal of the VO being an integral part of any future organization for micro-finance development, it was fraught with misgivings due to its suggestion that all the VOs put their savings in one account from which automatic deductions should be made in case of VO defaults.

49. In 1990 it was felt that the challenge for AKRSP was to formalise its credit programme so that dependence on AKRSP was minimised, yet ensuring that the genuine credit needs of the small farmers were met.[27] The objective was to ensure "village autonomy in development finance, as the formal credit structure was unlikely to revise the rules, procedures and attitudes towards the small farmer. If the small farmers were to access credit for agricultural needs as well as for other purposes, in a sustainable manner, then they would have to use their capital to create and manage their own financial institutions.[28] This was considered to be the only way to ensure autonomy in development finance and to preserve the sovereignty of the village level participatory institutions in Northern Pakistan. There was a strong argument for a key role for the VO in the future institutional model chosen to manage the micro-finance programme. The VOB operation demonstrated a rudimentary model of how this could be achieved and the experience with internal lending demonstrated the fact that VOs were willing to undertake and manage the risk entailed in micro-finance operations. In its early discussion of the Bank, AKRSP presented it as a Village Organization Bank and the operation of village level banking was a typical example of a semi-formal financial institution. "As soon as the VOBs

[25] Javaid Hassan. Finance Manager A Proposal for AKRSP Bank. February 1989.
[26] Mary Houghton, Richard Pattern and Ronald Grwzywinski. 1989.
[27] Village Organisation Banking. A status Report as of December 1990. Shoaib Sultan Khan et al. AKRSP.
[28] Shoaib Sultan Khan, Hussain Wali Khan, Mutabiat Shah and Khalil Tetlay. Village Organisation Banking. A Status Report as of December 1990.

fell under the regulation of the State Bank and were therefore legal, they would become formal financial operators".[29]

50. While it is very clear that there was strong support for the idea of formalizing AKRSP's micro-finance portfolio it is also very clear that the initial conception of this formalization was to make the VOs an integral part of the ownership and the management of the micro-finance operations. However, when AKRSP's decision to establish a bank was finally taken it was done without any role for the VOs. It was decided that AKRSP and AKFED would be the two main stakeholders in the First Micro Finance Bank (FMB). Thus the investment in the institutional growth of the VO as a financial intermediary was not capitalized upon and the opportunity to develop a truly village based system of banking with local ownership and management giving the VOs a role in their own destiny and linking them in a sustainable way with the formal sector was lost.

51. The Micro-Finance Section was separated from the other sections of AKRSP with effect from January 2001. This move was made as a first step in anticipation of the Micro-Finance Bank and it was assessed that it would help to reconcile tensions that have existed in some regions to unduly expand the Micro Finance Program to reflect well on performance and at the same time run a program in which portfolio risk is properly managed. At the time, it was felt that while the move towards autonomy was a rational one given the proposed shift to the planned Micro-Finance Bank, it divorced the Micro Finance section from the leverage that other programme components could exercise on the credit and savings portfolio. In particular, it was felt that the advantage of securing loan repayments as an incentive for further AKRSP investments at the village level would be lost. There was also an advantage in integrating the credit activities with technical assistance from other programme components and it appears that this aspect would also be weakened.

52. The feasibility analysis of the FMB assessed that it was not possible to establish a sustainable bank, if it was restricted to the six AKRSP districts. It was decided that the bank would be a national level bank and it would expand its operations to Karachi, interior Sindh and eventually to the rest of the country. However, it was stressed that the bank would ensure that the commitment to the North would remain, and it was estimated, that the FMB would have to cross-subsidize its operations in the North. The bank would focus on savings mobilization as well as loan disbursements. In 2002 the micro finance operations were incorporated into a new micro finance bank named the First Micro-Finance Bank and it started its operations from its head office in Islamabad. It appeared more and more that the micro finance strategy of AKRSP had been taken over and was being driven by the decision to establish a bank rather than seeing the bank as a means to achieving AKRSP's original objectives. The Fourth World Bank Evaluation also cautioned that while the idea of a bank was useful, in that, it would enable AKRSP to accept deposits, provide it legal cover for its micro finance operations and provide it long-term presence, there was a danger that the need to

[29] DU Marchie Servaas, p.31

make the bank sustainable would direct the development of the micro-finance programme and could divert it from its initial mandate of serving the poor.

53. The following key lessons emerge from AKRSP's model of institutional growth and development;

- AKRSP had a clear vision about its role in rural development. While this overall vision was necessary it was not sufficient to guide the specific development of different programme components especially micro-finance.

