

**MICRO FINANCE AND INFORMAL SECTOR DEVELOPMENT FOR  
POVERTY ALLEVIATION<sup>1</sup>**

**By**

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**and**

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<sup>1</sup> A study presented as a chapter contribution to the Poverty Reduction Strategy Paper for Sierra Leone

## **VISION**

“ To develop and integrate micro-finance into the broader financial system and facilitate the effective provision of sustainable micro-finance services in order to enhance the productive capacities of low income Sierra Leoneans as a means of reducing poverty and achieving economic growth”.<sup>1</sup>

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<sup>1</sup> National Micro-Finance Policy, Government of Sierra Leone, October 2003, pp10.

## Introduction

Sierra Leone is a rural economy with over 75% of the people residing in the rural areas, dependent on subsistence agriculture and micro enterprises/household enterprises<sup>2</sup>. This indicates that majority of the rural people are micro entrepreneurs, or smallholder farmers or both. It is now acknowledged that these people lack access to basic education and health facilities, operate small parcels of land, have high dependency ratios and have low per capita income. They also lack market opportunities, thread deplorable roads, lack communication and efficient source of energy. To crown it all, they lack access to financial services beyond those offered by family, Relatives, friends, usurious moneylenders and diverse traditional financial intermediaries such as the Rotating Savings and Credit Associations (ROSCAs) locally known as *osusu*, thrift and credit societies and other informal savings and credit schemes. Empirical reports indicate that these poor households/small-scale entrepreneurs/small holder farmers are creditworthy, can save<sup>3</sup>, and repay loans as the myriad of *osusu* groups, arrangements between friends and relatives, SAPA and "barray"<sup>4</sup> repayment records and other networks have shown.

However, moves to create the necessary avenues for the provision of credit to these households/farmers/entrepreneurs proved elusive. Furthermore, the informal credit they have at their disposal is expensive,

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<sup>2</sup> These enterprises are units of auto consumption and production-435,000 households operate solely for consumption & 287,000 for sale or service; 654,000 for own consumption and sale/service-Report on Demographic and Social Monitoring Survey (1992) - Central Statistics Office, now Statistics Sierra Leone

<sup>3</sup> Conteh, B.K., 1995, *Institutions in Rural Development: The case of Rural Banks in Sierra Leone*, Unpublished Ph.D. Thesis, University of Leeds, U.K. pp. 218.

<sup>4</sup> As at September 2003 SAPA had a repayment rate of 90%. A *barray* is a place in communities where people regularly meet to discuss issues and or find solutions to disputes between individuals or communities. Thus, group lending takes place in such fora, hence the name.

inadequate and short-term, though this form of credit overrides the bureaucratic steps involved in formal loan applications to commercial banks and has desirable social implications.

Another factor that affects the rural and banking operations of the commercial banks is their investment policies. Considering the level of monetisation in the overall economy, the commercial banking sector itself is liquid considering that their total deposits nearly doubles investments in treasury bills and other short-term investment instruments. Commercial banks argue that the supply of creditworthy borrowers that can be serviced at affordable transaction costs is limited. This conservative approach to lending is reinforced by the high interest rates they earned on Treasury Bills. With banks able to earn high returns on as “risk free” investment, there is little incentive for them to lend to perceived riskier clients based on the prime rate that has fluctuated around 20 percent per annum. The scenario characterized by sectoral instability and risk aversion, suggests that the reluctance by the commercial banking system to lend to the rural sector is not based on the shortage of funds. It is rather on the perception that lending to the poor and for rural development purposes carries a higher level of risks and costs than they are willing to tolerate.

A number of attempts by the government of Sierra Leone to encourage commercial banks to service the other segments of the population, including schemes under the Development of Industries Ordinance and other measures instituted by the central bank, such as Credit Guarantee Scheme etc., have had mixed results.

The specialized development finance institutions that were created to

provide easier access to financial services for rural entrepreneurs and the rural population in general functioned below expectations, and are unable to provide the cost-effective services demanded by the target groups. Other institutions have emerged, among them the Community or Rural banks and the NaCSA micro finance window .

Attempts by GOSL to encourage commercial banks through the Credit Guarantee Scheme in 1974 to extend credit to the Agricultural sector (including smallholder farmers) did not yield the desired results. What had emerged over time is that Government and various groups (NGOs, Descendants groups, Religious organisations) had resorted to the provision of small amounts of loans to various groups of organisations, various communities with no attempt at creating the basis for sustainability of these schemes.

It should be stressed here that Micro-finance is more than the provision of credit. It involves the provision of other financial services (most usually savings and in some cases insurance) and recognizing that even the poor have a variety of needs, not just credit. Securing sustainable access to micro-finances for low-income communities involves building (or reforming) micro-finance institutions, not just the delivery of time-bound micro-finance programs (such as offering short-term revolving funds). Effective and gender friendly micro finance programmes that target the poor is the only route in the provision of financial services for poverty reduction.

### **OVERVIEW OF THE SECTOR**

There are numerous groups of providers of micro-finance services in Sierra Leone. Private traders, Cooperatives and various NGOs, like Association for Rural Development (ARD- by April 2003 had 1500 clients and three

branches), American Refugee Committee (ARC- by April 2003 had a branch network of five branches and 2,440 clients), Christian Children's Fund (CCF), Sierra Leone Indigenous Business Association (SLIBA), World Hope International (has 4,337 active clients, with 2,987 in Freetown and 1,350 in Makeni), Promoting Initiatives for Micro Enterprise Development (PRIMED - May 2003, 657 clients<sup>5</sup>), among others provide credit/grant of some sort directed at improving the health and wealth of smallholder producers, traders and women. Most of these are limited in outreach and have small loanable funds and staff to properly target the vulnerable.

