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MICRO-FINANCE, MACRO-CHALLENGES: AN ANALYSIS OF THE EFFECT OF POLITICAL INSTABILITY ON MICROFINANCE OPERATIONS

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ABSTRACT

Microfinance has been highly lauded as an effective poverty reduction technique since Mohammad Yunus popularized the concept in the 1970s. Given that microfinance organizations often operate in countries with low political stability, this paper seeks to investigate how instability affects—or doesn't affect—the ability of institutions to grow and succeed. Although the exact relationship between political instability and microfinance success is difficult to capture, this paper examines the microfinance industry in three countries—Cambodia, Haiti and India—with varying levels of political stability to attempt to drawn some conclusions and lessons that can be learned from their experiences. An in-depth examination of each country is offered, starting first with an overview of the political stability within the nation and proceeding to analyze how microfinance organizations have dealt with that stability in order to best succeed. After comparing the three cases, it appears that political instability in and of itself is not a direct determinant of microfinance success. However, success does depend strongly on the ability and dedication of the government to prioritize the passing of microfinance legislation in order to guide and regulate the industry. Lessons learned and best practices are drawn from each country in order to advise both governments and microfinance organizations on what steps they can take in order to facilitate the development of a strong microfinance industry in their country.

Table of Contents

LIST OF FIGURES

LIST OF TABLES

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Chapter 1

Introduction

In the arena of international development, there have been precious few topics that have garnered as much attention as micro-finance has in recent decades. The strategy, which involves providing micro-sized loans to the poor, has found widespread success across the globe and is generally lauded as being a sustainable method to combat poverty. Although the concept of small lending can trace its roots back to the 18th and 19th centuries, the modern establishment of microfinance is generally acknowledged to have occurred in the 1970s and 80s, particularly with the work of Muhammad Yunus in Bangladesh. Since his founding of the Grameen Bank, grounded in the principle of solidarity group lending, the industry has taken off, finding the support of governments, non-profit organizations, and even commercial institutions.

Given the extreme range of countries and companies that employ microfinance, it is difficult to say what factors contribute to the success of any one particular microfinance institution (MFI). The size, strategy and clientele of each MFI are unique and depend on numerous variables, such as the ideology of the director of the MFI and their intended trajectory as an organization. External factors, such as the literacy rate and institutional framework of the country in which the MFI is operating also affect the functioning of the organization. Identifying the exact manner in which any one factor affects micro-finance institutions requires significant research and analysis of the factor at hand and MFIs that have experienced interactions with that factor.

This paper is intended to provide such an analysis of the effect that political instability has on the operation of microfinance institutions. Given that many of the countries in which MFIs operate are poor and in the stages of developing, political instability is a factor that has a widespread presence in the micro-finance industry. Using case studies of MFIs in Cambodia, Haiti and India, this paper will seek to uncover what effect, if any, political instability has on the ability of micro-finance institutions to grow and succeed.

Ultimately, this paper looks to provide insight and advice into how to account for political instability when establishing an MFI. By highlighting the effects of instability and identifying cases in which institutions managed to overcome instability, this research can provide a framework to developing institutions to guide their organizations in dealing with political instability, as well as to governments hoping to foster stronger microfinance operations within their country.

Literature Review

To begin, two terms must be defined in order to more precisely discuss the topic at hand. Although "microcredit" and "microfinance" are often used interchangeably, the two concepts are in fact distinct. Microcredit refers to the act of providing small loans to the lower echelons of the economy, specifically those who are unable to receive credit from commercial banks and large lending institutions (Sengupta & Aubuchon, 2008). These loans generally range from $50-$500 and are intended to assist the poor in growing and expanding their micro-businesses in order to move out of poverty. Microfinance, according to Sengupta and Aubuchon, instead refers to “the act of providing these same borrowers with financial services such as savings institutions and insurance policies” (2008, p. 10). Thus microcredit is but one facet of the larger concept that is microfinance.

Khandakar Elahi and Constantine Danopoulos draw a further distinction, asserting that microfinance institutions differ from microcredit not only by providing a broad range of services, but also because these institutions aim to become self-funded (by drawing on deposits made by clients) (Elahi & Danopoulos, 2004). This claim is not as widely portrayed as the more general differentiation, but does serve to emphasize the difference in capabilities between the two concepts. This paper will mostly utilize the term “microfinance”, speaking to the broader concept of providing financial services to the poor. The specific services and funding mechanisms necessarily will vary from institution to institution, and thus the term will be used at the most general level.

Although there are examples of microfinance schemes that were established in 18^{th} and 19^{th} century Europe (Becker, 2010), the modern microfinance framework took root in the late 1970s and early 1980s. Muhammad Yunus, a professor of economics, returned to his homeland of Bangladesh to live among the poor and try to gain a better understanding of the causes of poverty. His experience led him to believe that lack of credit was a significant contribution to poverty, and thus he decided to lend out $27 of his own money to 42 women to help expand their stool-making business. Yunus continued to expand and develop this model and in 1983 he received a special charter from the Bangladesh government to establish the Grameen Bank (Sengupta & Aubuchon, 2008).

Yunus and his Grameen Bank proved to be enormously influential, as they dismantled the widely held belief that the poor were not reliable debtors. Prior to the "microfinance revolution", Marguerite Robinson explains that the formal banking world merely ignored the poorest segments of society. This forced the poor to seek money from informal sources, such as moneylenders, who often charged tremendously high rates and offered inflexible repayment schedules (Robinson, 2001). They could not approach banks for credit opportunities, as these institutions saw the poor as too risky of an investment. With no collateral to offer as insurance and no credit histories to demonstrate their reliability, the poor posed both moral hazard and adverse selection issues to formalized lending institutions (Hermes & Lensink, 2007).

However, Yunus' Grameen Bank model helped to mitigate those risks. The model centered on group lending and joint liability to transfer the agency costs of lending from the bank to the borrowers. Clients formed groups of five members, two of whom received the first loans. Only when they both fully repaid their loans could the remaining members of their group receive their loans. This ensured that only reliable debtors would receive loans—as no client would want to group themselves with an unreliable debtor—and the social shame that would be bestowed should a client fail to repay their loan replaced more typical collateral (Sengupta & Aubuchon, 2008).

The Grameen Bank model proved to be revolutionary and the institution grew tremendously, today serving over 5.5 million clients. The framework spread to other countries and continents and several other major banks followed in Grameen's footprints, such as BancoSol in Bolivia and Bank Rakyat in Indonesia (Sengupta & Aubuchon, 2008). However, as the concept grew in popularity, differing perspectives on how the model should be approached took hold. Robinson notes that in the early 1990s a definitive split appeared in microfinance thought: those who took a "poverty lending" approach, and those who supported a “financial services” approach (Robinson, 2001, p. 22). The poverty lending” field of thought embraced a primary goal to provide credit and services to the poor, without concern for financial sustainability. This approach emphasizes additional programs such as education and health services, and largely relies on donors and grants for support. In contrast, the “financial services” train of thought emphasized financial sustainability of lending institutions, focusing more on efficient money-lending than on providing auxiliary services (Robinson, 2001). Some authors, such as Robinson, hail the financial services approach as the only method by which microfinance can be applied on a grand scale, while others such as Isobel Colemen argue that the poverty lending approach more fully supports the needs of the poor (Coleman, 2005). This paper takes no bias on this matter and will include instances of both approaches.

Another important development in the history of microfinance was the emergence of profitable microfinance institutions and the commercialization of microfinance as an industry. Bank Rakyat Indonesia (BRI) was one of the first organizations to have significant success in microfinance, as their KUPEDES credit program became profitable after just two years of operation. BRI has remained operational free from subsidy since 1987. BancoSol in Bolivia found similar success and became the first bank to amass capital from international investment funds (Robinson, 2001). Today, the microfinance industry remains a popular means of investment for socially-conscious capitalists who hope to achieve social progress while receiving reasonable returns on their investments (Budde, 2008).

The current state of the microfinance sector is impressive and is predicted to continue to grow tremendously over the coming decade (Platteau & Siewertson, 2009). According to the most recent available data, there are over 10,000 microfinance institutions serving 100-150 million clients around the world (Platteau & Siewertson, 2009). Of these, over 2,000 report to the Microfinance Information Exchange (MIX), an organization dedicating to providing financial and social performance data and analysis for the microfinance industry (Countries and Regions, 2010).

Given its explosive popularity, many have sought to determine just how effective microfinance is at poverty alleviation. However, such information has been met with some difficulty. Studies have found it difficult to isolate the effect of loans from other factors, such as entrepreneurial spirit and household particularities (Sharma & Buchenrieder, 2002). In instances where conclusions can be drawn, often they are limited to correlations and don't demonstrate causal relationships. And many results remain country- or institution-specific: there has yet to be a cross-cultural study with results of magnitude (Lard & Barres, 2007). Nevertheless, even given these limitations, there is still tremendous evidence as to the positive effects microfinance has for the poor. The general consensus remains that microfinance is an effective tool to combat poverty.

As Sharma and Buchenrieder point out, the fact that MFIs continue to grow is in and of itself evidence to their impact: if the programs weren't beneficial to clients, they would stop partaking in them and the microfinance industry would decline (Sharma & Buchenrieder, 2002). Apart from this theoretical argument for the impact of MFIs, plenty of other studies have highlighted positive impacts of MFIs, ranging from improved incomes, reduced vulnerability, female empowerment, and improved social services such as education and health.

Inevitably, the success of microfinance depends on a multitude of factors, many of which have been researched thoroughly on their own. This paper is focused on political instability as a factor of microfinance success. Political instability is a well-studied concept and has been found to affect a wide range of phenomenon, from tourism (Ioannides & Apostolopoulos, 1998) to inflation rates (Aisen & Veiga, 2008). Since instability can play a crucial role in many different fields, it is not unlikely that it will influence the development and success of microfinance sectors. In order to hypothesize exactly how instability might affect microfinance, we will first survey the literature focused on the effect of political instability on development, in particular on investment and economic growth.

As is the case with most research in the social sciences, exactly how to capture and measure political instability is not blatantly obvious. Generally speaking, most researchers have taken one of two approaches to measuring instability: either they measure executive instability, or they measure socio-political instability. Executive instability refers to the "propensity of government change", either by constitutional or unconstitutional means (Alesina & Perotti, 1996). Generally, this type of measurement involves constructing regressions calculating the likelihood of change occurring in the executive branch of government based on past instances of change and other institutional features.

The other method of measuring political instability, measuring socio-political instability, involves constructing indexes that measure the level and likelihood of social unrest in a nation. Many authors have developed such indices, such as Alesina and Perotti (1996) and Banks (2005). These indices are typically built using data on events such as politically motivated assassinations, number of people killed in instances of domestic mass violence, and the number of coup d'états (both successful and unsuccessful. The following review will overview studies that use each of these measures, as well as studies that use both, and will then establish the framework that will be used in this paper to examine political instability.

Firstly, Jakob Svensson looks to investigate why investment rates differ so significantly across countries and proposes that this variation is due to levels of political instability. His study measures private investment using a proxy of the ratio of real private domestic investment to real GDP. He captures political instability via the propensity of government change, coding instances of government change as general change (any transfer of executive power) and major (instances of irregular changes such as coups as well as polarized changes between regimes). His analysis reveals that political instability results in unsecure property rights, which lessens investment, stating that "political stability is conducive to capital accumulation due to the fact that it creates necessary incentives for the government to define, enforce and protect property rights" (Svensson, 1998, p. 1330).

Alesina, Ozler, Roubin & Nouriel (1996) examine the effects of political instability on economic growth more generally, again using propensity of government change as their measure of instability. They use data from Jodice and Taylor (1983) and also code for both general and major changes in government. They also find that political instability has a negative effect on growth, particularly when looking at instances of major governmental change. They assert that “political instability affects growth because it increases policy uncertainty, which has negative effects on productive economic decisions such as investment and saving” (Alesina, Ozler, Roubini, & Swagel, 1996, p. 191), offering a potential explanation as to the mechanisms through which political instability affects growth. Their research also found that past occurrences of political instability increased the future probability of government change, an indicator that political instability may be persistent.

Alesina also investigates political instability using the second method of measurement, socio-political indicators of political instability, in a different study with Perotti (1996). Specifically they hypothesize that income inequality increases instability, which in turn reduces investment. To pursue the analysis, they construct an index of socio-political instability, composed of variables measuring the number of political assassinations, the number of deaths in domestic mass violence, and the number of unsuccessful and successful coups. This index is meant to capture the concept of political instability threatening property rights. Alesina and Perotti’s analysis confirms their hypothesis, that income inequality increases political instability, which in turns reduces investment. They suggest that instability affects investment in three ways: it increases expected taxation (by reducing politician’s tenure and thereby reducing incentives to keep taxes low); it can disrupt productive activities contributing to economic growth; and it increases policy uncertainty, incentivizing investors to postpone projects or take capital abroad (Alesina & Perotti, 1996).

Several authors included both methods of measuring instability in their studies, in order to get a broader idea of the effects of instability. Richard Jong-A-Pin (2009) investigated the ways in which political instability was measured and analyzed 25 frequently used indicators. Using factor analysis, he finds four dimensions of political instability that were common amongst all the indicators: politically motivated violence, mass political violence, instability *within* the political regime, and instability *of* the political regime. He then uses those four dimensions to re-examine the effects of political instability on economic growth. He finds that only the instability of the regime has a significant negative effect on growth, asserting that this measure “comes closest to the concept that scholars have in mind when they refer to the uncertainty that investors face” (2009, p. 26).

Klomp and de Haan (2009) examine the effects of political institutions on economic volatility, in particular looking at regime type, stability of regime, and policy uncertainty. Similar to Jong-A-Pin, they use a four-factor model for political instability. Their model consists of “aggression” (i.e. guerrilla, revolutions, internal conflict), “protest” (strikes, riots, demonstrations against the government), “regime instability” (number of coups, regime durability, etc) and “government instability” (polarization and political cohesion). They use the relative standard deviation of economic growth as their indicator of economic growth volatility. Their analysis finds that all four dimensions increase economic growth volatility, but that the results were only significant for regime instability and government instability (Klomp & de Haan, 2009).

In addition to these studies, there is some evidence regarding the relationship of more broad policy uncertainty and economic growth. Dani Rodrik (1991) proposes a theoretical model that demonstrates that policy uncertainty acts as a tax on investment. He thus suggests that in developing countries, reforms that intend to strength the economic sector may inadvertently cause increased uncertainty and may stunt growth rather than encourage it. Similarly, Aizenmann and Marion (1993) find that macroeconomic policy uncertainty is negatively linked to private investment. Both of these studies suggest that even beyond regime instability, fluctuations in government policy can harm the economic sector of a nation.

Given the qualitative nature of this paper, we will keep a broad definition of political instability. The literature thus far has demonstrated that both propensity of government change, as well as socio-political indicators, are linked with economic challenges and reduced investment. Therefore, the case studies that follow will look at both regime instability as well as evidence of social instability when considering the effects of instability on microfinance.

Seeing that political instability and uncertainty reduces investment and stunts economic growth, one would expect to see the microfinance sector similarly suffer from lack of stability. However, many microfinance programs have flourished in developing nations that suffer from severe levels of government and political instability. Therefore, this paper looks to uncover the different manners in which political instability has interacted with the microfinance industry. Are certain institutions simply better constructed to deal with instability and uncertainty? Are there particular best practices that can lead to microfinance success under circumstances of instability? How can developing MFIs structure their organizations to be best equipped to deal with potential issues of instability? These questions, among others, will drive the three following case studies and shape the course of this thesis.

Case Selection and Paper Structure

Three cases have been selected for this study: India, Cambodia, and Haiti. The cases needed to be selected on the independent variable and thus needed to be countries with varying levels of political instability. The countries also needed to have some level of microfinance being conducted within their borders. Haiti was a natural selection as a casae, as it was the author's work with a microfinance institution operating in Haiti that motivated the development of this research. Haiti is known to have had a turbulent political history and, particularly in recent decades, extreme changes in political system and regime have rocked the nation. Haiti's experiences with microfinance have also faced difficulties, as according a report conducted by the Economist Intelligence Unit was ranked 38th out of 55 nations evaluated for their microfinance environment. By including Haiti as a case study in this research, conclusions can be drawn as to how significant a role Haiti's rocky politics played in Haiti's struggles to establish a solid business environment for microfinance intuitions.

In order to shed more light on this phenomenon, and also in order to provide advice and guidance to countries such as Haiti that need assistance in overcoming political instability to more effectively establish MFIs, strategic case selection was necessary. It was vital to select countries that could demonstrate varying experiences with political instability and the microfinance industry. It was determined that a country that found success in microfinance, even amidst political instability, would offer the opportunity to explore what factors and techniques can overcome instability challenges to foster microfinance growth. Such a country could be contrasted with Haiti to identify what practices by governments and microfinance organizations can best support microfinance amidst an unstable system.

In addition to this second case, a third case was desired that would demonstrate how a stable country fared with their microfinance industry. Examining a country in which political instability is not a pressing issue would help identify the ways in which microfinance growth is unrelated to political instability. In particular, if a stable country experienced difficulties in fostering microfinance, it would suggest that political stability is not a determinant of microfinance success.

In order to identify countries to use for the second and third cases, indexes measuring countries' levels of political instability and success in microfinance were cross listed to highlight potential cases.

In order to determine the level of political instability, the Political Instability Index was consulted. This index was developed by The Economist and was based primarily on the work of the Political Instability Task Force based out of George Mason University. The model developed by PITF draws on four factors: level of development (measure by infant mortality rate), extreme cases of economic or political discrimination against minorities, regime type, and occasions of violent conflicts in neighboring countries. The Political Instability Index draws from this model and includes 15 indicators, 12 of which measure the underlying vulnerability of the country and 3 of which measure the level of economic distress in the country. The overall score for a country is determined by taking the average of the score for underlying vulnerability and that for economic distress. Thus the final index ranks countries on a scale from 0-10, where 0 indicates no vulnerability to political and social unrest and 10 indicates the highest level of vulnerability (Political Instability Index, 2009).

To determine the relative success or failure of the microfinance industry in countries, the Global Microscope on the Microfinance Business Environment produced by the Economist Intelligence Unit was used. This study was piloted in 2009 and repeated in 2010 and 2011 and looked to quantitatively assess the business environments for microfinance in 55 nations around the world. Each country was assessed in three different categories that effect microfinance operations: institutional and regulatory framework for microfinance; general investment climate; and the level of institutional development. Overall, 13 indicators were used to evaluate the countries: 4 to evaluate the regulatory framework, 6 to evaluate the investment climate, and 3 to evaluate the institutional development. Each indicator was scored from 0 to 4, whereby 4 was the best possible score. To determine the overall index score, a 40% weight was assigned to the total from both the Regulatory Framework and Institutional Development categories and a 20% weight was assigned to the total from the Investment Climate category, resulting in an overall scoring range going from 0-100 whereby 100 is the best possible score (Global Microscope on the Microfinance Business Environment 2011, 2011).

Cross-listing these two indexes allowed for the identification of potential countries that could fulfill the requirements for the second and third cases. For the second case, a country that scored highly on both the Political Instability Index and the Global Microscope on the Microfinance Business Environment was needed. Several countries were highlighted as possibilities, and after further research Cambodia was selected. On the microfinance index, Cambodia received an overall score of 54.1, allowing it a rank of

14 out of 55. On the political instability index, Cambodia scored an 8.0, ranking it 4th in vulnerability to political and social unrest. Some basic research on Cambodia revealed that its microfinance industry appeared to develop right as the country was dealing with issues of political instability, which would allow for crucial insight as to how microfinance can grow amidst instability.

For the third case, a country that scored low on the Political Instability Index and also on the Global Microscope on the Microfinance Business Environment was desired. Although several countries were identified as potential cases, ultimately India was chosen as a unique case. Looking at its political instability index score, it received a 4.5, ranking it 135th out of 165 countries (meaning it is not particularly vulnerable to political instability). In regards to microfinance, in 2009 India scored quite well on the microfinance index, receiving a score of 62.1 that placed it 4th out of 55 countries. However, in further reports India dropped significantly, to 27th out of 55 countries. Investigating this phenomenon further showed that a severe crisis in the Indian Microfinance Industry had occurred at the end of 2010. As such, India offered a unique perspective on microfinance in a stable country, as there were years in which it flourished strongly but also during which it suffered. Analyzing the growth of the industry in India will help to identify what aspects of microfinance success and failure are not related to political stability or instability.