- It is essential to develop a clear vision for micro-finance and to articulate it in a manner that helps in establishing the parameters for institutional growth, guides product identification and diversification, specifies delivery strategy and shapes the management information system.

- While there was broad agreement that micro-finance should help AKRSP's clients enhance their incomes, there were frequent changes in micro-finance policy due to lack of direction on where the micro-finance programme was headed.

- State of the art training and interaction with other practitioners are key in shaping micro-finance thinking and infusing a vision into key aspects of the programme.

- Can you Change Livelihoods through Micro-Finance ?

54. It is difficult to answer the question regarding the impact of AKRSP's micro-finance programme and the extent to which it has enabled the transformation of livelihoods because of lack of empirical evidence. AKRSP has not undertaken credit utilization and impact studies on the basis that such studies are generally donor-driven and waste resources that could be productively used elsewhere. The average size of the loan was small and insufficient to transform livelihoods but was designed to deal with vulnerability and the small productive investments in the agriculture sector. A question that can be asked is if AKRSP by focusing on loan products designed for the low productivity agriculture sector limit its own impact. An informal assessment of credit utilization showed that AKRSP loans had helped in enterprise development, in providing loans for investments in the social sectors and housing and in reducing the vulnerability of poor households by helping them meet consumption needs. Women have particularly benefited from diverting loans for consumption purposes. In 1989, an assessment was undertaken of AKRSP as a source of credit in the Northern Areas. This analysis revealed that AKRSP had the greatest outreach in terms of the number of people it had reached and in Gilgit District it had provided 50 percent of the loans. In terms of loan amounts it had provided 22 percent of the total loan in Gilgit District, 44 percent in Chitral District and 21 in Baltistan District. While overall poverty trends show that poverty in the Northern Areas has declined. It is difficult to show the link of this decline to AKRSP's activities and more specifically to the micro-finance programme.

**Table 3:Analysis of Outreach and Significance of Financial Sources for Credit**

| Loan Sources | Gilgit | | Chitral | Baltistan |
|---|---|---|---|---|
| | Loan Amount | No of Loanees | Loan Amount | Loan Amount |
| Government Agencies | 1.8 | 0.4 | 0.1 | 0.0 |
| Commercial Banks | 45.0 | 7.1 | 8.0 | 6.5 |
| Cooperatives | 0.0 | 0.3 | 1.2 | 0.1 |
| AKRSP | 21.7 | 50.6 | 43.5 | 21.4 |
| Friends | 6.2 | 6.0 | 15.4 | 43.6 |
| Village Shop Keepers | 25.3 | 35.5 | 31.8 | 28.4 |

*Source: M.H. Khan. 1989.*

55. AKRSP's micro-finance programme has particularly benefited women who have been very proactive in this regard. It was the women of Sherquilla who in June 1983 formed a Women's Organisation and invited AKRSP to help them initiate a programme even before AKRSP had any plans on how to involve women with project activities. They had saved Rs 4000 or an average of Rs 59 per member.[30] Traditionally women do not own land and own few other assets. The savings programme provided women one of the few opportunities to own something of their own. The savings programme has empowered women by giving them their own accounts and ownership of the accounts. This programme also encouraged women to pursue opportunities of productive employment in the bid to increase their savings. By the end of 2002, about 50,221 women had cumulative savings of Rs 121 million. Interviews with women's organisations and the experience of women with savings across the Northern Areas and Chitral shows clearly that women have really been empowered as a result of the savings programme and have undertaken many innovative enterprises as a result. Women have valued AKRSP's savings component more highly than the credit component and have continued with savings with or without AKRSP. The large savings of women have changed intra-household dynamics and are helping to tilt the balance in a manner which offers women greater equity in her household interactions. The credit programme has also provided women with the opportunity to access credit in large numbers. About 3,459 women had obtained credit of a total amount of Rs 215 million. However, women members had received only 15% of the total loans disbursed between 1983 and 2000. There is significant variation in the amount of loan disbursed to women by region and loan types. Women had received 20% of the total loans disbursed in the Gilgit District, 12% in the Chitral District and only 5% in the Baltistan District in 2000. These figures are likely to go down further when the loan leakages to men are accounted for as many of the loans taken by women are passed on to the men in the family. There are also indications that some of the male WO managers maybe diverting some of the group loan extended to WOs for their own use.[31] An analysis of the disbursement of different

[30] page 9. Second Quarterly Report. May to July 1983. AKRSP.
[31] This appeared to be the case in some of the villages visited by the World Bank Team as members of some of the WOs met were unaware of the loans indicated against their organizations.

types of loan products by gender shows that women received 19% of the V/WOCP loans, 22% of the group loans, 8% of the individual loans, 4% of the short-term loans, 3% of the medium term loans and none of the Corporate Credit or the Business Committee loans. This analysis shows that women tend to benefit more by loan instruments that are designed for groups as compared to individual loan products.