The National Commission for Social Action (NaCSA) operates a micro credit programme (Social Action and Poverty Alleviation (SAPA) programme) targeting the rural communities, groups of women and various Community Based Organisations. This is the largest micro-finance programme funded by the African Development Bank (ADB) and the Government. The NGO programme was the original SAPA micro-finance programme initiated in 1998. The model utilised NGOs to disburse loans along strict guidelines. SAPA works with 41 NGOs who in turn work with 114 Community Based Organisations. The programme as at March 2004 maintains an active clientele of about 6,500 (through the NGOs) and a recovery rate of 90%, with the rate for women within (92%-95%). The programme is operated only through local NGOs who have limited financial capacity<sup>6</sup>.

In further response to the limited outreach of previous micro-finance attempts by the government the Chiefdom programme was developed in 2001. This lending model utilises community based " Chiefdom Micro-credit Committees (CMCs) comprising the Paramount Chief,

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<sup>5</sup> Peter Kool and John Tucker (June, 2003); *Micro Finance Sector Development: An Assessment*.

<sup>6</sup> National Micro Finance Policy, Government of Sierra Leone, October 2003

Chief, Youth, Elderly and women representatives. Each of the 149 chiefdoms in this country has a committee and each has received a micro-credit under this programme. This programme has an outreach of about 100,000 clients comprising 75%-80% women. All other schemes have about 5,000 clients, 90% women with a repayment rate of about 90%. It would be worthwhile for this programme micro-credit to small scale women entrepreneurship.

Commercial Banks shy away from providing credit to smallholder farmers/micro entrepreneurs/household enterprises, for diverse reasons, especially when they can only provide few financial services. The social settings in Sierra Leone hardly benefits prototype British banking practices and it is this bit that had not been incorporated in the operations of the commercial banks that has limited their own very activities within this economy.

The National Development Bank (NDB) and the National Cooperative Development Bank (NCDB) are two development banks currently engaged in micro-finance as their main activity with a limited coverage. NDB operates in Freetown and NCDB operates mobile units in Waterloo, Tombo and Komzige, 650 savings accounts, 1200 current accounts and 600 outstanding loans. The re-emergence of Rural Banks, re-opening of Post Office Savings Banks and the two pilot Community Banks are options to provide financial services to a broad spectrum of the poor in this country. The NDB envisages becoming active in wholesale finance to MFIs. It has been approved that NCDB, the cooperative bank, be transformed into a privately owned company specialising in Micro finance. Informal sources of finance have continued to complement these formal efforts and there is still no discernible reduction in the severity and pervasiveness of poverty in Sierra Leone.

The National Micro-Finance Policy clearly states that at present," there are several providers of micro-credit/finance with each agency implementing its own scheme. There are no guidelines in terms of policies or even regulatory or coordinating framework. This situation has the tendency of undermining good initiatives in the sector". The policy further highlights a major gap in the efforts at micro-finance as not been sustainable given the interest rates charged since it almost inhibits covering costs and risks of providing micro-finance services to a large number of people. Apart from the traditional problems of high loan default, high transactions costs, and others, there are numerous others, which we highlight below.

#### **Constraints in Micro finance Development in Sierra Leone**

The contraction of the banking network and even the provincial bank branches is a major constraint in Sierra Leone's banking system. The fact that the banks have limited services and outreach creates a serious gap in the banking system. When the Post Office savings bank and Cooperative Banks, which mobilized deposits from low-income groups, became moribund, this created a void in the rural financial system.

Presently, the six Commercial banks are geared mainly to cater for large-scale, and or international businesses. It is highly unlikely that these banks would engage in micro or rural finance in the future. Almost 80 percent of the population has no access to formal financial institutions and the only form of financial services they have access to, is limited to credit.

Inadequacy of rural infrastructure hinders access to markets and to technology. The road network is in a state of disrepair, power, water

supply, and communications are grossly inadequate, even in the urban areas, and absent in the rural areas. All these factors tend to increase the costs of doing business high or result in low-quality, uncompetitive products. They also reduce potentials for expansion and for attaining rapid rural economic recovery.

There are currently 14 local NGOs and about 59 international NGOs that are registered with SLANGO. Most of these NGOs provide social services, capacity building support and, on a very limited scale, financial services. Most of the international NGOs focus on the health and education sectors. Local NGOs virtually flourished overnight with many having little capacity to deliver any form of services. The use of NGOs for micro credit schemes may be desirable as a stopgap emergency measure.

However, experience elsewhere has consistently shown that NGOs are usually grant-driven, project-oriented, and unsustainable beyond the life of the projects that support them. Likewise, heavy reliance on donor-grants encourages a "social lending" syndrome (e.g., providing subsidized loans), discourages savings mobilization, or hinders the formation of desired values of thrift, self-reliance, and responsible borrowing among the target clientele. An attendant problem has been migration of the youth and able-bodied individuals from the rural to the urban areas, in search of 'the good life'.

In addition, there has also been a substantial out-migration of most of the educated and the entrepreneurial gentry. Consequently, there is a dearth of skilled or trained staff to run micro finance entities or cooperatives. Thus, the building up of skills, confidence, and institutional capacity to operate MFIs would be a slow and tedious process. A study,

*"Micro Finance Sector Development in Sierra Leone; An Assessment"* clearly states, " Absence of leaders that demonstrate that micro finance is commercially viable". The emergence of this class of participants in the sector will provide the required role models in micro finance. There is also strong political and social pressure to deliver credit, which is often seen as a panacea to hasten economic recovery. This and the lack of expertise is a potent mix that could result to pushing hastily designed grant or budget-funded credit schemes using ill-prepared credit conduits to deliver loans to an equally unprepared clientele. This in turn would repeat lessons learned elsewhere from cyclical, sporadic, and unsustainable credit schemes that consistently fail and eventually deprive the poor access to more permanent and sustainable financial services, while developing a dependency mode or "dole-out" mentality among them.

The existing Bank Licensing and Supervision Regulation is patterned after traditional banking laws designed mainly for regular commercial banking. It appears restrictive to the micro finance sector given the high minimum capital requirement (put in figure) to establish a bank, as well as other operational restrictions to financial services allowable.

