

**POVERTY AND IMPACT ASSESSMENT STUDY IN MOZAMBIQUE
OF THREE PARTNER INSTITUTIONS OF MEMBERS OF
THE NETHERLANDS PLATFORM FOR MICROFINANCE**

SUMMARY

***THE MICROFINANCE MARKET IN MAPUTO,
MOZAMBIQUE:
SUPPLY, DEMAND AND IMPACT***

A CASE STUDY OF NOVOBANCO, SOCREMO AND TCHUMA

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Opening Note from the Steering Committee of the Netherlands Microfinance Platform (NPM)

The poverty outreach and impact assessment study in Mozambique has resulted in findings and contains observations, which we -the NPM steering committee of this study - would like to share with the wider audience of microfinance practitioners and interested members of the public.

This study is conducted by independent researchers, therefore the conclusions are entirely theirs.

With thanks to the work delivered by the researchers,

The Steering Committee

1. Introduction

The study, entitled *The Microfinance Market in Maputo, Mozambique: Supply Demand and Impact – A case study of NovoBanco, SOCREMO and Tchuma*, undertaken on behalf of “The Netherlands Platform for Microfinance”¹ and funded by some of its members², assesses the Maputo-based business microcredit clients and depositors of three large operators. The assessment took place over the period June 2004 to February 2006. The multi-phase impact assessment study was undertaken with two principal goals: to justify the use of public funds and to inform strategic planning of the MFIs.

The MFIs involved in the study were SOCREMO³, NovoBanco and Tchuma, in which various members of the Netherlands Platform for Microfinance had different interests.

2. Approach and Methodology

The research was implemented in a participatory way with the management of the MFIs having a considerable input in each stage of the study including: the definition of hypotheses, the choice of indicators and the design of the questionnaires, while commenting on the reports emerging from the different phases of the study.

An important feature of the assessment was the division of clients into categories, premised on the understanding that the impact of microfinance varies for different types of clients. The participant MFIs chose loan size as the criterion for the stratification of the clients. Loan sizes were divided by three categories: the low loan category includes loans up to 7,499, 999 meticais⁴ (MT) (around USD 327); the middle loan category includes loans from 7,5 million MT– 19,999,999 MT (from USD 328 – 868); the high category includes loans of 20 million MT and more (USD 869)⁵.

It was assumed that impact would more fully manifest itself after a period of more than two years. For that reason the assessment focuses on the more-than-two-year-old micro credit clients of the three MFIs and depositors from two MFIs.⁶ To a limited extent ex-clients (dropouts) were studied and defined, for the purposes of the assessment, as clients who did not return to the institution within a period of six months after the repayment of the previous loan⁷. To be able to compare the interviewed dropouts with the interviewed active clients, “dropouts” must also have been with the institution for more than two years prior to leaving. However, SOCREMO and NovoBanco also provided general information on the number of all dropouts per loan category.

This research dealt with the challenge to attribute impact to the financial services by using a mix of research methodologies, enhancing the reliability of its findings by examining similar issues from different perspectives. The following methodologies were applied by the study:

¹ Members of the Netherlands Platform for Microfinance include: Hivos, Novib, FMO, ASN Bank, ABN Amro, Cordaid, DOEN Foundation, ICCO, ING, Interpolis, Ministry of Foreign Affairs, Oikocredit, Rabobank Foundation, SNV, Triodos Bank (see: www.microfinance.nl)

² Hivos, Novib, FMO, Doen Foundation and the Netherlands Platform for Microfinance with the support of the Ministry of Foreign Affairs

³ SOCREMO, Banco de Microfinanças de Moçambique, formerly known as Sociedade de Crédito de Moçambique.

⁴ National currency In 2006 the metical (singular of meticais) was gradually replaced by the “metrical da nova familia” (metrical of the new family) resulting the loss of three 0s for simplification. i.e. 1,000 MT became 1MTn. Full conversion took place at the beginning of 2007.

This report will present national currency figures as they were *before* 2007.

⁵ Exchange rate: 23,002 MT = USD 1 (June 2004)

⁶ SOCREMO had only introduced deposit facilities at about the time of the in-depth interviews.

⁷ This definition was based on the assumption that resting periods of most clients do not exceed six months. In order to understand better the magnitude of clients who interrupt taking loans, ‘resting’ periods of NovoBanco clients were analysed. This analysis was also meant to facilitate a well-informed decision about the definition of a dropout.

- Analysis of **historical loan portfolio data** of each MFI, divided by loan categories, to obtain an understanding of characteristics of the MFIs and the borrowing and repayment patterns of each loan category.
- Analysis of **loan appraisal data** of more-than-two-year-old clients of two branches in Maputo of each MFI.⁸ In total, the loan appraisal information of 1,287 clients and 78 ex-clients (having left after a period of more than two years) was analysed, providing an insight into client characteristics and possible impact per loan category.
- A **sample survey to assess the poverty level of Tchuma's Maputo clients** by category in comparison with the Maputo population.⁹
- **In-depth interviews with 140 clients and ex-clients** of each MFI¹⁰, providing the clients' perspective on use, impact and quality of services of MFIs. Moreover, the interviews gave an insight in clients' use of other financial services, including informal and the clients' perspective on their business environment.

3. Characteristics of the MFIs

The MFIs accounted together for 41% of the microfinance borrowers and 79% of the value of loan portfolio in Mozambique (by June 2004). The MFIs are the three largest MFIs by portfolio, but having very different institutional histories. Socremo and NovoBanco are registered as commercial banks while Tchuma operates as a cooperative. Both SOCREMO and Tchuma started as pilot projects in the early and mid 1990s, NovoBanco started off as microfinance bank ("micro bank") in 2000. Tchuma is the only institution that was not launched by an external agency. The support and ownership structure (investors, funding agencies and Technical Assistance) of SOCREMO and NovoBanco is more extensive and solid than for Tchuma which is planning to transform into a bank to attract more investors.¹¹

Tchuma has a specific poverty focus and strives for striking a balance between sustainability and reduction of poverty through reaching poorer clients; NovoBanco and SOCREMO have a more commercial approach and aim for increasing breadth of outreach including also SME (Small and Medium Enterprise) lending. The three MFIs are each others' main competitors in Maputo City.

⁸ NovoBanco retrieved the loan appraisal information of all (807) more than two-year-old active clients from two branches in Maputo City. From Tchuma and SOCREMO, a sample is randomly selected consisting of respectively 291 and 189 active clients. The data has been weighted and corrected for inflation of Maputo. A sample of 78 dropouts who had been clients for more than two years was selected from SOCREMO. However, Tchuma and NovoBanco did not provide information on dropouts due to time constraints, combined with, in Tchuma's case, limitations of its Management Information System (MIS)

⁹ For the assessment of Tchuma's clients' poverty level, a quantitative survey has been conducted among 164 (ex) clients of Tchuma, who had been credit clients for more than two years (April - May 2005). This sample was drawn from the sample used for the analysis of loan appraisal information. Results were weighted in order to be representative for all more-than-two-year-old (ex) clients of Tchuma. The poverty assessment included both dropouts and active clients. The assessment compares the poverty level of Tchuma's clients in Maputo City with the poverty level of the overall population in Maputo City. On the basis of the findings of the national household consumption survey (Instituto Nacional de Estatística (INE) (2004) *Inquérito aos Agregados Familiares Sobre Orçamento Familiar. Relatório Final*. Maputo, Mozambique), the most powerful indicators for poverty levels defined as household expenditure levels were identified. These indicators proved to be housing characteristics and availability of consumer durables.