56. The features of AKRSP's micro-finance programme is such that it is generally assumed that it will be of interest to mainly poor households. However, there are some features of the loan and savings programme with the potential for excluding the very poor households. The Group Loans can only be availed to the extent of the savings of individual members and the Individual Loans are not generally available to the very poor households as they require investment in an existing enterprise. A major problem with AKRSP's savings model was that it did not provide easy access to savings when they were required. Poor people tend to require greater access to their savings to manage risks and have a high liquidity preference. Until 1999 individual savings withdrawals were typically managed through an informal system whereby cash on hand with the manager or savings collected at recent meetings was used to meet the occasional needs for liquidity. According to policy, larger withdrawal demands were permissible (provided that the savings have not been pledged as collateral), but in practise, withdrawals required authorisation from AKRSP's regional management which was a time consuming process.

## I. International Experience and AKRSP

57. A key aspect of the study was to compare the theory of micro finance as it was practiced by AKRSP with the theoretical knowledge and understanding of micro-finance. There was constant experimentation at AKRSP and the micro-finance programme evolved from a small savings programme that added subsidized loans to its portfolio and gradually bifurcated credit from the rest of its operations and has formalized its operations under the newly established First Micro Finance Bank. The micro-finance environment has also rapidly changed in the period under review and the current study examined the factors in the evolving micro-finance environment that shaped AKRSP's micro finance policy and procedures. An attempt has also been made to compare AKRSP's experience with other practitioners in the region and elsewhere. The idea was to identify the manner in which other programmes developed and assess whether AKRSP's micro finance programme evolved differently or in a fashion similar to other programmes in the region and internationally and compare common and dissimilar aspects and isolate factors that shape micro-finance policy.

58. The international comparison between AKRSP and the other micro finance organisations has been organised around four main themes which are (a) community- based organizations (CBO's) as a basis for micro finance; (b) savings as a starting point for micro finance and as a source of funding (c) the contribution and cost of experimentation and innovation and (d) the lifecycle of MFI's and what remains after formalization.

**Community Based Organizations(CBO's) as a Basis for Micro-Finance**[32]

AKRSP demonstrated that CBO's can be a solid basis for efficient and sustainable microfinance that reaches large numbers of rural poor. AKRSP started basically as a promoter and facilitator helping VO's and WO's provide their members with financial services by linking them with formal sector commercial organizations. It ended up as a typical provider with the creation of the First Micro-Finance Bank, reaching out directly to the clients. In such a process, the role of the CBO's in financial service provision normally declines. The future will show how this choice will affect the attention to the poor.

59. AKRSP's community based model was successful in reaching a large portion of the rural poor. In developing this model, Shoaib Sultan Khan was inspired by Raiffeisen experience with cooperatives, a century old experience in quite another context. To mobilize the potential of the villagers, he introduced a model based on the three Raiffeisen principles: formation of financial capital through savings, upgrading of human skills through training and organization of the people. However there were also clear differences with the cooperative movement. Unlike the cooperatives, the Village Organizations did not become formally established entities. The savings was not meant to be the capital base for on lending, although VOs started diverting a large part of their savings towards on-lending. Additional elements have been adapted from the village organization and cooperation models that were successfully tried in Taiwan and Korea in the post 1945 era[33]

60. In terms of CBO based micro-finance, there were few experiences in developing countries AKRSP could learn from when it first started its operations in the recent past. One should bear in mind that in the beginning of the 1980's micro finance was still a largely unexploited field. Although CBO's had been around, particularly in Asia for a long time, there were no organized and documented experiences on CBO based micro-finance when AKRSP started. Village banking on the other hand had not been developed and a franchise organization like FINCA, now a major promoter of this system, started its operations only in 1985. The financial sector associations are a phenomenon of the nineties. ASHRAI Bangladesh, now acknowledged to be an interesting example of CBO based financial service provision, initiated savings and credit activities in 1992. This was originally based on the Grameen Bank model, but it was later decided to turn to a savings and credit group based model, which was self managed[34]. Looking back at this, AKRSP practically took the only route possible: to start with the commitment and conviction that village based finance had potential and experiment with it. Part of the savings could have been used to form equity for a cooperative model (see