Another factor that hindered the growth of the micro finance sector was the absence of an enabling legislation for Micro Finance Institutions (MFIs) such as ROSCAs, Thrift and Credit unions etc., necessary to rationalize and consolidate in one code, all the rules applicable and/or peculiar to them. Since a coordinated and institutionalized Micro Finance is in its embryonic stage, the policy guidelines provided are useful considerations for the development and sustainability of the financial services.

The above notwithstanding, regulatory guidelines<sup>7</sup> (Tools of Implementation), though not limited, could include-:

- mandatory registration of all units within the Micro Finance industry, as in the case of other corporate bodies, with the appropriate Agency. Registration procedures should be simple. This will break the aspect of informality.
- Deposit accepting, and, or savings mobilizing units must be licensed and subjected to prudential regulation and supervision for “best practices”<sup>8</sup>. However, minimum capital requirements would be less stringent relative to existing financial institutions such as banks and finance companies.
- Cooperative Banks and Credit unions will be licensed and supervised by the BSL.
- Traditional Savings schemes, such as “Osusu” (ROSCAs) will be excluded from prudential regulation and supervision, but would be encouraged to link up with reputable MFIs.
- No limits will be set on unsecured lending by deposit taking MFIs.
- For a start there will be no limitation on foreign ownership and maximum shareholding will be flexible.
- Deposit and lending interest rates will be determined by the cost structure and prevailing market conditions for the MFIs.
- Appropriate capital adequacy ratio should be set by the BSL based on its assessment of the particular MFI.

### **BASIS FOR PUBLIC INTERVENTIONS (The National Micro-finance**

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<sup>7</sup> National Micro finance Policy, pp 18-20.

<sup>8</sup> Lessons learnt from what works and does not work in micro finance provides the basis for coordinated action and an awareness of the pitfalls of some practices, while taking into consideration local realities.

## **Policy)**

A well functioning financial sector is indispensable to economic growth and development, and thereby the reduction of poverty. The ability of the financial sector in Sierra Leone to serve as an effective, low cost intermediary between savers and lenders has been compromised by problems that threaten its viability, soundness and stability. Some of these problems are beyond the control of the financial system while others can be reasonably managed. The first category of problems relates to policies that fall within the realm of central government. It is in this regard that we applaud the recent national micro finance policy, which aims at creating a conducive environment for micro finance institutions.

While Government's role in this sector will be transient, as required by the National policy, it behooves her to provide the fertile grounds for the emergence of MFIs with the capacity to improve the well-being of the rural and urban poor, the self-employed, smallholder farmers, youth, women and entrepreneurs. This role will include support to the private sector, with special emphasis on indigenes, local NGOs and their Implementing Partners (IPs) and to develop physical and social infrastructure that will facilitate the provision of financial services to a larger proportion of the poor population in every communal setting in this country.

Another intervention will be the role of the Ministry of Finance (MOF) and the Ministry of Development and Economic Planning (MODEP), in collaboration with the Bank of Sierra Leone (BSL) in ensuring the establishment of feasible mechanisms for monitoring the activities of

MFI's. They will be charged with ensuring that the beneficiary institutions conform to acceptable standards and to mobilise resources for developing the sector. The National Micro-Finance Policy emphasises that " the BSL will superintend the operations of licensed MFI's and to track and coordinate all resources for micro-finance".

Government will also intervene through NaCSA, SAPA (NaCSA's micro-credit window) by providing support in capacity building of local NGOs and IPs, coordination and information exchange with CBOs, local and international NGOs. Government is also required to provide incentives to Commercial, Development and Rural banks, now Community Banks to extend financial services to micro enterprises, household enterprises and the self-employed in the urban areas.

Government also considers it necessary to develop a policy framework that will encourage and support the development of a wide range of sustainable and viable micro-financial intermediaries such as Community/Village banks, Non Bank Financial Institutions (NBFIs), savings schemes, informal and formal credit and savings associations to serve low income and small and medium scale enterprises in the rural and urban areas.

One area of intervention by Government to ensure success in the micro-finance sphere is in the coordination of donor efforts to develop and make the sector self-sustaining. Government should ensure that proposed programmes approved by donors are followed to the letter and conform to general standards and laid down operational guidelines. Government should also ensure that they have accurate data and information on the operational funds made available to international and local NGOs.

While Government will not be involved in the administration of standards, it will support initiatives by MFIs and other private sector operators to establish Credit Bureaus and Rating Agencies.

Where all of the above are attained then “the Government will disengage from any direct involvement in the provision of micro-credit”. The disengagement of government will be a move to allow the private sector to take the lead in the provision of micro finance.

### **The Operations of the Informal Sector and Poverty Alleviation.**

There is a worldwide consensus that formal financial markets (FFM) have not met and or are not meeting the needs of small farmers/rural residents. On the other hand informal financial markets (IFM) continue to operate successfully in many rural areas, providing rural residents with vital resources and services. Such resources and services include loans (often non-collateralised), inputs (on loan), output marketing outlets and many other social services which formal sources are incapable of handling.

Quite a lot has been written about the informal sector. What has been in short supply in these analyses are policy recommendations on how this sector could be harnessed for economic growth. It is envisaged that this paper would provide some insight into the kinds of policy issues that will be utilised to engage the informal sector for higher contribution to economic growth.

The informal sector has been regarded as “unorganised” with little access to capital, low production and low capital utilisation. These inaccurate speculations have often led policy makers to believe that the

sector has little or no effect on issues such as fiscal, monetary and other economic policies.

We posit that this sector has been providing significant contributions to the economy and has tremendous potential for greater contributions to economic growth. What is needed is a deliberate policy that will not only recognise the sector's role, but to make sure that it is linked with the formal sector so that both can provide the impetus for accelerated economic growth.