¹⁰ In-depth interviews were conducted during the period June – September 2005 with a total of 140 clients, stratified as follows: 10 active clients per loan category per MFI; 10 dropouts per MFI; 10 clients who had (exclusively) deposit accounts of NovoBanco as well as Tchuma. The credit clients were selected randomly from the sample for the loan information analyses. Dropouts were chosen from the sample of 2-year-old clients active on June 30, 2004 but who had voluntarily dropped out afterwards and had not taken a loan six months prior to the time of the interview. To ensure rigour of the data obtained from the interviews, the so-called 'Qualitative Impact Protocol', or *QUIP*, developed by *Imp-Act* was used. Statistical analysis requires a critical sample size, while this is not the case with qualitative research: the more interviews held, the more benefits in terms of useful data. However, to be able to understand the main problems of clients of a specific category, the minimum number of interviews held per category should be 10 (*Imp-Act* Practice Notes 2004).

¹¹ For a recent review of the whole microfinance sector in Mozambique, see F. de Vletter (2006) *Microfinance in Mozambique: Achievements, Prospects and Challenges*, Mozambique Microfinance Facility / UNDP (Maputo).

NovoBanco and, increasingly, SOCREMO have a wider product range than Tchuma. All the MFIs provide individual business loans, while Tchuma, due to its poverty focus, provides also solidarity group loans, although to a very limited extent¹². The three MFIs provide current accounts, while NovoBanco and SOCREMO also offer term deposits. Other products include accounts in foreign currencies, house renovation loans, money transfer and foreign exchange facilities. In the table below, some key characteristics of the MFIs are presented.

Table 1: Key characteristics of the MFIs

Information as at June 30, 2004	Tchuma	SOCREMO	NovoBanco
Year of starting operations (as financial institution ¹³)	1999	1999	2000
Total number of outstanding loans	5,964	5,421	9,921
Portfolio outstanding (in USD)	1,361,886	2,378,335	5,164,073
Average loan balance of business loans (in USD)	234	439	448
Growth gross loan portfolio June 2003 – June 2004	30%	35%	143%
Growth number of clients June 2003 – June 2004	14%	-7%	35%
Number of deposit accounts ¹⁴	1,456	-	19,164
Portfolio at risk	3,96	0,86	1,96
Operational Self Sufficiency ¹⁵	106.77%	111.07%	103.81%
Percentage clients in Maputo City	61%	57%	72%
Percentage female clients in branches in Maputo City (business loans)	64%	61%	60%

4. Characteristics of the Assessed Clients

Client characteristics as determined from loan appraisal data and the in-depth interviews showed very close similarities across the three MFIs studied, probably accounted for by the fact that the business loan products of the three MFIs are similar in terms of their loan conditions.

One of the more surprising findings is the relatively older age of the clients. Despite the youthfulness¹⁶ of the informal sector, the average age of the more-than-two-year old client was over 40 for all three MFIs. There was no obvious explanation for the scarcity of younger clients, though lack of asset guarantees (exacerbated by the fact that many young people

¹² Tchuma started by providing solidarity group lending but later switched to individual lending. Lately, in an attempt to reach poorer clients, it has decided to re-introduce solidarity group loans.

¹³ The project preceding SOCREMO started in 1992; the project Tchuma started in 1996

¹⁴ Current accounts and term deposits in the case of NovoBanco, current accounts in the case of Tchuma. SOCREMO introduced deposit accounts in 2005 (data presented in table are from June 2004). Tchuma started in 2000 with a pilot project for stamp-based savings which was discontinued in 2005. In 2003, Tchuma piloted a passbook savings product, which it introduced in all branches by the end of 2004; NovoBanco introduced current accounts and term deposits in 2002

¹⁵ Source: Mix market 31/12/04 ,www.mixmarket.org

¹⁶ See F. de Vletter,(1996) *Study of the Informal Sector in Mozambique (Maputo and Sofala)*.Ministry of Planning and Finance. This study found that the vast majority of the vast majority of the informal sector workers were under 35 years of age.

continue living with their parents due to a lack of affordable housing) and perceived higher risk because of behavioral traits and residential instability were indicated as possible factors.

Qualitative interviews found that a large majority of the clients' households had more than two sources of income. Relatively high numbers of clients had at least some secondary education and very few had no education at all. Clients were involved in a broad range of trading activities, to a lesser extent in services and very few in production. Tchuma's retained clients operated on average smaller micro-enterprises than SOCREMO's and NovoBanco's clients, but still the average value of monthly sales was approximately USD 1700. The majority of SOCREMO's and NovoBanco's clients have fixed business assets while the majority of Tchuma's do *not*. Fewer women owned business assets than men, the difference being rather large in the case of Tchuma. A majority, albeit a small one, of clients operated their activities on their own. Between a third to a half of the clients had employees with men having a slightly higher propensity to employ workers than women.

Only a small minority of the two year old clients had a current account at their MFI: 13% of NovoBanco's clients¹⁷ and 28% of Tchuma's. Only 1 % of NovoBanco's two year old clients had a term deposit. Interviews showed that most of the middle and high loan category borrowers had previous experience with commercial banks in terms of holding accounts but little in terms of previous loans. In terms of its total client base, NovoBanco had more than two times more depositors than borrowers, attracting many clients who are not interested in credit¹⁸. During the interviews it became clear that the low average value of deposits of the observed MFIs is not a reliable indicator of client savings capacity, because most deposit clients also hold other bank accounts and/or belong to informal savings systems (see section 11).

Although there was considerable variation between the MFIs, the in-depth interviews revealed a pattern suggesting that the majority of low and middle level loan clients and a significant minority of those with high loans saved through daily deposits with mobile money collector or belonged to ROSCAs (Rotating Savings and Credit Associations), locally known as *xitique* groups. Despite the common assumption that people transit from informal systems to formal banking services when they have the opportunity, the evidence from the assessment suggests that there is a tendency to transit albeit not a strong one: clients with higher loans were more inclined to have deposit accounts and showed a lesser inclination to participate in informal financial arrangement. Interviews with deposit holders, however, found that wealthier clients tended to engage in a broad mix of formal and informal financial arrangements.

In the table below, some key characteristics of more-than-two-year-old clients are presented.

¹⁷From the beginning of 2005, all clients of NovoBanco have deposit accounts, as opening of the account is one of the requirements to qualify for a loan.

¹⁸ June 2004

Table 2: Key characteristics of more-than-two-year-old clients

	Tchuma	SOCREMO	NovoBanco
Average age	43	43	41
Secondary school completed (<i>Maputo population 20%</i>) ¹⁹	27%	n.a	n.a
At least some secondary school attended	n.a.	n.a	58%
No formal education (<i>Maputo population 26%</i>)	7%	n.a.	2%
Owners of fixed business assets	35%	56%	72%
Employers of labour	46%	44%	43%
Deposit account at the MFI	28%	n.a.	13%
Average value of monthly sales at time last loan (USD) ²⁰	1,774	2,145	2,559
Average loan size, last loan (USD)	499	554	690

5. A Poverty Profile of Tchuma's More-than-Two-Year-Old Clients.

Tchuma was the only MFI studied with a specific poverty focus and with the objective to reach further down the market. For this reason the poverty profile of more-than-two-year-old clients was only assessed of Tchuma, with the expectation that the results could help it develop a strategy of expanding its services to poorer clients. Because low loan clients tend to be higher risks²¹, Tchuma applies loan ceilings in order to ensure that poorer clients get sufficient attention from the loan officers who, otherwise, would tend to go for the less problematic clients with larger businesses.

This study compared welfare indicators applied to Tchuma's more-than-two-year-old clients with the results of the National Household Consumption Survey and found that 43% of these clients had attributes similar to the top 20% (by expenditure levels) of Maputo households. At the same time, it is important to recognize that most of the clients belonging to the upper expenditure quintile are not rich: they are better off in relation to the largest part of the Maputo population.²² The interviews revealed that, with the exception of a notable few, the majority of these clients could be considered to be at the lower end of an emerging middle class.

A small but still significant minority of Tchuma's more-than-two-year-old clients – 13.6 % - live below the poverty line determined for Maputo City, while this is the case for 53.6% of the Maputo population in general. The poverty line²³ for Maputo is determined at 19,515 MT per person per day, which is USD 3.90 when using the dollar exchange rate at Purchasing Power Prices (PPP)²⁴. More than 90% of Tchuma's at-least-two-year-old clients had electricity

¹⁹ Calculated from the data collected by the National Household Consumption Survey. For comparability with the MFI clients, the age group 25-65 was selected.

