

# **Spinning Off for Sustainable Microfinance**

## **Save the Children Federation into JWDS, Al Majmoua, and FATEN**

### **Case Study**

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## Executive summary

**W**orldwide, microfinance is moving from government- and donor-funded subsidized credit to sustainable financial intermediation. In the Middle East and North Africa, however, many microfinance programs are lodged in larger parent organizations that provide social or charitable services. Although some of these institutional forms may be appropriate in the early stages of a microfinance program, they will likely block a program's development as a financial intermediary. To decrease its dependence on donors, achieve growth, and become fully sustainable, a microfinance program should gain access to commercial sources of funds.

Not all microfinance programs can or should be spun off from their parent institution, however. Spinning off is a strategic choice—one that makes sense only if it is done in the context of another strategic choice: achieving full sustainability. This is the context in which the discussion of and rationale for spinning off microfinance programs must be examined.

The only known spin-offs in the Middle East and North Africa's microfinance industry are Save the Children's microcredit programs in Jordan, Lebanon, and the West Bank and Gaza. Spinning off the Jordanian Women's Development Society (JWDS), Al Majmoua, and Palestine for Credit and Development (FATEN) was complicated and difficult. But these experiences brought to light many of the issues inherent to such program restructuring—issues similar to those typically found in a corporate context. These include external market factors,

marketing considerations, and the legal, financial, and programmatic futures of the institutions, especially as they relate to their prospects for growth and sustainability.

Added to this were numerous intangible factors and positive externalities brought about by spinning off, such as the building of local capacity or the regional microfinance industry. Today all three institutions are optimistic about their futures as independent entities and seem determined to face any challenges they encounter.

The experiences of Save the Children and JWDS, Al Majmoua, and FATEN offer important lessons for organizations that are considering spinning off their microfinance operations. Regulatory and legal issues and institutional governance structures must be carefully considered when building a new institution, because they can profoundly affect an institution's ability to achieve full sustainability.

Another important aspect of spinning off is to instill a sense of ownership in new boards of directors, as well as a sense of responsibility for institutional quality and operations. Ownership and responsibility are also relevant when it comes to transferring staff from a setting with a program focus to one based on the functions and objectives of an independent institution. The three spin-offs have often found themselves having to change a corporate culture rather than build a new one.

Also important is the timing and technicalities of transferring management information and accounting systems. During the transitions to institutional

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**Managing an institution is not the same as managing a program**

independence, all three programs only gradually assumed responsibility for operational and portfolio management. Thus it is important to consider a program's preparedness for spinning off at every level—as well as to plan for contingencies.

One of the biggest challenges in the transformation process is to develop a working relationship between the parent institution and the spin-offs that benefits both parties and solidifies the bridge between them. The role of the parent must be properly defined, with a clear division of responsibility and accountability from the start of the spin-off process.

External factors directly or indirectly influence the transition to institutional independence. In this context the role of the donors needs to be examined, because the approach that donors take to microfinance and the requirements they set for microfinance institutions can help determine the development of this industry and the future of many microfinance institutions. Donors can play an invaluable role in developing the microfinance industry. But the key is to identify areas—such as building capacity and establishing a policy dialogue—

where donors have real advantages and that require resources.

There is no evidence linking the spinning off of Save the Children's microfinance programs to the fraud that subsequently plagued the JWDS and FATEN. Still, fraud has had significant effects on the spin-off process. Both fledgling institutions' experiences with fraud were devastating and threatened to destroy them. But both institutions learned valuable lessons early in their institutional development that may have made them stronger and so contributed to their long-term stability.

Finally, Save the Children, the JWDS, Al Majmoua, and FATEN agree that perhaps many of these issues could have been addressed—or avoided altogether—if from the outset lending operations had focused on developing a sole-purpose, independent microfinance institution rather than continuing in a program-based setting. Recognizing that managing an institution is not the same as managing a program could have enhanced the spin-offs' institutional capacity to manage more products and services, mobilize resources, and enhance management information systems.

## The move toward microfinance

**M**icrofinance is a powerful development tool—one that can reach the poor, raise their living standards, create jobs, and contribute to long-term economic growth (box 1). Yet institutional microfinance worldwide continues to suffer from what has been called an “absurd gap” between demand and supply. Despite the widespread demand for financial services, some 90 percent of microentrepreneurs in developing countries lack access to institutional finance (Robinson 1995).

Microfinance has shown that it can alleviate poverty in many parts of the world. Although the potential effects may be similar in the Middle East and North Africa, the region’s microfinance industry is still in its infancy. As a result the region has been the least exposed to microfinance best practices. The region contains more than 60 million poor people—defined as those living on less than \$2 a day—but only 112,000 (less than 2 percent) have access to financial services. Nearly \$1.4 billion in microloans is needed to bridge the funding gap (Brandsma and Chaouali 1998).

Microfinance providers worldwide include a wide range of organizations and institutions with public owners, private owners (corporate and mutual institutions), and no owners at all (nonprofits). While private capital, whether in the form of sole proprietor or partnership or corporation, dominates most countries’ economies, this is not the case for microfinance. In the Middle East and North Africa, for example, there are more than 60 active microfinance programs. Of these, 40 are run by nongovernmental organizations

(NGOs)—often with microfinance activities lodged within the organizations’ larger social operations—and quasi-governmental organizations—including state-owned banks operating under government pressure and serving merely as windows for credit delivery. Few private banks in the region are engaged in microfinance.

Instruments have been designed to provide accountability and performance incentives to the microfinance programs operating in this way. But the financial services provided by nonprofit NGOs are supply driven, as the programs are typically designed and funded by outside actors, limiting the freedom of local decisionmakers, program managers, and staff with direct, hands-on experience in the local microfinance market. Given historical and cultural values and charitable

Despite widespread demand, some 90 percent of microentrepreneurs in developing countries lack access to institutional finance

### Box 1. What is microfinance?

Microfinance institutions provide the entrepreneurial poor with financial services—such as credit, deposit, and savings—that are tailored to their needs. Good microfinance programs rely on:

- Small, usually short-term loans and secure savings products.
- Streamlined, simple appraisal of borrowers and investments.
- Alternative approaches to collateral.
- Quick disbursement of repeat loans after timely repayment.
- Interest rates or fees that are high enough to cover costs—including costs of capital.
- Convenient location and timing of services.

Source: Goldberg and Fruman 1997; UNDP 1997.

The demand for institutional microfinance can be met only by sustainable financial institutions

and social work traditions in the Middle East and North Africa, the 40 microfinance programs run by NGOs and quasi-governmental organizations will likely face serious organizational obstacles on the path to sustainability. Most of them will probably not make it if they maintain their current ownership and governance frameworks.

The demand for institutional microfinance can be met only by sustainable financial institutions. Early microfinance programs focused on extending credit services, but today achieving financial sustainability, mobilizing savings, and integrating with the domestic financial markets have become just as important. This new focus on economic results and sustainable businesses—together with primary indicators such as profitability, operational efficiency, service quality, institutional stability, and cap-

ital mobilization—requires greater attention to the ownership and governance of institutions providing financial services to microenterprises.