Thus, Haiti, India and Cambodia offer three different perspectives on how instability interacts with the microfinance industry. Investing these three cases will help identify lessons learned and best practices for both governments and microfinance organizations to foster microfinance growth in all levels of political stability.

An institution from each country was selected to provide an in-depth examination of its structure, products and policies. These institutional case studies offer details into which sorts of techniques were used by institutions operating in the various levels of stability. In Haiti, the organization Sogesol was selected as an institutional study. This organization was chosen because it had found moderate levels of success in periods of low stability, but did so by operating in coordination with an established commercial bank. This strategy is one that could perhaps be imitated by other organizations, and thus this institutional study offers insight into how to implement such a strategy. ACLEDA was chosen in Cambodia because it demonstrated continued success across varying levels of stability. The organization was established at a period of low stability but was able to quickly grow and institutionalize itself. Although the growth was never extremely high, it was persistent. It maintained its growth as the stability level fluctuated and was able to scale its operations tremendously. The case study on ACLEDA offers insight into how organizations are able to grow and transform, even as the level of stability changes. Finally, in India, the organization SKS was selected as an institutional study. SKS was chosen because it experienced both success and challenges in periods of relatively high stability. The study of SKS offers a perspective on how extreme levels of growth could be achieved under stability, but also on how stability in and of itself does not guarantee microfinance success. The recent struggles of SKS indicate that even organizations operating in stable countries need to take caution in their operations and growth.

The structure of the paper will proceed as follows. A chapter on each country will follow this introductory section. Each chapter will begin by overviewing the history of political instability in that country, and then offer various quantitative measures of the change in instability over time. Several expectations regarding the microfinance industry will be hypothesized, and then an overview of the microfinance industry in the country will be provided. A detailed case study of a microfinance institution within that country will follow. Finally an analysis section will comment on the role political instability played in the microfinance industry, if any, and provide some lessons learned from the actions taken by the country's government and microfinance organizations operating within the country. The paper will conclude by presenting a chart that seeks to visualize the relationship between microfinance success and political instability. Overall conclusions, lessons learned and best practices drawn from the case studies will be provided as a practical application of the research done in this thesis.

Data Sources

The data used in this will be drawn from a variety of sources. Information regarding the political instability atmosphere and history for each country will come from a variety of news and reference sources, including the State Department and various country encyclopedias. Information regarding the microfinance industry in each country is largely drawn from organizations' websites and scholarly articles written by both academic scholars and microfinance experts. Much of the quantitative data on organizations is drawn from the Microfinance Information Exchange, or the MIX, which is a third party provider of data on microfinance organizations.

For each country, charts portraying changes in the political instability atmosphere over time are presented. These were drawn from four major datasets: the Polity Project, the Freedom

House Report, the World Bank's World Governance Indicators, and the Cross-National Time Series.

The Polity Project: Polity Authority Trends

The central aim of the Polity project, directed by Ted Gurr at the Center for Systemic Peace, is to measure and analyze authority characteristics of states. The data collected are only regarding the official state entity and do not apply to non-state polities within a nation. The indicator used here, the Polity2 score, is an indicator of the democratic or autocratic nature of the regime. It is calculated by subtracting a state's autocracy score from its democratic score. Both the democratic and the autocracy scores for a nation are on an eleven point scale, from 0-10. Subtracting the autocracy score from the democracy score thus creates a scale from -10 to 10, whereby -10 indicates a full autocracy and 10 indicates a full democracy. The democratic score is calculated by coding the competitiveness and openness of executive recruitment, the constraint on the Chief Executive, and the competitiveness of political participation. The autocracy score is also coded for competitiveness and openness of executive recruitment, constraint on chief executive and competitiveness of participation, as well as regulation of participation, though it uses different weights. The Polity data can be looked at and analyzed for extreme changes in the polity score, which can indicate strong swings between more democratic and autocratic regimes. These sorts of severe shifts could suggest political instability, as policies and procedures are changing drastically (Marshall & Jaggers, 2010).

The Freedom House Report: Political Rights and Civil Liberties

Freedom House's Freedom in the World Report provides a rating of a country's freedom by ranking the political rights and civil liberties in the countries. The rankings are created via a survey that evaluates three subcategories of political rights—electoral process, political pluralism and participation, and functioning of government—and four subcategories of civil liberties—freedom of expression and belief, associational and organizational rights, rule of law, and personal autonomy and individual rights. The answers to the survey are then weighted and compiled, and each country receives a score for political rights and for civil liberties. The scores range from 1 to 7, whereby 1 represents the most freedom and the 7 represents the least freedom. The Freedom House scores provide a composite look at how the political regime affects the citizens of the country. High scores suggest that the regime does not offer stable institutions that can protect and ensure individual well-being. This would potentially indicate an environment that is not conducive to microfinance institutions (Freedom in the World, 2011).

World Bank World Governance Indicators: Political Stability Indicator

The World Bank's World Governance Indicators (WGI) constructs aggregate scores on six categories of governance. This paper is looking at the Political Stability and Absence of Violence indicator, which measures perceptions of the possibility that a government will be overthrown by violent means. The indicator is scored on a range from -2.5 to 2.5, whereby -2.5 indicates a weak government and 2.5 indicates a strong government. The data for the indicators are collected from 35 sources and 33 organizations, and draw from surveys given to experts in the private, public and NGO fields. Examples of organizations included in the survey are the Gallup World Poll, the Economist Intelligence Unit, and development banks. WGI offers perspectives on the likelihood that a government will be destabilized, as well as portraying levels of violence in the country. Significantly low scores suggest that the government is quite susceptible to plots, and may cause citizens to have a lack of trust in political systems and institutions. This may challenge the microfinance industry in the nation, as uncertainty regarding the future of the government could decrease investment and funding (World Governance Indicators, 2010).

Cross-National Time Series Data: Weighted Conflict Score

The Cross-National Time Series (CNTS) was created by Arthur Banks as an attempt to quantify and systematically store data from *The Statesman's Yearbook*. The archive contains indicators for a wide variety of data, including primary school enrollment, voter turnout, employment and transportation, among many others. The data presented here are the aggregate indicator for conflict. This indicator weights and aggregates information on: number of assassinations; general strikes; guerrilla warfare; government crises; purges; riots; revolutions; and anti-government demonstrations. CNTS portrays the level of socio-political instability in the country. Higher scores indicate unstable conditions and significant uncertainty regarding future governments. For the microfinance industry, this may prevent institutions from being able to operate smoothly, or may discourage potential clients from seeking out microfinance services (Banks, 2005).

Chapter 2

Cambodia

Political Instability Overview

Up until the mid-19th century, Cambodia boasted a fairly rich and powerful history. However, internal struggles began to plague the country and the nation appeared on the verge of collapse. In 1863, Cambodia became a protectorate of France, and by the mid-1880s it joined the Indochina Union as an official French colony. Colonial rule persisted until the Second World War, when in 1945 Japanese forces dissolved the colonial administration. At this point, Prince Norodom Sihanouk declared an independent, anti-colonial government. However, the Allied forces soon deposed that government. Seeking to bring independence to the country, Sihanouk went into self-imposed exile in order to pressure the French government to come to an agreement (Background Note: Cambodia, 2011).

A settlement was finally reached by November 1954, granting Cambodia full independence as a monarchy under the rule of Sihanouk. Although the nation attempted to maintain neutrality, they acquiesced to North Vietnamese forces establishing bases to support their operations in South Vietnam. The situation grew worrisome for the United States and South Vietnam, and in 1969 the U.S. launched air raids against the North Vietnamese bases in Cambodia(Background Note: Cambodia, 2011).

Sihanouk held power until 1970, but domestic politics remained contentious and significant opposition grew in factions of the population. In March, General Lon Nol overthrew Sihanouk and abolished the monarchy, renaming the nation the Khmer Republic. However, dissention remained strong and the Khmer Rouge insurgency emerged out of a communist movement. On New Year's Day, 1975 the Khmer Rouge launched an offensive that lasted 117 days and ultimately resulted in the overthrow of the Khmer Republic. A former leader of the Communist movement who went by the name of Pol Pot led the new Khmer Rouge Regime (Background Note: Cambodia, 2011).

Upon solidifying control of the government, the Khmer Rouge ordered a mass evacuation of Cambodian cities and towns, forcing the rural population to relocate to the countryside in order to work the land. Thousands of citizens died during the evacuation, either from starvation or exhaustion. Those who survived faced tremendous hardships, as they settled in new villages that were lacking in infrastructure, health care, and food supplies. Anyone who resisted the evacuation was executed, as were most military and civilian leaders from the former regime. The Khmer Rouge led an oppressive government, establishing torture centers where dissenters would be publically beaten. Daily life was extremely hard, as agriculture was collectivized and there was no national currency or banking system (Background Note: Cambodia, 2011).

The Khmer Rouge remained in power for four years, during which time it is estimated that two million Cambodians died or were killed. The government was decidedly anti-Vietnamese and often provoked clashes along the border. In the middle of 1978, Vietnamese forces penetrated the Cambodian border. On January 7, 1979 the Vietnamese troops overtook the capital city of Phnom Penh and dismantled the Khmer

Rouge government (Freedom in the World: Cambodia, 2011). They established a new government, led by Heng Samrin, who was surrounded by Vietnamese advisors and officials. Hundreds of thousands of Vietnamese troops were posted around the country and Vietnamese nationals settled in many of the villages and towns. Tension and hostility between Cambodians and Vietnamese remained extremely high until the end of 1989 (Background Note: Cambodia, 2011).

In July and August 1989, representatives from 18 countries and the 4 Cambodian political parties met with the UN Secretary General to work out a peace agreement. A settlement was reached that eventually was formalized into the Paris Peace Accords of 1991, which established a cease-fire and declared Cambodia a constitutional monarchy (Background Note: Cambodia, 2011). However dissention persisted and the Khmer Rouge maintained an insurgent presence (Freedom in the World: Cambodia, 2011).

In 1993, the UN helped to stage national elections, which were won by the royalist party Funcinpec. The foreign minister under the Heng Samrin regime, Hun Sen, came in second, but sought to manipulate the political system. He wrestled power away from Funcinpec and in 1997 led a violent coup that resulted in the overthrow of the government, placing power in the hands of his Cambodian People's Party (CPP). Sen led an oppressive regime and used voter intimidation tactics and violence to influence the outcome of the 1998 national elections. In 2003 he again used coercion to influence the election outcome, but the CPP failed to win enough seats to form a majority government. An initial attempt at a coalition government failed and it wasn't until 2004 that a coalition government with Funcinpec was finally formed (Freedom in the World: Cambodia, 2011).

However, Hun Sen harassed Funcinpec leader Sam Rainsy, because of his critiques of the CPP, and stripped him of his parliamentary immunity. Rainsy fled the country and in his absence Hun Sen held a trial finding him guilty of defamation, though the trial did not meet international standards for a fair legal process. International pressure led Hun Sen to negotiate an agreement with Rainsy, whereby he was allowed to reenter the country but was forced to make a public apology to Hun Sen (Freedom in the World: Cambodia, 2011).

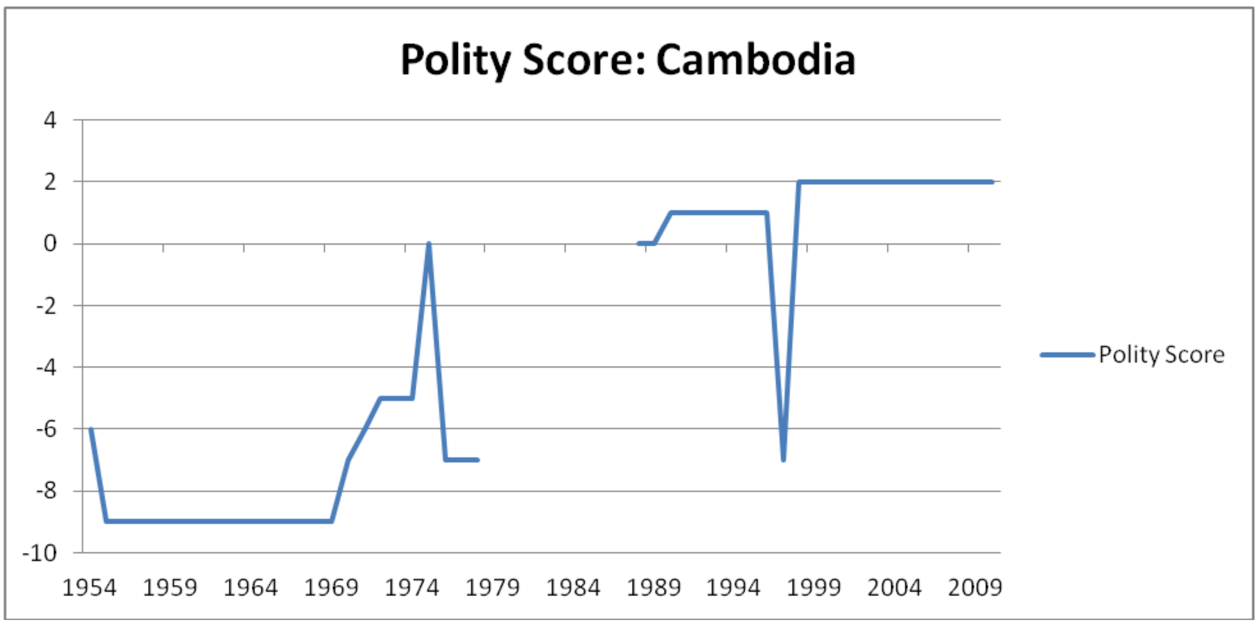
The government continued to rule by intimidation, arresting in 2005 critics of their border treaties and detaining human rights activists (Background Note: Cambodia, 2011). However, the CPP maintained a stronghold on Cambodian politics, securing 90 of the 123 parliamentary seats in the 2008 elections. Division amongst opposition parties rendered them untrustworthy in the public's eye, thereby leaving them with little choice but to continue to support Hun Sen (Freedom in the World: Cambodia, 2011).

In 2008, tensions between Cambodia and Thailand increased over a dispute regarding a historic temple located on the border of the two countries. Cambodia applied for the temple to be listed as a UNESCO Heritage site, but Thailand wanted the temple to be listed as belonging to both Thailand and Cambodia. The two countries began to build up troops around the temple, and in April 2009 violence was sparked as fire was exchanged across the border. In February 2011, several days of violence erupted and eight people were killed. The UN ruled the area to be a demilitarized zone, but tensions remain high along the border (Q&A: Thailand-Cambodia Temple Dispue, 2011).

Political Instability Data

The following data and charts demonstrate changes in Cambodia's political stability over time. The time frame and scale for each set of data is determined by the index used.

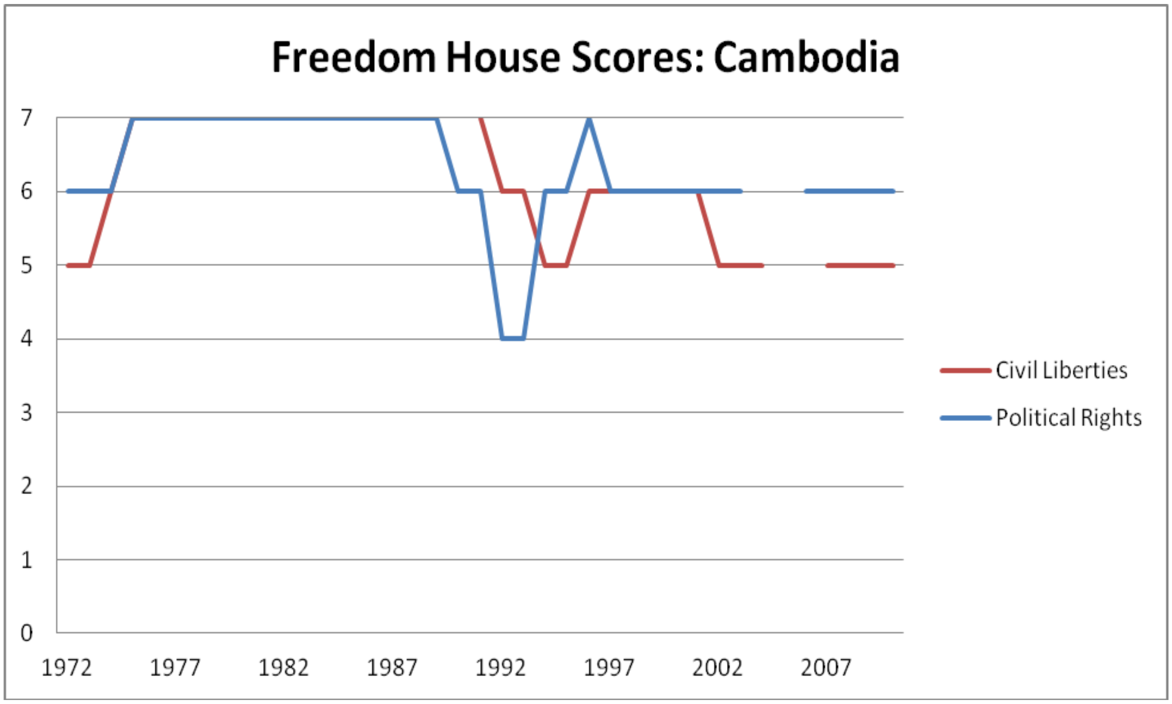
Figure 2.1: Polity Authority Trends, Cambodia



NOTE: From 1979 -1989 Vietnamese forces controlled the Cambodian government, thus there was no Polity score computed for this time period
Source: Marshall, M. G., & Jaggers, K. (2010). *Polity IV Project: Political Regime Characteristics and Transitions, 1800-2010.* http://www.systemicpeace.org/polity/polity4.htm

The Polity Data for Cambodia presents several severe and dramatic changes, particularly before 2000. These large swings suggest political instability, as policies and procedures are changing drastically. The uncertainty regarding the characteristics of the ruling regime may have hampered microfinance growth and success.

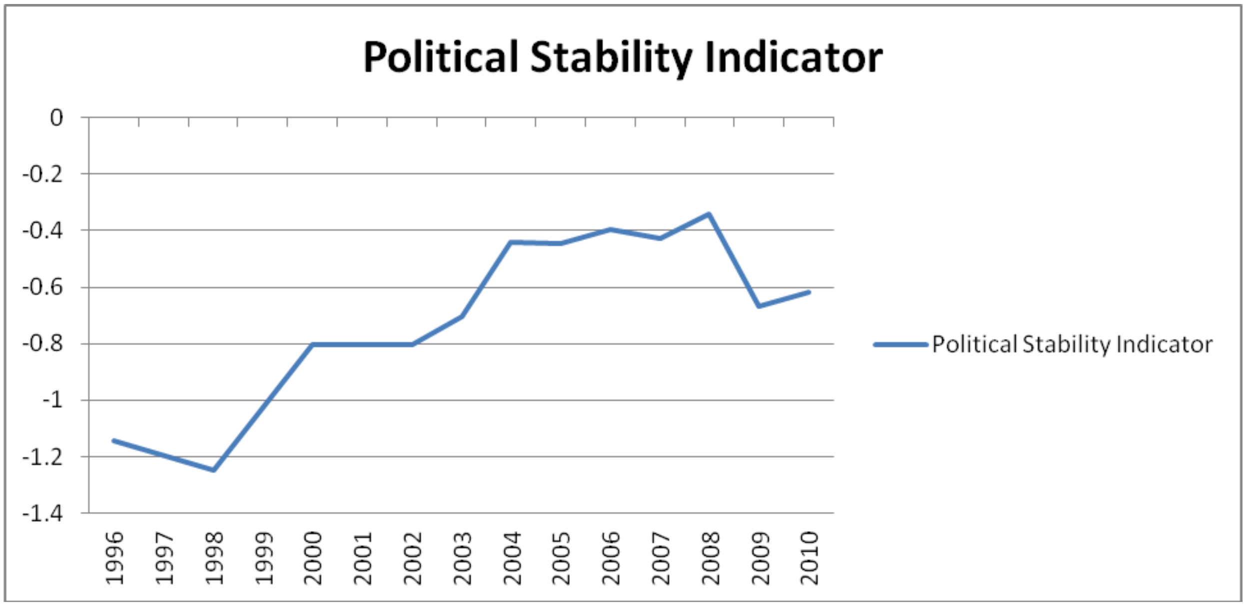
Figure 2.2: Freedom House Scores, Cambodia



Source: *Freedom in the World*. (2011). http://www.freedomhouse.org/report-types/freedom-world

Cambodia has received rather high scores from Freedom House regarding their political rights and civil liberties. Although they have fluctuated over time, in general they have remained above 5, which suggests a persistent lack of freedom. This lack of freedom may have inerfered with microfinancing efforts, as individual rigths are not strongly protected and stable institutions to protect individual well-being do not consistently exist.