²⁰ Exchange rate: USD 1 = 23,002 MT

²¹ The analysis of loan portfolio data showed that clients of the low loan category have the most repayment problems. The portfolio at risk (PAR) of Tchuma's low loan clients is 6.8% that is more than twice that of the middle and high loan clients (2.9 and 2.3% respectively). The PAR of SOCREMO's low loan category clients is 2%, against 0.4 and 0.25 for the middle and high loan clients; the PAR of NovoBanco's low loan category clients is 2.19 against 1.48 and 0.63 for the middle and high loan category.

²² The top 25 % of the Maputo population account for over 64% of the total consumption in the city. Email communication Robert James, *Direcção Nacional de Plano e Orçamento* (DNPO)

²³ The poverty line is based on the findings of the second National Household Consumption Survey (2002- 2003) (see footnote 9). Region specific poverty lines were constructed on the basis of the Cost of Basic Needs methodology. The data collection for the National Household Consumption Survey was carried out by the National Institute of Statistics (INE); analyses were made by INE, IFRPI and Purdue University

²⁴ USD 1 PPP equals USD 0.22 or five thousand MT in 2004. Since the exchange rate metical- USD did not change much and inflation was limited, the values in 2002/03 will not be very much different. It is important to note that PPP rates were designed for comparing aggregates from national accounts and not for making international poverty comparisons. As a result there is no certainty that an international poverty line measures the same degree of need or deprivation across countries. See <http://www.worldbank.org/data/notes/tb2-7.htm> and <http://www.worldbank.org/data/datatopic/GNIPC.pdf>

versus less than half of the Maputo citizens and twice the proportion owned cars for private use (about one-quarter versus an eighth).

The average daily expenditure of the households of Tchuma’s clients is PPP USD 9.94 per person per day against USD 8.93 per person per day spent by the households of the Maputo population. Location of agencies was an important factor in reaching poorer households. Households of the clients of a branch located near a large market in one of the poorer suburbs were found to spend USD 7.42 per person per day, against USD 11.92 spent by households of clients of a branch in the city centre. No household was found to be under the international PPP USD 1 per person per day poverty line.

Looking at the distribution of the poor by loan category (defined by the last loan) we find the majority of the poor clients (defined as those living under the poverty line) in the lowest loan category, some in the middle category and none in the highest category. A statistically significant inverse relation was found between poverty level and the size of the last loan. It can therefore be concluded that loan size of more-than-two-year-old clients is a good proxy for their levels of poverty. This is not the case for the size of the first loan of these clients, which is logical, given the fact that Tchuma applies a loan ceiling for the first loans.

The division of the portfolio by categories helps to more clearly demonstrate the trade-off between poverty outreach and sustainability: clients of the lowest loan category, who are likely to be the poorer clients, are more costly per unit of currency loaned. The lowest loan category clients cause a higher portfolio at risk, drop out more often and fewer clients of the lowest category clients take sequential loans. The middle and high loan categories are more important in terms of portfolio volumes, have shorter resting periods and show better repayment records i.e. they are better clients in terms of institutional sustainability.

In the table below, key data of the poverty profile of Tchuma’s more-than-two-year-old clients are presented.

Table 3: Key data of poverty profile of Tchuma’s clients.

Poverty profile	More-than-two-year-old clients Tchuma	Maputo City
Below local poverty line	13.6%	53.6%
In top 20% expenditure group	43 %	20%
Average daily expenditure	PPP USD 9.94	PPP USD 8.93
Car for private use	23.8%	12.8%
Electricity	91.4%	45.6%

As Tchuma, with a clear poverty focus, has 43% of its more-than-two-year-old clients in the top 20% highest expenditure level, it can be assumed that SOCREMO and NovoBanco would have more of their retained clients in this group. This is backed by the fact that the average value of monthly sales and of the average loan size of Tchuma’s retained clients is lower than those of SOCREMO’s and NovoBanco’s retained clients. Moreover, fewer of Tchuma’s retained clients owned fixed business assets. Also, the poverty level estimation carried out as part of the in-depth interviews found that proportionally more of the poorer households were Tchuma’s.

It should be kept in mind that the poverty profile of new clients is probably different, given the fact that the poorer clients tend to drop out more frequently before they are two years with

the institution. Moreover, the wealth level of successful clients probably improved over the course of the years, as is confirmed through the in-depth interviews.

The national household consumption survey found that 24% of Maputo's economically active population is self-employed²⁵ of which the majority could be considered to be potential beneficiaries of microfinance. The self employed are almost equally distributed among the quintiles, with the exception of the lowest quintile where the self-employed represent only a small percentage of the population. The fact that the Tchuma's clients are predominantly concentrated in the two highest quintiles, suggests considerable potential to reach the self-employed further down market through products with no or lenient collateral requirements, such as Tchuma's solidarity group loans and savings products.

6. Client Borrowing Patterns

Reasons for Borrowing

The clients assessed were obtaining loans meant for business application and, in most cases this was contractually stipulated for working capital loans. The increase of merchandise stocks (the most common business application for loan funds) is not only done in anticipation of higher demand but also for increasing efficiency (less travel time), reduced costs through bulk purchases and to create demand (more articles are said to attract more customers). However, many clients apply their "business loans" to non-business purposes, in particular for residential construction or rehabilitation²⁶ or for the purchase of household durables. Loans are also applied to covering unexpected expenses arising from crisis or for expenditure smoothing for households that typically suffer from unpredictable income fluctuations.

Resting Periods

A considerable number of more-than-two-year-old clients rest more than 30 days in between loans: around one third of SOCREMO's and NovoBanco's clients²⁷, and 40 % of Tchuma's clients. Only a few more-than-two-year-old clients rest longer than 180 days²⁸. Clients rested for several reasons, for example, to evaluate the effect of credit on their business or because they felt credit stress. Also, clients who faced a crisis took a resting period to recover from it. An important influence affecting many vendors is the seasonality of their credit needs, particularly over the Christmas and Easter periods as well as over long-weekend holidays.

²⁵ A person is considered as self-employed when working on her own without employing labour. The percentage self-employed in Mozambique is 51%; the main reason for this difference with Maputo is the high percentage of self employed peasants in Mozambique. The data on employers were not taken into account, as these were not reliable, as INE data collectors made a mistake in the classification of the status of employment. Data on poverty level of self employed were calculated on the basis of the database of INE's consumption household survey (Maputo 2004).

²⁶ It should be noted that NovoBanco does in fact offer housing loans which it prefers to call "renovation loans" as they are usually used for small projects with flexible terms and flexible amounts.

²⁷ The calculation of resting periods of NovoBanco's and SOCREMO's clients include loan processing time (estimated as approximately two to three days). This was not the case for the resting days of Tchuma's clients.

²⁸ This means that the definition chosen for dropout (client who did not take a loan within six months after having paid the previous loan) is adequate for 2 year old clients. However, an analysis of all clients of NovoBanco showed that of all clients, much more clients rest longer than 180 days: 16% (by June 2004)

Client Retention Rates

Although the three MFIs studied are relatively young, by far the greatest number of clients served by these institutions is no longer with them. The assessment study took a longitudinal perspective on retention, taking into consideration all new clients registered between July 2001- June 2002 and then assessed the records of all those clients who still remained active by end-June 2004. Although the results could be somewhat distorted by active clients who happened to be resting at end-June 2004, the findings showed that only about a quarter of clients remained after two years.

Concerned with the high dropout rates, Tchuma commissioned a study to examine the extent and causes of client dropout. Client retention is important because longer term clients increase average loan balance and reduce loan delivery costs. NovoBanco estimated that clients only start becoming profitable to them after about three loans (close to two years). Moreover, higher client retention rates become critical in the increasingly competitive and saturating microfinance market of Maputo City.