According to a World Bank study, less than a third of the more than 60 microfinance programs in the Middle East and North Africa are implemented using best practice principles (box 2). As the region's industry develops, however, positive developments are becoming increasingly evident. Only two programs in the region are considered fully sustainable—covering their costs and maintaining or deepening outreach—and eight others are on the road to sustainability (Brandsma and Chaouali 1998). Fifty-five programs have not achieved minimum outreach and do not cover 100 percent of their operational costs. Poor loan portfolios, inadequate management infor-

### Box 2. Guiding principles of best practice microfinance

Experiences in countries as varied as Bangladesh, Bolivia, Egypt, Senegal, Mali, and the West Bank and Gaza show that the poor are bankable and that savings and credit services can be delivered to the poor on a sustainable basis. Long-term financial sustainability depends on charging interest rates that cover operational costs (including the cost of loan defaults) and capital costs (including interest on borrowed capital and inflation on owned capital). Successful microfinance operations worldwide charge interest rates that are higher than market rates. Guiding principles of best practice microfinance include:

- *Covering costs.* To become sustainable, microfinance institutions—regardless of their institutional setup—must cover their costs of lending. If such costs are not covered, the institution's capital will be depleted and microenterprises' continued access to financial services—and even the existence of the microfinance institution—will be in jeopardy.
- *Achieving a certain scale.* Successful microfinance institutions have reached a certain scale, as measured by the number of active clients. This number depends on the country setting, lending methodology used, and loan sizes and terms offered.
- *Avoiding subsidies.* Microentrepreneurs do not require subsidies or grants—but they do

need rapid and continued access to financial services. Besides, microlenders cannot afford to subsidize their borrowers. Subsidies send a signal to borrowers that government or donor funds are a form of charity, which discourages borrowers from repaying. Moreover, microfinance institutions have learned that they cannot depend on governments and donors as reliable, long-term sources of subsidizing funding.

- *Promoting outreach and demand-driven service delivery.* Successful microfinance institutions increase access to financial services for growing numbers of low-income clients, offering them quick and simple savings and loan services. Loans are often short term, and new loans are based on timely repayments. Loans are based on borrowers' cash flows and characters rather than their assets and documents, and alternative forms of collateral (such as peer pressure) are used to motivate repayment.
- *Maintaining a clear focus.* It takes time and commitment to build a sustainable microfinance program. Thus mixing the delivery of microfinance services with, for example, the provision of social services is inadvisable because it sends conflicting signals to clients and program staff.

Source: Brandsma and Chaouali 1998; UNDP 1997.

mation, excessive donor reporting requirements, and inefficient systems and procedures hamper the operational sustainability of these organizations. In this context many of the region's programs may never become sustainable—unless they make sustainability a strategic choice. Examples of emerging but not yet fully sustainable institutions include the Save the Children Federation's spin-off programs: the Jordanian Women's Development Society (JWDS), Al Majmoua in Lebanon, and Palestine for Credit and Development (FATEN) in the West Bank and Gaza.<sup>1</sup>

Best practice experience shows that the joint provision of social services and microfinance by the same program usually does not work. Often the objectives, culture, and managerial and operational systems of the larger program clash with those of the microfinance program. For instance, the socially oriented parent organization may have a charitable outlook, give grants to the needy, employ social workers and rely on volunteers, and use a cash-based budgeting system. A successful microfinance program, however, needs a business orientation, business-oriented loan officers who are rewarded based on performance, and financially oriented administrative and budget systems. It also needs a governance structure to provide strategic direction, ideas, and solutions to managers to ensure the longevity of the program.

These clashing objectives and operations may result in "institutional schizophrenia" that permeates the entire organization. On the one hand, the organization provides grants to the poor; on the other, it provides loans for which repayment is strictly enforced. The clients of the social program are beneficiaries and the clients of the microfinance program are customers who buy a service that they value. A good social worker is not necessarily a good loan officer, and a good loan officer is not necessarily a good social worker. The confusion of staff, donors, and clients is often reflected in poor repayment rates and high delinquencies—elements that directly

undermine the sustainability of the microfinance provider. Thus programs that are engaged in both types of services should manage their provision separately, with different managerial and administrative procedures, recruitment, staffing, and sometimes even names.

### **Why study spin-offs in microfinance?**

Worldwide, microfinance is experiencing a paradigm shift away from government- and donor-funded subsidized credit to sustainable financial intermediation (Robinson 1996). Institutions cannot become fully sustainable if they onlend donor funds at subsidized interest rates and combine social and financial services. Instead they remain dependent on continuing donor or government injections of low-cost funds. To become sustainable, these institutions must raise interest rates on loans, mobilize voluntary savings, and separate social and financial activities. This is the context in which the discussion and rationale for spinning off microfinance programs has been placed.

Yet there is hardly any documented hands-on experience on how to spin off a microfinance operation from a larger social program. There is no best practice and no worst practice. Moreover, the issues are daunting and include:

- The timing of the spin-off.
- Legal issues involving decisions on the organizational form of the new entity.
- Funding issues, including making arrangements for subgrants,<sup>2</sup> searching for new donors and grants, and raising funds in local capital markets.
- Ownership and governance issues, including selecting the board of directors and determining the appropriate roles for different levels of governance.
- Staffing issues and changing or building a corporate culture.
- Managerial and operational issues.
- Psychological issues of the "divorce" from the parent institution.

**The joint provision of social services and microfinance by the same program usually does not work**

Spinning off is often essential for a microfinance program to become sustainable

In addition, spinning off gets even more complicated when it is understood that the process is done while normal lending operations continue because clients want continued access to finance. The period when the program operates on concurrent systems—the old one and the new one—can be especially harrowing. Finally, one of the most complicated pieces of this puzzle is the continuance of a symbiotic relationship between the parent institution and the new institution.

Still, spinning off is often essential for a microfinance program to become sustainable. Microfinance programs that are newer add-on activities face serious obstacles ranging from institutional ambivalence, image problems, internal obstruction, bureaucracy, transition problems, and capital constraints. In many cases the parent organization is legally prohibited from engaging in financial obligations—such as mobilizing deposits or borrowing for onlending—when the microfinance organization must be able to do so in order to grow and serve more of its poor clients. In many cases spinning the microfinance operation off of the parent organization may be the only way for the microfinance operation to become sustainable. Thus the operation must be an independent legal entity with its own objectives and with managerial and operational systems appropriate for microfinance.

### Save the Children's spin-offs

The only known spin-offs in the Middle East and North Africa's microfinance industry are those of Save the Children's microcredit programs in Jordan, Lebanon, and the West Bank and Gaza. Group Guaranteed Lending and Savings programs previously housed under Save the Children's larger umbrella were spun off into three legally independent entities: the JWDS, Al Majmoua, and FATEN.

Although at different stages, these three spin-off processes are nearing completion and appear to have been successful. They have provided many lessons, illustrating the

complexity of the issues involved in such institutional transformation and offering knowledge about key guidelines for other microfinance programs contemplating such undertakings. Still, the main objective of this case study is not to present a one-size-fits-all model on how to spin off a microfinance program, or to provide an in-depth evaluation of each of the institutions created by the spin off process. Rather, the study seeks to explain the most important aspects of the spin-off discussion, the process to arrive at the spin-off decision and its justification, and the spin-off process itself, using these three examples as part of the learning experience.