According to Professor C. Magbailay Fyle<sup>9</sup>, the informal sector does not only serve the poor and low-income group of the population. It is patronised by all sectors of society. The ILO/JASPA advisory employment mission report, 1990, described the activities in the informal sector as ranging from petty trading, to carpentry, blacksmiths, tailoring gara-tie dyeing, soap making, market women, palm wine tapers small scale construction, manufacture of basic tools and capital goods such as axes, hoes, local cement block making machines, and other skill-intensive activities such as watch repairs, motor, radio, television repairs and many more. This array of activities suggests that informal activities involve all sectors of the economy. Another characteristic of the informal sector is that it is unregistered and unregulated with little or no formal accounting practices. The production process is mostly labour-intensive, low capital based and with relatives, friends and apprentice as the major employees whose salaries/wages are determined outside the realm of organised labour standards. Another striking feature of this

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<sup>9</sup> C. Magbailay Fyle(1988); *History and Socioeconomic Development in Sierra Leone*; A SLADEA Publication, pp 149-179

sector is the wide variety of links between lenders, borrowers and savers sometimes in simple and non-commercial credit arrangements.

The major types of savings/credit arrangements border on the self-help and the ROSCAs. While the self-help type relies on the voluntary mobilisation of savings to provide capital for loans, the ROSCA is a group (a loose association) of individuals who come together and to pool their savings in agreed amounts and at a pre-determined interval. The resources so pooled are handed over to one member of the group. The process is repeated until the entire membership has received the contributions (the *pot*)<sup>10</sup>. Membership can range from as low as four to as high as twenty and individual contributions can range from Le2,000 to Le 1.0 million. Some of these groups now have links with the formal financial institutions through the *Master Susu*<sup>11</sup>.

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<sup>10</sup> The pot is the total collection of members' contributions less the amount deducted by the Master osusu

<sup>11</sup> The Master osusu is the man or woman who acts as the Chairperson of the group. He/she collects individual contributions for onward transmission to the member whose turn it is to collect the *pot*.

Braima (1994)<sup>12</sup> has amply demonstrated the resource mobilisation capacity of this sector (see Table 1 below).

**Table 1. Balances for Disbursement by two ROSCAs Operating a ten-month cycle**

1. Oct. 1993 – July, 1994		2. Jan. 1994 – Oct. 1994	
Month	Amnt. (Le)	Month	Amnt. (Le)
Oct.	179500	Jan.	267200
Nov.	368375	Feb.	587840
Dec	604468.75	Mar.	972440
Jan.	896968.75	Apr.	143480
Feb.	1260968.75	May	1978080
Mar.	1710468.75	June	2623560
Apr.	2279468.75	July	3386420
May	22954218.75	Aug.	4276800
June	3599218.75	Sept.	5848000
July	3765718.75	Oct.	7156660

Source: Braima, 1994

In Group 1, 36 members were involved contributing Le 4000 per member per month. An interest rate of 25 percent is charged if a member borrows from the *pot*. In Group 2, 56 members are involved (including 8 women) contributing Le 4000 per member per month and 20 percent is charged should a member decide to borrow from the *pot*. It must be emphasised that only members are allowed to borrow from the *pot*. This is a precautionary measure to ensure that members' contributions are protected and only members known to the group can benefit from the resources of the group. The table reveals that a large quantum of cash

<sup>12</sup> S. Braima (1994); *Myths and Realities of the Informal Sector in Sierra Leone*. Economics Dept, FBC.

floats within the informal sector. Within a year, these two ROSCAs have accumulated almost Le 11.0 Million, a clear indication that intermediation in this sector should not be underestimated. A crude project for fifty of these ROSCAs operating within the year could be able to mobilise over half a billion leones. It has been reported that in Ethiopia in 1988, total saving mobilised by *Ekubs* (local name for ROSCAs in Ethiopia)<sup>13</sup> was 10 percent of total annual savings in the financial system of that country. In Cameroun, an estimated 75 percent of all males and about 80 percent of all females belong to *Djanggi* (Local name of the ROSCA in Cameroun)<sup>14</sup>. It has also been reported that the *Kou* (Local name of the ROSCA in Japan)<sup>15</sup> is the precursor of their modern financial system. The widespread nature of the ROSCAs indicates their resilience. They minimise adverse selection of risk and it is a system that has survived the test of time.

In addition the range of interest rates on the informal sector is interesting. Braima, (1994)<sup>16</sup> observed that interest rates ranged from 5 - 200 percent. This tends to suggest that the rate may not be the problem. Rather, it is the availability of the credit at the right time that poses limiting problems to access.

Commercial banks play a very marginal role in providing funds for the diverse activities in the informal sector. This is not only typical of Sierra

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<sup>13</sup> Bouman, F. J. A. (1983); *Indigenous Savings and Credit Societies in the Developing world*. In J. D. Von Pischke, Gordon Donald and Dale W, Adams (eds.) *Rural Financial Markets: Their Use and Abuse*. Baltimore, MD., John Hopkins University Press.

<sup>14</sup> Bouman, F. J. A. and K. Hartvelt (1976); *The Djanggi: A Traditional Form of Savings and Credit in Western Cameroun*. *Sociologica Ruralis* Vol. 6 No. 1-2 pp.102-117

<sup>15</sup> Bouman F. J. A. (1994); *Financial Landscapes Reconstructed*. In Bouman F. J. A and O. Hospes, (eds) *Financial Landscapes Reconstructed: The Fine Art of Mapping Development*. Westview Press, Colorado

<sup>16</sup> Braima (*Op cit.*)

Leon but has also been observed in Ghana, Nigeria and most low-income countries especially in Africa. The main sources of funding in the informal sector in Sierra Leone are own funds, relatives and friends as the Table 2 indicates.

Table 2. Sources of initial funding (%)

<u>Sources</u>	<u>Freetown</u>	<u>Bo</u>	<u>Kenema</u>
Own Savings	53.3	53.6	72.2
Friends and Relatives	41.8	44.4	27.8
Contributions by Partners	4.1	1.2	0.0
Commercial Banks	0.8	0.4	0.0
Government or other agencies	0.0	0.4	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>

Source: ILO/JASPA Report 1990

The informal sector has also been dismissed as insignificant on account of low savings. This myth has been challenged by data from Brima (*Op. Cit*) and Conteh (*Ibid*). The Table 3 below reveals the saving mobilisation capacity of the informal sector. Over 46 percent of savings in this sector lie below Le100,000 (one hundred thousand leones) and less than 2 percent fall between Le400,000 to Le1,000,000 (four hundred thousand to one million leones). The table has also corroborated the ILO/JASPA (1990) findings (Table 2).