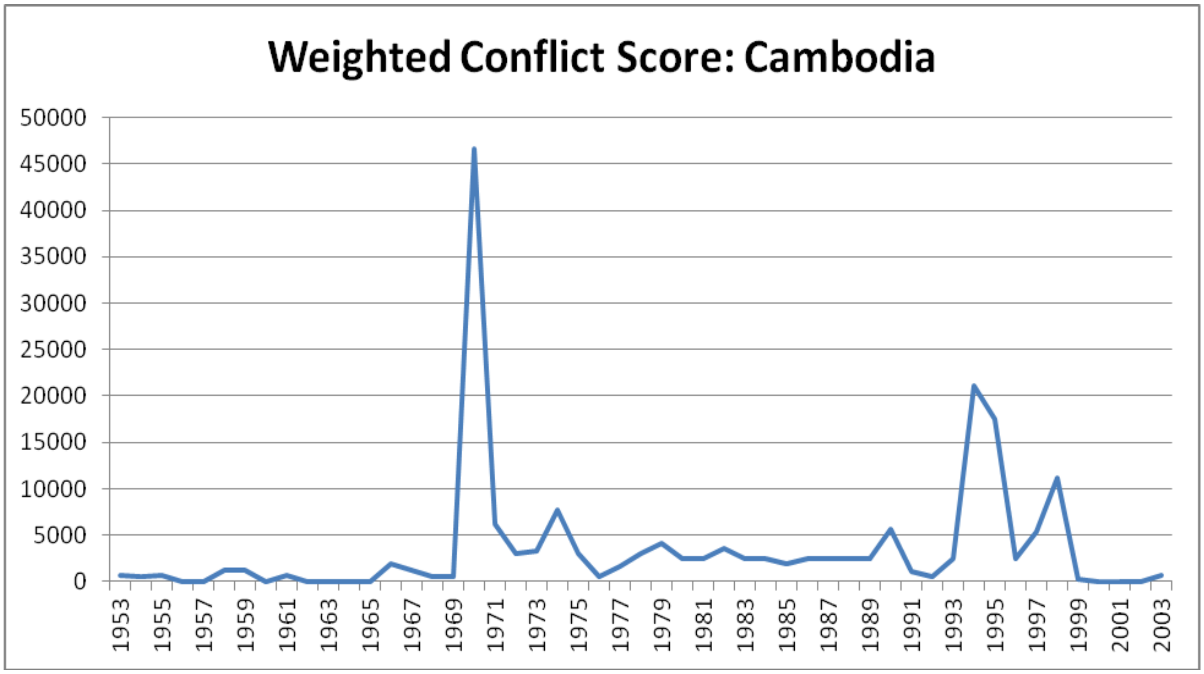
Figure 2.3: World Bank World Governance Indicators-- Political Stability, Cambodia



Source: *World Governance Indicators*. (2010). http://info.worldbank.org/governance/wgi/resources.htm

Cambodia's indicator has remained negative for the past 15 years, which may suggest persistent uncertainty regarding the country's ability to ward off coups and uprisings. However in recent years the indicator has become less negative, which may be beneficial to microfinance organizations.

Figure 2.4: Cross-National Time Series Data--Weighted Conflict Score, Cambodia



Source: Banks, A. S. (2005). Cross-National Time-Series Data Archive. Binghamton.

Cambodia has seen several spikes in its weighted conflict score over time, including several during the 1990s. This may be indicative of unstable conditions that microfinance organizations had to deal with while establishing and trying to grow their institutions.

Expectations Regarding Microfinance

Cambodia's political system has experienced significant changes over the past three decades. Several major coups have occurred and for large periods of time the central government exercised little control across the nation, allowing insurgency groups to flourish. Violence and corruption have played a considerable role in politics and many international bodies have questioned and criticized the lack of human rights protection in the nation.

Given these major political issues, it would seem that microfinance operations would face significant difficulties. The history of violent coups in Cambodia could greatly threaten the ability to attract investors and maintain strong portfolios. Furthermore, the lack of banking sector and collectivization of agriculture under the Khmer Rouge might prevent potential entrepreneurs from trusting organizations with their business and financial matters.

However, it is also important to note that although the government is marred by corruption and coercive tactics, Hun Sen's regime has been in place for over a decade. Although it is perhaps not an ideal government, the fact that one leader has held power for such a significant amount of time might allow microfinance organizations to find success. If organizations are able to find methods and processes that work, once they are up and running they might be able to operate free from interactions with the central government.

Microfinance Industry Overview

Start of Industry

The beginning of the microfinance industry in Cambodia can be traced to the early 1990s, as increased aid flowed to the country following the signing of the Paris Peace agreements in 1991 (Allden, 2009). Much of this aid came by way of multilateral donors and international NGOs that sought to sustainably develop the Cambodian economy, which had been ravished by years of conflict. It was clear that lack of access to credit was a major hindrance for much of the Cambodian society, and thus credit-lending projects were often a key component to rural development programs (Flamming, Duflos, Latortue, Nayar, & Roth, 2005). At the time, the Cambodian economy lacked effective institutions and the government was not well-informed about microfinance practice and policies (Allden, 2009).

Growth of Industry

However, it quickly became apparent that microfinance was an effective and powerful tool, and steps were taken to foster its development. Many of the NGOs operating rural credit projects came together to create a forum where they could share experiences, strategies, and visions. The Cambodian government also took a step to assist the microfinance industry by establishing the Cambodian Committee for Rural Development (CCRD), a government body that allowed more formal and in-depth discussions on microfinance (Vada, 2010). In 1998, the government took a yet more important step by creating the Rural Development Bank (RDB) as a wholesale financer of microfinance institutions. The RDB is mandated to mobilize capital from domestic sources as well as international funders and channel the money to organizations providing micro and rural credit (Badiola, 2007).

By the late 1990s, many NGOs were operating as MFIs in Cambodia, but there was no central organization to monitor or oversee their operations. The Royal Cambodian

Government (RCG) worked with the International Monetary Fund and the Asian Development Bank to create a legal structure that could support a central bank that would both provide financial services as well as regulate the microfinance business. In 1996, the RCG passed the Central Bank Law, which created the National Bank of Cambodia (NBC). Formally, the NBC has five main functions:

> "(1) to act as the monetary authority; (2) to act as the sole issuer of national currency of the country; (3) to act as the supervisory authority over the banking/ financial system; (4) to oversee the payment system of the country; and (5) to manage the international reserves of the country" (Badiola, 2007, p. 6).

The government continued to develop the financial sector and in 1999 passed the Law on Banking and Financial Institutions, which delineated a legal framework for financial service businesses. As these developments occurred, the NBC began to assume responsibility for managing the microfinance industry and regulating the various organizations working within the country (Allden, 2009).

Along with these developments, the outreach of the microfinance industry grew tremendously. In 1993, a mere 4000 Cambodians were borrowing from micro-credit schemes, whereby in 1998 140,000 citizens were receiving loans, demonstrating a growth rate of 3400% over five years (Pickens, 2004). By 2000, there were approximately 90 NGOs that offered credit lending services to the poor (Allden, 2009). The NBC took further steps to strengthen the microfinance industry by passing new regulations in 2000 and 2002 that established a process for licensing and registering Microfinance Institutions (Vada, 2010). By 2003, the number of borrowers from microfinance organizations increased to over 370,000 (Pickens, 2004).

Following the issuance of the new regulations, many NGOs followed procedure to receive registration and licensing as microfinance institutions. ACLEDA, the leader in the microfinance industry, underwent a transformation process to become a fully commercialized bank, while still maintain a focus on lending to the poor. Following their lead, many other organizations have focused on becoming institutionalized and self-sustainable (Flamming, Duflos, Latortue, Nayar, & Roth, 2005).

Current State of Industry

As of the end of 2010, there were 25 licensed Microfinance Institutions operating in Cambodia, and 28 registered rural credit operations. Of these, 17 institutions report data to the Microfinance Information Exchange Network (MIX), the primary international microfinance monitoring institution. Approximately 1.02 million Cambodians have received loans from these organizations, amounting to a total of approximately 443.7 million USD in loans (Annual Report 2010, 2010). The number of active borrowers and gross loan portfolio of the leading three organizations (according to number of active borrowers) is presented in the following table.

Table 2.1: Leading Cambodian Microfinance Organizations

Institution	Gross Loan Portfolio (USD)	Number of Active Borrowers
AMK	47,950,000	275,739
ACLEDA	1,011,362,189	272,316
AMRET	99,269,901	266,914

Source: Microfinance Information Exchange. (2011). *Microfinance in Cambodia: Country Profile*. http://www.mixmarket.org/mfi/country/Cambodia

Current Regulations and Laws

A prakas, or regulation, passed in 2002, define the process and requirements for MFIs to register or get licensed. The NBC requires organizations that are engaged in microfinance to register with them if their loan portfolio is greater than or equal to 100 million KHR or if they take savings and have over 100 depositors or over 1 million KHR in savings mobilized (PRAKAS on Registration and Licensing of Microfinance Institutions, 2002). Registered MFIs will receive a certificate from the NBC and must submit quarterly reports to the NBC that demonstrate that they are complying with all NBC laws (Badiola, 2007).

Licensing is required for microfinance institutions that have a loan portfolio of over 1,000 million KHR, or that have over 1000 borrowers. It is also required for institutions that collect savings and have more than 100 million KHR mobilized in savings, or have more than 1,000 borrowers (PRAKAS on Registration and Licensing of Microfinance Institutions, 2002). Licensed MFIs have stricter requirements for levels of capital and reserve, and must submit monthly, rather than quarterly, reports to the NBC (Badiola, 2007).

Institutional Case Study: ACLEDA

Introduction and Background

ACLEDA, or the Association of Cambodian Local Economic Agencies, was originally founded on January 19, 1993 as an NGO that was supported by the International Labor Organization (ILO) and the United Nations Development Program (UNDP). The organization developed out of a project that was called the Local Economic Development Agencies (LEDA), which was established through a UNDP donation of $613,000 that comprised a revolving fund which was used to provide micro-loans to the poor. In late 1992, the ILO ruled that the revolving fund had to be managed by a separate legal entity from the LEDA project, which spurred the creation of the ACLEDA organization (Heng, 2008; Hakemulder, 1997).

The newly created organization stated its mission to be "to establish an integrated small enterprise and informal sector program to support economic development and to contribute to poverty reduction through a sustainable provision of financial services" (Heng, 2008, pp. 45-46). The ILO and the UNDP continued to support the new institution and other international organizations added their support, such as Cambodian Resettlement and Rehabilitation Program, the United Nations Population Fund, and Shell Company of Cambodia Ltd. Originally, ACLEDA consisted of a general assembly, a board of directors, an executive committee, technical staff, and a series of district and provisional offices. Over the first two years of its existence, ACLEDA continued to develop and refine its operational strategy and plan while at the same time providing loans for the poor. During the period 1993-1995, ACLEDA lent to over 5,000 clients, distributing over 9,000 loans and posting a

99% loan recovery rate. By 1996, the staff of the organization began to focus on becoming self-funded (Heng, 2008; Hakemulder, 1997).

By January, 1998, the organization had experienced tremendous growth. Its portfolio had tripled since the time of inception and it had become profitable, earning over $1.8 million over the end of 1997 (Mot, 2009). This success led the executive leadership to decide to transform the ACLEDA NGO into a commercial bank. There were three primary motivations for such a transformation. Firstly, the leadership of ACLEDA realized the enormity of the demand for microfinance and was worried about relying on donors to meet that demand. The potential funding for NGOs was very limited in Cambodia and did not appear sufficient to maintain the growth that ACLEDA had previously been experiencing. By transforming into a bank, ACLEDA would be able to access commercial funding from both domestic and international sources. Secondly, transforming into a bank would allow ACLEDA to accept savings from its clients. Apart from offering a beneficial service to their customer population, holding savings could act as a source of funding for the organization and help them reach full sustainability. Finally, at the time of transformation the Cambodian government was discussing potential changes in their economic policy that could affect microfinance organizations. Particularly, ACLEDA was worried that policy changes might prevent them from claiming ownership of their accumulated donor capital. By becoming a full bank, they could establish legitimate claims to their capital (Mot, 2009).

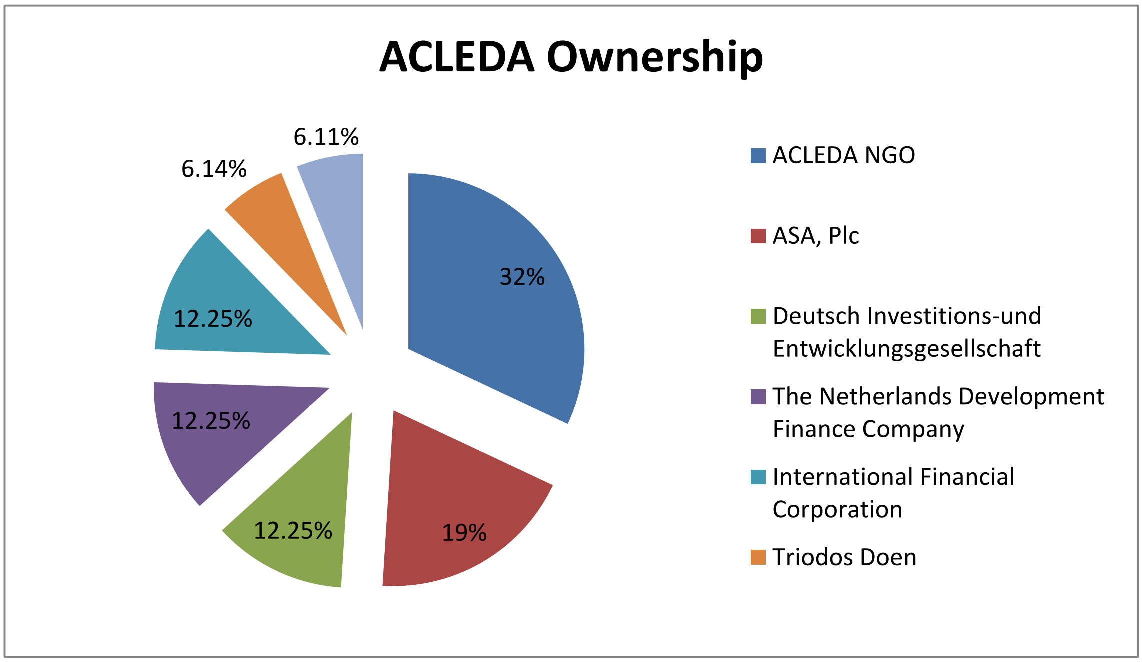
The transformation process began in 1998 and in order to facilitate the procedure, members of ACLEDA's executive staff travelled to BancoSol in Bolivia to learn from their experience. BancoSol had commercialized six years earlier and had found significant success. In particular, ACLEDA was able to draw relevant insight from BancoSol in the areas of employee ownership, competition in the sector, and preservation of donor capital. They leveraged these lessons and applied them to their own transformation process (Mot, 2009).

The first step in the transformation process was to upgrade from an NGO to a specialized bank. A specialized bank was distinct from a commercial bank in a few ways, most notably in the minimum reserve and capital requirements. Consequently, the specialized banking license is valid for only three years and limits the extent of banking activities the organization can pursue (Mot, 2009). This transformation occurred in October 2000, as the NGO sold its assets to the newly formed ACLEDA bank in exchange for shareholders and loans. At this point, ACLEDA bank maintained $4 million in capital. By the end of its specialized banking license, in December of 2003, ACLEDA had increased its capital to $13 million and was able to achieve commercial banking status (Heng, 2008).

Following the transformation, ACLEDA had to accustom itself to several changes. Firstly, it lost its donor funding and was now subject to regulation, taxing and license fees (Mot, 2009). It also had to make significant changes to its management structure, as the management of a bank was more complex than that of an NGO. It had to manage new and more diverse products, had to manage assets and liabilities, and had to create a board of shareholders. The bank also now had to concern itself with external relations, as it needed to attract and maintain investors. Finally, ACLEDA also had to deal with the moral change that accompanies a transformation from non-profit to for-profit organization. It dropped several non-profitable services from its offerings and in broadening its clientele base, lost its focus on micro-businesses. The challenges accompanying these shifts will be discussed in more details in an ensuing section.

Post-transformation, ACLEDA had seven shareholders, including the original ACLEDA NGO.

Figure 2.5: ACLEDA Ownership



Source: Mot, P. (2009). The Transformation of ACLEDA Bank Plc: From an NGO to a Commercial Bank. *Waseda Business and Economic Studies* , *45*, 57-82.

Products and Lending Procedures

The products offered by ACLEDA can be categorized into three general categories: small enterprise lending, informal sector lending, and savings. At its inception as an NGO, ACLEDA only offered small enterprise lending and informal sector lending, as savings could not be legally offered until it became a full bank. Each branch of ACLEDA is staffed by a branch manager, an administrator, professional staff (such as loan officers), an advisory committee, and a local credit committee. At ACLEDA headquarters, there is a Central Revolving Fund Management Committee that consults with local branches when evaluating loan applications (Heng, 2008).

ACLEDA posts strong training records for their staff in the areas of operational risk, asset and liability management, internal control and audit, and information technology. Each loan officer at an ACLEDA branch is responsible for approximately 300 borrowers. The lending procedures followed by the loan officers differ between the small enterprise loans and the informal sector loans (Heng, 2008).

The small enterprise loans are intended for established business people who are looking to grow their enterprise. The lending procedure begins with the loan officer interviewing the applicant regarding his or her business plan. The interview allows the officer to evaluate the applicant’s level of comprehension of his or her business idea, as well as to determine if the applicant belongs to the target group. If the officer approved of the client’s interview, he or she can then submit an application for a loan. The loan sizes for a small enterprise loan range from $500-$1500 and require 20% collateral from the applicant. If loans are under $1000, they can be approved by the local credit committee at the branch office. If they exceed $1500, they must be approved by the revolving fund management committee at ACLEDA’s central headquarters (Heng, 2008).

The informal sector loans are intended for a poorer segment of the population, those who would like to start a new micro-enterprise. The lending procedure begins when a branch office identifies a village with a high concentration of potential candidates. The officers then hold group and individual meetings to introduce the program and loan procedures. Interested applicants may then form solidarity groups of 2-10 people. Each group member may select their own loan size, from $12.50 to $500, but if any member defaults on their payment the rest of the group must compensate for the missing funds. Loans are for 6 months for amounts under $100, and 12-months for loans of $100-$500, and carry an interest rate of 3-3.25% on a declining balance basis. All applications for the informal sector loans are approved by the local credit committee at the branch office (Heng, 2008).

Challenges and Obstacles

ACLEDA's transformation from NGO to commercial bank brought with it some substantial challenges. The shift from non-profit to for-profit is reflected not only in the organizational structure of the bank, but also in its mentality and mission. Following its transformation, ACLEDA terminated several programs and services that it previously offered, as they were not profitable and didn't align with the new commercial aspect of the bank. These programs included vocational training programs for aspiring entrepreneurs, and a mandatory six-day business training program for all applicants in the small enterprise program. Another such program was a woman's empowerment program, which focused on lending to women and supporting them as they strove to gain equality in the household and as a business person. Furthermore, the ACLEDA NGO would require its loan officers to follow up on their clients, offering them advice when they ran into business challenges. Eliminating these programs post-transformation significantly altered ACLEDA's role in the community, as they went from being a comprehensive assistance service to a mere money lender. The shift also incentivized loan officers to seek new applicants, which often led to an over-distribution of funds without proper assessment of the repayment capabilities of the client (Heng, 2008).

The transformation also led to a broader inclusion of clients, which meant that more upper-level clients were drawn to ACLEDA's services. As such, the percentage of clients that were receiving micro loans diminished, lessening the focus of the organization on the poor population. Although the absolute level of poor participants has not declined, the transformation nonetheless has altered the strategy and mindset of the bank (Heng, 2008).