The study highlights a series of crucial issues—including legal issues, governance issues, organizational and operational issues, personnel issues, and important psychological issues. The costs of the spin-off process, the needs for proper process management, and the possible need for technical assistance in this process are also described. The study also discusses the evolving relationship between the parent organization and the newly independent institutions, and critically examines some factors external to the spin-off process (such as the involvement of donors and the impact of administrative crises on a microfinance institution's institutional stability and development).

Microfinance is not a panacea for poverty. But it can have enormous effects in the lives of the most disadvantaged. The clients of microfinance institutions are the measure of the successes or failures of each program. These clients' stories are brought throughout the text as examples—but also as a reminder that, in essence, microfinance is about and for the entrepreneurial poor.

### Notes

1. Except where otherwise noted, all mentions of Save the Children refer to Save the Children Federation/U.S.

2. If the proceeds of a grant—all or part—are to be made available to executing agencies other than the primary grant recipient, the donor may require the recipient to enter into a subsidiary agreement with the executing agency. Subgrant agreements

are typically subsidiary agreements between the primary grant recipient and the executing agency, which set out the terms and conditions of the transfer of funds. In addition, if the executing agency

does not have a direct contractual relationship with the primary donor, the agreements spell out the obligations of the executing agency for the execution and operation of the project.

## Save the Children's spin-off history: from programs to independent institutions

For Save the Children, economic and social advancement rest on self-sufficiency and sustainable solutions to pressing development problems

Save the Children is a voluntary, non-sectarian, nonprofit entity established in 1932 to assist the children of U.S. coal miners suffering the effects of the Great Depression. During World War II Save the Children began expanding its frontiers beyond the United States and started helping children around the world. Today Save the Children is a multisectoral international development organization providing services for children and self-help for communities, participating in projects in 39 developing countries. The funds for its operations come from private donors (who contribute through child sponsorship programs) and public donors (including the U.S. Agency for International Development, the U.K. Department for International Development, and the Dutch government).

Like all U.S. nonprofits, Save the Children finances some of its core management and administrative costs through a “cut” of funds received from donors. This indirect cost recovery rate is applied to all Save the Children programs. Save the Children does not see this cut as profit but as real cost—because it covers the cost of delivering programs worldwide, and because Save the Children believes that this cut represents part of the real value of the organization’s community development knowledge and worldwide experience.

In developing countries Save the Children provides services in three main areas: education, primary health care, and economic opportunities, especially for women. Save the Children’s main initiative, part of the economic opportunities pro-

gram, are the Group Guaranteed Lending and Savings programs, which provide credit to groups of poor female microentrepreneurs (box 3). In addition to credit and other economic support, the lending programs sometimes include health and education initiatives for the women and their families.

For Save the Children, economic and social advancement rest on self-sufficiency and sustainable solutions to pressing development problems. Following this approach, in the early 1990s Save the Children embarked on economic opportunities projects in the Middle East and North Africa. The original program and the subsequent spin-offs have given families (with a focus on women) access to credit, savings opportunities, and support that have enabled them to develop small businesses—businesses that could help them break free of poverty.

### Save the Children in the Middle East

Save the Children has a brief history of microlending in the Middle East. Until the early 1990s its operations focused on health services, children’s education, public infrastructure, and environmental programs (including safe water and sanitation services). In the early 1990s, however, microloans became more prominent—as Save the Children began to redefine its role in the region, with a stronger focus on income-generating activities. Save the Children’s Middle East operations are coordinated through its regional headquarters in Beirut

**Box 3. What are Group Guaranteed Lending and Savings programs?**

Designed to help meet the high demand for sustained access to credit among disadvantaged women, Group Guaranteed Lending and Savings program usually:

- Open a long-term line of credit by providing small initial loans that grow larger with every new loan cycle, which typically run from 4.5 to 6.0 months. Each borrower is expected to take out a series of loans over a number of years.
- Charge borrowers market-related interest rates—and in some cases, fees that cover financial and operating costs—and protect the value of loan capital against inflation and defaults.

- Allow borrowers to implement individual projects, but to receive loans require that borrowers form credit and savings groups, usually with at least 10 members who guarantee repayment of one another's loans. Such groups eliminate the need for formal collateral and so provide these female entrepreneurs with access to finance that would otherwise be denied to them in the formal financial sector.
- Require group members to conduct all repayment and savings transactions at nearby branches of commercial banks.
- Allow loans to support a variety of business activities, including food production, stores, clothes, hair care, and animal rearing.

(Lebanon), with field offices in Egypt, Lebanon, Jordan, and the West Bank and Gaza. The field offices can be considered as branch offices of the U.S.-based headquarters, under the supervision of the vice president for international operations. In addition, the Washington, D.C.-based Economic Opportunities technical unit provides support to the region.

*The approach to microfinance*

Despite capital constraints, Save the Children has a good track record of lending to poor female borrowers at commercial interest rates (table 1). Until the spin-off process created the JWDS, Al Majmoua, and FATEN, the Group Guaranteed Lending and Savings programs were one of the main components of Save the Children operations in the region.

When Save the Children introduced Group Guaranteed Lending and Savings programs in Jordan, Lebanon, and the West

Bank and Gaza, it knew that selecting or creating a local microfinance institution and enhancing its capacity to manage the program was the starting point for providing disadvantaged female microentrepreneurs with sustainable access to microfinance services. This approach was in line with cost-effective program strategies that cover costs through interest payments and other fees, as well as strategic planning and the creation of a proper institutional framework for expanding the programs that Save the Children pursued from the start of Group Guaranteed Lending and Savings operations.

Thus, with the goal of achieving long-term program sustainability by building up local institutional capacity and ultimately handing over the programs to local institutions in Jordan, Lebanon, and the West Bank and Gaza, Save the Children considered a number of local financial and non-financial organizations as potential partners. Earlier it had teamed up with a local partner in other program areas as well. For

**Table 1. Basic data for Group Guaranteed Lending and Savings programs in the Middle East, December 1996**

Indicator	Jordan	Lebanon	West Bank and Gaza
Date of the first loan	June 1994	July 1995	January 1995
Number of active borrowers	2,690	1,465	1,266
Outstanding loan portfolio	\$220,197	\$240,205	\$374,007

Source: JWDS, Al Majmoua, and FATEN data.

The spin-off process was long and complex in all three countries

example, in the West Bank and Gaza, Save the Children was implementing an institutional development program (funded by the U.S. Agency for International Development) with several local NGOs to enhance their capacity to implement sustainable development programs.

But the nontraditional methods of the Group Guaranteed Lending and Savings programs—small loans, market based interest rates, lending based on groups, a focus on women, and complex management needs—made it impossible to find a right match with organizations in the region. In addition, the partnership model required co-management by Save the Children and the local partners. As first proven in Lebanon, this duplicated model created confusion about accountability and responsibility, and it increased operational costs. At one point this model almost led to the resignation of all local staff in Lebanon's microfinance program. Recognizing these difficulties, Save the Children concluded that local partnerships were not appropriate for managing Group Guaranteed Lending and Savings programs. Hence for a few years the programs were implemented without local partners and under the Save the Children umbrella.

#### *The decision to spin off*

Two events initiated the spin-off discussions and process. First, in December 1995 Save the Children's Economic Opportunities Office hosted a 10-day business planning conference in Cairo for staff from Save the Children offices working in or interested in beginning programs such as Group Guaranteed Lending and Savings. The local partnership framework Save the Children had originally chosen was discussed, and as a result the idea to spin off came to the forefront. Several international microfinance experts—the facilitators of this workshop—suggested this course of action as well.