From the above analysis it can be concluded that the informal sector is dynamic and cash oriented and should be linked with the formal financial institutions. Its modus operandi could be studied and used as a basis for this linkage.

Table 3    Distribution of Savings in the Informal Sector

<u>Savings (Le000)</u>	<u>Freetown</u>	<u>Bo</u>	<u>Kenema</u>	<u>Makeni</u>	<u>Total</u>
0-<100	54	48	60	55	217
100 <200	22	5	4	20	51
200-< 300	20	1	1	22	44
300-<400	0	20	0	0	20
400-<1,000	1	2	0	2	5
Total	97	76	67	97	337

Source: Braima, 1994

If rural residents are to be provided with instruments that give them a command over resources, a blend of the modus operandi of both the FFM and the IFM should be instituted.

In this regard, four main aspects need to be addressed in order to achieve this goal. These are accessibility, self-sufficiency, self-sustainability/savings mobilisation and a conducive economic environment.

#### Accessibility

Providing accessibility for the rural disadvantaged is usually an important criterion by which a credit programme can be judged. Several factors influence accessibility. Where banking outlets are situated far away from the clientele, it becomes difficult to forge an effective relationship with them. The relationship between the moneylenders and rural residents provides a stark contrast in this regard. Several alternatives are available to increase accessibility of

CBs to rural residents. One alternative is to permit CBs to employ private lenders to act as their agents. Under the 'one-man village banker' scheme in Pakistan, for example, a resident of the village is appointed as a banker by the financing institution and he or she is accessible to clients at his residence on a 24-hour basis. There are a number of well-documented cases of private lenders having been employed by institutional lenders to act as agents in extending and recovering loans. According to Wells (1980)<sup>17</sup>, the credit of the Agricultural Bank of Malaysia appointed co-operatives, farmers' organisations and private lenders, after screening, to act as agents of the bank. The bank sets the interest rate the agents could charge clients and the commission they received. In the early 1970s, the interest rates were 9 and 6 per cent for unsecured and secured loans, respectively, with a 3 per cent commission. These arrangements gave farmers a choice of lenders and created an incentive for agents to compete for clients.

Although Wells (*Op cit.*) also noted that the decision to admit private moneylenders into the scheme was controversial, yet their superior performance in utilising lines of credit from the bank and recovering loans vindicated the decision to include them. One problem with this alternative is that if the commission is based on lending alone, enough incentive may not be created to compete for good customers. A way of overcoming this is to base the commission on the rate of recovery of loans they extend and to offer a small salary or allowance to make the burden of the lender's risk tolerable.

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<sup>17</sup> Wells, xxxxxxxxxx

Other alternatives to achieving greater accessibility involve mobile banking and flexible hours. The first involves the use of vehicle(s) or transport of some sort and the second relates to keeping the bank or its branch/branches open on special days (market days etc.) and for extended hours. The bank can also move to market locations to offer services such as savings mobilisation, loan extension and receipt of repayment from borrowers. In Sierra Leone the periodic markets, locally known as *Lumas*, can be used to take banking to these rural economic agents.

The above alternatives should be determined on the basis of local custom and culture. In Sierra Leone, one or a combination of these alternatives can usefully be deployed to improve accessibility. In addition, lending procedures should be made simple for farmers to understand; and the provision of loans should not only cover production but also consumption needs. A small percentage, to be determined by negotiation, can be earmarked for the latter. Again, we should recall that the moneylender's operations accommodate both production and consumption credit and he or she is capable of achieving high repayment rates. Whatever alternative is preferred, frequent and effective monitoring procedures should be developed to discourage rent seeking behaviour by bank officials, which characterised formal credit institutions in the past (see Appendix 2 for monitoring procedures).

#### Self-sufficiency

Self-sufficiency in resources is important to any credit institution. To achieve this, three main actions, namely reduction in default rates, mobilising savings and guarding against inflation are necessary.

Institutions that combine deposit mobilisation and lending become more familiar with their clients' cash flow, savings habits and wealth. This is true especially for countries with low inflation, can provide positive real rates of return on savings and several savings options. In Sierra Leone, the CBs and other formal financial institutions in rural areas do not yet provide diversified savings options. Thus information about clients is not readily available to them. To overcome this problem, more savings options similar to those practiced in Ghana and Nigeria, which utilize both group and individual deposits collection procedures, could be deployed. In Ghana and Nigeria, savings schemes have been introduced in schools to instil the habit of savings from a young age. The school savings scheme could be sponsored by co-operatives and supported by government. Women's savings clubs like those in Zimbabwe; and Mobile banks and rural credit agents as known in Pakistan could also be used to tap the deposits at the doorsteps of rural residents.

In this regard, one recalls the operations of the *Master Osusu* in Sierra Leone and the methods he/she utilises in mobilising savings of *osusu* members, especially of market women. These *osusu* clubs could also be linked with CBs through the provision of attractive savings options as is done in South Africa and Ghana<sup>18</sup>. Whatever combination of the above savings mobilisation strategies is adopted, the procedures for depositing and withdrawal should be made less cumbersome. These formalities should be simplified for the illiterate clients so that their confidence in the formal institutions can be developed. Rural people are usually cautious about letting others know about or handling their money. Thus,

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<sup>18</sup>Burman and Lembete, (1995)xxxxxxx

the safety of their money, secrecy and continuity of the financial institution are some of the factors that can foster confidence.