Impact and Significance

ACLEDA is clearly the dominating success story in Cambodian microfinance. As a commercial bank, their outreach and lending portfolio is considerably larger than most other organizations. They have managed to scale their operations to support millions of clients and offer a model for other institutions who want to expand their outreach exponentially. The following chart highlights ACLEDA's growth over their existence.

Table 2.2: ACLEDA's Growth

Year	Active Portfolio (USD)	Active borrowers	Portfolio at risk (>90 days)
1997	$5,860,574	*	*
1998	$10,071,381	*	*
1999	$13,719,210	56,412	*
2000	$16,667,328	60,860	*

2001	$20,967,416	81,446	*
2002	$26,846,703	82,598	*
2003	$40,572,670	98,905	0.57%
2004	$65,981,228	122,173	0.69%
2005	$99,994,807	140,920	0.47%
2006	$158,463,941	159,930	0.34%
2007	$315,073,995	185,492	0.06%
2008	$464,477,809	214,337	0.29%
2009	$538,237,407	247,987	0.76%
2010	$744,664,196	265,937	0.43%
2011	$1,011,362,189	272,316	*

* indicates missing data
Source: Microfinance Information Exchange. (2011). *MFI Report: ACLEDA.* http://www.mixmarket.org/mfi/acleda

Analysis

In the early 1990s, Cambodia was reeling from several decades of conflict and high instability. Internal conflict and repression, along with foreign disputes, had caused severe institutional and societal damage. In the years following the Paris Peace Agreement, Cambodia was a fragile state, yet managed to foster the development of a strong microfinance industry. The ability of the RCG to acknowledge the potential power of microfinance, even amidst uncertainty regarding the durability and security of the government, was critical for MFIs to succeed.

The political coup that occurred in 1997 did impact the microfinance industry, as the Cambodian Committee for Rural Development ceased to function following the change in government (Llanto, 1998). However, this interruption was rather short-lived, as the Rural Development Bank was formed the following year and became the major platform of support for MFIs. It could also be argued that instability indirectly affected the industry in that there weren’t ample government resources to devote to developing and maintaining public infrastructure. This limited the outreach capabilities of microfinance industries and created crowding of the sector in regions that had easy accessibility. Organizations thus faced tougher competition in these areas (Williams, Vantha, & Ngim, 2001).

By and large, the Cambodian government and microfinance organizations within the country followed several important practices that helped them surpass the challenges presented by instability. In the early 90s, the government faced a lacking system of financial institutions and possessed little knowledge of the microfinance industry. However, they realized the importance of the sector and worked to foster its growth. From the beginnings of the microfinance movement, the government built a framework and government regulations to monitor its development. Putting these guiding forces in place helped to ensure that the industry would grow in a desirable manner. It also helped assure both investors and clients that the sector had governmental support and was being supervised, improving the odds of success (Badiola, 2007). Equally important was the fact that the government understood that there were complexities in microfinance markets, and developed regulations that supported organizations' growth without restricting their freedom to operate. Particularly in regards to the determination of interest rates on loans, it was critical that the government did not set industry-wide standards and instead allowed organizations to work under supervision (Vada, 2010).

From the microfinance organizations' perspectives, they faced mistrust towards authority and institutions from the Cambodian people. Years of instability and conflict had devastated the society and left citizens hesitant to trust others with their financial well-being (Allden, 2009; Pickens, 2004). To address this issue, many organizations focused on ensuring transparency within their organizations, particularly in terms of accounting and training methods. Allowing clients to see and understand where their money was going and how it was being monitored gave them a necessary sense of security and control (Allden, 2009).

Another important tactic utilized by microfinance organizations was to solicit the approval of local leaders in starting their projects. Gaining the support of these leaders, who often carried the trust of their village, lent credibility to the organizations and rendered them more trustworthy to the Cambodians. Cambodian Community Savings Federation, a major savings-led program with over 14,000, spends significant time and energy in soliciting the advice and support of village leaders before they initiate a project. The stamp of approval from these leaders is often critical in convincing people to trust the organization with their savings (Pickens, 2004).

Drawing from the case of ACLEDA, two important practices can be identified. The first is that of institutionalization. ACLEDA took the largest step possible in transforming to become a commercial bank. Such an extreme transformation may not be appropriate for all organizations, but in any case working to institutionalize should be a priority. When an organization has sufficient funds and support to reach a higher level of institutionalization, they should strongly consider it, as institutionalization gives them greater freedom in operating and attracting capital. Transformations should be slow and well-thought out, but can be a huge asset to microfinance institutions. The second practice that can be drawn from the ACLEDA study is that of drawing from other MFI's experience. Part of ACLEDA's success came from their close study of BancoSol's experience in Bolivia. Talking to, working with, and learning from an organization that has gone through a similar experience is invaluable to MFIs hoping to grow. In any situation where an organization has the opportunity to use the support and knowledge of another, successful organization, they should not hesitate to do so.

Chapter 3

Haiti

Political Instability Overview

After years of Spanish rule, Haiti became a French colony in the late 17th century. The French used the country as a resource base, establishing sugar plantations that became the foundation of the country's economy. Slave labor drove the plantations and significant wealth was exported out of Haiti. In 1794, a slave uprising began against the French colonizers. Local forces fought with the French military and 10 years later revolutionary forces overthrew the French powers (Schwartz, 2010).

However, Haiti struggled post-independence and suffered from considerable political disorder. Twenty-two government changes took place during the period 1843-1915 and the international community largely isolated the nations, relying on "gunboat diplomacy" to enforce their will. In 1915, the U.S. led a military intervention and occupied the country for the next 19 years. Upon their withdrawal in 1934, Haiti continued to struggle with repressive leaders, although there was relative stability for the next decade or so (Background Note: Haiti, 2011)

The 1950s brought a series of military coups which ultimately led to the installation of Francois "Papa Doc" Duvalier as president in 1957. Duvalier was an oppressive leader and deemed himself "President-for-life" in 1964. Supporting Duvalier was a set of paramilitary forces named the Tontons Macoutes, formed from gangs in the slums. Multiple plots were attempted against the government under Duvalier's regime and he responded by unleashing the Tontons Macoutes on the population, implementing harsh "counterterrorism" methods. Duvalier ruled until his death in 1971, at which point his son Jean-Claude "Baby Doc" Duvalier succeeded him at the age of 19. Like his father, Jean-Claude also proclaimed himself president for life and was a repressive ruler, eliminating many human rights and processes (Haiti, 2004).

Political tension and discontent grew under the Duvalier regimes and led to a popular uprising in the 1980s. Revolutionary action led Jean-Claude Duvalier to resign from the presidency and flee the country on February 7, 1986. After his departure, there was significant mob violence and retribution led against the Tontons Macoutes. Following Duvalier's exit, Army General Namphy was installed as president in 1987. However, less than a year later the army removed him and installed General Prosper Avril. Avril ruled until 1990, when he fled due to international criticism and pressure. In November 1990 national presidential and parliamentary elections were held. Jean-Bertrande Aristide, a former priest, won the presidential election and assumed office in February 2011 (Carey, 2006).

However, Aristide's platform was based strongly around "class warfare" which, combined with his personality cult, strongly angered and alienated the Haitian political elite. Thus eight months after his inauguration, Aristide was ousted by a violent coup led by these elite and supported by elements of the military (Carey, 2006). Strong opposition of the coup came from both domestic and international sources and turmoil ensued. De facto military rule led the government for the next three years while international organizations formulated a plan of intervention. A multinational coalition led by U.S.-forces entered the country and began to wrest power away from the Haitian military forces. The OAS and the UN urged its members to assist in returning power to Aristide and by 1994 the former president returned from exile and resumed his presidency (Haiti, 2011).

In June 1995, presidential and parliamentary elections found overwhelming success for Aristide and his political party. However, a constitutional clause prevented Aristide from succeeding himself and he stepped down from power. His prime minister, Rene Preval, then won the presidency and took office. Preval was met with significant opposition and he struggled to work with parliament. He was unable to pass most legislation and did not successfully orchestrate parliamentary elections. Opposition parties convened and formed an alliance against President Preval and his government. The opposition alliance boycotted the national elections in November, during which voter participation was estimated to be a mere 5% (Background Note: Haiti, 2011).

Aristide, running again for president, won the 2001 elections and was inaugurated in February 2002. However, he also was faced with opposition from the alliance and a violent tension arose between opposing political parties. In July, gunmen attacked police forces and in December the National Palace in Port-au-Prince was attacked. A serious political crisis was emerging and Aristide maintained little control over the situation (Haiti, 2011).

In January 2004, leaders of the Caribbean Community met and devised a plan to resolve the Haitian political crisis. Aristide said he would accept the proposal and made plans to visit with the group in late February to discuss an implementation procedure. The opposition alliance strongly opposed Aristide's acceptance of the proposal and publicly criticized the move. On February 5, the Artibonite Resistance Front—an anti-Aristide revolutionary group—led an uprising and seized the town of Gonaives. Other anti-Aristide groups began to emerge and lead uprising, taking villages and towns across the coast. By February 28, a revolutionary group had moved within 25 miles of the capital city and on the next day, Aristide resigned as president and fled the country (Background Note: Haiti, 2011).

Following the sequence of succession laid out by the constitution, Supreme Court Justice Boniface Alexandre became the interim president. He led an interim government for two years and organized national elections to be held in 2006. Former President Rene Preval again won the vote and began a second presidency. Under Preval, the parliament clashed with the government and ousted two prime ministers, causing some political turbulence (Freedom in the World: Haiti, 2011). In April 2008, civil unrest led to a popular uprising sparked by a recent surge in the prices of food and fuel. In August and September, four tropical storms hit the country and exacerbated the situation by displacing thousands of citizens (Background Note: Haiti, 2011).

However, despite these difficulties, Preval managed to bring some security and stability to Haiti. International organizations took note and began to channel more funds into the country. The U.S. made Haiti a priority and appointed former President Bill Clinton as Special Envoy to Haiti. By the end of 2009, Haiti was experiencing relative stability (Haiti, 2011).

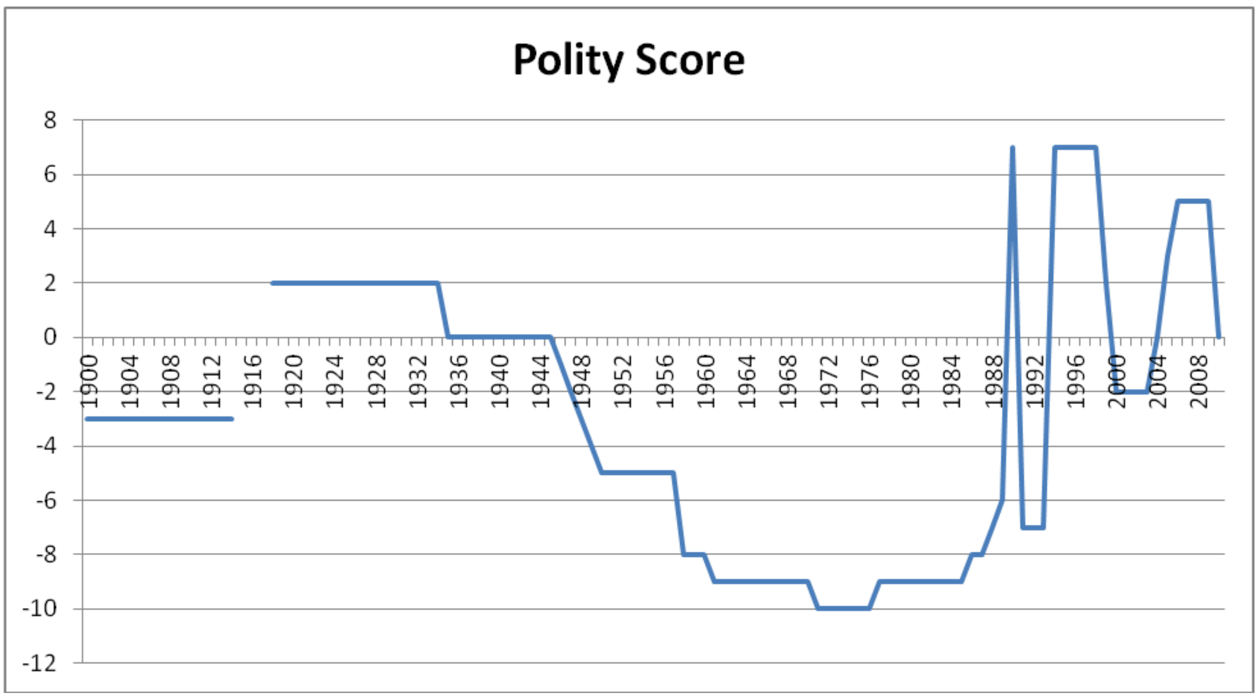
On January 12, 2010, a massive 7.0 earthquake struck the capital city of Port-au-Prince and caused immense destruction. Hundreds of thousands of citizens were killed and millions more displaced. It is estimated that the total cost of rebuilding and recovering from the damages will be $11.5 billion, an exorbitant amount for a nation in which 80% of the population lives on less than $2 a day. The earthquake also severely interrupted the political system, as legislative elections were postponed and current members of the Senate saw their mandates expired. Parliament passed a bill allowing President Preval to remain in power past the end of his term, in order to allow national elections to be rescheduled (Background Note: Haiti, 2011).

Elections were finally held in November 2010, although there were serious allegations of tampering and fraud. A series of protests and violent demonstrations were held in response to the elections and the OAS led an external investigation into the fairness of the elections. They ruled to have found significant evidence of tampering and voter manipulation and proposed that a second round of elections be held between the two leading presidential candidates. Those elections were held in March, 2011 and resulted in popular former musician Michel Martelly winning the presidency (Haiti, 2011).

Political Instability Data

The following data and charts demonstrate changes in Haiti's political stability over time. The time frame and scale for each set of data is determined by the index used.

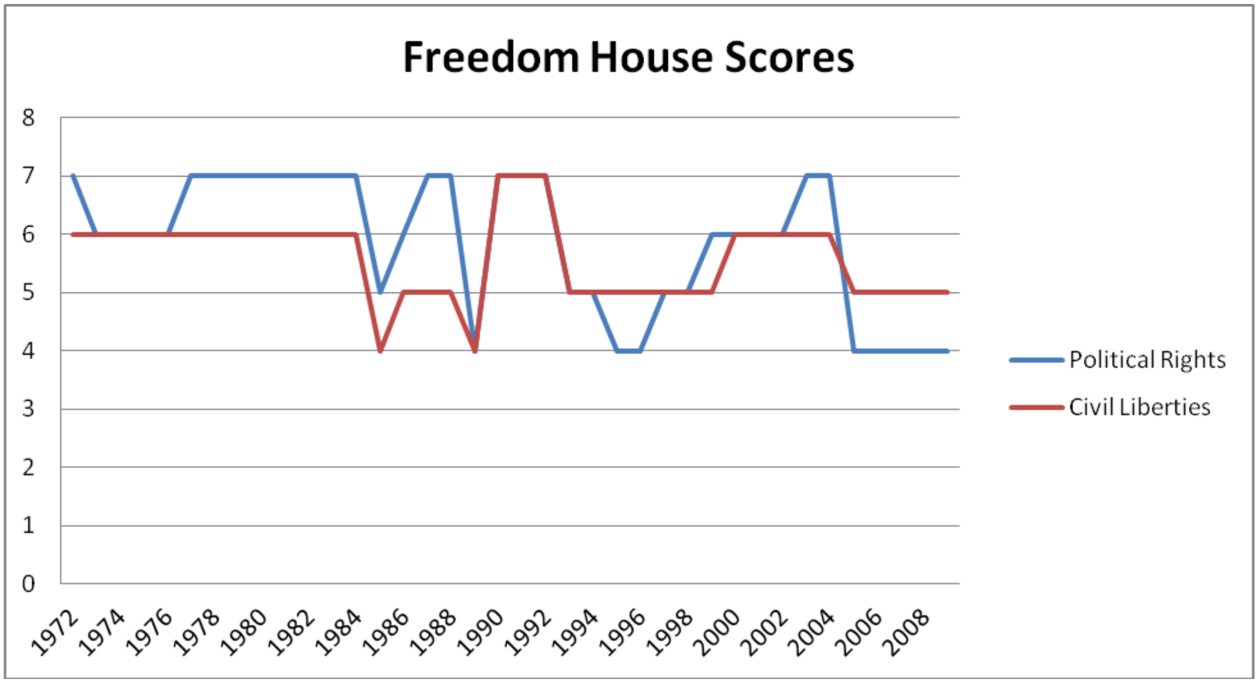
Figure 3.1: Polity Authority Trends, Haiti



Source: Marshall, M. G., & Jaggers, K. (2010). *Polity IV Project: Political Regime Characteristics and Transitions, 1800-2010.* http://www.systemicpeace.org/polity/polity4.htm

The Polity Score for Haiti has risen and fallen dramatically across its history. Although movements towards the democracy side of the index may be seen as positive, the fact that changes in the polity score have not persisted and consistently shift indicates significant uncertainty towards the state of the ruling regime.

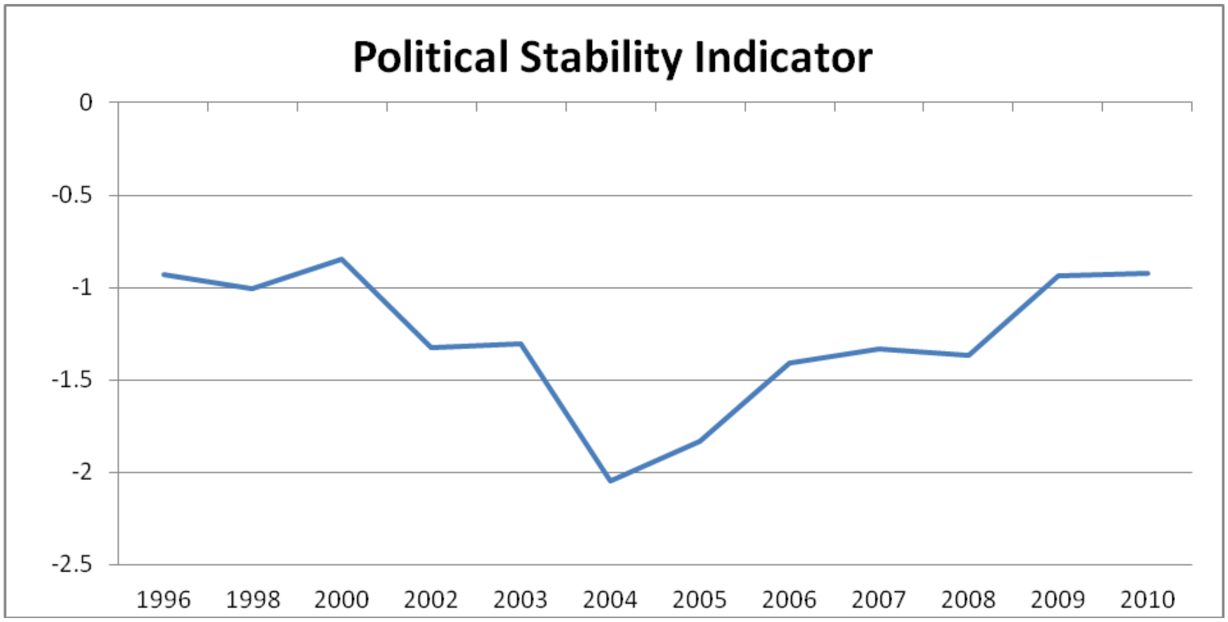
Figure 3.2: Freedom House Scores, Haiti



Source: *Freedom in the World*. (2011). http://www.freedomhouse.org/report-types/freedom-world

Freedom House has scored Haiti relatively high on their report on political rights and civil liberties across time. While at times, the scores fall as low as four, the consistent changes in the scores suggest that individual rights and well-beings are not consistently well-protected. This may hamper the microfinance industry, as citizens are uncertain about their ability to protect private property and may not wish to risk going in debt for a loan.