Then in mid-1996 the Consultative Group to Assist the Poorest, a multidonor

program hosted by the World Bank, appraised these programs—in consideration of a future grant to help spin them off to new institutions and to manage the transition. At the time the Jordan operation was being restructured, so the appraisal covered only the programs in Lebanon and the West Bank and Gaza. But the process of defining the appropriate role for Save the Children's headquarters in Westport, Connecticut (United States) and mobilizing technical assistance took much longer than anticipated, and work was delayed by a year. The original partnership agreement included a time frame that had to be renegotiated because of this delay—a delay that partly occurred because Save the Children's budget scheme included an indirect cost recovery rate for overhead that CGAP found unacceptable.

Once the delay was resolved, the grant agreement was signed in June 1997. CGAP's \$250,000 investment financed microfinance advisers that were to go through all the technical and managerial aspects of an institutional spin-off by tapping expertise on such topics as governance, legal issues, information systems, branch and product development, staff training, and business planning. CGAP has considered the investment successful because all three of the field microfinance programs are now independent institutions (CGAP 1998). Still, the process was long and complex in all three countries.

#### **From Save the Children to the Jordanian Women's Development Society (JWDS)...**

In Jordan Save the Children began implementing the Group Guaranteed Lending and Savings program as a pilot project in June 1994 in the Amman refugee camps of Mahatta and Natheef (box 4). Before this, in April 1994, Save the Children held an extensive workshop in Amman to present the basic principles of the Group Guaranteed Lending and Savings program to the staff in the region. This workshop marked a turning point for

**Box 4. Key dates for the JWDS**

June 1994	Save the Children introduces a Group Guaranteed Lending and Savings program in Jordan
December 1995	Save the Children organizes a business planning workshop in Cairo. The idea to spin off, rather than partner with local organizations, is developed
1995–96	Unsuccessful attempts are made to partner with the Jordanian Women's Union
December 1996	The JWDS is registered as an independent Jordanian NGO with an independent board of directors
April 1997	The JWDS assumes responsibility for implementing the cost side of the program, including the transfer of staff contracts
August 1998	The JWDS assumes full responsibility for the program, including management of the loan portfolio and transfer of the management information system
January 1999	The JWDS completes the move to its own premises

The JWDS was the pioneer in the spin-off process

Save the Children regionwide. Before the workshop all field offices were involved in small enterprise development programs, but they all gradually switched to Group Guaranteed Lending and Savings programs.

The Jordan project incorporated a dual purpose: to test the feasibility of the Group Guaranteed Lending and Savings methodology in Jordan and to provide poor women with access to credit and savings mechanisms. Based on early success and using funds raised through the United Nations Children's Fund and other donors, Save the Children expanded its Group Guaranteed Lending and Savings activities to two new areas in March 1995—the Prince Hassan (Nasser) refugee camp in Amman and the Mafraq governorate in rural Jordan. The project was successful, and the methodology appeared well suited to Jordan's culture and economy.

As the program began to grow beyond the pilot stage, Save the Children began modifying the program's goals and started reevaluating the institutional framework under which the credit program was to continue in the long term in order to achieve full sustainability. Save the Children tried to partner with the Jordanian Women's Union, a similar local multisectoral organization. The union had targeted women in the provision of its services and had a large network—features that were in line with Save the Children's strategy and focus.

But it soon became clear that a partnership would not work because the union lacked administrative discipline due to the social and charitable nature of its operations. In addition, senior and middle managers lacked commitment and capacity to carry out complex tasks under the Group Guaranteed Lending and Savings program. No accountability could have been established in such circumstances. Save the Children and the union held opposing views on such fundamental issues as the need to recover costs and the interest rates that clients were expected to pay. The failed partnership later proved to be a blessing in disguise, as Save the Children had more reasons to abandon the idea of partnering with the union.

In 1996 Save the Children field managers decided to spin off Group Guaranteed Lending and Savings operations and create a new NGO. Two goals were defined: to create a sustainable local institution capable of providing poor female microentrepreneurs with access to financial services, and to empower women as income earners and decisionmakers in their families and communities. After completing lengthy preliminary work, the JWDS—the pioneer in the spin-off process—was registered as an independent Jordanian NGO in December 1996.

Effective 1 April 1997, the JWDS assumed responsibility for implementing the spin-off program through a subgrant from Save the Children. Since then the JWDS has

increased its capacity to implement this large and complex program, while Save the Children has provided funding, technical assistance, and institutional development support. On 1 August 1998, and consistent with overall program strategies, the JWDS assumed responsibility for directly managing the loan portfolio and management information system. By February 1999 the JWDS had nearly 5,000 active female borrowers (table 2). By the end of March 1999 operational sustainability was 66 percent and financial sustainability, 55 percent.

### ...to Al Majmoua...

Save the Children has been working in Lebanon since 1953, implementing humanitarian emergency and development projects

across the country. Lebanon saw its first Group Guaranteed Lending and Savings program in April 1994 as a response to the postwar lack of liquidity and need for financial services to support the development of the disadvantaged—particularly female microentrepreneurs—in war-affected communities (box 5). The introduction of the program was facilitated by funds from a previous credit program under the Small Enterprise Development initiative.

During the program's first phase (June–December 1994) implementation was undertaken primarily by Save the Children. Efforts during this time focused on developing a loan methodology and building implementation systems. Links were established with Fransabank for making all cash transactions, processing loan dis-

**Table 2. Basic data for the JWDS, Al Majmoua, and FATEN, February 1999**

Indicator	JWDS	Al Majmoua	FATEN
Number of disbursed loans	29,358	22,135	24,730
Amount of disbursed loans	\$4,505,582	\$7,872,135	\$6,958,510
Number of active borrowers	4,465	3,138	4,068
Outstanding loan portfolio	\$529,127	\$755,236	\$704,143

Source: JWDS, Al Majmoua, and FATEN data.

### Box 5. Key dates for Al Majmoua

April 1994	Save the Children launches the Group Guaranteed Lending and Savings program
June–December 1994	Efforts focus on developing a loan methodology and building an implementation system
1995	Changes are made to the loan methodology and local partners are identified to eventually hand the program over to
August 1995	Secour Populaire Libanais identified as a local partner
December 1995	Save the Children organizes a business planning workshop in Cairo. The idea to spin off, rather than partner with local organizations, is developed
June 1996	Partnership with Secour Populaire Libanais terminated
September 1996	In preparation for the spin-off, Save the Children's offices are split up to physically separate the Group Guaranteed Lending and Savings program from other Save the Children activities
September 1996– October 1997	Preparations are made for the spin-off
January 1997	Application to create an independent NGO is submitted to the Ministry of Interior
September 1997	Approval is granted and Al Majmoua is registered as an independent NGO
January 1998	Al Majmoua assumes full responsibility for the portfolio, expenses, and program management of the Group Guaranteed Lending and Savings program

bursements, accepting loan repayments, and opening savings accounts for groups.