Consistently, a disproportional part of the dropouts (voluntary and involuntary²⁹) belonged to the low loan category, suggesting that the poorer clients tend to drop out more frequently. In the case of SOCREMO, on average 75% of all dropouts were from the low loan category and, in the case of NovoBanco, 64%. According to SOCREMO, almost half of the dropouts did not have repayment problems. The assessment did not look at impact on the majority of dropouts who leave within two years of being a client. This still leaves an important area for further research as it is possible that, apart from the clients who satisfy their credit needs or were expelled, other clients leave because they did not benefit from the loans. The in-depth interviews suggest that the effect of crises might be an important influence in forcing clients to quit: while just over half (52%) of the still active clients faced a crisis, 70% of the clients who dropped out (after two years) did.

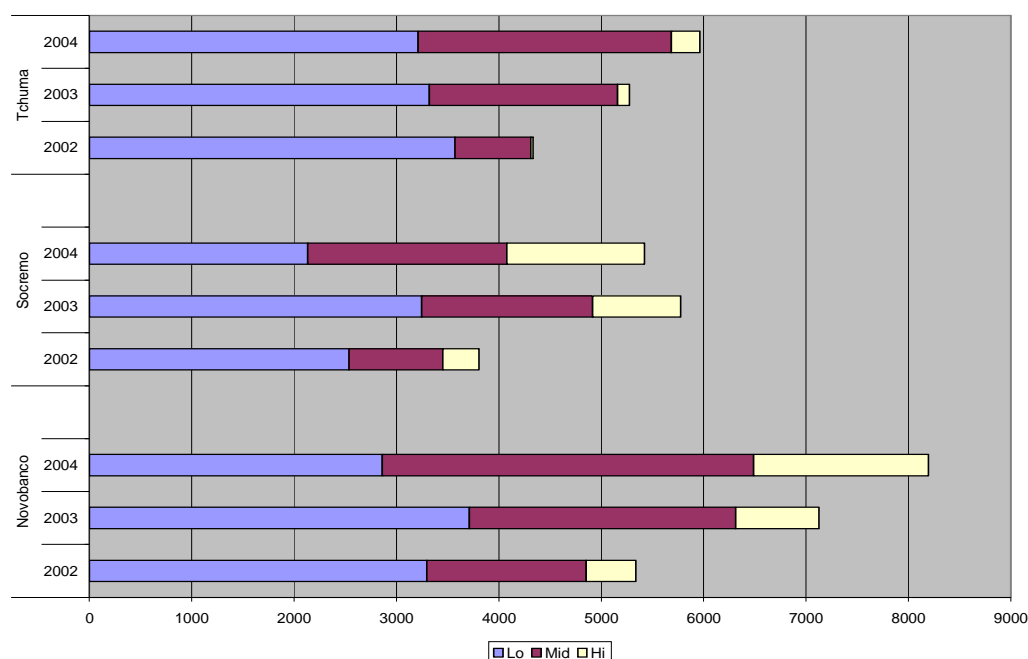
The in-depth interviews suggested that few clients switch to other MFIs in search of better conditions. Most clients were found to remain committed to their original MFI with little interest to find better conditions from alternative MFIs. Interviews showed that only very few of the clients who left their MFI for reasons linked to their MFI would try to find better conditions with an alternative MFI, possibly because the products offered were so similar. Overall, few clients have parallel loans with other MFIs but a significant minority of high loan clients did.

Distribution of Client Loan Categories

In terms of client numbers, the low loan category is the most important for Tchuma and SOCREMO while, in the case of NovoBanco, the largest portion of clients is found in the middle category. Although both NovoBanco and Tchuma reach approximately the same number of low loan category clients, Tchuma, due to its smaller size and its stronger poverty focus, has a considerably higher proportion of these clients. The relatively slow growth of higher category loans in Tchuma is largely attributable to its regulation that all clients must start with a minimum loan size and increase them by fixed increments. The sharp decrease of SOCREMO's low loan category clients is due to its policy of portfolio consolidation as part of its restructuring, which included an increase in the minimum loan amount and resulted in a reduction of the number of low category clients.

²⁹ Voluntary: clients who do not reapply. Involuntary: clients who reapply and were rejected

Figure 1: Number of clients by loan category (business loans, all branches)



In terms of volume of outstanding portfolio, the situation is different; the middle loan category is the most important for Tchuma: more than half (53%) of the volume of its loans belongs to this category. The high loan category is the most important for both SOCREMO and NovoBanco, accounting for around 60% of the volume of their business loans.

While women were the majority in all loan categories, the difference decreased with each progressive loan category³⁰.

Arrears

Data on arrears per loan cycle of more-than-two-year old clients showed very low averages for NovoBanco (just over two days), five days for SOCREMO to just over eight days for Tchuma. The higher number of days in arrears (and lower dropout rates as discussed before) for the latter is probably explained by a more tolerant policy towards late payments as well as a more explicit poverty focus. Clients from the lowest loan category have the most repayment problems, possibly reflecting the vulnerability of these clients to crises and shocks. Interestingly, the more-than-two-year-old female clients of SOCREMO and NovoBanco have more short term repayment problems than men, especially in the age group of 30 – 39. However, most women resolve their repayment problems within 30 days. Consequently, portfolio at risk (>30 days) with regard to female clients is generally better in all categories. Tchuma's portfolio at risk (>30 days) is 4%, of SOCREMO's 0.86% and NovoBanco's 1.96%³¹.

³⁰ In the case of NovoBanco and Socremo. Tchuma did not provide gender disaggregated loan portfolio data

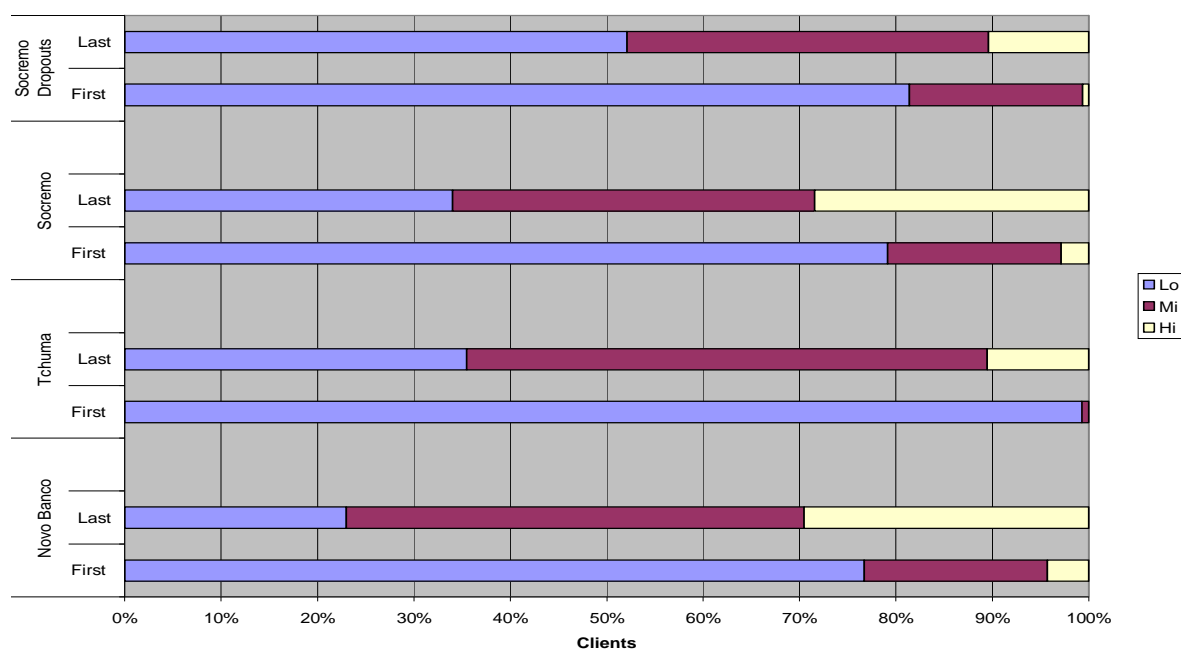
³¹ June 30, 2004

7. The Impact of Credit on Economic Activities

Transition between Loan Categories

Figure 2 shows how the loan categories have shifted over the period June 2002-June 2004, demonstrating that the-more-than-two-year old clients for all the MFIs mostly started with low loans but that the majority two years later had either middle or high level loans.