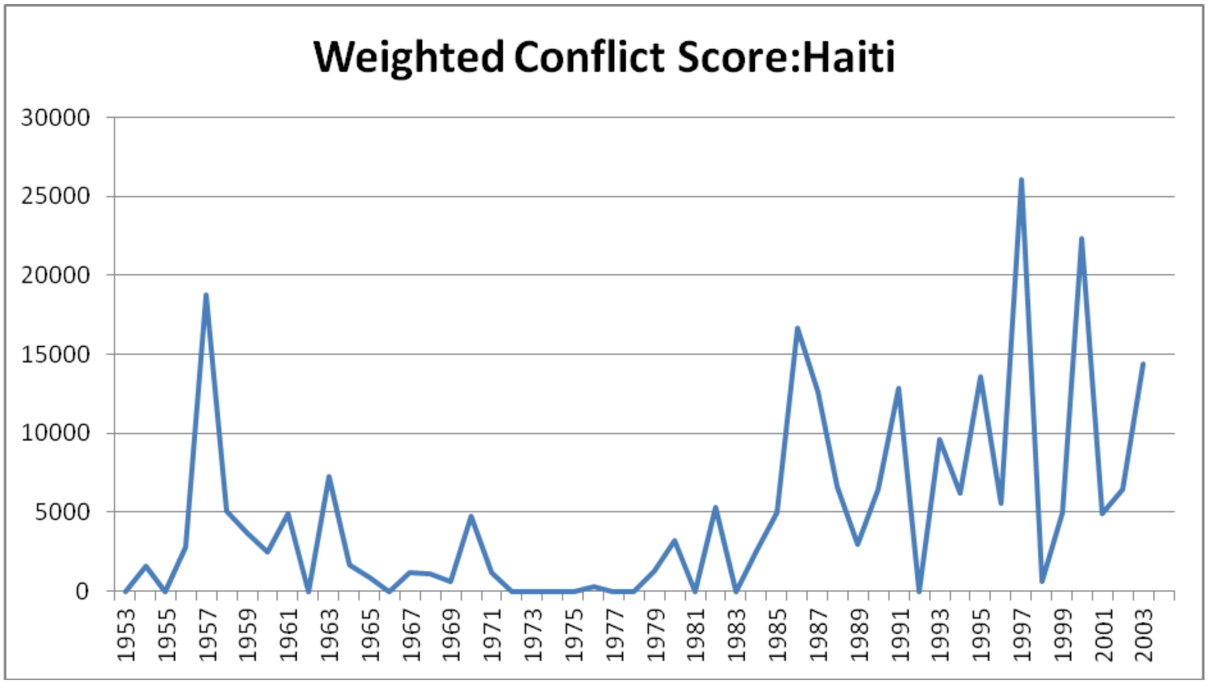
Figure 3.3: World Bank World Governance Indicators--Political Stability, Haiti



Source: *World Governance Indicators*. (2010). http://info.worldbank.org/governance/wgi/resources.htm

Haiti's Political Stability Indicator has remained below -1 for most of the past 15 years. It approaches the lowest level of the indicator at one point, which indicates severe political instability. This suggests that the government is quite susceptible to coups and uprisings. This type of instability could significantly restrict microfinance activity, as citizens may distrust institutions and funding for microfinance might suffer due to uncertainty in the future of the government.

Figure 3.4 Cross-National Time Series Data--Weighted Conflict Score, Haiti



Source: Banks, A. S. (2005). Cross-National Time-Series Data Archive. Binghamton.

The weighted conflict score in Haiti has seen extreme and frequent spikes, particularly in recent years. This indicates high levels of violence and unrest, which could pose extreme difficulties for organizations attempting to do microfinance. A lack of security might dissuade potential entrepreneurs from pursuing business enterprises.

Expectations Regarding Microfinance

Haiti has experience significant political instability over its history. Coup d'états, repressive regimes and military rule have occurred quite frequently. High levels of poverty and several natural disasters have compounded the situation and resulted in fragile regimes. Although national elections have been in place since the 1990s, concern regarding the fairness and freeness of those elections is widespread and it is difficult to label Haiti as a functioning democracy.

Examining the above data, this instability is quite clear. Haiti has seen tremendous swings in its Polity scores as well as in its Freedom scores, which have remained on high (indicating little freedom). Its political stability score has remained negative and the country has experience varying levels of conflict, particularly over the recent decade. These charts demonstrate a high level of socio-political instability and suggest major challenges for the nation.

Given the lack of strong government and presence of many social challenges, Haiti would appear to be a difficult environment for microfinance institutions to flourish. There is little support from the government and citizens may be hesitant to trust any sort of institution with their business. More importantly, investment and funding may be difficult to accumulate, given the uncertainty of future risks. There are many potential roadblocks to establishing a successful microfinance institution in Haiti.

Microfinance Industry Overview

Start of Industry

Microfinance had existed in Haiti since the 1980s, when USAID helped create a small organization in the country. However, there was not significant growth or expansion in the industry until the mid 1990s, when the Haitian government began to liberalize the economy and organizations could take advantage of the greater operating freedom

(Duval, 2003). In 1995, the government removed ceilings on interest rates and lowered the required amount of reserves a bank must hold, which allowed existing organizations to reach out to new customers and encouraged new organizations to join the sector. Specifically, groups looking to reach the informal economy were better poised to do so, which sparked the development of many MFIs (Summary of Client Protection in Haiti, 2008). In 1996, USAID implemented a new funding strategy in Haiti and created a Microfinance Fund to support NBIs. The fund helped to grow seven institutions in Haiti and USAID also created a support network for these institutions called the Financial Services Network for Entrepreneurial Empowerment (FINNET) (Duval, 2003).

Growth of Industry

Organizations continued to grow and reach out to new clients. Many of the institutions that continue to operate today were formed in the late 1990s and early 2000s. In 1998 the Konsey Nasyonal Finansman Popilè (National Council of People’s Funding, known as KNFP) formed as a network intended to support microfinance organizations. The network helps to train rural finance institutions, lobbies and advocates for the advancement of the sector, and facilitates information exchange and strategic discussion on the challenges of rural finance (Summary of Client Protection in Haiti, 2008). The industry continued to expand, as the number of Haitians with access to microcredit more than tripled from 1997 to 2001 (Reed, 2005).

However, the growth in the industry was not matched by growth in regulations and legislations. A major crisis in the credit cooperative sector in 2002 led the government to issue a new law to regulate credit cooperatives, but no framework was put in place to regulate MFIs (Whiteside & Wardle, 2008). The many organizations offering microcredit in Haiti have varying roots and structures, ranging from NGOs, community-based organizations and private companies, and the lack of regulation creates many inconsistencies in the sector. Some suggest that the lack of a uniform regulation system for MFIs is one of the primary roadblocks in growing the industry (Summary of Client Protection in Haiti, 2008).

Organizations and institutions continued to expand, albeit hampered by the lack of assistance from the government. In 2002 the National Association of Microfinance Institutions in Haiti (ANIMH) was founded in order to further develop the microfinance sector. It looks to disseminate research and best practices among microfinance institutions, facilitate the exchange of information between organizations and create networks of support between other national and international microfinance associations. The association also advocates for stronger regulation and legislation to guide the microfinance industry, and acts as an official representative of the microfinance industry before the Haitian government (Summary of Client Protection in Haiti, 2008).

The industry suffered several major blows in the mid-late 2000s. Following the political violence that led to the ousting of President Aristide in early 2004, thousands of Haitians fled the nation, causing many organizations to lose thousands of dollars and experience a surge in rates of default (Stuart, 2002). Major flooding that occurred later that year caused significant damage and killed hundreds of Haitians. Lending organizations had to refinance and write-off many of their loans due to the upheaval caused by the storm (Werlin & Hastings, 2006). The devastating earthquake that hit Port-au-Prince in January 2010 added another challenge to the microfinance industry. Following the disaster, the overall default rate on microloans in Haiti more than doubled, surging to a rate of 18% (Costello, 2010). The influx of aid following the quake offered new capital for microfinance projects, but many organizations are still reeling and struggling to get back on track.

Current State of Industry

There are approximately 21 organizations offering microfinance in Haiti, although the lack of government regulation makes it easy for organizations to operate undetected. Of these, 8 report to the Microfinance Information Exchange Network (MIX). These eight organizations serve 89,174 borrowers and have a gross loan portfolio of 56.9 million USD (Microfinance in Haiti: Country Profile, 2011). Data from the other organizations is not easily accessible, given the poor reporting standards in the Haitian industry. The number of active borrowers and gross loan portfolio of the leading three organizations (as determined by number of active borrowers) is presented in the following table.

Table 3.1: Leading Haitian Microfinance Organizations

Institution	Gross Loan Portfolio (USD)	Number of Active Borrowers
Fonkoze Financial Services	11,631,331	35,332
ACME	13,642, 791	21,906
Fonkoze	2,695,054	15,866

Source: Microfinance Information Exchange. (2011). *Microfinance in Haiti: Country Profile.* http://www.mixmarket.org/mfi/country/Haiti

Current Regulations and Laws

The banking sector in Haiti is framed by the decree passed in 1980 that regulated banking. The decree established the Bank of the Republic of Haiti (BRH) as the regulator of commercial banks. A crisis in the credit union industry in 2002 provoked the passage of a separate act that placed credit unions and cooperatives under the authority of the BRH as well. However, neither of these acts includes non-cooperative micro-finance organizations, leaving the microfinance industry unregulated. Since many institutions have different structures—some are small non-profits, some are large self-sustaining institutions—there is a severe lack of standardization.

Given the lack of legislative regulations, several networks and associations of organizations have formed to lend support to the microfinance sector. KNFP was formed in 1998 and represents 9 rural microfinance organizations. The network requires that its members implement standard controls and operate transparently, lending a slight framework to its participating organizations. The National Association of Haitian Microfinance Institutions

(ANIMH) consists of 17 non-cooperative microfinance institutions. While ANIMH doesn't have required policies its members must follow, it does seek to install best practices amongst the organizations by coaching and training sessions. Both ANIMH and KNFP state the development of national legislation regulating the microfinance industry as one of their top priorities (Summary of Client Protection in Haiti, 2008).

Institutional Case Study: SOGESOL

Introduction and Background

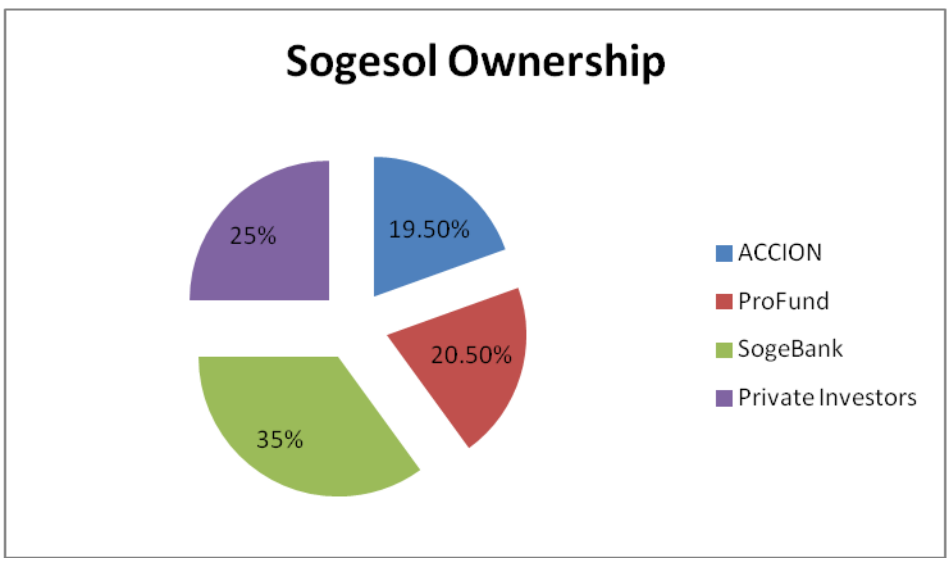
As the service company of one of Haiti's largest banking institutions, Sogesol has grown over the past decade into one of the nation's leading microfinance organizations. It is a non-financial subsidiary of Sogebank, an institution that was established in 1986 when a group of Haitian businessmen purchased the assets of the Royal Canadian Bank. By the year 2000, Sogebank had grown to be the largest commercial bank in Haiti, consisting of 28 branches and holding $300 million in deposits and a 27% of the market share. Sogebank has a history of innovation, as they were the first issuer of credit cards in Haiti and remain the only company to offer ATMs across the nation (Stuart, 2002)

The concept of a microfinance arm of the bank was developed by Pierre-Marie Boisson, a board member for the bank. Given the stark poverty level in Haiti, he viewed microfinance as a channel for Sogebank to pursue social goals in addition to financial ones. Eighty percent of the Haitian population lives below the international poverty line of $2 a day, while the GDP per capita is a mere $671 (World Development Indicators, 2010). Boisson believed that these statistics indicated a strong market for micro-loans, which had received positive press as poverty reduction tools. He convinced the rest of the board of directors that his idea had potential and began pursuing the project (Stuart, 2002).

In January, 1999 Sogebank received a $300,000 grant from the Inter-American Development Bank to create an affiliated company that provided microfinance services to the poor. This grant allowed the bank to move forward and pursue the creation of a business plan. Realizing that they needed significant assistance in the developing the terms of the program, Sogebank brought ACCION International on as a technical assistance partner in January, 2000. ACCION is a well-established microfinance organization that has found considerable success in Latin America (Stuart, 2002)

ACCION then purchased a 19.5% stake in the company, while an international investment fund based out of Costa Rice named ProFund bought a 20.5% share. Sogebank maintained a 35% share and the remaining 25% was owned by private investors.

Figure 3.5: Sogesol Ownership



Source: Stuart, G. (2002). *A Commercial Bank does Microfinance: Sogesol in Haiti.* Harvard University, Kennedy School of Government. Cambridge, MA: Harvard University Press.

The board of Sogesol consists of five members: three representatives from Sogebank, one from ProFund, and one from ACCION. Boisson chaired the board and

Sabine Valles was brought on as CEO in 2000. Both Boisson and Valles insisted that lending through Sogesol be individual, a marked change from most microfinance institutions that employed group and peer lending (Stuart, 2002)

Given the affiliated nature of Sogesol with Sogebank, determining the exact specifications of the relationship between the two companies was a sensitive affair. It was particularly important to avoid the moral hazard problem, given Sogesol's dependency on Sogebank for lending funds. Should Sogebank decide to implement unfair practices or rates, it would be extremely difficult and costly for Sogesol to switch partners. Thus, when Boisson and the other board members drew up the contract delineating the formal relationship between the two entities he tried to ensure as many accountability methods as possible (Rhyne, 2005).

The contract was established as follows. Sogebank provided capital for Sogesol to offer loans to its clients, which were then managed through accounts at Sogebank. Sogesol received all of the interest from its loans. It then used that income to pay for operating expenses, as well as fees to Sogebank for their services (Rhyne, 2005). These fees included a management services fee and an operational fee, which amounted to 0.75% of Sogesol's average loan portfolio and covered the expenses incurred through Sogesol's customers using Sogebank's tellers and ATMs. Sogesol is also required to maintain a fund that amounts to 3.5% of its outstanding loan portfolio to act as a loan loss reserve (Stuart, 2002).

The non-financial relationship between Sogebank and Sogesol is critical, as well. All of Sogesol's clients make their payments at a Sogebank branch through a bank teller. Initially, the teller would record the transaction twice: once in Sogebank's books, and once in Sogesol's management information software, Si Credito. However, Si Credito relied on network access in order to relay information to headquarters, and infrastructure problems frequently lead to a disruption of this access. Without the access, the loan officers for Sogesol didn't receive critical information regarding late payments and borrower profiles. Thus they altered the process, and now have bank tellers enter the information into their system, using dummy indicators and special categories to track loan progress. This information is then shipped daily to headquarters, necessitating a one-time network access instead of a live feed (Stuart, 2002).

The non-financial subsidiary nature of Sogesol provided many benefits to the organization. Their start-up was relatively easy and inexpensive. Furthermore, they benefited from the bank's staff, which reduced their personnel costs. It also allowed Sogesol to link their branding with Sogebank, which was quite well-known, and therefore improved its credibility. However, it also added to the bureaucratic process. Often, work for the microfinance company was given a lower priority than work for the bank by members of the bank staff. The bank staff is also not well trained in microfinance, leading to certain communication and procedural errors (Rhyne, 2005). For the most part, though, Sogesol was able to overcome the difficulties of being a subsidiary and utilize the relationship to improve their growth and performance.

Products and Lending Procedures

As mentioned earlier, Sogesol's executives decided to implement individual lending rather than group loans. They offer a term loan, with a fixed interest rate and an up-front commission. Each loan varies in loan amount, the amount of installment to be repaid, the frequency of repayment, and the length of the loan, according to the needs and capacities of the client. All of the loans are paid in periodic installments that amortize the loan. Sogesol uses a 28-day month schedule and tries to align repayments with revenue streams, so that clients have cash readily available when they have to make payments (Stuart, 2002).

Sogesol's relationship with ACCION allowed them to implement proven lending procedures. The loan approval process at Sogesol begins with orientation meetings for clients, which are held every morning. Loan officers for Sogesol—who have been trained by ACCION's staff—lead the meetings and give an introduction to the organization. They outline loan eligibility criteria and the loan application process. At the end of the meeting, the people in attendance can decide to fill out a loan application and submit it to the loan officer. The officer screens it to determine if it is eligible, and if so assigns it to a zone (which is determined by the location of the business). Each loan officer is responsible for a particular zone and must make daily trips to the zone to meet with applicants as well as distribute late repayment notices (Stuart, 2002).

In order for a loan to be approved, the client must first be interviewed on their income and expenses, the income and expenses of their family, and the general finances of their business (i.e. average revenue and costs). This information is written up in the application and generally must be submitted to a credit committee for approval (senior loan officers may make loans without committee approval, but only for amounts up to 9,000 Gourde). The loan officer who wrote up the application works with the credit committee to decide on the final terms of the loan and, if it is approved, reports back to the client (Stuart, 2002).

Challenges and Obstacles

Sogesol faced a few external challenges. In late 2003 to 2004, a rebel uprising in Haiti shook the country and brought widespread violence. Gangs surrounded the nation's capital and demanded the resignation of then President Jean-Bertrand Aristide. After weeks of being under-siege, Aristide resigned and fled the country, citing international pressure to step down as the motivating factor. At this point, the country was torn apart and suffering from massive riots and looting. Tens of thousands of Haitians fled the country and an international peace-keeping force was stationed around the nation. Sogesol, like most microfinance organizations, suffered tremendous losses, both in dollars and in clients. Their rate of risk rose from 3%-7.4% and they struggled to restart business (Rhyne, 2005; Carey, 2006; After, 2004; Embattled, 2004; Zarella, 2004).

Furthermore, the massive earthquake that struck Haiti in 2010 caused significant problems, as Haitians struggled to survive and many were unable to maintain day-to-day business. Sogesol reacted swiftly and refinanced and restructured 75% of their outstanding loans, in most cases extending repayment periods or lowering interest rates (Dewez, Welch, & Devaney, 2003). While the earthquake did set them back, they survived the catastrophe and were able to continue to provide financial services. Recovering from the earthquake and continuing to expand and improve their products and procedures will remain a challenge for the organization.

Impact and Significance

In 2003, ACCION led a Poverty Outreach Assessment to determine if they were reaching the preferred client population. Using information from Sogesol's management information software regarding the 4, 454 clients that received a loan from Sogesol during the period from April 2001 to May 2002, in addition to national surveys led by the Haitian Institute of Statistics, ACCION compared the level of poverty in their clients to that of Port-au-Prince and Haiti as a whole. Although their results were only preliminary, due to data limitations, they found that the clients of Sogesol had a similar poverty profile to that of Port-au-Prince, which indicated that the organization was functioning as intended (Dewez, Welch, & Devaney, 2003).

After one year of operation, Sogesol had expanded to serve over 2,000 clients. Only 5.85% of their loans featured late payments, while only 1. 48% were between 31 and 90 days late and a mere .52% were more than 90 days late (Stuart, 2002). Although they were 10.6 million gourde short of breaking even after the first fiscal year, they reached profitability by 2002. By 2003 they had expanded to offer 7 branches, 3 of which were outside of Port-au-Prince. The following chart demonstrates their growth over the past 9 years.