As program parameters were set and expansion was under way, Save the Children followed its original plan to identify potential local partners to experiment with joint program implementation. But during this second phase (January–December 1995) it became clear that most existing institutions did not share Save the Children's understanding and vision of the program. In August 1995 Secour Populaire Libanais was selected as a potential partner. In addition, the U.S. Agency for International Development made funding available for the Lebanon program. At that point the program, working with Secour Populaire Libanais, began to expand implementation in three areas: Akar, south Lebanon, and Baalback-Hermel. The objective was for Secour Populaire Libanais to become the main implementer of the Group Guaranteed Lending and Savings program, while Save the Children would provide funding and technical assistance.

But this partnership remained tenuous at best. The co-management model that this partnership assumed was problematic from the start, undermining accountability and responsibility and increasing operational costs. In addition, differences in capacity, program vision, and organizational culture between Save the Children's Group Guaranteed Lending and Savings team and Secour Populaire Libanais further strained this partnership—and, most important, the sustainability of the program in Lebanon.

After the business planning workshop in Cairo in December 1995, the idea to spin off program operations was discussed with the U.S. Agency for International Development. At first USAID/Beirut rejected the idea, insisting on the partnership with Secour Populaire Libanais. Following extensive negotiations, a USAID consultant was dispatched to review the grant and to assess the structure and capacity of Secour Populaire Libanais as a partner in the Group Guaranteed Lending and Savings program. The consultant's report concluded that the partnership had

not been fruitful and that Secour Populaire Libanais would not be the best partner given the two organizations' very different features and capacity. A second external evaluation by CGAP consultants in May 1996 further endorsed the spin-off proposal.

Essential for proceeding with the spin-off, however, were the motivation and commitment of the staff of the Lebanon field office—particularly the staff of the Group Guaranteed Lending and Savings program—to developing a leading Lebanese microfinance institution that would implement the program nationwide. The key principles that guided the staff were best practice principles of financial sustainability, service-oriented activities, and accountability to clients. In the words of Al Majmoua's executive director, "there was a strong feeling of ownership of the program among the staff. This was crucial for our successful transition."

The final decision to terminate the 10-month partnership between Save the Children and Secour Populaire Libanais came in June 1996. This third phase of the process provided invaluable lessons about the ingredients needed for building local capacity and establishing an adequate organizational structure when creating an independent microfinance institution.

The fourth phase of the spin-off process (September 1996–October 1997) saw extensive preparation for the creation of the new institution. To assess the administrative needs of a new institution devoted solely to microcredit, Save the Children's field offices were physically separated in September 1996. Over the next year the new organization's institutional structure was developed and refined, staffing and human resources were improved, and new systems were created. The bylaws and statutes of Al Majmoua were defined to regulate its functioning and to allocate powers and responsibilities to the bodies created (general assembly, board of directors, officers, and the finance, staff, operations, and strategic planning committees). As with the programs in Jordan and the West Bank and Gaza,

**A strong feeling of ownership among Al Majmoua's staff was crucial for its successful transition**

By moving to smaller loans, FATEN was better able to target poor people

lending operations continued while all these spin-off activities were under way.

In January 1997 Al Majmoua applied to the Ministry of Interior to register as an independent NGO dedicated to providing micro-finance services. This approval was granted in September 1997. During its fifth phase of development (November 1997–June 1998) Al Majmoua took steps to increase its institutional capacity through board training, promotion campaign, human resources recruitment, training and development, product testing and development of business plans for expansion and branch development. On 1 January 1998 Al Majmoua assumed full responsibility for the Group Guaranteed Lending and Savings program’s portfolio, operational costs, and management. By February 1999 Al Majmoua had 3,138 active female borrowers (see table 2). At that time operational sustainability was 66 percent and financial sustainability, 59 percent.

**...to Palestine for Credit and Development (FATEN)**

Save the Children had run a credit program in the West Bank and Gaza since 1986, starting with the Small Enterprise Development program. In February 1993 Save the Children

initiated a pilot Group Guaranteed Lending program to address the shortcomings of the Small Enterprise Development program, which did not adequately respond to the economic situation in the West Bank and Gaza or achieve the desired outreach or financial sustainability. In August 1993 an internal assessment of the program suggested that smaller initial loan sizes would allow Save the Children to reach poorer Palestinians, thus more effectively serving those who traditionally have no access to credit.

Drawing on this finding, on experience gained from international workshops and visits to group-based lending and savings programs in other countries, and on Save the Children’s earlier experiences in Lebanon, Jordan, and Egypt, the Palestinian credit staff reformulated the group-based lending and savings program in January 1995 (box 6). The new program seemed to respond better to country circumstances, and Save the Children felt that it enabled the agency to better achieve its primary goals by targeting female microentrepreneurs. Since January 1995 agreements have been reached with several commercial banks in the West Bank and Gaza to service program needs.

Having failed to identify a suitable local partner to co-manage the Group Guaranteed

**Box 6. Key dates for FATEN**

January 1995	Save the Children introduces a Group Guaranteed Lending and Savings program in the West Bank and Gaza
December 1995	Save the Children organizes a business planning workshop in Cairo. The idea to spin off, rather than partner with local organizations, is developed
1996	Failed attempts are made to identify a suitable local partner
May 1996	CGAP appraisal
Early 1997	Process initiated to select the board of directors of a new institution to be created
November 1997	Fifteen people meet to found the new institution
January 1998	bylaws are approved and FATEN is chosen as the official name
April 1998	Founders meeting held in Larnaca, Cyprus; the first board of directors is elected
May 1998	Board of directors and staff meet in Antalya, Turkey, to discuss FATEN’s mission, goals, and guiding principles
July 1998	FATEN officially registered as a nonprofit joint stock company with an independent board of directors
March 1999	FATEN assumes full responsibility for the operation and management of its loan portfolio, operational costs, and management information system

Lending and Savings program—and having learned from its experiences in Jordan and Lebanon—Save the Children worked with donors to create a new local institution geared toward long-term implementation and sustainability. Existing program staff were to make up the core of the staff of the new organization. Early 1997 saw increased efforts by Save the Children and program staff to lobby some 100 prominent Palestinians for this initiative.

After this vetting process, about 15 people in Gaza and 25 people in the West Bank were invited to a series of meetings where the methodology of the program, its vision, and its working principles were explained and discussed. The draft plan for spin-off was presented and legal issues related to the establishment of the organization, the role and characteristics of board members, and the vision of the new organization were considered. Because of the limited freedom of movement between Gaza and the West Bank for Palestinians, these meetings had to be held in Cyprus and in Turkey. These limitations continue and have made FATEN's institutional management more complex.

After considerable preliminary work, in July 1998 FATEN was registered as an independent nonprofit joint stock company dedicated to providing microfinance services. On 1 March 1999 FATEN became fully responsible for managing the entire program. At that time FATEN had more than 4,000 active female borrowers (see table 2). During this first month of complete institutional independence FATEN's operational sustainability was 62 percent and its financial sustainability, 52 percent.

### Where are the institutions today?

Although the JWDS, Al Majmoua, and FATEN are at different stages of development, all three are trying to refocus the basic model for microfinance in their countries. To that end, they have each succeeded in reaching out to poor women and are now focusing on their operations, their vision for devel-

oping their target groups, and the strategies for the evolution of their institutions. Issues have been raised about target markets, financial products, operational structures, and institutional forms. Before proceeding to the next stage, all three institutions plan to work through these issues and develop realistic strategic business plans that take into account their needs and those of their clients.