Figure 2: More-than-two-year old clients by MFI, loan category and time of appraisal



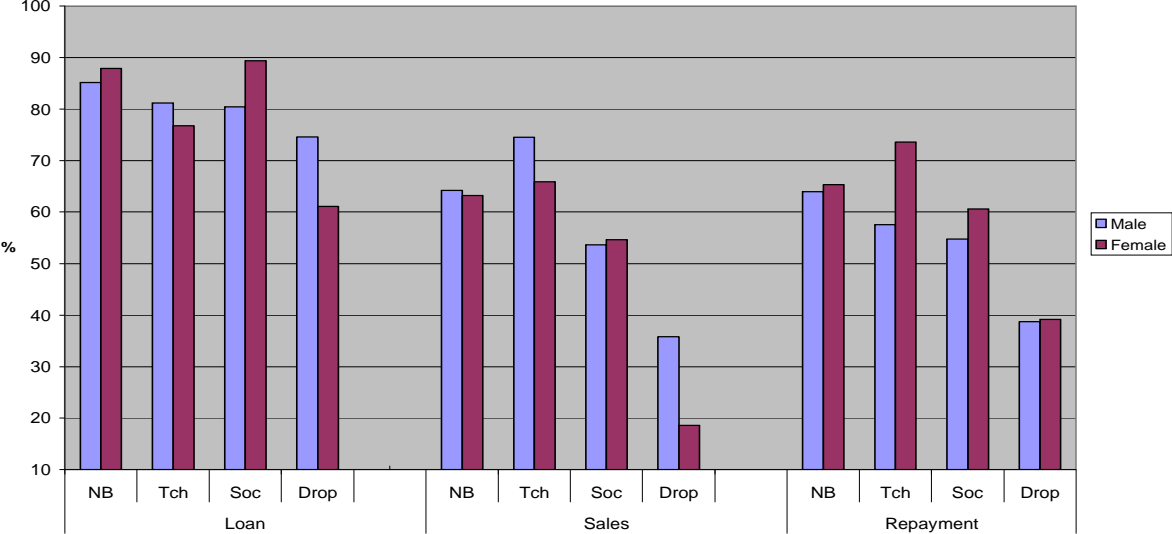
The majority of the clients started in the low category: virtually all clients of Tchuma and 80% of the clients of NovoBanco and SOCREMO. Most of these clients succeeded to move to another loan category. Due to its policy on loan growth, comparatively few of Tchuma's clients moved to the third category. The percentage of NovoBanco's and SOCREMO's clients in the high loan category (at the time of the last loan) was almost identical. Although a similar percentage of the dropouts and active clients started in the first category, more than half of those clients who dropped out after a period of around two years had remained in this category. Results from the interviewed clients showed that for the period 2002-2004, loans grew significantly for all categories but particularly for the high and middle category clients (all of whom graduated from lower loan categories).

Monthly Sales (size of activity)³²

The majority of the more-than-two year old clients experienced increased real value of sales (proxy for business size) and repayment capacity (calculated on the basis of a cash flow analysis on household level). However, the percentage of clients increasing their real loan sizes is much higher. Among the three MFIs the trends are similar, as can be observed in the figure below.

³² The amounts of the information derived from the most recent loan appraisals of the more-than-two-year-old clients are corrected on the basis of monthly inflation rates from Maputo City, to make them comparable with the information at the time of the first loan.

Figure 3: Percentage of clients with increased loans, sales and repayment capacity



The loan appraisal data showed that, in the case of Tchuma, all clients in the high category (based on the last loan) experienced considerable growth of loan size and started from the low loan category. Similarly, the majority of the high loan category clients of SOCREMO and NovoBanco started with low loans. Faster increasing average loan size could be due to cautiousness of both client and MFI at the time of the first loan. It could also be due to a lack of business opportunities, of business skills, or to application of loans for non-productive purposes. Significantly, the majority of clients who remained in the low loan category over two years also succeeded to increase the value of their monthly sales.

The pattern that clearly emerged from the two MFIs without a loan ceiling was that the higher the loan category of the first loan, the lower the increase in sales. Of NovoBanco, 66% of clients who started in the lowest loan category increased the value of their sales vs. 60% of those who started in the middle and 44% of those who started in the highest loan category.

A more detailed analysis of NovoBanco client data showed that the lowest decile with monthly sales volume of less than USD 500 at the time of the first loan (approximately) showed increases of almost 185% over a 2 -3 year period vs. negative rates of growth (-11%) registered by the 20% of the largest businesses with a monthly volume of sales of more than USD 2,000 (approximately) at the time of the first loan.³³

The data suggests that, by the time the low loan category clients reach the high loan category, their businesses would have registered substantial growth. On the other hand, the larger micro enterprises, starting with high category loans, are unlikely to grow further without undergoing substantial structural changes. We should keep in mind that these are working capital loans with conditions not usually favourable for longer term investments.

There is little difference between the percentage of active male and female clients whose business increased. The average level of increase of women’s businesses is higher than of men’s businesses, although the difference is very small. From SOCREMO’s clients who

³³ For Tchuma and SOCREMO, these analyses could not be made, because of limitations of the sample size.

dropped out after two years, only a minority experienced growth of value of sales (36% of the male dropouts and only 19% of the female).

Client Responses in Relation to Loans and Business Performance

Almost all more-than-two-year-old clients felt that their loans were important for their businesses. Most of those who did not increase their level of sales, said that their business would have been worse if they had not received a loan. The interviews showed that just under half (48%) of the respondents felt that their activities “grew” while 43% felt that their businesses fared worse since first receiving loans.³⁴ The highest percentages of clients who felt they grew were in the highest loan category.³⁵ It should be noted that none of the interviewed clients started with a high category loan. The reasons for the downturns in their business performance (according to respondents from SOCREMO) were split into three categories: i) those affected by economic influences (46.1%), ii) those affected temporarily by a crisis or unexpected event (30.7%) and iii) those who could be considered to have brought about the problems themselves - basically due to poor management (23.1%).

Interviewed high category loan clients demonstrated business strategies typically associated with entrepreneurs such as diversification, expansion and employment creation. Low category loan clients indicated that they mainly increased stock (although a significant percentage had lowered their stock recently in response to economic difficulties).

The loan appraisal data found that a minority of the clients who already have fixed business assets managed to increase their asset base. For example, in the case of SOCREMO and NovoBanco, 48% and 36% of the clients who own fixed business assets, had increased their asset values³⁶. The percentage of clients owning fixed business assets did not increase during the period of more than two years of receiving loans.

The loan appraisal data demonstrated that, generally, the clients used the loans for increasing stock. Furthermore, the value of the stock increased on average much more than the level of sales, suggesting reduced efficiency and higher inventory costs as increased stock from the loans carry the additional cost of interest. The qualitative results, on the other hand, showed that many lower category loan clients felt that their stock had been reduced during the past year due to worsening economic conditions. Much less frequently, loans are used for investment in business assets: the loan appraisal data showed that the number of clients with business assets did not increase. The qualitative results suggest that the interest rate is an impediment for high loan category clients and therefore the MFIs appear to be limited in its capacity to provide larger micro-enterprises funds for expanding their activities through the purchase of fixed business assets.

The total number of employees remained more or less the same over the time period studied.³⁷ Therefore, the findings do not support the widespread assumption that microfinance contributes towards job creation. Given that the vast majority of clients invest their loans in

³⁴ Interviews were conducted after a year that was considered to be difficult in comparison to the previous years covered by the loan appraisal data.