Table 3.2: Sogesol's Growth

Year	Active Portfolio	Active Borrowers	Portfolio at risk (> 90 days)
2002	$2,677,000	6,364	*
2003	$4,832,000	7,070	*
2004	$5,542,674	6,246	6.33%
2005	$5,760,470	7,931	5.34%
2006	$11,246,000	11,617	4.23%
2007	$13,000,000	11,946	1.36%
2008	$12,922,000	12,938	4.23%
2009	$12,326,000	13,491	4.97%
2010	$15,577,000	11,444	41.76%
2011	$13,938,000	11,378	*

* indicates missing data
Source: Microfinance Information Exchange. (2011). *MFI Report: Sogesol.* http://www.mixmarket.org/mfi/sogesol

Analysis

Haiti's turbulent political history has prevented any government regime from devoting adequate time to addressing the needs of the microfinance sector. Coups and violent uprisings are a frequent problem, making security a dominating priority for leaders and leaving little time to devote to other issues. Microfinance, like many other industries, has been largely overlooked from the side of the legislature.

The lack of national legislation and regulation in Haiti has lead to a wide range of success in microfinance institutions. Certain organizations—such as ACME and SOGESOL-- have been able to grow and expand their outreach successfully in the country, while others – such as Fondespoir and Finca—have struggled to sustain growth. The lack of regulation does result in full operation freedom, which enables some institutions to implement ideal practices and lending rates, although it also renders many clients vulnerable to exploitation. Client protection in the MFI industry is minimal and lending organizations can easily charge excessive rates.

To foster growth and success in the microfinance industry, the Haitian government needs to make it a priority to work with microfinance networks to draft and pass national legislation regulating the industry. Several microfinance networks have drafts of legislation and are eager to coordinate with the government, meaning that ideally the process should be rather swift. Utilizing the networks to provide insight and technical experience will enable the government to pass legislation that fully addresses the needs and demands of the sector.

Microfinance organizations, for their part, should continue to join and strength microfinance networks. Framework and regulation stemming from these networks will greatly help to standardize controls and policies across the sector, leading to more efficient growth and better protection for clients. Furthermore, if networks are able to coordinate with one another they can identify certain critical best practices and work to implement them across the country.

Analyzing the case of SOGESOL, using well-established organization as partners or assistance can strongly facilitate success, even amidst the vacuum of support found in Haiti. As an affiliate of the commercial bank, SOGESOL was able to eliminate certain start-up and operating costs and utilize members of SOGEBANK’s staff. Having a partner organization that is established and successful allowed SOGESOL to identify and implement effective policies. Other MFIs struggling in Haiti might look to SOGESOL as an example of how to overcome some of the challenges that are prevalent in the country.

Partnering with a bank, or an established MFI in a different country, should be an option for organizations hoping to attain greater growth and success.

Chapter 4

India

Political Instability Overview

Imperialism first touched India in 1619, when the British established the first East India Trading Company post at Surat on the northwest coast. They expanded their operations to include posts at Madras, Bombay, and Calcutta before formally establishing rule in 1757. By the 1850s, the British controlled most of the surrounding area, including modern day Sri Lanka, Pakistan and Bangladesh. However in 1857 a large rebellion movement began in Northern India and although it was ultimately unsuccessful, it provoked the British to transfer ruling powers from the EITC to the British government itself, thereby assuming responsibilities for the daily administration of the nation (India, 2006; Background Note: India, 2011).

In 1885 the Indian National Congress was established as a political group. The INC was comprised of elite members, most of whom lived in urban settings and were Western-educated. As a group, they lobbied for greater Indian participation in the government and administration (India, 2006). Partially due to their advocacy, in the late 1880s Great Britain moved to greater incorporation of Indian politicians and leaders in the government. A set of Indian councilors were appointed to assist in advising the British viceroy and provisional councils comprised of Indian members were established to facilitate local governance (Background Note: India, 2011).

In 1914, after the onset of World War I, Britain declared India a participant in the conflict without consulting Indian leaders. Involvement in the war brought extreme economic hardships, particularly to the poor, as they struggled to confront commodity shortages and sharp price increases. These struggles fostered civil unrest and sparked a nationalist movement amongst the populace, inspiring leaders to advocate more strongly for Indian self-rule. In 1920 Mohandas Gandhi emerged as a nationalist icon, transforming the Indian National Congress into a mass movement agitating for the removal of British rule (Background Note: India, 2011). Using parliamentary and non-violent resistance, Gandhi mobilized both Hindu and Muslim factions of societies to dissent against the government. In 1930 he led a massive 240-mile march from Ahmedabad to the sea to protest the British government's monopoly of salt production, which sparked a rash of civil disobedience across the country (India, 2006).

The British government gave the Indian population a slight concession with the Government of India Act of 1935, in which they maintained strong control of the country but expanded the right to vote and established fully elected Indian provincial government. However, in 1939 Britain brought India into World War II, again without consulting Indian politicians. The Indian National Congress members all resigned their government posts in protests and launched the Quit India movement in 1942, which led to a massive civil uprising. Britain responded forcibly, repressing the movement and amassing Indian prisoners to be used as combat troops in the war (India, 2006).

By the end of the war, political unrest in India was dangerously high. Britain was facing post-war recovery efforts at home and didn't have the resources or willpower to control the Indian uprising. The Muslim League and the Indian National Congress, the two major political parties in the nation, were both advocating strongly for Indian independence. In 1946 the Muslim League called for "direct action" to be taken against the British and sparked a string of violence in modern-day Pakistan. Overwhelmed by the disorder, British Prime Minister Clement Attlee announced the withdrawal of the British presence in February 1947 (India, 2006).

On August 15th 1947, India became a dominion within the British Commonwealth and Jawaharlal Nehru assumed the position of Prime Minister. The territory that comprised British India was split into two: the Hindu-majority India and the Muslim majority Pakistan. In January 1950, India ratified its national constitution and officially became a republic, but elected to remain a member of the British Commonwealth (Background Note: India, 2011).

In 1952 the first national elections were held and Nehru and his supporting party, the Indian National Congress, won decisively. Although India had achieved its independence, Nehru maintained many facets of colonial administration, such as a top-heavy state and over-reliance on non-elected official (Background Note: India, 2011; India, 2006).

Nehru governed until his death in 1964. At that time, Congress appointed Lal Bahadur Shashtri as the new Prime Minister. However, Shashtri only ruled for two years and died in office in 1966. Indira Gandhi, daughter of Nehru, then won the position of Prime Minister and came to power. She manipulated a split in the dominating Congress party and created internal disputes amongst its members. Gandhi then played off of these disputes and, citing political and economic disorder, declared a state of emergency in 1975. The move was largely seen as a political maneuver, as she was then able to expand

and abuse her powers and assume total control. In 1977 Gandhi called for national elections, hoping to secure a strong victory and thus justify her expansion of powers, but was instead defeated by the Janata Dal (an alliance formed of opposition parties). Moraji Desai, head of the alliance, assumed the Prime Minister position (Background Note: India, 2011; India, 2006; Ramesh, 2006).

Desai ruled for two years before being replaced by Chaudhary Charan Singh. Singh ruled briefly but the Janata party soon crumbled and elections were held in January 1980. Indira Gandhi was re-elected, but was assassinated in 1984 by her own Sikh bodyguard as revenge for a military mission that destroyed a sacred Sikh temple. She was succeeded by her son Rajiv Gandhi (Lal, 2011).

Gandhi's government was accused of corruption and elections were called for in November 1989. Gandhi's supporting party, called the Congress (I) Party, won the largest number of seats in parliament but couldn't form a majority government. Several coalition governments attempted to form, but none lasted and at the end of 1990 Congress (I) formed a government with Janata Dal. This coalition also collapsed and another set of elections were called for in June 1991 (Background Note: India, 2011).

Congress (I) won 213 seats in that election and returned to the head of the government, placing P.V. Narasimha Rao as Prime Minister. His government ruled a full five-year term and supported significant economic liberalization of the country. However, in 1996 the Bharatiya Janata Party (BJP) won the largest number of seats in the national elections. They formed a coalition government under Atal Behari Vajpayee as Prime Minister, but his government lasted a mere 12 days. A 13-party coalition government was then formed under Prime Minister Deve Gowda, who resigned after less than a year.

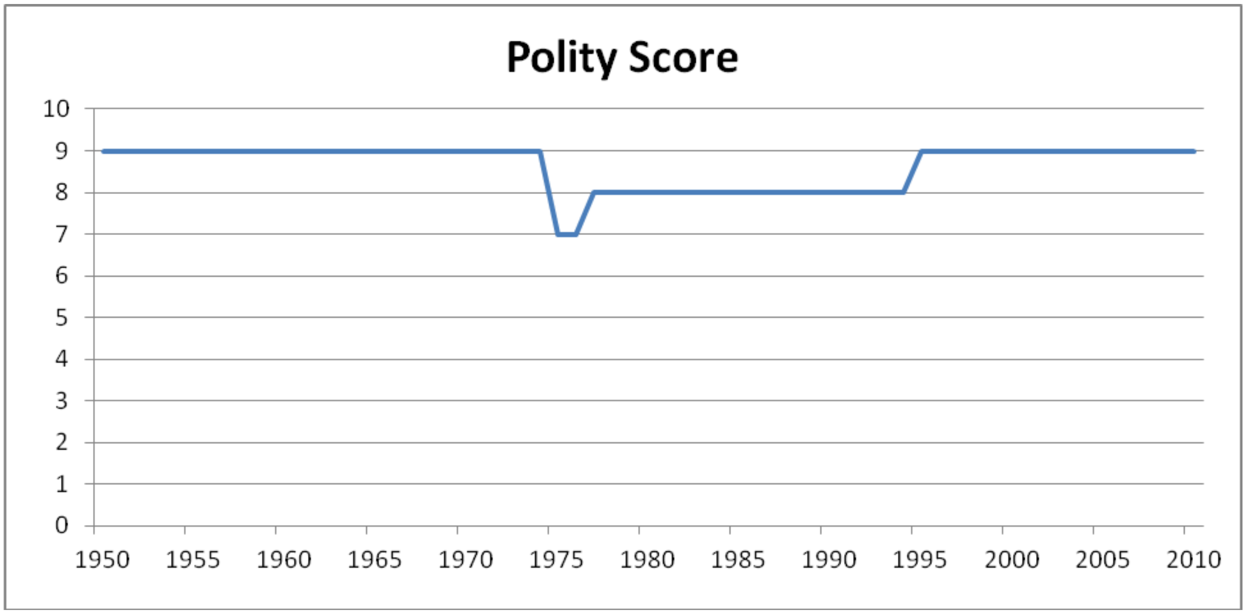
Inder Kumar Gujral succeeded Gowda but similarly ruled for less than a year. Elections in February 1998 gave the BJP the largest number of seats again and Vajpayee again formed a coalition government and took the position of Prime Minister. However, his decision in May 1998 to make India a nuclear state rattled his supporters and the coalition broke down (Lal, 2011).

In the September 1999 elections the BJP won with a new coalition called the National Democratic Alliance (NDA). They served a full five-year term but were defeated in the 2004 elections by a new coalition named the United Progressive Alliance (UPA). Monmohan Singh was the Prime Minister and the UPA continued many of the BJP's policies, including improving relations with the US. The UPA's stability grew over the years, as in 2008 they won a confidence vote and increased their seats in the 2009 election. With that election, Singh became the first Prime Minister since Nehru to return to power after serving a full five-year term (Background Note: India, 2011).

Political Instability Data

The following data and charts demonstrate changes in India's political stability over time. The time frame and scale for each set of data is determined by the index used.

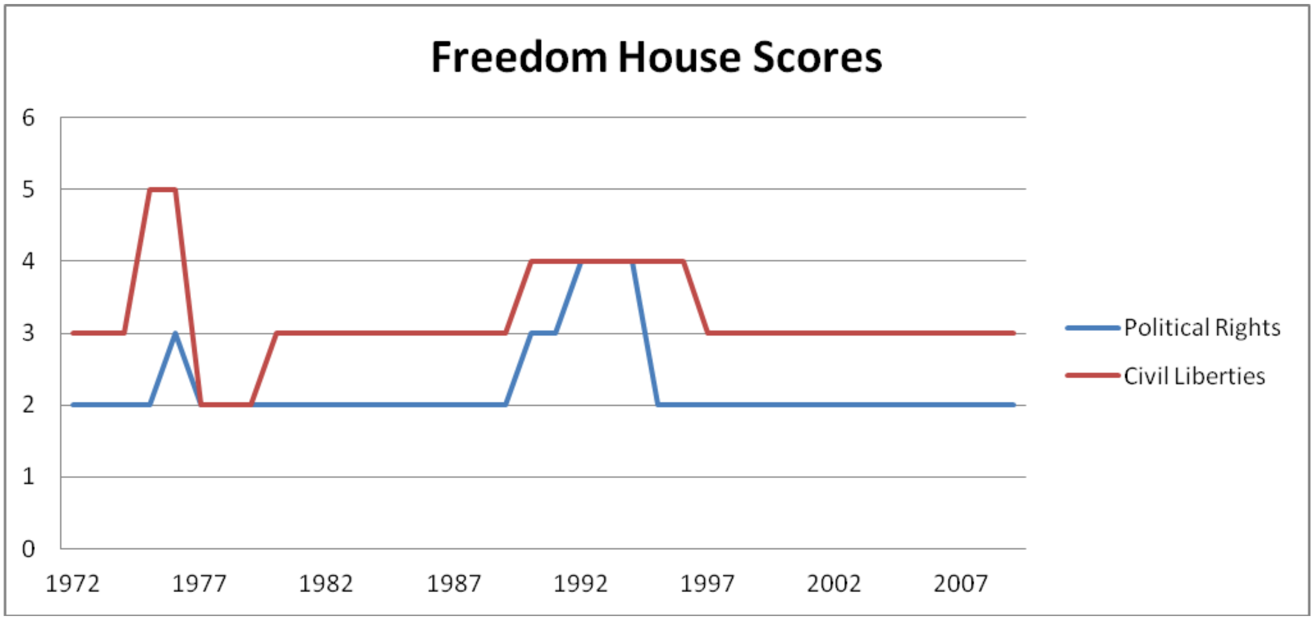
Figure 4.1: Polity Authority Trends, India



Source: Marshall, M. G., & Jaggers, K. (2010). *Polity IV Project: Political Regime Characteristics and Transitions, 1800-2002.* http://www.systemicpeace.org/polity/polity4.htm

The Polity Score for India has remained extremely high and stable. There are few changes in the score, which indicates that the nature of the Indian government has not undergone major changes that would drastically affect policies and procedures. This would appear to benefit microfinance organizations, as they can well predict what the government will look like year after year.

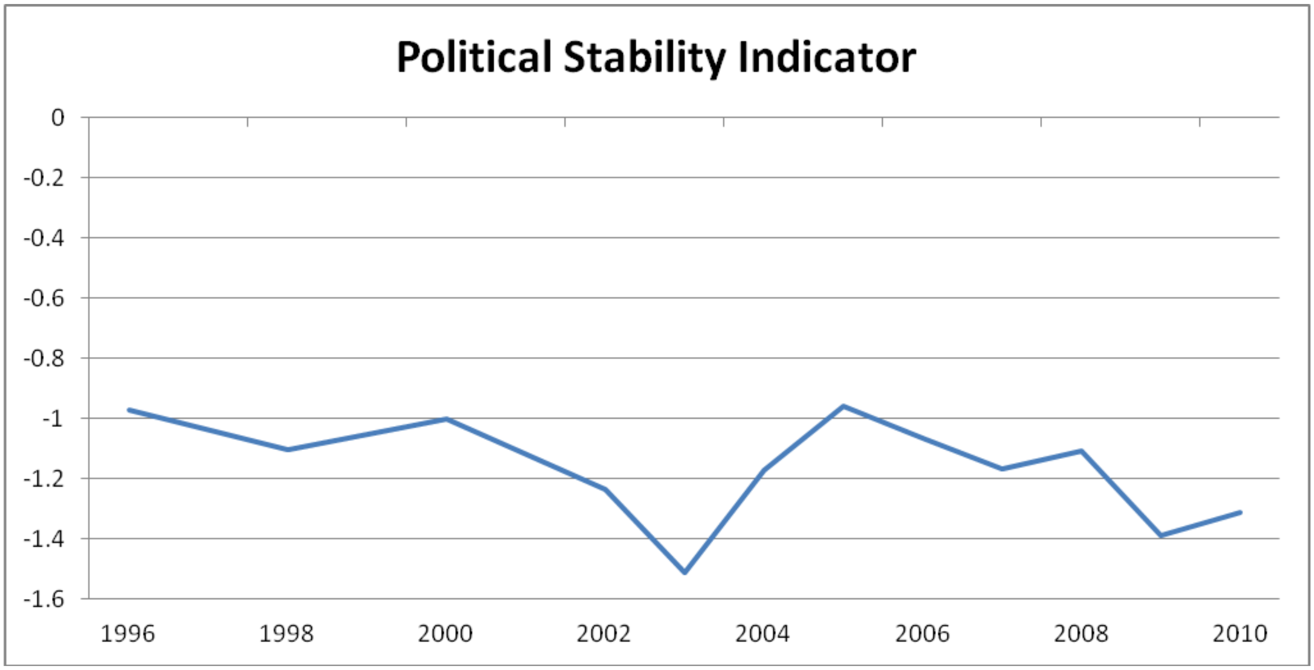
Figure 4.2: Freedom House Scores, India



Source: *Freedom in the World*. (2011). http://www.freedomhouse.org/report-types/freedom-world

There have been several bumps in India's Freedom House Scores, but in general they have remained rather low and constant. This would suggest a higher level of protection for individual property rights and a greater presence of stable institutions to secure well-being, both of which could greatly benefit microfinance institutions.

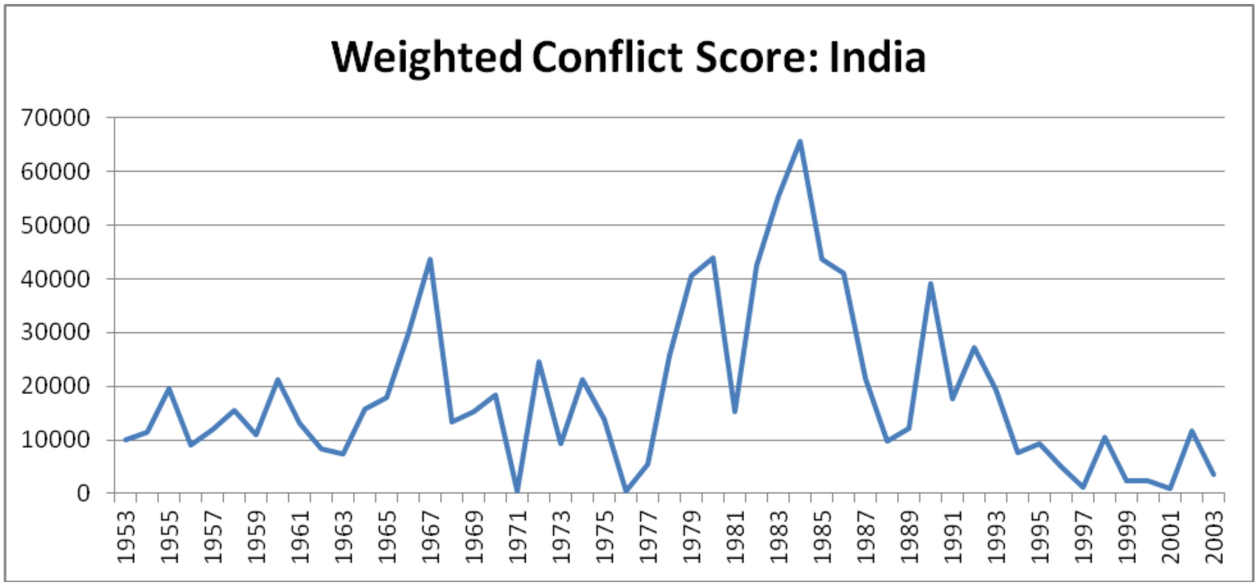
Figure 4.3: World Bank World Governance Indicators--Political Stability, India



Source: *World Governance Indicators*. (2010). http://info.worldbank.org/governance/wgi/resources.htm

Surprisingly enough, India's Political Stability Indicator has remained persistently negative over time. This may be reflective of the constant turnover in ruling party that is present in the Indian Political System, or of violent issues regarding conflicts with neighboring countries. This indicator may suggest that there are some underlying political stability issues for India, although they do not appear clearly in other inicators or in the political history.

Figure 4.4: Cross-National Time Series Data--Weighted Conflict Scores, India



Source: Banks, A. S. (2005). Cross-National Time-Series Data Archive. Binghamton.