[32] Worldwide there is discussion about the role and efficiency of community based organizations (CBO's) in providing financial services. Different models exist, from informal Savings and Credit Associations to village banks, from the traditional cooperatives to the Financial Sector Associations, a model that emerged in Africa in the nineties. See e.g. the comparative work by Jeffrey Ashe and the Symposium on avings led Microfinance and the rural Poor.
[33] OED, World Bank: AKRSP, an interim evaluation. 1987. p.4,
[34] Srinivasan, G., Biswas, S. and Mirza Najmul, H. Ashrai and its Advasi Groups. Evaluation Report for SDC Bern, 2000. : Girija Srinivasan, Soumen Biswas and Mirza Najmul Huda.

e.g. Nepal, Latin America) or AKRSP could have promoted a more active relation between the VO's and their banks, making them into credit clients (e.g. equity Building Society in Kenya).

61. AKRSP experimenting and developing its own model and was very successful in expanding the savings and credit services to the villages. In doing that it combined the role of the promoter and facilitator with that of the provider. Early discussions at AKRSP reveal that the NGO was grappling with how it could use the VO's and WO's for the formation of a banking system (See earlier sections). In other words AKRSP was looking for the possibility to keep on combining both roles. Staff from within AKRSP as well as several consultants developed ideas for a sustainable banking system as a continuation of the credit and savings programme[35]. The idea of village organization banking was originally proposed to assist clusters of VO's to take loans for on-lending to members. This would have meant the development of a system of village banking and building upon the more or less spontaneously started internal lending. Another possibility would have been to focus on maturing the VO's (a.o. by bringing in efficient administrative systems, by guaranteeing adequate governance and by creating a federation) and linking them directly with banks (the banks that already knew them because of the savings relation), this was the model applied by NABARD in India. Both options would have required capacity building at the VO level in the field of financial services provision and the promotion of uniform guidelines. By this time, international experience had become available through FINCA and NABARD in India but was not used. Failure to access this experience limited the scope of internal lending which could have been used to guide VOs[36] at this stage.

62. A comparison of AKRSP's decision to create a bank[37] with international practice, gives a mixed analysis. On the one hand, the evolution into a supervised institution can be considered a natural progression. The EDPYME's in Peru and the FFP's in Bolivia illustrate this. On the other hand, there is a "school" in favour of the idea to base financial services on CBO's and use existing banks to provide them with credit and loan facilities[38]. The latter option can be more cost effective as the CBO's undertake a lot of the ground work, and have a much wider outreach than a formal financial institution limited by its higher cost. In the end this discussion is about how to reach the rural poor[39]. AKRSP could have compared the sustainability and outreach of both models when taking its decision on the establishment of the new Bank. The final verdict on this will be based on how an analysis of the client profile of the First Micro Finance Bank and its outreach to the poor.

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[35] Du Marchie Sarvaas, E.C:: Creating a sustainable savings and credit facility in the Northern regions of Pakistan, 1991. p. 26.

[36] Although there is no exact information on the volume of internal lending, contact with the field revealed that only in Gilgit internal lending has developed well, with Hunza taking the lead (35 of the approx. 300 V/WO´s do internal lending). In Chitral and Baltistan less than 1% of the VO/WO's do internal lending.

[37] As far as we know, the feasibility of a VO/CBO based financial services system was not studied.

[38] An interesting experience is being developed in Tanzania where the CRDB Bank establishes links with ROSCA's to use them as part of the Banks's network, offering in turn financial services to the Associations

[39] Based on the July 2003 internet discussion about Micro finance and the potential of SHG's. Contribution of J. Ashe.

**Savings as a Starting Point for Micro-Finance**

In a period where supply driven credit ruled the development world, AKRSP distinguished itself internationally by putting savings first. Applying some of the basic principles of the cooperative movement, it managed to mobilize big amounts of savings which contributed to financial soundness of the credit operations and to the empowerment of the villagers. This pioneering of savings contributed to the now universally accepted knowledge that the poor can save. And very important it set a standard for other Rural Support Programs throughout Pakistan. However internal choices and external circumstances made the model hit its limits. Unlike successful international experiences, the formal link between savings and credit was not made.