### *The JWDS is working toward its strategic goals*

The vision of the JWDS is to harness the productive capacity of every potential microentrepreneur in every sector of the economy, with a focus on people who lack access to formal financial markets. The Group Guaranteed Lending and Savings program has been successfully implemented in seven governorates in northern, central, and southern Jordan: Amman, Balqa, Irbid, Mafraq, Rusaifeh, Karak, and Madaba. A program in one area, Zarqa, was closed in early 1999 because of substantial fraud cases that are still pending in court. A thorough investigation of the Zarqa area continues to assess the possibility of reopening it for new clients.

In line with its strategic plans, the JWDS aims to achieve several objectives over the next few years. It plans to achieve and maintain a strong portfolio with good client services. It plans to develop and test new individual loan products catered to client needs. In trying to

**All three institutions are trying to refocus the basic model for microfinance in their countries**

*Hoda has been borrowing from the JWDS for two and a half years and is now on her eighth loan, for 350 Jordanian dinars (\$494). A friend told Hoda about the program; currently she is in a seven-member group. Hoda produces facial creams at home. She has her own secret formula and uses natural ingredients. The creams are of high quality and have been selling well. Hoda makes 0.5 dinars of pure profit per small jar of cream and usually sells 50–70 jars a month. Recently she has been planning to patent her formula and has approached the Ministry of Commerce. Although a patent will be expensive, it will be essential if Hoda is to consider mass production. But for this she will need a small workshop and more ingredients.*

Al Majmoua's mission and independence have allowed it to develop a strong identity that has affected staff, target clients, and the general public

widen its client base, the JWDS plans to replicate best practice branch models. Finally, it plans to strengthen staff capacity to operate an efficient institution so that it can use its capacity to become eligible for donor funds. To become more efficient, the JWDS must—among other things—develop financial products, review its legal structure, assess the viability of strategic alliances with formal banking institutions, and broaden its capital base (possibly to include commercial funds).

#### *Al Majmoua has a strong reputation*

The next three years will be expansive ones for Al Majmoua. With its solid and promising past as a pilot project with Save the Children and then as an independent institution, Al Majmoua is ready to grow to a national scale and achieve financial sustainability. It plans to rely on its well-trained staff, strong institutional image, and exceptional track record to expand the delivery of group-guaranteed loan and credit services, develop new financial products, and establish an extensive branch network. Its defined mission and independent status have allowed Al Majmoua to develop a strong identity that has affected staff, target clients, and the general public.

Al Majmoua's greatest strengths include its client base and the experience it has gained since 1996. Current clients represent an exceptional database of microentrepreneurial information in Lebanon. The large number of loans issued in recent years, coupled with the high rate of repayment, have given Al Majmoua a strong reputation for reliability. Thus client satisfaction will be key to ensuring Al Majmoua's growth—particularly given the increasing competition from other NGOs and banks.

New products need to be developed to meet client needs. The first new product—larger loans to repeat clients—has already been developed and will be followed by other innovative products. Al Majmoua is expected to achieve operational sustainability in 2000 and financial sustainability in 2001. Al Majmoua projects that it will have 5,800

*Turfah owns a store that sells sweets and juices in Ain-El Helweh Camp, located in Saida (Sidon) in southern Lebanon. One of the first clients of Al Majmoua, Turfah has been borrowing for four and a half years and is on her twelfth loan, for \$900. Her store is profitable and has grown significantly since she became an Al Majmoua client. Turfah recently used the proceeds of a loan to purchase a juice stand for better marketing opportunities. Part of her business is seasonal. For example, during the Feast, following the holy month of Ramadan, her business prospered because of high demand for specialty sweets. Turfah hopes to soon purchase a new machine so that she can increase output when demand is high. Her monthly revenue averages nearly \$1,100. Each month she uses \$800–\$900 to purchase supplies and pays \$65 in rent. Thus her retained monthly earnings come to \$100–\$200 a month.*

clients by 2000, 10,900 by 2001, and nearly 18,000 by 2002. If successful, this ambitious growth plan will make Al Majmoua the leading player in Lebanese microfinance.

Current funding will ensure that operations remain on track over the next two years, after which Al Majmoua will need to secure new grants or begin to access private funding, with the eventual possible aim of seeking a strategic partner such as a banking institution. Any concrete discussion of such a strategic alliance would be premature at this point, however. Given Lebanon's busy banking sector, Al Majmoua should expect to face further competition as commercial banks begin to engage in microfinance.

Again, Al Majmoua can rely on the lessons it has learned about reaching poor clients in Lebanon. This is a clear advantage for Al Majmoua over its more formal banking counterparts, but one that must not be relied on too heavily. Al Majmoua plans to remain focused on serving women and will continue to deliver microloans tailored to conditions in Lebanon.

#### *FATEN faces challenges but has unique strengths*

Having only recently overcome some fraud that coincided with the spin-off preparations—while its microfinance program was still

under the Save the Children umbrella—FATEN is drafting a three-year business plan that will more clearly outline its development goals and strategic directions. Senior managers are working closely with board members in this exercise to develop a joint plan that reflects the full ownership of the institution.

FATEN's mission is to strengthen the economic base of Palestinian microentrepreneurs and to provide high-quality and sustainable financial services to them—particularly to female borrowers in the West Bank and Gaza. By charging a market-based interest rate, the program is expected to achieve financial self-sufficiency by the end of 2000. FATEN provides financial services to women in Khan Yunis, Gaza City, Rafah, and Jabaliya in Gaza and in Jenin, Hebron, Nablus, and Tulkarem in the West Bank. By the end of 2000 the program is expected to cover most major urban areas in the West Bank and Gaza. The program is funded by the U.S. Agency for International Development, the U.K. Department for International Development, and Irish Aid.

One of FATEN's greatest strengths—one that was supported while it was under Save the Children's umbrella—is its ability to adapt and to learn from clients. For example, for clients starting the fourth loan cycle, FATEN has cut the group size to five,

*Alia, who lives in Hebron, borrowed from FATEN for the first time when her primary business was trading clothing. She is now on her fifth loan, for 500 Jordanian dinars (\$705). She buys cheaper clothes in Amman, Jordan, and resells them, earning a small profit. Her revenue averages 2,000 new Israeli sheqels (\$590) a month, while retained earnings come to 500–600 sheqels (\$150–\$180) a month. Alia's monthly expenses total about 300 sheqels (\$90), which covers the cost of employees who purchase the supplies, rent for the shop, and so on. So far her profits have been used to expand her business and to reinvest in her household. In addition, she has been able to diversify her business and is now selling spices and nuts. Besides business reasons, Alia mentioned that if she did not invest her profits, her husband might use them to marry a second wife.*

increased the loan amount and term, and cancelled mandatory savings. Additional criteria, such as the size and capacity of a borrower's business, are considered a step toward individual lending.

Of the three spun-offs, FATEN faces the most complexities. In effect, FATEN must run three programs and offices (in Gaza, Hebron, and North) and all that comes with them. Yet in many ways FATEN has the potential to become the most successful institution given its dedication, market potential, and drive for independence. In the end the complexities it deals with may facilitate its sustainability and growth.