India has had many spikes in its weighted conflict score, although they have lessened in severity over time. Again, this may suggest that there are some political instability issues that aren't as emphasized using other measures.

Expectations Regarding Microfinance

India has a long history of frequent regime changes, although they occur constitutionally. Parliamentary elections are frequently called and often prime ministers have been unable to complete a full five-year term. That being said, the constitutional framework to India's government has been constant and stable (with the minor exception from 1975-1977) and regimes have not appeared susceptible to coups.

Examining the above data, particularly in recent years India has appeared somewhat stable. It’s Polity score has not shifted and its freedom scores have remained relatively low. However, it’s Political Stability score is negative and has experienced some changes, and the country has seen low levels of conflict. Nevertheless, given the level of stability regarding the political process and systems, it would appear that political stability shouldn’t present too much of a challenge to the microfinance industry.

Microfinance Industry Overview

Start of Industry

Providing credit to the poor has long since been a priority of the Indian government and thus microfinance can trace its roots in the country back to the early 1970s, when Indian commercial banks were nationalized. The government stipulated that they must lend 40% of their lending funds to the “priority sector” at favorable rates. The priority sector encompassed the lower classes, particularly those living in rural areas or pursuing agriculture business (Ghosh, 2006). In 1980 the government launched the Integrated Rural Development Programme, a credit scheme that sought to assist the poor out of poverty by providing them with loans. However, the program was largely not a success, due to the extreme levels of bureaucracy that accompanied the project. There was also no solid mechanism to verify the actual level of need of clients, meaning that many better-off citizens took loans from the program dishonestly (Smith, 2006).

Outside of the government sector, the emergence of the Self-Employed Women's Association (SEWA) in 1970 marked the beginning of microfinance in India. The group was a self-help group (SHG), a collection of women who formed an urban cooperative bank. The purpose of an SHG is to unite together clients who jointly receive a loan from a bank, and then lend out the money amongst its members. The concept of SHGs grew popular in the 1980s and began to expand across the country, along with microfinance institutions that employed solidarity group lending (Microfinance in India: A Crisis at the Bottom of the Pyramid, 2011).

Growth of Industry

In 1990, the Reserve Bank of India (RBI) underwent several financial policy reforms and liberalized the financial sector. As a result, interest rates were less regulated and new competition emerged in the banking sector, as well as in the microfinance and SHG movement. The removal of limits on interest rates allowed microfinance organizations to operate more freely and expand their outreach of lending to the poor

(Smith, 2006). The 1990s then saw an influx in the number of NGOs operating as MFIs in the country. Noticing the importance of microfinance in poverty reduction, the government launched the Swarnjayanti Gram Swarojgar Yojana Program (SGSY) in 1999. The program offered government assistance to NGOs working with SHGs by offering funding to successful groups. However, much as was the case with the IRDP, the government program faced several challenges. Primarily, the distribution of subsidies became a political issue as groups would lobby for funding. Furthermore, local state governments now had an incentive to form their own SHGs and microcredit operations, thereby competing with already formed NGOs. The NGOs had more experience and better operational manpower to lead successful SHG programs but often received less funding than the groups formed by the local government. Thus the SGSY was a rather inefficient system (Chakrabarti, 2004).

Despite the shortcomings of the SGSY, other government and NGO programs continued to foster growth in the microfinance industry. SHGs grew in popularity and the National Bank for Agriculture and Rural Development (NABARD) developed a program to link SHGs with commercial banks. The program was an enormous success and by 2002 had connected over 500,000 SHGs with the banking sector (Chakrabarti, 2004).

The success of early programs led to an increasing popularization of microfinance in India, and the microfinance sector in India boasted the highest growth rate in the world from 2002 to 2010 (Microfinance Industry in India, 2010). Microfinance organizations have drawn attention from many commercial investors, both domestically and overseas, and appeared to offer significant opportunity for “socially conscious” investors to both make a profit and make an impact in the developing world.

However, this impressive success brought with it a rapid rate of expansion that was largely ignored by the Indian government. As microfinance organizations continued to emerge and spread quickly across the nation, the government failed to take any steps to control the growth. In some cases, they encouraged the growth of the industry and welcomed the emergence of new microfinance institutions. Unfortunately, this extreme growth became an issue as organizations tended to operate in specific regions, resulting in intense competition and overcrowding in those areas. Certain states, such as Andhra Pradesh, became oversaturated with microcredit organizations (Srinivasan, 2010). Many households wound up borrowing from multiple institutions, as there was no external regulation or oversight of who organizations were lending to. These clients were then likely to borrow more than they could repay and often became buried in debt.

In 2010, politicians attributed a rash of suicides in the Andhra Pradesh region to client over-indebtedness and claimed that MFIs were exploiting their poor clientele. The Andhra Pradesh government quickly passed the Andhra Pradesh Microfinance Institutions Ordinance of 2010, subjecting MFIs to new, strict regulations. Organizations were forced to register, potential loan applications had to be submitted to the government for approval and interest rates were capped (Nair, 2011). Furthermore, local politicians urged clients to default on their loans and encouraged citizens to walk away from the lending programs (Tharoor, 2011).

The crisis resulting from the situation in Andhra Pradesh had resounding effects, both within the state and across the country. Organizations within the region saw a drop in repayment rates of 15-20% (Nair, 2011). The Reserve Bank of India also reacted and introduced nationwide caps on lending margins and interest rates (Global microscope on the microfinance business environment, 2011). The sector as a whole suffered dramatic losses and a decrease in client outreach.

Current State of Industry

At present, there are over 94 million people in India who are borrowing from a microfinance organization (Stancati, 2011). The recent crisis and the sector and the shifting regulations make it difficult to identify the precise number of organizations operating as MFIs, but there are 147 such organizations that report to the Microfinance Information Exchange (MIX). These organizations have lent to 31.7 million borrowers for a gross loan portfolio of 5.3 billion USD (Microfinance in India: Country Profile, 2011). The number of active borrowers and gross loan portfolio of the leading three organizations is presented in the following table.

Table 4.1: Leading Indian Microfinance Organizations

Institution	Gross Loan Portfolio	# Active Borrowers
Bandhan	598,763,757	3,388,317
Spandana	519,685,018	3,507,991
SKS	341,123,257	4,303,000

Source: Microfinance Information Exchange. (2011). *Microfinance in India: Country Profile.* http://www.mixmarket.org/mfi/country/India

Current Regulations and Laws

Organizations pursuing microfinance in India can be classified as either non-profit or for profit. Non-profit organizations include NGOs providing microfinance services, cooperative banks, and Section 25 companies, which are special non-profits that advance commerce goals. Most MFIs in India belong to one of these three categories. For-profit MFIs are Non-Banking Financial Companies (NBFC) (India, 2011).

Following the crisis in Andhra Pradesh, the Indian government passed the Microfinance Institutions (Development and Regulation) Bill in June 2011. This bill made the Reserve Bank of India (RBI) the sole regulator of microfinance activities and requires that all organizations engaging in microfinance activities register with the RBI. The bill also created a separate category of NBFCs called NBFC-MFIs, specifically for organizations that conduct microfinance (Kline & Sadhu, 2011). All MFIs that have a loan portfolio of greater than $22.4 million must transform and register as NBFC-MFIs (Ghosh S. , 2011). In addition, the bill limits the income potential borrowers may have. It also caps the interest rate and lending margin of loans (Ghosh S. , 2011).

Institutional Case Study: SKS

Introduction and Background

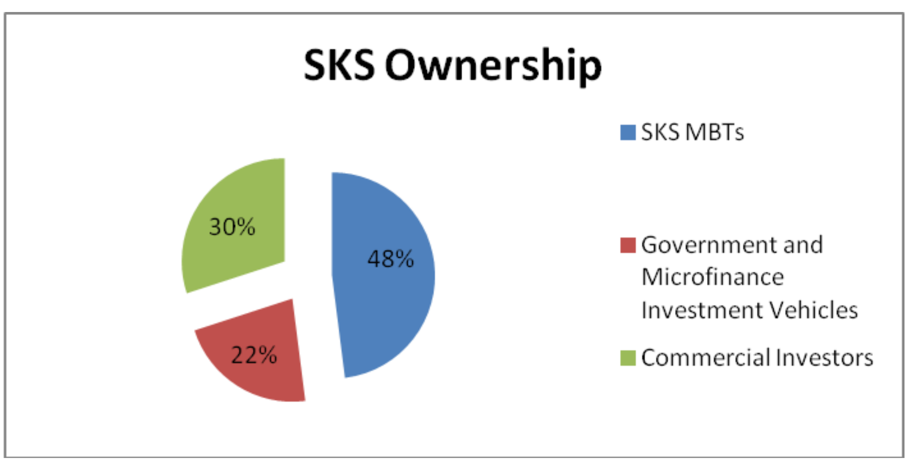
SKS Microfinance was founded by Vikram Akula, an Indian American who devoted himself to the overwhelming task of combatting global poverty. After having attended Tufts University to study Philosophy and English, Akula went to India to work for a non-profit named Deccan Development Society. The job gave him significant field experience as he lived among the poor while leading an expansion project in a rural village. He attributed these experiences with having given him keen insight into how best to help the poor. After a few years of field-work, Akula returned to the United States to pursue a Ph.D in Political Science from the University Chicago. It was during these years that he formed the idea of forming a for-profit microfinance institution. He approached several major microfinance organizations—such as the Grameen foundation and the Self Employed Women's Association—but was unable to find a group willing to partner with him. Convinced of his idea's eventual success, Akula resolved to establish his own organization in order to implement his vision (Akula, 2010; Bio, 2012).

Thus, SKS Society was founded in 1997 as an NGO funded by individual and institutional donors. The organization was established in the state of Andhra Pradesh in southern India and began by lending to 19 clients (MFI Report: SKS, 2011). By 2003, it had grown to having over 11,000 clients (Chen, Rasmussen, Reille, & Rozas, 2010). In 2005, SKS transformed from an NGO to a Non-Banking Financial Company (NBFC), a for-profit institution that was regulated by India's central bank. Chapter III of the Reserve Bank of India Act, 1934 establishes the ability of the central bank to acknowledge and govern these types of institutions. The act specifies the capacities and limitations of NBFCs and requires any such organization to be registered with the central bank. NBFCs may perform most typical banking functions, although they are not allowed to collect demand deposits (Non-Banking Financial Companies, 2008). The move from an NGO to a NBFC allowed the organization to raise capital from equity investments and from debt raised through banks and other commercial institutions. It also enhanced the credibility of the organization, as it now had to be monitored and regulated as would any bank. These regulations and established controls caused other banks to feel more comfortable investing in the organization. By subjecting itself to observation by the central bank, SKS was able to prove to commercial investors that it was a legitimate institution that was worth investment. After this organizational change, equity investment in the institution was as follows: 40% clients (borrowers); 6% SIDBI; 13% CEO of Sun Microsystems; 13% Ravi Reddy; 13% Unitus, 15% SKS ESOP (Maroju, 2007)

However, the move from NGO to NBFC also required the formation of Mutual Benefit Trusts (MBTs), entities that are allowed to legally invest in the company. SKS transferred its assets to these MBTs, which then purchased the shares of the NBFC. The MBTs are governed by a general body composed of SKS clients and legal trustees who are appointed to render and execute decisions for the MBT. While the general body of each MBT is supposed to hold the trustees accountable for their decisions, in essence this structural change adds a new level of bureaucracy and may render it more difficult to ensure transparency and accountability (Chen, Rasmussen, Reille, & Rozas, 2010).

After becoming a NBFC, SKS increased their clientele from 74,000 borrowers in 2005 to 174,000 in 2006. A first round of equity raised $1.6 million and resulted in the ownership structure shown in Figure 4.5.

Figure 4.5: SKS Ownership



Source: Chen, G., Rasmussen, S., Reille, X., & Rozas, D. (2010, September). Indian Microfinance Goes Public: The SKS Initial Public Offering. *Focus Note , 65*.

In the second round of equity in 2007, an additional $12 million was raised and Sequoia Venture Capital purchased a 19% stake. The number of borrowers increased to 513,000. By 2008, the organization was expanding rapidly and made a tremendous leap to 1.63 million borrowers as a third round of equity raised $37 million dollars (Chen, Rasmussen, Reille, & Rozas, 2010). The organization was experiencing an average annual growth rate of 165% and saw an astonishing repayment rate of 99% (Maroju, 2007).

SKS's success was due in large part to Akula's unique vision of a for-profit model. Although many criticized the notion of making money by helping the poor, the for-profit approach ensured financial sustainability and allows organizations to scale up to reach more people. In India, there is an estimated $75 billion demand for micro-lending, of which only a fraction is provided. The for-profit microfinance model is arguably one of the few ways to bridge supply and demand of microloans (Maroju, 2007).

Products and Lending Procedures

A standard, 50 week loan comprises 85% of the loan portfolio in SKS's microfinance program. This loan starts at $230 and employs an effective interest rate of 25-30%. This loan is administered using the Grameen model, which is centered on trust groups of 5 borrowers (mostly women). A group leader identifies two clients to receive the first loans. The group then meets weekly with a loan officer from SKS who collects small repayments from the first two borrowers. Only when these borrowers have repaid their loans can the other group members receive theirs. This system employs social collateral which is responsible for the high rates of repayment (Maroju, 2007).

In addition to these loans, SKS also provides emergency loans to its clients, the amounts and repayment schedule of which are determined on a case-by-case basis. It also offers insurance, both credit and life insurance, to borrowers and their spouses, for a cost of 1% of the insurance amount. SKS covers approximately 1.2 million clients with their insurance (Maroju, 2007).

SKS is composed of over 2,000 branch offices, each of which is responsible for monitoring 20-30 villages (MFI Report: SKS, 2011; Maroju, 2007). In order to train their loan officers, 6-10 of which are staffed at each branch, SKS employed methods utilized by companies such as Starbucks and McDonalds. By borrowing techniques from these highly effective corporations, SKS was able to train over 500 officers each month and ensure standardization and strong performance across their many branches (Chen, Rasmussen, Reille, & Rozas, 2010). This improved the efficiency of SKS, as every loan was handled in the same manner and errors in repeating or missing steps in the loan process could be avoided. It also improved communication throughout the organization, as officers from different branches utilized the same techniques and could confer on issues in other branches if necessary. In essence, such training significantly reduced the potential for redundancy or error in operations.

SKS loan officers are primarily responsible for three “customer-facing” operations and one internal operation. In terms of customer interaction, first the officers must identify villages that would make suitable locations for new lending. To determine if a village is suitable, the officers travel to the location and administer a survey to villagers. Simultaneously, they assess the political stability and accessibility of each village. If the village is experiencing turmoil due to political issues that may threaten the ability of the loan officers to work, or if it is not easily accessible for the loan officers, it will likely be rejected as a lending location. If the officers decide to lend to the village, they introduce their organization first with a large meeting, and then with small group and individual meetings if necessary (Maroju, 2007).

Then, they must help form joint liability groups (JLGs) consisting of five borrowers each, and organize those groups into larger centers, which are composed of anywhere from four to twelve JLGs. Each center must go through standardized training on SKS's lending procedures. Finally, the loan officers are responsible for carrying out weekly transactions. This includes meeting with each group, discussing problems and issues, and collecting and recording repayments.

Back at the branch office, the loan officers must manually enter the data they collected into SKS's management information software (MIS), which was developed uniquely for SKS. The program tracks portfolios, assists with accounting and enables management reporting. All of these data are then transmitted to headquarters, either by Internet if it available, or via a CD that is mailed each week after collection (Maroju, 2007).

Challenges and Obstacles

Although the trainings, strategy and management employed by SKS enabled them to grow quickly and reach tremendous levels of success, they have faced significant challenges in recent years. As mentioned earlier, they increased their portfolio at a rapid rate and attracted investment from venture capitalists and commercial banks both in India and abroad. Their enormous success, which by 2009 had propelled them to over 3.5 million clients and a gross loan portfolio of over $960 million, led the executive board to decide to issue an Initial Public Offer (IPO) on the company (MFI Report: SKS, 2011). They were the first Indian MFI to do so, three years after Banco Compartamos in Mexico became the first MFI worldwide to go public (Chen, Rasmussen, Reille, & Rozas, 2010).

Again, there was criticism of the move, as the offering turned the board of SKS into instant millionaires. However, Akula insisted that he held the interest of the poor as the top priority, arguing that offering public shares would allow for greater capital accumulation and the ability to scale up even more (Finance and Investment, 2010).

Initially, it appeared that this would be the case. After floating the first IPO in August, 2010, shares shot up more than 50% and the offering was 13 times oversubscribed (Chen, Rasmussen, Reille, & Rozas, 2010; Bajaj, 2011). However, that success was short-lived due to an ensuing crisis in the microfinance industry. In the Andhra Pradesh region of southern India, where SKS was first established, an oversaturation of the microcredit market occurred due to state laws that made microfinance easy to implement. Several large MFIs—most of which operated for-profit—flocked to the state and began offering a multitude of loans. Credit was easy to access, and thus many poor households eagerly sought out as many loans as they could find, without too much concern for their ability to repay the loans. The MFIs were not well regulated by the state and lacked diligence in their lending. The resulting consequence was that many households were not able to repay their loans and began to default (Priyadarshee & Ghalib, 2011).

According to many sources, the MFIs then resorted to aggressive methods in order to collect repayments. By late 2010, the press was reporting that borrowers were committing suicide to avoid the potential actions of the MFIs. At this point, the Indian government took notice and vowed to write new legislation to monitor MFIs more closely. Politicians portrayed MFIs as greedy loan-sharks and often encouraged individuals to default on their loans (Priyadarshee & Ghalib, 2011).

Before the end of 2010, the state government in Andhra Pradesh passed a new law that required microcredit institutions to submit each new loan to the government for approval. The law also required that repayment collections be conducted in front of a public official. Furthermore, the central bank of India passed a law in early 2011 that restricted both the effective interest rate and the total loan amount that microfinance organizations could issue (Bajaj, 2011).

While the intent of the laws was to protect microfinance clients, the new regulations severely limited the ability of MFIs to conduct business. According to Vikram Akula, by mid-2011 the government in Andhra Pradesh had approved only 2.25% of the loans submitted, significantly curtailing the growth of microfinance in the state (Bajaj, 2011).

The hits that SKS took from the new legislature and the negative reputation they had been given plunged them into a series of losses and negative quarters. By November 2011, shares were down 90% from the initial offering and SKS forced its chairman and founder, Vikram Akula, to step down from his post (Bajaj, 2011). The company reportedly lost $83 million during the final quarter of 2011 (Microfinance Around the World, 2012).

Impact and Significance

SKS's initial success was quite remarkable. They experienced tremendous growth before suffering major setbacks in late 2010.

Table 4.2: SKS Growth

Year	**Active Portfolio (USD)**	**Number of borrowers**	**Portfolio at risk (> 90 days)**
1998	$ 4,704	19	*
1999	$ 15,115	191	*
2000	$64,472	1068	*
2001	$ 278,514	5080	*
2002	$ 10,739,950	11,127	*
2003	$ 2,702,832	24,799	*
2004	$ 7,604,875	73,635	5.12
2005	$20,593,830	172,970	1.18
2006	$63,247,572	513,108	0.12
2007	$ 261,686,364	1,629,474	0.03
2008	$ 484,975,269	3,520,826	0.19
2009	$ 960,793,988	5,795,028	0.22
2010	$ 925,844,433	6,242,266	*
2011	$536,878,566	4,676,000	*

* Indicates missing data

Source: Microfinance Information Exchange. (2011). *MFI Report: SKS.* http://www.mixmarket.org/mfi/sks

Time will tell if SKS is able to rebound from its drastic losses over the past year. Its initial success and strong growth during the late 2000s indicates that the organization, at its roots, employs solid methodology and a strong vision. Adapting that methodology and vision to account for the recent changes in political and public sentiment will prove to be the critical factor in SKS's success over the upcoming years.

Analysis

India has had a fairly long period of political stability, reaching back well into the mid 20th century. This appears to have allowed the government to focus on implementing and expanding policies to assist the well-being of its peoples, including microfinance. India has a long history of developing programs that support micro-lending, reaching back to the 1970s and the creation of the financial inclusion mandate. Since then, many government-led committees and programs have funded and facilitated the growth of the microfinance sector, clearly unhindered by any instances of political instability.