63. From a microfinance best practices point of view, the focus on savings was a very good choice. It is now widely acknowledged that poor people, as part of their effort to manage the little money they have, do want a safe place for their savings[40]. In promoting and demonstrating this, AKRSP has been one of the frontrunners in terms of putting savings at the centre of financial services provision. It was one of the first donor supported rural development programmes to include savings as an important component. Unlike in the cooperative movement, the savings never became a formal source of funding. The money was deposited at banks that did do not provide direct lending to the VO's. The savings however did generate a more or less informal system of village banking when villagers started to do internal lending. In its early years AKRSP did not provide one of the fundamental elements poor people want when they deposit their money: easy access (people save in order to get the money when they need it for emergency, for life-cycle events or when investment opportunities arise). This is one of the factors that influenced savings pattern at AKRSP along with the returns on savings (See Box). Internationally it is increasingly being recognized that this access is fundamental for the steady promotion of savings. International experience shows that successful savings and credit institutions like the Cajas Municipales in Peru and the Equity Building Society in Kenya offer flexible savings products, with few limits in terms of minimum amounts and withdrawal. These and other non bank institutions also offer a somewhat better interest rate than the banks. They heavily promote an image of trust to compensate for the traditional distrust people have in non bank financial institutions. AKRSP did not gain from higher savings as it did not need the money for its loans as these were externally financed. AKRSP has made no special effort to keep on attracting savings. Little or no innovation took place in AKRSP's savings model in the last twenty years and after the creation of the First Micro-Finance Bank, the link between savings and credit is lost. In fact, the Micro Finance Bank cannot use the savings of the AKRSP clients as most of these are deposited in long-term bonds with the government.

**Box 3: Growth in Savings**

[40] Rutherford, S." The poor and their money, 2000.. See also the research and insights contributed by MicroSave.

During the first years of the Programme, average savings per member doubled every 2 years. Saving money was attractive because it yielded 18%. At the end of the eighties, growth rhythm slowed down, a trend that continued in the nineties. Between 1994 and 1998, average savings per member increased by 50% in Rupee terms. The highest amount in real terms was reached in 1995/1996 with VO members having an average of US$ 85 in savings and WO members an average of US$ 52. Between 1998 and 2002 growth practically came to a halt[41]. In real terms (US $) average savings per member have decreased and in 2001 stood at the level of the beginning of the nineties.

**The Contribution and Cost of Experimentation and Innovation.**

The willingness to learn and the availability of donor money have allowed AKRSP's micro finance program to grow steadily and to survive crisis and mistakes. The lesson learned is that offering the right financial services to the poor requires knowledge of the clients and their needs and that innovation is needed to keep up with the changing preferences and circumstances. Donor money can be fundamental to finance innovations and experiments.

64. One of AKRSP´s principles has been "learning by doing" and donor funding has effectively made it possible to apply this principle to all components of the programme, including micro finance. However it should be noted that this experimentation has not been a planned one. Planned experimentation would for example mean starting group lending with two methodologies and comparing their effectiveness against a predefined set of parameters. Or start with a low interest rate service charge to find out whether it allows the combination of widening the client base with a sustainable operation at institutional level. Consequences of certain choices were not estimated or calculated beforehand. Until 1996 there was not a single projection of loan portfolio. Nor was there a calculation of financial indicators or basic costs of delivering the savings and credit component. The experimental nature of the approach lies more in the fact that the programme tried out different approaches and was quite flexible in changing or bringing in new elements. The same holds true for the reaction when things went wrong. There are indications that the culture of experimentation also allowed for bringing in more financial logic into the savings and credit component from 1990 onwards. The component was not so tightly structured that change became impossible. However there was resistance to certain changes. A typical case is the introduction of interest rates and the subsequent increases. AKRSP continued to charge below market rates until the mid nineties, apparently unaware of the rapidly shifting views on rural credit and its cost. The negative effects of cheap credit had already been widely documented and in 1984 Adams, Graham and von Pischke had published their book "Undermining rural development with cheap

[41] In real terms (US $) average savings per member have decreased and in 2001 stood at the level of the beginning of the nineties (based on AKRSP statistics).

credit"[42] which changed the paradigm. It took years for these views to penetrate into AKRSP and when they were promoted, the field staff questioned these changes[43]. There was also opposition at the Board level.