Conteh (*Ibid.* 1995) demonstrated that the levels of default in RBs in Sierra Leone were very high, and therefore contributed to their lack of viability. If self-sufficiency is to be restored in CBs drastic reductions in default rates will have to be achieved. The first steps in achieving this objective include an improvement in loan appraisal procedures leading to financing good projects, providing transport facilities for field staff, eliminating cumbersome procedures in order to reduce delinquency, and introducing an incentive system for both borrowers and CBs staff. The incentive to borrowers should emphasise larger subsequent loans after full repayment of the previous loan, and educating them about their responsibilities to the lending institution, about the effective use of credit and the adverse effects of default. For RB staff, incentives should be based on loan recovery performance rather than on achieving lending targets. CBs in Sierra Leone have not instituted any kind of incentive schemes for either staff or borrowers. It is, therefore, worthwhile to consider the experience of the Grameen Bank in Bangladesh in this regard in order to reduce the default rates in CBs and other formal credit institutions in Sierra Leone.

CBs policy should consider linking credit to input supply and output marketing. Credit/market interlinkage, enables moneylenders to collect more information about their clients. This puts the moneylender in a better position than CBs in reducing moral hazard and adverse selection of risk. Interlinkage also enhances repayment performance because the lender is in a position to deduct repayment at source from transactions in another market. CBs and most formal credit institutions in Low

Income Countries (LICs) are not structured to handle input/output marketing because of the specialist knowledge required and the need for additional staff. Encouraging private entrepreneurs to set up input/output marketing outfits can help to solve this problem. But this calls for a high degree of co-ordination between financing institutions and the input/output market outlets. Procedures relating to this should be made less cumbersome and clear to the borrowers. They should know how much they owe, when and how much to repay. Repayment in kind should also be considered. Finally, a sound accounting and management information systems is essential for better repayment procedures. The absence of sound bookkeeping has been a major cause of default in many credit institutions in LICs such as Sierra Leone.

### **Self-Sustainability/Savings Mobilisation**

It has already been pointed out that that RBs in Sierra Leone were highly subsidy-dependent and, therefore, were not viable in the sense of being self-sustainable<sup>20</sup>. In order that the present CBs do not suffer the same fate, four main aspects need to be addressed. These are lending rates, borrowing rates, loan turnover and transaction costs. The fixing of lending rates for agricultural development is a complex and sometimes controversial issue. However, as we pointed out earlier, lending rates should be high enough to cover administrative costs, bad debts and to make a reasonable profit. They should also be positive in order to protect the institution's equity capital and maintain its efficiency in allocating scarce resources. In addition, lending rates should be differentiated and progressive to reflect short-term loans, as well as, small and large loans.

To increase turnover, 'saturation-lending' may be useful. This involves accommodating large number of clients in all categories, such as small, medium and large, as well as those involved in non-farm activities. A policy of allowing the financial institution to compete and pay the full cost for external funds should also be encouraged. It is not a bad policy to provide some subsidy for start-up costs. The payment of these should, however, be spread over a number of years to allow the institution to achieve viability within the shortest possible time. The central bank cannot maintain subsidies in perpetuity. In other words, there is a limit to the amount and tenure of external sources of funds, particularly concessionary funds. CBs are therefore, unlikely to be viable and sustainable unless they can raise the bulk of their resources through deposit mobilisation on competitive terms. Most importantly, an aggressive saving mobilisation policy should be adopted in order to increase resources. A sound liquidity management policy should also be made a priority. In this regard, adequate training and refresher courses for CB staff are very useful measures to be considered. Provision for incentives and professional advancement should also be created. This would help to improve staff morale and enhance staff efficiency. It is also recommended here that the informal sector be encouraged to organise itself into Trades Associations which can then be linked with formal financial institutions. This has several advantages. Firstly, it will accord policy makers to be able to capture data on the operations of this sector into the national accounts. Secondly, it will enable the various trades associations to know its members, speak with one voice and affect government policy in their direction. Thirdly, government will be in a position to widen the tax base and increase revenue collection.

## **The Need for a Conducive Environment**

In order to ensure a conducive environment for rural credit markets to function, three steps are necessary. These are structural adjustment, financial sector reform and institution building. The Sierra Leone economy has undergone substantial structural adjustment since 1992.

The macro-economic environment exerts a major influence on both the country's economic performance and on its financial system. Financial institutions find it hard to operate in the unfavourable economic environment. In particular, government should regard the rural financial market as an instrument for allocating scarce resources by instituting suitable macro-economic policies and the production of viable technologies through research should be encouraged.

An appropriate legal framework is also required to protect the resources of the REM and to recover outstanding loans. Government officials and politicians should refrain from making pronouncements that imply debt forgiveness or which makes credit appear as government handouts. Deposit insurance is necessary to protect the resources of both lenders and savers. In addition, linking formal with informal lenders can help to strengthen enforcement, improve loan recovery and financial intermediation.

Supporting services such as input supply/output marketing; training and infrastructure are other aspects of reform. A poor marketing infrastructure contributes to high production costs and low profit margins. It is incumbent on government to devote adequate resources to improving rural market infrastructure. More specifically, existing feeder roads should be repaired and new ones constructed to link

production areas. Market centres should also be constructed to facilitate the exchange of goods, services and information. This could improve producer bargaining power.

High transaction costs are an obstacle to developing financial markets. Monetary and other costs tend to limit the services financial intermediaries are able and willing to offer. Prohibitive costs in terms of time and inconvenience can cause prospective clients to shy away from using financial institutions. It is, therefore important for the intermediary to reduce transaction costs by improving their techniques, mode, scale and scope of operation. Although there are moves towards instituting regulations and procedures to improve operations, little effort has been devoted to devising management information systems with a view a to improving efficiency, probity and loan portfolio management.

The liberalisation of interest rates and the removal of sectoral ceilings could enhance financial intermediation by channelling savings to higher yielding investments. The restructuring of financially distressed CBs, introduction of training programmes for their employees and improvement in supervision by the Bank of Sierra Leone can also enhance the soundness of future banking activities and increase confidence in the banking system. Ghana's financial sector reform and institution building programmes can serve as a model for Sierra Leone to improve its financial system.