³⁵ This was the situation witnessed with Tchuma and SOCREMO but not for NovoBanco where most of the highest loan clients claimed to have weaker performances (although average loan growth for NovoBanco's highest loan clients average a growth of more than 300% from mid-2000 to mid-2005).

³⁶ No information was obtained from Tchuma in relation to fixed assets during first loan appraisals.

³⁷ Information on number of employees was only available from NovoBanco. Employees recorded by NovoBanco's loan officers can be part- or full time and have or have not a regular salary. Tchuma and SOCREMO collect information on cost of labour.

buying more stock, the subsequent spillover effects of business expansion during a 2-3 year period may not have been significant enough to manifest themselves in terms of increased fixed investments or employment creation. However, the in-depth interviews show that a relatively small percentage of clients have grown considerably faster than most of their fellow borrowers and were able to diversify, expand and increase employment.

8. Impact of Credit on the Level of Household Welfare

The impact study made an attempt to code the level of well-being of the interviewed clients based on the information gathered and observations at their home or enterprise. The “norm” consisted of a cement block house, electricity and what was considered to be a standard array of household assets. Very few households were encountered that could be considered to be significantly below the norm. Interviews revealed that many clients applied at least part (and often a significant part) of their “business” loans to what was referred to as “*futuro*”-related expenditures i.e. the construction or rehabilitation of their residences or acquiring household goods.

The qualitative interviews showed that the majority of clients from all client categories felt that their overall level of household welfare had increased since starting to borrow and the vast majority of clients across all categories felt that credit had a positive role on the level of household welfare. Increased household welfare, however, came in two forms: indirectly through increased income attributed to improved business resulting from the business loan or, more conspicuously, from the direct application of the business loan to either the construction or rehabilitation of their household residence or the purchase of household goods. Given the difficult economic environment and the limited ability of many clients to apply their loans to positively beneficial business purposes, the benefits derived by these clients was greater when channeled directly towards increasing the level of household welfare. Some of the interviewed clients indicated that they simply did not want to expand their businesses, probably because income earned was considered adequate and the scale of operations manageable, given their available resources.

9. Influence of Crises

The in depth interviews showed that 55% of the 120 credit clients (active and dropouts³⁸) interviewed and most of the 20 interviewed clients holding only deposit accounts (no credit) faced one or more crises in the past three years. This percentage was considerably higher for credit clients who had dropped out (70%) than for clients who were still active (52%). A minority (30%) of the dropouts, indicated that they stopped borrowing as a result of crises they faced, sometimes linked with perceived unduly harsh and inflexible behaviour of loan officers. The real percentage of clients an MFI loses due to crises is likely to be higher as clients who drop out before being two years with the MFI and clients who were expelled after two years due to late repayments and defaults were not included.

Most of the crises clients faced were related to health problems (either of client or within family) and deaths of family members: half of the credit (ex) clients and the majority of clients with exclusively an account. Due to the high prevalence rate of HIV/AIDS (16.2%) in Mozambique, it is likely that some of the health problems and deaths in the family were HIV/AIDS related, as some clients revealed spontaneously during the interviews (questions were not HIV & AIDS specific).

³⁸ 90 active clients and 30 dropouts

10. Reasons for More-than-Two-Year-Old Clients to Drop Out.

The historical loan portfolio data showed that the majority of clients drop out within the first two years of borrowing. The study focused on an atypical group of dropouts, i.e. those who leave after having had more than two years of loans, in order to compare the performance of these clients to those who remained with the MFI. An assessment of loan appraisal data was undertaken for 78 dropouts of SOCREMO and interviews with dropouts from all three MFIs. The loan appraisal data show that drop-outs had lower increases in loan size and that significantly fewer increased their monthly sales values and repayment capacity during the more than two years they received loans.

Although loan appraisal data for SOCREMO's dropouts showed that their business performance was significantly worse than other more than 2-year-old clients, interviews with small samples of dropouts (10 per institution), and therefore subject to caution, suggest that many clients who voluntarily leave the institution (dropouts) operate (according to the information provided during the interviews) successful businesses and, according to repayment histories, have normally been good credit risks.

The main reasons for dropouts deciding to leave were associated with events such as crises. The data above suggests that this could apply to about a third of the dropouts. Although clients often said that their MFIs can be sympathetic to the effect of crisis on some clients, many clients with temporary repayment difficulties felt that, despite long and good credit histories, zero-tolerance arrears policy is being over-zealously applied by some loan officers. This provoked ill will and often led to a decision on the part of the client to stop further borrowing. Only some sought loans from another MFI.

11. Use and Impact of Deposit Accounts

Interviews were conducted with clients with exclusively deposit accounts (i.e. from Tchuma and NovoBanco only as SOCREMO introduced accounts in mid 2005).³⁹ The interviews showed that security against theft, fire and self-control to prevent unnecessary spending were the most mentioned motivations to open an account. The favourable conditions such as a low opening balance, low or no minimum subsequent deposit requirements and the vicinity of the branches were important incentives to open an account at the MFI.

As is described in the microfinance literature⁴⁰, poor people often use a broad diversity of savings tools, including illiquid services (whereby savings cannot be withdrawn at any time) to build up lump sums and liquid savings services for emergencies. Each savings tool has its own specific purpose. The interviews showed that this strategy of 'targeted savings' was used by the poorer as well as by the better off clients. The trend was the wealthier the client, the more diversified the package of formal and informal services used. The combination of services used by wealthier clients included, for example, current accounts at the MFI and another bank (liquid services), membership of a *xitique group* (ROSCA), a funeral association and a term deposit account (illiquid services).

The majority of the interviewed clients used the current account at the MFI for longer-term savings. They chose a current account because they wanted to accumulate money gradually

³⁹ Ten of Tchuma and ten of NovoBanco. Tchuma has only some dozens of clients with current account, while NovoBanco has more than three times more clients with a deposit account than borrowers.

⁴⁰ See for example: G. Wright (1999) *A critical review of savings services in Africa and Elsewhere*. MicroSave. Kenya.

and to be able to access money in case of emergencies. A small minority of clients of NovoBanco used a term deposit. The MFIs do not yet offer a more flexible interest bearing savings product.

Most of the clients used the MFI current account with the intention to save for 'opportunities' e.g. for starting or running a business and acquiring a business or household assets. However, less than half of these clients actually applied at least part of their savings for this purpose. The most common reason for savings withdrawal was emergencies like theft and illness. Clients running a business in the markets near the branches used the current accounts on a daily basis for business management. The use of the account by those clients who had also credit from the MFI was generally related to credit: saving for reimbursement and facilitation of credit transactions.

The majority of the interviewed clients were involved in one or more informal financial systems; the *xitique* group, *xitique geral* (money collector) and funeral associations. *Xitique* groups were most popular among women of all wealth levels. The better-off are probably more attracted by the social aspect of the *xitique* groups, and the poorer by the peer pressure to save. Clients mentioned the easy access and security as comparative advantages of the current accounts in relation to the informal products. However, most of the clients did not stop using informal systems after opening a bank account. The peer pressure to save and the social contacts were commonly mentioned as advantages of the popular *xitique* groups. Although almost all interviewed clients mentioned the security of the money collector in the markets (*xitique geral*) as a concern, the proximity of the MFIs' branches compensating for the ease of the money collector operating in the markets was mentioned only once.

Contrary to expectations, clients with deposit accounts⁴¹ did not show a significantly better repayment record. Interviews revealed that *xitique* or *xitique geral* was in many cases an important tool to save for the reimbursement of the loans. Moreover, many clients appeared to have accounts in other banks. Most clients who had accounts in other banks said that they use those accounts more frequently than the MFI account, mainly because of the ease of the ATM services for daily expenses.