**Of the three spin-offs, FATEN faces the most complexities**

## Building blocks for spinning off

A strong sense of institutional independence and program self-sustainability drove each of the spin-offs

The three spin-offs (the JWDS, Al Majmoua, and FATEN) widely accept that from the outset their existence has largely been due to the financial and institutional support of Save the Children. But Save the Children—having failed to identify suitable long-term partners to implement the Group Guaranteed Lending and Savings programs in Jordan, Lebanon, and the West Bank and Gaza—has viewed the creation of independent microfinance institutions as essential to ensuring sustainable access to credit for female microentrepreneurs. A strong sense of institutional independence and program self-sustainability drove each of the spin-offs.

Each institution acknowledges the immense contribution of Save the Children to its programs as well as to the development of the microfinance industry in the Middle East and North Africa. At the same time, the support that nurtured these programs in their early stages was not sufficient for their rapidly growing operational, management, and market needs. This shortcoming may have been largely due to the fact that as these programs developed, their needs were not simply increasing but changing.

Some of these needs followed from a desire to focus solely on microfinance, possibly improving on the group guaranteed lending and savings methodology—for example, by changing its target audience and group sizes. As one manager noted, the old group approach was “100 percent rigidity and 0 percent analysis. Becoming an institution gave us room to analyze and think.” Reforms were considered for

employee incentive plans, staff training, and administrative systems and internal controls.

Such changes ultimately point to the desire of each of the programs and their staffs to become independent and self-sustainable businesses following separate operational and management models. As parts of larger organizations, the programs would not necessarily have been able to achieve this technical and strategic independence. Several steps are involved in the spin-off toward institutional independence: choosing a legal form, deciding on institutional governance, determining the status of staff in the process, and transferring management information and accounting systems.

### Choosing a legal form

Regulatory and legal issues are key to consider when building a new institution because they can have a profound impact on institutions’ ability to achieve their stated objectives. As noted, in the Middle East microfinance programs are often lodged in larger parent organizations that provide social or charitable services. These organizations are often registered as NGOs or as voluntary or charitable associations. Though these legal forms may be appropriate in the early stages of a microfinance program, they will likely block a program’s development as a financial intermediary. To decrease its dependence on donors, achieve growth, and become fully sustainable, a microfinance program has to gain access to commercial sources of funds—that is, by borrowing from banks for onlending or taking deposits.

The legal structure of the parent organization can impede a microfinance program’s move toward sustainability. NGOs and charitable associations do not have identifiable owners who can be held personally or institutionally liable (even to a limited extent) for achieving the organization’s statutory objectives. As a result these types of organizations often have no proper governance structure and lack accountability and transparency. Thus commercial providers of funds (whether of loans or equity) are unwilling to invest in such entities.

Thus an NGO microfinance provider eventually has to change its legal form to ensure an appropriate ownership structure and related accountability. In other parts of the world the new legal forms have included non-profit company, for-profit company, financial intermediary, and even deposit-taking bank (licensed by banking authorities). Some countries, for example, have created a special legal form for microfinance intermediaries.

Legal and regulatory factors played an important role in the choices made by Save the Children’s spin-offs. The JWDS and Al Majmoua registered as NGOs because both believed that they had no other feasible or cost-effective legal option (table 3). But FATEN—after extensive discussions based on presentations made by lawyers, auditors, and representatives of the Palestinian Monetary Authority—decided not to register as an NGO. FATEN’s founders investigated several legal options, including registering as an NGO, but bureaucratic complications with the Ministry of Interior barred them from doing so. Because the fledgling institution’s resources were too limited to register as a financial company, it chose to become a non-

profit company, an option available under the British commerce law still used in Gaza. Moreover, the founders believed that this approach would make it easier to become a for-profit or a bank.

Besides the perception that there was no alternative cost-effective structure, it is possible that the ease of operation—as NGOs in Jordan and Lebanon, and as a corporation in the West Bank and Gaza—contributed to each institution’s choice of legal form. That is, each arrangement involved the least potential political and bureaucratic resistance or subsequent interference. But while these forms may have been the right choice in the short term, they appear to contradict the organizations’ stated reason for spinning off: to build sustainable and independent institutions.

Although the JWDS and Al Majmoua appear to find the NGO form to be an acceptable institutional structure, some troubling issues are starting to emerge. One hinges on each institution’s capacity to legally enforce repayment of its loans. For example, because there is little experience in the region with nonprofits engaging solely in the delivery of financial products, there is a want of related jurisprudence in courts. Thus it is difficult to predict how a judge will react to a nonprofit organization suing a client who the judge perceives to be poor when the organization is claiming to be doing social good. Another issue that may crop up is ownership of each institution’s assets. For example, Al Majmoua’s assets are projected to rise to nearly \$8 million over the next few years. Defining who owns these assets will become important.

On the other hand, while the legal structure of FATEN—as a nonprofit—ensures

**An NGO microfinance provider eventually has to change its legal form**

**Table 3. Comparative institutional indicators for the JWDS, Al Majmoua, and FATEN**

Indicator	JWDS	Al Majmoua	FATEN
Month and year of registration	December 1996	September 1997	July 1998
Legal structure	NGO	NGO	Corporation
Number of board members	7	6	9
Save the Children represented on the board?	Yes	No	No

Source: JWDS, Al Majmoua, and FATEN data.

In the corporate context the primary reason for institutional governance is to separate ownership and control

accountability and transparency, the institution's lack of a profit objective may undermine future capitalization and growth. Similarly, the JWDS and Al Majmoua will have to change their legal form if they want to reduce donor dependence, enhance sustainable growth, and access commercial funds to finance that growth. Hence the sustainability objective and related integrated business orientation may be more buzzwords than actual practices reflected and integrated in the institutional structure and ownership of the three microfinance institutions.

The managers and boards of the JWDS, Al Majmoua, and FATEN recognize—though to varying degrees—the potential limitations of their current organizational forms. But they also point out that their current structures may simply be stepping stones as the institutions evolve. As they grow, some of these managers hope to make the institutions true financial intermediaries, reaching the point where they turn a profit, capitalize their assets, and, in the distant future, even transform into a bank.

### Deciding on institutional governance

In deciding on institutional governance, two main questions must be answered. How will the board of directors be selected? And what role and responsibilities will the board have?

#### *How to select the board of directors?*

In the corporate context, institutional governance deals with mechanisms through which an institution's stakeholders exercise control over management to protect their interests. Stakeholders can include creditors, donors, and other claimants who supply capital as well as employees, clients, and other suppliers. The managers, the entrepreneur, and other insiders control the institution's key decisions. Thus the primary reason for institutional governance, in the corporate context, is to separate ownership and control.

This distinction has been clearly understood in the spinning off of the JWDS, Al Majmoua, and FATEN. Founders and board members sought to separate daily management of each institution from a separate body with a strong sense of ownership—a body that will help oversee and guide the vision and strategy of the institution. The spin-offs into the JWDS, Al Majmoua, and FATEN also resulted in a unique situation: Save the Children program staff and management in all three countries were actively involved in identifying individuals to serve on the boards of the institutions being created. Those who negotiated and explained the program and tried to convince current board members to take on the job are now serving and reporting to their boards. As one of the institution's managers put it, “the staff brought in their supervisors.”