To achieve the above objectives, a detailed review of rural financial services, including those provided by the informal sector, should be undertaken as part of the country's financial sector reform. It is

central to the argument pursued in this paper that a better understanding of the informal financial system can provide insights into how to develop suitable formal financial services in rural areas. The informal financial sector already performs in a noteworthy fashion and should be encouraged to grow, diversify and integrate with the formal sector institutions. The long-term strategy for rural financial sector development should, however, be to improve and expand the formal financial system, concentrating on savings mobilisation which does not rely on external sources for long-term lending resources, and adopting a 'savings-deposit-led' strategy as opposed to the past 'supply-led' approach.

Much could be learned from the informal financial sector. It has been successful in the past in providing cost-effective and convenient savings/deposit facilities to rural residents, and has proved a dependable and ready source of loans with little or no bankable collateral. Many of the services offered and some of the instruments used by this sector could be adopted, with modifications if need be, by CBs and other formal financial institutions. In this regard, Pattern and Rosengard (1992)<sup>19</sup> have suggested that:

***"emulation instead of elimination of the informal financial system, and complementing instead of supplementing should be the strategy for policy makers in efforts of to develop the formal financial sector".***

Emphasis should also be placed on the autonomy of financial institutions. This implies that the lender should have the right to say 'no' to risky loan requests, and to any borrower whose debt repaying capacity is low.

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<sup>19</sup>Pattern, R.H. and J. K. Rosegard (1992); *Progress with Profit: The Development of Rural Banking in Indonesia*. Sanfrancisco; ICS Press

Non-agricultural loan and loans to small- and micro-enterprises for any viable income-earning activity should be incorporated into the loan portfolio, thus diversifying risk and facilitating rural development. In the light of the above we forward the following as instruments/products/schemes that micro finance institutions could utilise to achieve effective financial intermediation for poverty alleviation.

#### PROGRAMMES TO PROMOTE MICRO FINANCING IN SIERRA LEONE

Several schemes could be implemented to provide financial services and help finance economic activity in the rural areas with a view to alleviating poverty. Some of these could be models that have been tried in other countries and others could be those that are being utilized presently by some of the institutions in the country. Whatever model or combination of models utilized it is important that certain characteristics have to be attained. Our recommendation is the use of several models/product/programmes for this purpose. Our recommendations have taken into consideration the role of the private sector in providing the leadership in micro financing for poverty alleviation. To this end we propose;

##### (a) COMMUNITY FARMING SCHEME (CFS)

This is a programme designed for peasants or small-scale farmers especially in the rural areas. These could be groups of farmers or group of farming Youths in a community, or groups of farming women, or cooperative farmers.

The operational guidelines are- :

- All beneficiaries must belong to a group consisting of a maximum of 10 members.

- CMCs in collaboration with MFI officials will identify the worthy groups.
- Each member of the group establishes his own savings account with the MFI, and operates it for a minimum of three months before applying for credit.
- Credit limit is equivalent to three times your savings, the minimum of which must be Le 150,000.00. The savings account is to appreciate by at least Le 15,000.00 per month in addition to the cross guarantee of members.
- Loan repayment is tied to the gestation period of each enterprise but not more than fifteen months.
- The Agricultural Guarantee Scheme of the BSL must be obtained.
- Each member undertakes to accept liability not only for individual loan granted him/her but also for the loans granted to other members of the group for each cycle. The group accepts joint liability for the borrowing of every member.

(b) AGRICULTURAL LOAN SCHEME

Under this arrangement smallholder farm units are financed through corporate organisations that depend on the output of such farmers for their raw material requirements. For example, The Sierra Leone Palm Kernel Oil Mill (SLPKOM) will operate with some communities that produce Palm Oil, or the Eastern Clinic Rural Development (ECRD) limited guarantees Le 100 million (one hundred million Leones) on behalf of Mandu Oil Palm Farmers in the Kailahun district. The corporate body accesses the loan for the farmers and passes the credit over to the smallholder farmers, who in turn, would supply the corporate body, its product after harvest. Here the smallholder farmer is assured for a ready market for

his product and at the same time has easy access to timely credit. The Bank (sometimes), the corporate body, the leaders' representatives selected from among the benefiting farmers jointly do the supervision of the farm units or enterprises.

(c) FISHERMEN/WOMEN -WILD FISH CAPTURE SCHEME

By the end of this conflict, many riverine communities lost their fishing gears. The cost of acquisition and maintenance of these fishing gears is now prohibitive. To this end an MFI provides credit facilities to Fishermen (women) for the purchase, and, or repairs of drying floors, ovens, nets, boats, outboard motors/ engines, hooks, lines and other allied paraphernalia. NaCSA and some NGOs like AFCORD, GTZ had operated with some fishing communities in this country with mixed results.

(d) SELF-HELP GROUPS

This programme encourages communal decision in providing infrastructure, and, or facility within a locality through voluntary contributions and sourcing of funds locally or from descendant associations/groups. This programme encourages a dual link between clients and MFI s- a flow of deposit from client to MFI and flow of credit from MFI to clients. This is more of a savings linked credit in which the beneficiaries build up a savings deposit of at least 25% of their eventual credit requirements within a period of four months and maintain such build up all through the life of such credit facility.

(e) CREDIT SCHEME FOR AGRICULTURE

This scheme slightly replicates the Credit Guarantee Scheme. That is, it is based on a guarantee fund model involving a partnership between the MFI, the Bank of Sierra Leone, a Trust Fund provider and a group of beneficiaries. The Trust Fund provider could be either a Private sector corporate body, or an Agency of government. The Trust Fund provider capitalises on the MFI's expertise and capacity for due diligence for effective credit delivery and administration.

A memorandum of understanding, which specifies the role of each party, defines the relationship under this product. The beneficiaries provide a deposit of about 25%, while the Trust Fund provider puts up a deposit of about 50% of a defined limit. The MFI provides the credit facility in the sum of the defined limit. BSL guarantees the facility to the extent of 75% of any amount in default net of the deposits held in the event of default. The Trust Fund is held in an interest bearing deposit account.