65. While donor backing allowed for experimentation and learning from mistakes, they brought in no clear view on the need for sustainability or non donor dependent funding. It was contact with the best practices in micro finance that brought about a change in the orientation and thinking about micro-credit by inspiring those managing the credit programme in AKRSP. In 1995 two high level staff of AKRSP participated in the micro finance course in Boulder in Colorado. They brought back home the paradigm of sustainable micro finance. From 1995 onwards, sustainability, real interest rates, separation of financial and non financial services and specialization of staff became real issues. It was at a time that internationally it was already being acknowledged that a sustainability perspective was fundamental. From the beginning of the nineties onwards, it became clear that sustainability and outreach were not contradictory and that "Micro-finance institutions can and indeed need to be self-sustaining if they are to achieve their outreach potential by providing access to financial services to the poor."[44]

**The Lifecycle of MFI's and the Influence of the Drive to Sustainability and Formalization.**

Although the lifecycle with many MFI's worldwide show comparable patters, each institution walks a distinctive road to becoming a sustainable provider of financial services. With 20 years in micro finance, AKRSP is one of the oldest players on the Asian micro finance scene. Although the perspective to become a supervised financial institution has been present almost from the beginning, the road to becoming a bank has been long. As most MFI's embarking upon the road to commercialization, it has not thoroughly assessed the possibilities of mission drift and has no clear strategy to assure the continued provision of financial services to the original client group.

66. Micro finance institutions are very diverse, so is their life cycle. Many MFI's have been born out of NGO's or development programs. They start as socially oriented initiatives, often with several components including social and economic sectors and later specialize in financial service provision. This process is being repeated all over the world and its duration can be anywhere from 3 to 20 years. Some MFI's start as specialized and regulated institutions, a typical example being the Grameen Bank or the specialized micro finance banks set up in the Balkans in the past 5 years. Others make it to maturity and become regulated institutions after

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[42] Adam, D, Graham, D. and von Pische, J.D.: Undermining rural development with cheap credit. Boulder, 1984.
[43] Interview with Stephen Rasmussen, former CEO of AKRSP.
[44] CGAP Focus Note, Maximizing the Outreach of Micro enterprise Finance: The Emerging Lessons of Successful Programs, October 1995

having evolved from a development program or a multi purpose NGO. FINCA International[45] presents a model with three growth stages that applies to the evolution of its own affiliates and is also representative for the Life-cycle of many MFI's[46]. International experience shows that, as MFI's move through this lifecycle, the principles of sustainability and efficiency get applied in a stricter way. In practice this means cost-based pricing, stricter screening of clients with more weight given to the ability to pay back and other measures that might contribute to cost-efficiency such as concentration of branches in areas with a critical mass of clients. This drive towards commercialization sometimes misunderstood as the dominance of commercial/profitability goals over development goals can cause mission drift.

**Box:4 The Three Stages of MFIs**

- During the Start-up phase, the MFI can have different "shapes" and institutional characteristics. Quite often micro finance is not dominant at this phase or is being run in a basic way, with little focus on sustainability. NGO's adopt micro finance because it is a tool to provide the target group with financial means which in turn is expected to reduce poverty. Or a donor funded rural development program includes it because the identification has stressed the importance of providing small farmers with loans because they don't have access to banks. The loan product is normally a simple and standard one. Financing is provided by donors. For AKRSP this phase was very long and lasted from 1983 till 1994/5. During this period, AKRSP made no pretension about being a sustainable financial services programme. Industry wide this phase normally takes from 3 to 8 years. A typical indicator of the shift towards the next phase is the separation of AKRSP into three divisions (1994): Development, Micro-finance and Enterprise Support. This organizational change had far reaching consequences for the micro finance component. It laid the basis for separate accounting and allowed the development of an orientation towards sustainability. It also allowed the management to select people with a mindset suitable for micro finance.

- During the Expansion or Self-sufficiency phase, the micro finance activities become an activity in its own, with sustainability becoming a goal. The poverty alleviation or social objective is still present but board and management know that in order to provide the clients with a sustainable service, the institution has to be run on commercial grounds. Expansion takes place, with an expansion of the branch network and an increasing diversification of the loan products. Financing is still provided by donors, but grants are complemented by funds from subsidised sources and special credit windows. For AKRSP this phase ran from 1996 to 2001. That is in line with the industry standards.

[45] FINCA International (based in the USA) has promoted a village banking model throughout Latin America, Africa, Eastern Europe and Central Asia. Actually it counts with more than 40 affiliates with a client base of *
[46] FINCA International. Paper presented by Lawrence Yanovitch at the Almaty Micro Finance Conference in April 2003.