Men used the accounts generally more frequently than women. This can be explained by women's' priority for contributions to *xitique* groups. Most of the clients involved in *xitique* groups saved more frequently and higher amounts per month in the groups than they had as a balance in their bank accounts. Some women were found to save up to a third of their income with the *xitique* groups. According to clients, *xitique* groups cater mainly for women because men do not trust each other sufficiently or would not have the patience to attend group meetings. The fact that forced savings remain beyond the control of family members and friends is likely to be one of the underlying reasons for the popularity of *xitique* among women.

Impact has been estimated by considering what would have happened differently in the clients' socio-economic lives if the MFIs had not offered savings accounts. It appeared that the majority of interviewed clients who had exclusively a deposit account would be worse off if the MFIs had not existed. All these clients had a low income or were classified as poor; some were clearly too poor to qualify for an individual loan of the MFIs. According to these clients, they would have had greater difficulties in coping with crises; they would have been exposed to considerably more risk of theft and would have spent more time and money on

⁴¹ NovoBanco and Tchuma only; Socremo did not have yet clients with deposit accounts during the period of analysis.

transport to deposit money in another bank (in the case of those who had another account). For a minority of clients, it would have made little difference if the MFI had not existed as they had easy access to other banks.

12. Client Satisfaction

Clients positively responded to all the issues raised in relation to loan product and related services. However, lesser degrees of enthusiasm were evidenced in relation to guarantor policy; guarantee requirements and valuations/depreciation rates; and high interest rates (felt particularly by high loan categories). Although the MFIs were seen in a very similar light, there were some features that distinguished one MFI from another such as arrears tolerance, rapidity of loan processing, interest rate levels, etc. Some clients reported that loan officers recommended that they increase their collateral (sometimes urging the replacement of functioning household appliances that were older and therefore written off) in order to increase their borrowing capacity.

Most clients with exclusively deposit accounts were satisfied with the MFIs' products and services. Clients were most positive about the treatment, the proximity of the branch to the house or market and the low costs for opening an account. Many clients would appreciate the introduction of automatic teller machines (ATMs) and payment of interest on accessible savings. Interestingly, the clients of Tchuma did not complain about the monthly maintenance fee on their current accounts, while the clients of NovoBanco did, even though most of them were wealthier than the Tchuma clients.

A product feature valued by Tchuma clients was the minimum amount accepted for deposit after opening their account (10,000 meticaís which is USD 0.40) as it made them feel that even very little money was welcome, even though bank statements proved that none of the interviewed clients ever had deposited such a small amount. The other MFIs accept any amount for deposit

Another positive feature was the fact that Tchuma asks the client to nominate a person who is entitled to the money in the event of death, as it was reported that, in banks other than those studied, it can take months for the spouse to get access to the deceased's money, if at all.

13. Summary of Findings

The main findings of this impact assessment are the following:

- In-depth interviews with clients of different loan categories as well as dropouts showed an overall positive impact on both the supported economic activities as well as household welfare. Clients whose business deteriorated, felt that their situation would have been worse without having received credit.
- Microcredit, though contractually stipulated for business purposes in the case of these three MFIs, also plays an important role in improving living standards through direct application into housing construction or renovation and household durables. Households prefer small, sporadic injections into housing, reflecting their often volatile financial situation.

- The profile of the more-than-two-year-old clients surveyed under this assessment shows that they are better educated than the average Maputo citizen, middle-aged, economically active people with considerable business experience.
- A small part of the more-than-two-year-old clients of the poverty focused Tchuma could be considered to be poor as defined by living under the poverty line, while this is the case for more than half of the Maputo population. This probably follows from the fact that individual guarantee-based loans require the ownership of assets, most of which operate with electricity, putting them into a relatively higher income level.
- Almost half of the more-than-two-year-old clients of the poverty focused Tchuma (43%) and, assumingly a larger portion of the clients of the other MFIs, belong to the top 20% income group of Maputo City. The clients' households are not wealthy, but clearly better off in relation to the majority of Maputo's households. Most of these clients can be considered to belong to the lower end of an emerging middle class.
- A large majority of clients did not continue to take loans after two years. The majority of dropouts leaving within the first two years of borrowing were from the lowest loan category and probably poorer than the retained clients.
- Higher numbers of the low loan category clients cause a higher portfolio at risk. Clients of this category also drop out more often and are less inclined to take sequential loans. The middle and high loan categories are more important in terms of portfolio volumes, have shorter resting periods and show better repayment records i.e. they are better clients in terms of institutional sustainability.
- Although NovoBanco reaches approximately the same number of low category clients as the poverty oriented Tchuma does (taking into account all clients in Mozambique), Tchuma has a much higher proportion of low loan category clients (54% of all clients as at June 30, 2004) than NovoBanco (35% of clients with business loans).
- Credit provided by the MFIs proved to have most impact on those borrowers who tend to have basic entrepreneurial skills and who started with small loans. Even during times of economic difficulties, clients who had climbed to higher loan categories continued to increase their loans, suggesting loans were also important to confront such difficulties. Borrowers of lesser entrepreneurial capacity or those encountering multiple crises in household or business were unable to use their loans as effectively.
- Our evidence also showed that even the majority of clients remaining with low loans (accounting for between a quarter to a third of the more-than-two-year old clients) succeeded in increasing their level of sales.
- Although instrumental in promoting the growth of smaller micro-enterprises into larger ones, loans have not been very successful in promoting the growth of the existing relatively larger micro-entrepreneurs. This suggests that the available loan products are good at stimulating growth from small to larger micro-enterprises but are limited beyond that.
- On average, the value of stock of the clients increased suggesting increased inefficiency due to higher costs of merchandise (now including interest rate charges). Only a minority

of clients succeed in increasing the fixed asset base while the overall effect on employment numbers was negligible. Fewer women owned business assets or employed labour.

- Around the same percentage of active male and female clients were able to increase the value of monthly sales. The level of increase was slightly higher in the case of women than of men.
- Clients who drop out after a period of two years, performed – on average - worse during these two years than the clients who continue with an MFI. However, many dropouts claim they had well-performing businesses and were good loan clients but decided to leave for reasons often associated with crises. For the MFIs this could mean that they lose long-term good clients due to short-term financial problems. Some dropouts claim that the treatment by loan officers, as a result of minor repayment problems resulting from crisis, stopped them from further borrowing.
- Client growth rates of the three MFIs have so far been maintained because new clients exceed dropouts. The microfinance market of individual loans in Maputo is very competitive and it is questionable if growth can be sustained.
- SOCREMO and NovoBanco compete with each other for a specific segment of the loan market, limited at the lower end by the need for collateral or individual guarantees and at the upper end by what are essentially working capital loans with interest rates considerably higher than those of the commercial banks. Tchuma has recognised the limitations of up-market growth and decided to improve its solidarity group lending in a bid to service the lower end of the market.
- Current accounts reduced the vulnerability of clients towards emergencies and helped to manage their businesses. The experience of the rapid growth of the number of current accounts with NovoBanco, exceeding the number of borrowers by more than twice⁴², demonstrates the enormous demand for this product.
- Informal financial systems still play a very prominent role in helping urban households cope with their erratic fund flows. *Xitique* and *xitique geral* is often used for saving for monthly reimbursements. The findings of the interviews of clients exclusively holding accounts suggest that informal arrangements, rather than substituting microfinance products, are more likely to complement these arrangements. However, the findings of the credit clients show that the higher loan categories were less involved in informal arrangements, suggesting that the importance and usage patterns of informal financial systems requires further study.

14. Conclusions and Recommendations.

Looking at the two major goals of the impact assessment i.e. to justify the use of public funds and to inform strategic planning of the MFIs., the following conclusions can be drawn and recommendations given:

⁴² As at June 30, 2004

Goal 1: Justification of the use of (public) funds of the members of the Netherlands Platform for Microfinance.

On the basis of the overall positive impact on both economic activities as well as household welfare of more than two-year-old MFI clients, one can conclude that the use of (public) funds is justified for these microfinance institutions.