The target beneficiaries and primary obligors are the rural sector enterprises, Smallholder Cooperatives, Community Based Organisations, Rural Youth organisations and Women's organisations.

(f) Sierra Leone Rural Enterprise Programme

This programme replicates the NCDB **barray** credit Programme (solidarity group guarantee). The SLREP will operate a personal loan scheme with regular meetings and a loan scheme for *Osusus*. Like the *barray* method in use by the NCDB these entrepreneurs meet fortnightly to deposit money, receive loans, disburse money and discuss their problems with the designated loan/credit officers. Bringing together Officials will set up the SLREP from SLIBA, PRIMED and ARD, local NGOs that had been engaged in micro finance provision. The SLREP will provide loans to these

NGOs to enable them provide personal loans, training programmes, research and evaluation programmes and consultation service programme.

### Conclusions and Recommendations.

Against the above analysis, we recommend the establishment of micro finance institutions and the extension of banking services by existing commercial banks in the rural areas for the purpose of providing micro finance and financial services as follows;

1. 20 (Twenty) Community Banks should be established (see Appendix 2 for costs) as follows:
  - 6 (six) in the East Province
  - 6 (six) in the South Province
  - 6 (six) in the North Province and
  - 2 (two) in the Western areaThe Bank of Sierra Leone guidelines for the establishment of these institutions should be followed and each provided with micro credit funds, which would form the nucleus of its loan portfolio. This policy will remove government's involvement in this activity, make it more commercial oriented, less subsidy-dependent and reduce the market distortions inherent in the present micro credit policy.
2. Encourage Commercial Banks to open branches (through moral suasion) in the provinces.
3. Strengthen the National Cooperative Development Bank as a micro finance institution with the use of its **Barry** method. This involves capacity building and the building up of its micro credit portfolio.
4. Encourage the linking of the informal sector with the formal sector through various Trades Associations/Unions that can be easily identified as conduits for development ideas and other issues.
5. Encourage NGOs to be more involved in capacity building for these institutions instead of being directly involved in credit delivery.

The truth of the matter is, these informal units need capital and technical inputs; but most of the people involved in this sector do not have the time to attend formal courses away from their operations. Therefore if NGOs can provide the capacity building measures close to these units and in the micro credit institutions, the effect on both will be mutually beneficial.

6. Government should be proactive in cajoling the private sector to provide seed capital on a joint Trust Fund basis with micro finance institutions as suggested in paragraph (e) above. This could be done through Workshops to sensitise operators in this sector.
7. All micro credit institutions should be monitored and supervised by the central bank until an Apex body/industry supervisory mechanism is put in place in the medium to long term.

We are convinced that these measures will, in the short to medium term help in providing the needed capital, skills training, and an enhancement of the output from this sector and hence increased incomes and poverty alleviation.

**Appendis 1 COSTINGS FOR THE ESTABLISH OF 20  
COMMUNITY BANKS**

ITEMS	COST (LeMillion).
1. Construction of 2-storey building to house the CB (ground Floor) and the Manager's living quarters on the first floor.	100.00
2. Securitised vehicle (preferably a Land Rover) for specie movement. This vehicle can also serve as the Manager's official vehicle until the CB is liquid enough to secure one for him/her	90.00
3. Two (2) motor bikes for the Loans officer and his/her assistant. These bikes would be used for follow up action on borrowers and other activities	10.00
4. Micro Credit Fund (this could be a grant or loan) given to the CB to form the nucleus of its loan portfolio	50.00
<b>Total</b>	<b>250.00</b>
<b>Total Cost for 20 Community Banks</b>	<b>500.00</b>

In addition The NDB and the NCDB should be granted funds (micro credit funds) about Le 50 Million each for their operations.

This brings the total recommended funds to **Le 600 Million.**

## Appendix 2

### Micro credit Performance Measures

Degree of Market Formulation	
Quantitative Measures	Performance Evaluation
<ul style="list-style-type: none"><li>• Active borrowers</li><li>• Conversion ratio (loans lent as a % of applicants or outreach contacts)</li><li>• Percentage of staff time spent on outreach and group formation</li></ul>	Number of contacts needed to find, screen, and yield clients, or efficiency of staff outreach and marketing
Development Impact	
Quantitative Measures	Performance Evaluation
<ul style="list-style-type: none"><li>• Number of clients served</li><li>• percentage increase in customer incomes</li><li>• Number of businesses created, maintained, or grown</li><li>• Jobs created (including self-employment)</li><li>• Qualitative gains/personal development</li></ul>	Whether the intended results are being achieved and whether they remain appropriate
Operating Results	

Quantitative Measures	Performance Evaluation
<ul style="list-style-type: none"> <li>• Total costs per average loan</li> <li>• Revenues per average loan</li> <li>• Clients per loan officer/staff person</li> <li>• Staff expense as a percentage of average assets</li> <li>• Net interest margin</li> <li>• Unit cost ratio</li> <li>• Cost per currency unit lent</li> </ul>	<p>Whether annual volume of clients is increasing and whether costs are decreasing per loan</p>

# "Sound Banking" - Implications for MFIs

## Framework for Sound Banking

This framework is for micro finance institutions (MFIs) themselves, and how they can improve their programmes.

The IMF's Executive Board has broadly agreed that the following objectives should provide guidance for strengthening financial systems:

- increasing transparency and the role of market forces;
- limiting distortions created by official safety nets;
- controlling risk through regulatory and supervisory oversight;
- strengthening the broader structural framework;
- fostering national and international supervisory coordination.

Some of the reasons cited for 'unsound' banking included -

- weak internal governance of banks leaves the system vulnerable to macroeconomic shocks;
- financial deregulation, competition, and innovation outstrip the capacity of banks to manage risks prudently;
- financial deregulation takes place before adequate prudential regulation and supervision are in place;
- weak and insolvent financial institutions are allowed to continue operations, thus weakening the entire system;
- declining business profits, together with excessive corporate indebtedness, lead to a deterioration in asset quality.