- During the Transformation phase the institution becomes regulated and enters the formalized and supervised financial sector. As it can attract savings, it can start to diversify its funding, thus reducing the dependency on donors and institutional fund providers. The MFI pays special attention to the market and focuses on client needs, which often results in the development of individualized loan and savings products. For AKRSP this phase had its origin in the eighties (the first discussions about becoming a bank) but formally started in 2002 with the creation of the First Micro-Finance Bank.

67. In Latin America the drive towards regulation has been spurred by the search for funding. In countries like Bolivia and Peru the leading MFI's lobbied successfully for a special license that would allow them to obtain access to savings and to central bank funds. In East Africa (Uganda, Kenya) several NGO's transformed into regulated institutions or are in the process of doing that. These processes are often characterized by discussions between management, field staff and board members (including donors) on the trade off between regulation/commercialization and continued service provision to the original target group[47]. AKRSP was no exception to that standard but managed to come to a clear cut decision: all the micro finance activity was brought into the FMB. In Bolivia the NGO's who constituted one of the first Fondos Financieros Privados (FFP), had a 2 year long discussion about bringing their loan portfolio into the newly established institution. This kept the portfolio growth of FFP well below its target and finally resulted in the owners selling the portfolio to another FFP.

68. In the case of AKRSP, the last World Bank report mentions that "there are significant risks for poverty outcome in the shift toward the Microfinance Section autonomy, and finally the microfinance bank.[48]" In the case of AKRSP this risk has already materialized in the past years as client selection became stricter. Loan approvals decreased as loan conditions and screening became stricter[49]. Although there is awareness that the shift away from the poorer clients is a risk, no serious study has been undertaken to estimate this risk or to take actions to control it. A reference is the work done by Robert Peck Christen on Latin America[50].

[47] FACET BV has carried out several assignments for MFI's in different moments of their transformation. This experience shows that the management and the headquarter staff normally are the stoutest defenders of the transformation. This can partly be explained by the fact that they are responsible for the funding and see the limitations of future access to donor money. Initiatives to increase interest rates and to rationalize on client attention also often come from this level because they directly relate to the performance indicators that have to be "shown" to the board and to the outside world (As stated by one of FACET's clients: "As we all publish our performance indicators, I can not allow our MFI to perform below the industries benchmark here"). Field staff on the other hand often shows a "protective"attitude towards the clients. Sometimes this reflects fear to loose clients or reluctance to become the carrier of bad news (higher interest rates).

[48] World Bank, OED: The Next Ascent, p. 105.

[49] Interview with Salim Jiwani, COO of the First MicroFinance Bank, until 2001 responsible for AKRSP's savings and credit program

[50] Christen, Robert P.: Commercialization and Mission Drift. The transformation of micro finance in Latin America. CGAP, 2002.

**ANNEX 1**

**Brief History of the Co-operative Movement in England and Europe**

1. In England the first attempts to organise were made by workers in the factory system where the workers realised the need to organise to improve their working conditions and their economic situation. It was the result of this thinking that as early as 1760 workers organised their own two corn mills in Chatham and Woolwick. This was at a time when the UK government discouraged workers from uniting. The Combination Act of 1824 allowed workers to combine together only to improve wages and for nothing else. In 1834 a group of farmers in Dorset organised a union and were tried for administrating illegal oaths. They had adopted their oath directly from the one based by the Rochdale Weavers to organise their union. The farm workers were found guilty and transported to Australia and became known as "Talpuddle Martyrs". Their case and the severe sentences served on them dampened the spirit of farmers and workers and discouraged them from organising themselves openly for many years. It was only in 1868 that trade union congress dared to have its first national meeting.

2. Cooperatives had been in existence in Britain as far back as 1769 when the Fenwick Weavers' Association was formed. However, the first documented cooperative institution was founded in 1844 in Rochdale, England. The success of cooperatives in Rochdale was due to many factors including, the volatile economic and social climate at the time of the emergence of the Rochdale cooperative. This volatility was caused by the Industrial Revolution. Prior to the industrial revolution, Rochdale had been a center for the manufacture of flannel using the handloom. The industrial revolution resulted in increased competition as the power loom came into existence, producing more flannel in a faster time scale. In addition, increases in American tariff policies resulted in lost markets. These two events caused the decline of the local flannel industry. The result of this caused the people of the area to suffer from periodic unemployment, low pay and dangerous workplaces. There were no social benefits such as insurance, healthcare or pensions. The common people were dependent on merchants for goods and work. Many of these were unscrupulous, exploiting the helplessness of the poor by selling at high prices, adulterating goods, or trapping the workers with credit agreements.[51] At this time, the government was not democratically elected and therefore the people had no voice to protect themselves. Their answer to these social problems was to form a kind of mutual self-help through co-operative endeavour. .