However, stability did not guarantee success in the Indian microfinance industry. The government, although it was free to encourage microfinance growth, did not regulate said growth adequately. The programs they initiated and supported lacked an institutional framework to monitor them appropriately (Nair, 2011). The government took growth in the industry as an indicator of success and failed to inform themselves about the sector and how it operated in order to identify areas or issues of concern. Then, after failing to reign in unbridled growth, the government acted too swiftly and implemented draconian measures that hurt the industry.

Thus, it appears that in a country where stability was high, both the government and microfinance organizations were tempted to take a laissez-faire attitude towards microfinance policy and regulation. The government, able to create programs that facilitated success, took that success for granted and underestimated the importance of a strong institutional framework. Microfinance organizations, unconcerned by instability and with full faith in their government, did not ask for more government regulation. Evidently, this lack of regulation and framework resulted in a major crisis in the sector.

Examining the case of India, one can identify a few suggestions of best practices for governments and MFIs to ensure success whilst enjoying relative political stability. Governments need to acknowledge their own shortcomings in familiarity with the microfinance sectors. For governments to properly monitor the microfinance industry, they need to be well-versed enough in the industry to know what patterns or situations to be cautious of. In the case of India, the government took growth as an indicator of success and did not investigate other factors of a healthy microfinance sector. A major aspect of becoming informed is working with MFIs to determine what they need to succeed. In interviews with MFI operators following the passage of the Microfinance Institutions (Development and Regulation) Bill, many expressed concern over the measures that the government had taken, particularly in placing regulating power in a centralized body. What the MFI operators would have preferred would have been more decentralized regulation and the facilitation of information exchange between MFIs. For example, most organizations supported the proposed microfinance credit bureau found in the bill (Kline & Sadhu, 2011). Institutions such as this, which connect organizations without subjecting them to blanket regulations, would be more beneficial to monitoring and controlling the microfinance sector.

Microfinance organizations themselves should take greater steps to self-regulate. Although programs and policies that encourage growth may signal to MFIs that the government is in adequate control of the sector, it is clear that the government does not always take appropriate steps to ensure success. MFIs should embrace the support given from a government but should also seek support from microfinance networks and subject themselves to voluntary regulation. The frameworks established by such networks are more beneficial than ones developed by the government, because they were created by people and organizations that have significant experience working in the microfinance sector.

Examining the case of SKS, it is evident that financial stability should be a priority of microfinance institutions. By implementing a unique for-profit model, SKS was able to attain levels of success that far exceeded those of other Indian institutions. The ability to attract venture capital allowed SKS to scale up operations tremendously and lessened the need to focus on attracting donors to maintain operations. Although the for-profit model may not be ideal for all organizations, finding new and innovative ways to ensure financial sustainability is undoubtedly a critical goal that must be addressed. However, from SKS one can also draw the lesson that hastiness should be avoided. SKS was quick to float an IPO—an unusual act in the microfinance industry—and the crisis in the sector that occurred around the same time resulted in massive losses for the company. Although it could be argued that the crisis was unforeseeable, one must acknowledge that SKS should have considered the potential costs of going public more thoroughly. The microfinance industry is still quite new and will undoubtedly present many unforeseen challenges, and thus organizations must exercise extreme caution when venturing into unfamiliar territory. Organizations should look at the study of SKS and resolve to thoroughly consider the benefits and costs of making significant changes to their structure.

Chapter 5

Conclusions

Institutional Chart

To help quantify some of the issues discussed in this study, the following chart was constructed as a visual aide to supplement and extend the qualitative work done earlier. The chart displays microfinance organizations and their growth during periods of instability and stability. The data regarding the microfinance organizations was taken from the Microfinance Information Exchange (MIX), while the information regarding stability was drawn from the case studies included previously. The chart and data were coded according to the following regulations.

Sampling

Four institutions were selected from each country. The institution that was the subject of each detailed case study was included, and three other institutions were selected randomly from the organizations found on the MIX Market.

Stability

In order to see better how organizations fared during different levels of stability, each institution was broken down according to different periods in the political history. Significant events in the political history were chosen as the start and end points for each period, and the periods were classified according to the following specifications:

a. Low: Low political stability refers to time periods during which significant events directly threatened the political system and the regime in power. These events include such things as coup d'états, social uprising, political deadlocks, and major natural disasters that disrupted daily administrative functioning.
b. Middling: Middling political stability refers to time periods during which events disrupted some aspect of daily life, but did not directly affect the political system or the regime in power. This also refers to time periods during which steps towards greater stabilization were being taken, but not yet well-established. These events include things such as external conflict or violence and the implementation of a new constitution or establishment of national elections.
c. High: High political stability refers to time periods during which there were few major disruptions to the governing process. Ruling capability was unhindered and the regime and processes surrounding the government were well established.

Success

Capturing success on the part of a microfinance institution is extremely difficult. In order to determine whether or not an institution was successful in alleviating poverty, detailed data would have to be collected on the relative wellbeing of its clients before and after having received a loan. Such data were not available for this study, so success is measured more simply. Two aspects were identified of an organizations success: outreach and institutionalization.

a. Outreach: If an organization is finding success, they should be able to fund both more loans and attract more borrowers. Thus their number of active borrowers should grow from year to year if there is relative success. This growth obviously depends on the initial structure of the organization, and one organization's growth cannot be directly compared to that of another organization. However, by providing the growth rates during periods of differing stability, we can see how that organization fared when faced with different stability levels. Outreach in this chart was first determined by taking the annual growth rate over each period listed. Then the annual growth rates were categorized into the following levels:
    i. Low: Annual growth rate of less than 10%
    ii. Medium: Annual growth rate of 10%-70%
    iii. High: Annual growth rate of 70%+

b. Institutionalization: For many organizations, becoming more institutionalized is both an indicator of success as well as a step to greater success. For an organization to be able to take steps to become a more formal body, they must be well-run and well-governed and have found substantial enough success to justify the growth. Since institutionalization varies by country, this indicator is merely a dummy indicator: if a country underwent some sort of formalizing process during a time period, the column is marked “Yes” with the year of institutionalization given in parentheses. Note: In Haiti, there are no institutionalization processes. Thus none of the organizations listed are coded as having institutionalized.

Table 5.1: Institutional Chart

Institution	Country	Years	Stability	Annual Growth rate	Level of Growth	Institutionalization?
ACLEDA	Cambodia	1997-1998	Low	*		No
ACLEDA	Cambodia	1998-2002	High	11.60%	Medium	No
ACLEDA	Cambodia	2002-2004	Low	24%	Medium	Yes (2003)
ACLEDA	Cambodia	2004-2008	High	18.85%	Medium	No
ACLEDA	Cambodia	2008-2011	Middling	9%	Low	No
AMK	Cambodia	2003-2004	Low	11.30%	Medium	Yes (2003)
AMK	Cambodia	2004-2008	High	205%	High	No
AMK	Cambodia	2008-2011	Middling	15.40%	Medium	No
Sathapana	Cambodia	2001-2002	High	55%	Medium	Yes (2001)
Sathapana	Cambodia	2002-2004	Low	20.90%	Medium	Yes (2003)
Sathapana	Cambodia	2004-2008	High	85%	High	No
Sathapana	Cambodia	2008-2011	Middling	17.80%	Medium	No
Seilanithih	Cambodia	1999-2002	High	*		No
Seilanithih	Cambodia	2002-2004	Low	17.50%	Medium	Yes (2003)
Seilanithih	Cambodia	2004-2008	High	9.88%	Low	No
Seilanithih	Cambodia	2008-2011	Middling	35.56%	Medium	No
ACME	Haiti	2000-2004	Low	47.77%	Medium	No
ACME	Haiti	2004-2006	Middling	88.10%	High	No
ACME	Haiti	2006-2008	Low	8.25%	Low	No
ACME	Haiti	2008-2009	Middling	10.30%	Medium	No
ACME	Haiti	2009-2011	Low	-17.40%	Low	No
SOGESOL	Haiti	2001-2004	Low	91.03%	High	No
SOGESOL	Haiti	2004-2006	Middling	11.91%	Medium	No
SOGESOL	Haiti	2006-2008	Low	11.92%	Medium	No
SOGESOL	Haiti	2008-2009	Middling	9.50%	Low	No
SOGESOL	Haiti	2009-2010	Low	-17.00%	Low	No
Fonkoze Financial Services	Haiti	2004-2006	Middling	49.80%	Medium	No
Fonkoze Financial Services	Haiti	2006-2008	Low	10.44%	Medium	No
Fonkoze Financial Services	Haiti	2008-2009	Middling	-1.72%	Low	No
Fonkoze Financial Services	Haiti	2009-2010	Low	9.01%	Low	No
MCN	Haiti	2004-2006	Middling	59.33%	Medium	No
MCN	Haiti	2006-2008	Low	-2.11%	Low	No
MCN	Haiti	2008-2009	Middling	23.97%	Medium	No

MCN	Haiti	2009-2010	Low	-30.50%	Low	No
SKS	India	1998-2001	High	853.22%	High	No
SKS	India	2001-2003	Middling	194.08%	High	No
SKS	India	2003-2004	High	196.90%	High	No
SKS	India	2004-2006	Middling	298.41%	High	Yes (2005)
SKS	India	2006-2011	High	223.30%	High	No
Swadhaar	India	2005-2006	Middling	1839.65%	High	No
Swadhaar	India	2006-2011	High	1080.55%	High	Yes (2008)
ESAF	India	2004-2006	Middling	300.30%	High	No
ESAF	India	2006-2011	High	35.55%	Medium	Yes (2007)
BASIX	India	1996-2001	High	452.60%	High	Yes (1996, 2001)
BASIX	India	2001-2003	Middling	*		No
BASIX	India	2003-2004	High	*		No
BASIX	India	2004-2006	Middling	60.20%	Medium	No
BASIX	India	2006-2011	High	100.15%	High	No

* indicates missing data
Source: Microfinance Information Exchange. (2011). http://www.mixmarket.org

Patterns

Cambodia

Cambodia displayed many years of medium growth and outreach. It had 25 institution-years of medium level growth, as compared to only 7 institution-years of low growth and 8 institution-years of high growth. Thus it can be concluded that growth in Cambodia was generally persistent and controlled, which may be a result of the established framework and substantial regulation offered by the Cambodian government.

Tables 5.2 and 5.3 offer a country level analysis of Cambodian Microfinance. Table 5.2 tallies the total years experienced at each level of stability as well as at each level of growth. Note that Stability is measured in years, whereas Level of Growth is mentioned in institution-years, as multiple institutions were recorded for each year.

Table 5.2: Cambodian Stability and Level of Growth

Level	Stability	Level of Growth
Low	3 years	7 years
Medium	3 years	25 years
High	8 years	8 years

Table 5.3 breaks down the levels of growth according to the level of stability. That is, for each level of stability, the number of institution-years at each growth level is listed, as well as occurrences of institutionalization.

Table 5.3: Breakdown of Cambodian MFI growth level according to stability level

	Low Stability	Middling Stability	High Stability
Institution-years of Low Growth	0	3	4
Institution-years of Medium Growth	7	9	9
Institution-years of High Growth	0	0	8
Instances of Institutionalization	4	0	1

There is not an obvious correlation between growth rate and stability levels in Cambodia. As was mentioned earlier, there were far more institution-years of medium growth than of low or high growth. Interestingly, institution-years of low growth did not occur during periods of low stability, but rather during periods of medium and high stability. It should be noted, however, that the only institution-years of high growth occurred during high stability. What this may suggest is that although low stability does not necessarily mean low growth, high stability is necessary to achieve high levels of growth. Institutionalization, surprisingly enough, most often took place during times of low stability. This suggests that the framework established by the government of Cambodia was stable enough to function efficiently, even during periods of instability.

These data indicate that the framework in place in Cambodia allowed for the formalization and growth of organizations, even during low stability. This allows institutions to find success without being hampered by instability issues. Looking at Table 5.1 at the data regarding ACLEDA, it's clear that the organization was quite consistent across time, even as stability changed. Although the most recent years reflect a drop in growth, the organization's initial success is clearly persistent.

Finally, although there were a few outliers, the annual growth rate was relatively stable across institutions. In general there was not tremendous variance, which suggests that the Cambodian microfinance framework encourages growth at a strong and controlled rate.

Haiti

In contrast to Cambodia, Haiti experienced equal levels of low and medium growth and far fewer years at high growth, as can be seen in Table 5.4. It is pretty evident that on the whole, Haitian institutions had less success in growing their operations than did Cambodian institutions.

Table 5.4: Haitian Stability and Level of Growth

Level	Stability	Level of Growth
Low	8 years	11 years
Medium	3 years	16 years
High	0 years	5 years

Table 5.5 breaks down growth in Haitian institutions according to level of stability. Low growth occurred far more often in periods of low stability than in middling

stability, but medium and high growth occurred equally as often in low and middling stability. Low stability periods produced relatively more institution-years of low growth than did periods of middling stability, so it appears that low stability might have a slowing effect on Haitian institutions.

Table 5.5: Breakdown of Haitian MFI growth level according to stability level

	Low Stability	Middling Stability	High Stability
Institution-years of Low Growth	9	2	0
Institution-years of Medium Growth	8	8	0
Institution-years of High Growth	3	2	0
Instances of Institutionalization	0	0	0

From Table 5.1, it can also be seen that the range of growth rates also appears to be more varied than that in Cambodia. Rates tended to spike or fall more frequently than in the Cambodian institutions, which may reflect the lack of Haitian regulation of the industry. Looking at the data regarding the organization Sogesol, which was the focus of an institutional study, its early years demonstrated high growth. This is perhaps indicative of its partnership with an established bank, which allowed it to lessen start-up costs and inefficiencies. However, even this strategy of partnership did not guarantee success, as Sogesol experienced decreasing growth after its initial phase of high growth.

These data suggest that Haitian organizations are perhaps more vulnerable to external issues and political instability than Cambodian institutions. It appears that it is more difficult to grow at high rates in periods of low stability in Haiti. This is most likely due to the lack of framework to guide microfinance in Haiti. Organizations do not have strong support from the government and therefore don't have much protection from socio-political issues.

India

Indian institutions grew at significantly higher rates than Cambodian and Haitian institutions, as can be seen in Table 5.6. There were no instances of low growth rates from the samples presented. This suggests that the greater levels of stability in India helped foster stronger microfinance growth.

Table 5.6: Indian Stability and Level of Growth

Level	Stability	Success
Low	0 years	0 years
Medium	4 years	7 years
High	10 years	31 years

Table 5.7 breaks down the growth rates in Indian institutions according to level of stability. There were no instances of low stability or low growth. Comparing periods of middling stability and high stability, high stability produced far greater institution-years of high growth, but also consisted of significantly greater years than middling stability. The relative level of high growth is pretty consistent across middling and high stability periods.

Table 5.7: Breakdown of Indian MFI growth level according to stability level

	Low Stability	Middling Stability	High Stability
Institution-years of Low Growth	0	0	0
Institution-years of Medium Growth	0	2	7
Institution-years of High Growth	0	7	24
Instances of Institutionalization	0	1	3

Looking at Table 5.1, it is also evident that the growth rates in India reached far greater levels than in the other two countries, indicating that excessive growth was not inhibited. This portrays the government's encouragement of microfinance and lack of control over the industry's growth. Focusing on the data regarding SKS, the high success of the organization is clearly demonstrated. However, the recent struggles of the organization are not evident, masking the difficulties it faced even amongst high stability. Thus the detailed case study on the institution is extremely important, as it sheds light on the caution that must be taken even when operating in a stable county.

These data indicate that growth was equally possible in periods of middling and high stability in India. As was the case in Cambodia, Indian institutions that supported microfinance might've helped smooth growth over differing levels of stability. Institutions received encouragement from the government and were able to grow at strong rates.

Overall Conclusions

After having closely examined the cases of Cambodia, India, and Haiti, it appears that political stability or instability is not a predetermining factor of microfinance success. In Haiti, the rampant instability has precluded strong sector growth, but in Cambodia the industry has managed to flourish even though it was established at a time of significant instability for the nation. Furthermore, even in a stable country such as India, stability was not enough to prevent a major industry crisis. Thus, it is not political stability or instability itself that microfinance organizations should be concerned about, but the ability and dedication of the government to building a strong regulatory framework for the industry. Cambodian's government, although it was dealing with plenty of other domestic issues at the time, acknowledged the importance of the microfinance sector and worked with organizations to establish an enabling environment for institutions to grow. Haiti's government has not been able to prioritize establishing such a framework, and even though microfinance networks have developed draft legislation to guide the sector the government has not been able to pass and establish the appropriate regulations. India's government encouraged microfinance growth without dedicating adequate time to becoming knowledgeable about the sector. Rather than closely monitoring the sector, they allowed it to grow independently and then, when crisis struck, took action without consulting those in the industry. Their unwillingness to work with the sector to determine how to control and regulate growth resulted in a severe crisis and damaged many institutions.

Several important lessons can be drawn from the information presented in this paper as to how to effectively implement microfinance in varying levels of political stability. Governments and microfinance organizations should draw from these best practices in order to avoid issues whereby stability hinders their success.

Governments

The potential benefits of microfinance are undoubtedly appealing to governments, particularly those whose nations are plagued with extreme levels of poverty. Microfinance organizations are often able to attract high levels of funding and investment to bring new capital into a country, something many governments struggle to achieve. Organizations are also often well-suited to train and educate their clients, offering them more opportunities to find employment and contribute to society. Again, this is something that most governments are not able to do effectively. However, as was demonstrated in the case of India, a crisis in the microfinance industry can have devastating effects for its clients. Therefore, governments should take care to implement policies not only to encourage strong microfinance performance, but also to prevent any serious crisis from arising. Several suggestions for such policies have been identified from the previous three case studies.

Governments in countries where microfinance activity is significant should prioritize passing legislation to regulate the industry. They should work with microfinance organizations and networks to determine what sort of regulations should be in place and to identify methods of institutionalization to help foster growth. Governments should listen closely to the needs and knowledge of establishing MFIs and draw from their experience. While regulation should be strong, governments should refrain from restricting the operating capability of organizations, particularly in regards to pricing mechanisms such as interest rates, and should not seek to restrict the ability of organizations to approve loans. Governments should aim to facilitate information sharing between organizations, particularly in regards to credit ratings and client information. By helping organizations liaise more, the government can improve regulations without limiting the organizations. Finally, special priority should be put on monitoring. Governments must know indicators of potential issues or problems in the industry and know when to intervene to avoid a crisis.

Microfinance Organizations

Establishing a microfinance operation is a complex and difficult task. As with any business venture, the start-up costs are extremely high, and the challenges faced are magnified by the lack of infrastructure and development in many countries where MFIs operate. In order to truly have success and create long-lasting poverty reduction, an organization must be able to sustain for a relatively long period of time. Thus it is important that MFIs act smartly and effectively, to ensure that their funding and mission reach their full potential. They should look to replicate techniques and implement policies that have proven successful for other organizations. A collection of these best practices has been drawn from the previous case studies and is detailed below.

Although ideally governments will established and implement appropriate legislation to support microfinance, organizations should take it upon themselves to establish their own frameworks through networks and associations. Particularly in countries where instability is high and organizations are unsure about the capability of organizations to effectively legislate the industry, MFIs should join together to form networks and implement methods of self-regulation. Not only will these keep the industry strong, but if networks can form their own guidelines for regulation, they can more easily lobby for governments to implement some of those guidelines as national legislation. Furthermore, organizations should look to partner with or learn from other institutions that have found success, both within and outside of their country of operation. Drawing on the knowledge and guidance of organizations that have faced similar challenges will greatly assist organizations. Knowing which methods and practices worked best will improve efficiency and allow organizations to better deal with other challenges, such as instability or lack of support from the government. Finally, all organizations should seek to become as familiar as possible with the country in which they are located. Institutions should familiarize themselves with the customs of the people in order to identify suitable products and processes. If possible, organizations should work with local leaders to facilitate the formation of trust between themselves and their clients. In countries where instability is high and there is a strong distrust in authority and institutions, using local leaders to bridge that trust gap can be a tremendous asset.

In conclusion, political instability is not a major hindrance to success in the microfinance industry. Both national governments and microfinance institutions can take steps to improve the likelihood of success and overcome some of the challenges that are present in the sector. With due diligence, both actors can facilitate strong growth and assist in developing an effective and well-established industry.

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