However, there are some important concerns:

- The overall impact of the MFIs' services could be highly over-estimated as the assessment was limited to only the more than two-year-old clients and to a specific group of dropouts i.e. those who had been with the institution for a period of more than two years⁴³. The assessed microcredit clients represent a minority of all clients as about three quarters of the clients drop out before a period of two years.
- Other impact assessments found that "benefits on households and businesses of clients were generally associated with continuing access to micro-credit, not just one or two loans"⁴⁴. It is possible that many early dropouts 'voted with their feet' and stopped taking loans because their needs were not met or because difficulties were encountered during repayment. This hypothesis is supported by the finding that businesses of clients who dropped out after a period of two years performed worse than those clients who continued.
- From the institutional point of view, recurrent clients are important because longer-term clients increase average loan balance and reduce loan delivery costs. Moreover, higher retention rates are critical in the increasingly competitive and saturating microfinance market of Maputo City.
- The findings of the assessment contribute to a nascent but growing debate about the distributional impact of microcredit⁴⁵. Most of the clients who drop out before two years are from the low loan category and probably poorer than the clients of the higher loan category. This suggests that fewer poorer clients benefit from the loans. However, it is also important to note that most of the low loan category clients who continue to take a loan for two years, realized more business growth than those clients starting with higher loans. Donors should channel more research into the distributional effect of microfinance, so that interventions can be more focused on microcredit delivered to those clients with the most potential to benefit from these services.
- In Mozambique, the MFIs supported by members of the Netherlands Platform for Microfinance mainly retain relatively old and experienced micro-entrepreneurs from the lower end of an emerging middle class. These tendencies are attributed largely to their focus on individual guarantee based loans. To increase the outreach and retention of lower income groups, NPM members should also consider supporting other MFIs and/or to encourage the current MFIs to conduct market research and to pilot test other, possibly more appropriate, products e.g. more diversified savings products tailored to the needs of microfinance clients for both easily accessible and less easily accessible savings (liquid and illiquid savings).

⁴³ Alexander and Karlan (2006) demonstrated that failing to include dropouts can bias estimates of impact. They found that after including dropouts some of the measures of impact changed dramatically. Where the AIMS cross-sectional methodology showed an increase of US\$1,200 in annual microenterprise profit, including dropouts caused the estimate to fall to a *decrease* of about \$170. Source: Karlan and Goldberg (2006) *The impact of Microfinance, a review of methodological issues*.(pg 20) Yale University, New Haven, USA

⁴⁴ See CGAP Focus Note 36, May 2006, pg. 2

⁴⁵ See for example: Thomas Dichter (2006) *Hype and Hope: The Worrisome State of the Microcredit Movement* South African Institute of International Affairs, and A. Legovini (2002) *The Distributional Impact of Loans in Nicaragua* The World Bank. Findings of the latter study suggest that it is only the richer households that have clearly benefited from business loans while poorer households are more likely to have become poorer as a result of borrowing.

- Tchuma, the locally rooted MFI with a specific poverty focus, has the weakest support and ownership structure (investors, funding agencies and TA) and has the most difficulties to attract funding. Therefore it is limited in its possibilities to launch new products and to cope with the increased competition after the establishment of NovoBanco. The members of the Netherlands Platform for Microfinance should better coordinate and balance their support to international and local MFIs: greater technical and financial support should be provided to locally rooted and well-performing, (potentially) sustainable poverty focused MFIs.
- The low loan category clients are more costly per unit of currency loaned. Donors and investors should realize that the route to sustainability of exclusively poverty focused MFIs is generally longer.

Donors and investors can play an important role in ensuring that the social mission of MFIs remains of central concern, despite the increased focus on commercialization and scale of microfinance. Microfinance stakeholders have a growing interest in developing systems to manage, monitor and report on social performance⁴⁶. The following recommendations should be understood in this context:

- Support MFIs to track changes over time and to monitor changes (with regard to different client categories) as part of a social performance management and reporting system.
- Support MFIs to set up a system to monitor the poverty level of new clients and to assess the changes over time of the poverty level of retained clients.
- Support MFIs in researching reasons causing clients to drop out within a period of two years.
- Promote the development of a standardized formula to calculate dropout rates while taking into account resting days. The development of such a formula should contribute to comparability of dropout rates between MFIs.
- Promote the calculation of the retention rate of longer-term recurrent clients (e.g. clients who continue to take loans for two years).

Goal 2: Inform strategic planning of the MFIs

The research provided insights in several areas important for strategic planning of the MFIs. Overall, it is recommended that the MFIs become more driven by client needs, especially with regard to product development and product delivery as well as improving their awareness of what type of clients are being served and how through better internal tracking and monitoring systems. Below, specific recommendations are provided for these and other issues.

Market research and product development

Looking at the client characteristics, there seems to be potentially unexplored market segments such as the age group below 35 years, less educated people, and poorer clients. There are signs that the market for collateralised microcredit is saturated. Savings products are in high demand and have the potential to reach deeper into the market. Market research and possible introduction of new products might open other interesting income segments in the competitive market currently served by the MFIs.

⁴⁶ Social performance is defined as the 'effective translation of an institution's social mission into practice' Bart de Bruyne & Johan Bastiaensen (2006) *How to put social performance management into practice?* Trias, Brussels

The following is recommended:

- Undertake a market study of potential young clients (younger than 35).
- Introduce a flexible interest bearing savings product whereby savings can be more easily accessed than term deposits
- Review collateral requirements for retained clients with a good credit record.
- Factor in the reality (and probability) of crises and introduce products (besides the existing micro-deposit products) that are specially designed to cushion the impact of a crisis e.g. insurance products and short-term emergency loans.
- Assess the profiles of higher loan category clients with the objective of introducing appropriate longer-term loans that could stimulate growth.
- Given the fact that business loans are used for business and consumption purposes, consider the provision of multi purpose loans for micro entrepreneurs based on cash flow analysis and analysis of guarantees.
- In the case of Tchuma, if outreach to poorer clients is to be achieved, methodologies that do not require the types of guarantees currently required need to be pursued e.g. by reviving the solidarity groups
- It is also recommended that Tchuma undertake market research to develop risk-management financial services for vulnerable populations.

Product delivery and customer service

Good product delivery and customer service strategies are important for improving client retention and attaining more effective impact. Most clients had faced some form of crises in the last years which were found to be important factors in causing client dropout. Tchuma has the lowest dropout rate of the three MFIs, possibly explained by its more tolerant policy towards late payments.

The following is recommended:

- Consider training of loan officers to better respond to clients with common repayment problems caused by crises.
- Introduce incentives for loan officers to improve retention rates.
- Revise arrears policy to allow greater tolerance for clients with a clean track record.
- Conduct research into the effect of being more tolerant for clients in arrears on client dropout.

Internal tracking, monitoring systems and research

Information on clients is crucial to be able to assess the market and to ensure clients' needs are met.

The following is recommended:

- Monitor more effectively the retention rate of clients, by keeping track of the length of borrowing periods of (different types of) clients
- Make an informed decision on when (how many months after having paid the last loan) a client is considered to be a dropout, taking into account average resting periods
- Conduct research on reasons for clients dropping out within a period of two years
- Monitor more effectively dropout rate and the reasons for dropping out.

To ensure that the social mission of the MFIs is put into practice, MFIs should consider setting up a social performance management and reporting system. To facilitate this, the following actions are recommended:

- Make use of data collected for loan appraisal in order to assess changes over time, e.g. in business size, repayment capacity or other indicators that are important given the mission of the MFI. Additionally, consideration should be made to periodically conduct a limited number of in-depth interviews to better understand the observed trends.
- In the case of Tchuma, it is suggested to assess the poverty level of new and repeated clients in relation to the poverty levels of Maputo households, by using the short list of durables and characteristics that has been developed for this purpose by this study. In this way, both the poverty profile of new clients and changes in the poverty level of retained clients can be assessed.