3. Some of the factors which explain why Rochdale in particular, was successful in its co-operative movement include the following; first, the town was well known as a center for cooperative idealism and radical politics. It had a history of strong support for movements, whose ideals supported raising social standards and rights for the ordinary people. These movements included the trade-union movement (violent strikes were recorded in Rochdale in 1808 and in 1829), Chartism (campaign to obtain the vote for ordinary people) and the Factory

[51] Fairbairn,1994.

Act movement for regulation of industry and the protection of employees. In addition, Rochdale had strong links with the Owenite movement. This movement was named after Robert Owen, an industrialist who supported the ideal of socialism, trade unionism, social reform and cooperation. To achieve social reform Owen believed that economic and educational improvement was essential for improving social standards.

**Box: The Objectives of the Rochdale Co-operative**

From the outset the overriding concept underlying the purpose of the Rochdale cooperative was that of self-help. The cooperative existed for the benefit of its members and the improvement of their social and household condition. The cooperative was multi-purpose and the founders prepared objects to guide how the cooperative should be developed. Firstly, a store would be opened (Toad Lane, 1844), then housing would be undertaken, next cooperative production would provide employment to the members, from this a utopian cooperative community would evolve. Finally, a temperance hostel would be founded to improve moral standards. To achieve the objects, monies were required. To obtain cash, members could subscribe for shares, which could be paid for by small weekly amounts. These shares formed the capital of the cooperative. This capital was used to purchase goods at low cost and to sell them to its members at retail price. Any surplus made was to be distributed to the members according to their use of the store after paying the capital providers a small fixed sum, retaining some for the development of the society, retaining 2.5% for the education of the members (introduced in the 1854 changes). Education was of vital importance to the founders of the society. By 1850 the society had a library and unlike most modern cooperatives promoted all forms of education. One professor from Cambridge was invited to give a lecture on astronomy!

4. While the UK movement was largely the product of industrial workers, similar attempts were made in other parts of Europe. In France, Francis Buchez promoted co-operative associations for cabinet-makers and goldsmiths between 1832 and 1834. During the same period Hermann Schulze and Friedrich Wilhelm Raiffeisen (1818-1888) promoted credit co-operatives in Germany. Although Raiffeisen adopted Schulze Delitzsch's principles of self-help there were fundamental differences between these two types of societies. Raiffeisen insisted on brotherly love and Christian principles for motivating the credit unions, while Schulze was mainly concerned with promoting economic self-sufficiency. Moreover, Schulze concentrated on urban workers and shopkeepers, while Raiffeisen devoted himself to helping farmers. Schulze also believed that membership should come from a large and economically varied area, but Raiffeisen preferred to restrict membership to small district, preferably a parish. The Raiffeisen Co-operative Societies enjoyed much larger growth than the Schulze. The Rochdale movement of UK and Raiffeisen of Germany particularly influenced the Asian cooperative movement.

## ANNEX 2

**Key Principles of Co-operatives**

**International Co-operative Alliance 1937:**
**Seven Principles Defining Cooperatives**

The International Cooperative Alliance (ICA) formed in 1895 with delegates from many countries including UK, Germany, Russia, Holland, Hungary and Serbia, etc. The aim of the list of principles was to provide a benchmark against which entities could be compared, to establish whether they were genuine cooperatives or not. In 1961 these principles were revamped. However, the modified list included most of the principles formulated in 1937. The main change was that the emphasis placed on the promotion of education and the cash trading principle was dropped. An additional principle called 'Cooperation among cooperatives' was inserted.

1. Open membership;
2. One man one vote;
3. Distribution of refunds on a patronage basis;
4. Limited interest payments for the use of capital;
5. Political and religious neutrality;
6. Cash trading
7. Promotion of education

# 8. ANNEX 3

## NABARD, India

Different forms of the Relation between the Self-Group and the Bank

More than 300 banks participate in the Program. As for the relation between the banks and the SHG's, NABARD applies three models:

- bank lends through an NGO to SHGs (9%)
- bank forms SHGs and lends to them directly (16%)
- NGO facilitates and SHG borrows directly from the bank (75%)

SHG loan normally on basis of 1:1 to the savings and gradually increase to 1:4

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