This peculiar feature of all three spin-offs is reflected in the actual selection of the board members. This process was driven by a desire to identify individuals who were committed to microfinance and who shared the vision and principles developed by the staff and management of these programs. Attention was also paid to including members with diverse backgrounds—from social work to banking, academia to industry—and not necessarily a lot of board experience. The institutions have found that such diversity brings tremendous benefits because each board member contributes different expertise to the work of the board.

*Sameera has taken two loans from FATEN. She and her husband are supporting a large family, with seven daughters and four sons, and she is expecting. They all live in Hebron. Sameera used the proceeds from her first loan of 150 Jordanian dinars (\$212) to buy her first sheep. The second loan of 200 Jordanian dinars (\$282) was used to buy another sheep and more food for her animals. In addition to breeding sheep for their young, she is raising them for milk, cheese, and butter—products that are converted into an average of 150 Jordanian dinars (\$212) of pure profit each month. Repayments for her loans come from the sale of cheese and milk. Young sheep are assets that are being accumulated.*

FATEN had the most open, thorough, and transparent process for selecting board members. In 1997, the year prior to the spin-off of FATEN, staff of the Group Guaranteed Lending and Savings program, supported by upper management, met with about 100 Palestinians—including bankers, businessmen, members of the Palestinian Authority, and other interested individuals in the West Bank and Gaza—to explain the program. The intention was to create a broad base of interest and support for the program and to select candidates for the board from among individuals who expressed interest and were enthusiastic about the program’s vision.

Technically, there are no representatives from Save the Children on the board, because the board members believed that that organization’s presence could cause conflicts of interest and undermine the institution’s independence. But although it does not directly participate in regular decisionmaking, Save the Children holds a 26 percent equity stake through a Save the Children staff person. Thus it effectively has a voice or veto in case of any changes to FATEN’s bylaws.

The JWDS and Al Majmoua, on the other hand, took a more individualized approach. Both programs asked prominent individuals whom they knew and whom they could trust. Especially in Jordan, Save the Children played an active role in recruiting board

members. The JWDS’s founding board had seven members, of which two were representatives of Save the Children. That these two members accounted for nearly 30 percent of the board had other implications for the JWDS as an independent institution. This was aptly demonstrated when the program experienced a serious case of fraud and the board assumed full control of the institution—including its daily management—after the executive manager resigned in the midst of crisis.

Al Majmoua’s board contains no representatives from Save the Children. Instead the board is made up of six individuals selected to be the founding members of Al Majmoua. Board members have diverse backgrounds, ranging from an academic working in development to bankers and even an industrial engineer. The board represents the general assembly, and plans are in place to introduce new members to the general assembly. Al Majmoua’s board has become an important strength for the institution, especially given its intentionally non-religious and nonpolitical affiliation.

#### *What role and responsibilities should the board have?*

As noted, any institution’s stakeholders may include clients, donors, suppliers, and others. The board of directors should be accountable to all these groups, because to some extent these groups have some form of ownership in the institution (box 7). The concept of ownership prevents this legitimate special group of stakeholders from being lost in the general array of stakeholders. Moral rather than legal ownership could be the basis on which a board ultimately determines its accountability. In cases where the government requires nonprofits to have legal ownership, the board must determine whether the moral ownership is a larger concept far beyond the bounds of the formal membership.

Similarly, one of the important aspects of the spin-off process was to instill a sense of

**Any institution’s stakeholders may include clients, donors, suppliers, and others**

*Amna lives in the Balqua area, outside Amman, in one of the Palestinian camps. Amna does sewing and tailoring and owns a workshop and store in the neighborhood. When we visited her, several clients were in the store picking up old orders and making new ones. Amna recently learned about the JWDS and has received two loans. She used both to increase her working capital, buying an additional stitching machine, some sewing tools, and tailoring scissors. Amna employs a young friend of hers, Alia, and the two of them can hardly meet the demand for their work. They would need to go a month without taking new orders to finish the backlog of orders. On average, Amna makes about 300 Jordanian dinars (\$423) in profit each month. She hopes to take another loan, get another sewing machine, and employ one more person.*

The role of the board is being intensely discussed and is evolving as the three institutions develop

### Box 7. Roles and responsibilities of boards of directors in the corporate context

The essence of any institution lies in what it believes, what it stands for, and what and how it values. The telling assessment of an institution's beliefs are its works, not its words. These values and perspectives might form the basis for the more mechanical and visible aspects of an institution. Prudential governance might begin by recognizing this central determining feature of any institution. Setting goals, deploying staff, writing procedures, formulating plans, developing strategy, and other board activities depend on core values and perspectives that are best blended in the concept of policy.

Thus policymaking might be proactive, concerning the broadest issues, rather than reactive to all issues. Board policies might become crucial to all executive action. Brevity and clarity are essential qualities of any policy, so that updating becomes far easier and makes policies more of a reference than a tome. Most resolutions in board meetings might be motions to amend policy structures so that policy development is not an occasional chore for the board but its main occupation. Though the board may charge its officers or committees with parts of these tasks, the ultimate responsibility lies with the entire board.

As important as it is for the board to control the complexity and details of staff operations, it also needs to have a certain degree of free-

dom. The board needs control because it is accountable for all organizational activity, however obscure or far removed. But the board needs to be free from operational matters because it is merely a part-time body. Some boards might relinquish control to be free from details or to grant the executive director freedom from board intrusion; such boards might be guilty of "rubber stamping." Other boards forgo freedom to control many details; such boards might be guilty of meddling. Thus the challenge for boards is to be reasonably certain that nothing goes wrong and to grant as much latitude as possible to people with the skill and talent for the work to be done. Boards need to oversee staff operations without obscuring role differences and without taking staff members off the hook for their decisions.

Also essential is for boards to maintain an arm's-length distance from prescribing staff means. It is as damaging to have a board that constrains an institution too much as one that does not at all. For institutions to gain the most from their relationship with the board, there must be a balanced relationship between the two. The board should not impose technical policies without considering the recommendations of operational staff who know more about clients, but it should hold sufficient leverage to assert its authority.

*Source:* Mueller 1981; Chait and Taylor 1989.

ownership in the board of directors, as well as a sense of responsibility for institutional quality and operations. In this regard the role of the board is being intensely discussed and is evolving as the three institutions develop. While the boards have not been expected to take over management responsibility, they have committed their reputations and, in the case of FATEN, accepted legal liabilities for these institutions. But this does not necessarily reflect equally on the definition or level of involvement of the boards of each institution.

Although the board of FATEN is the only one that is in theory legally liable, it also appears to be most "hands off." By contrast, the board of the JWDS, which as an NGO was not at all legally liable, maintained active involvement until recently. This active role

was mainly due to problems with fraud and management, after which the JWDS's board had to step in to rescue the program. From the outset Al Majmoua chose an approach that board members refer to as an "advisory role." The board is responsible for overseeing and strategically directing the institution and supervises the work of the executive director. The board reports to the general assembly, but under the law on non-profits in Lebanon, the general assembly's only power over the board is to dissolve it and call for elections.

Once the board's role has been clarified, its responsibilities are often partitioned into committees. The existence of committees should in no way disturb the wholeness and authority of the board or the "single voice" of governance. Board committees should

exist to help complete the board's job, not the staff's job. This division of labor on the boards of the JWDS, Al Majmoua, and FATEN has occurred in some cases on a temporary basis and in other cases on a permanent bases, as each of the program's boards resorted to subcommittees to deal with aspects of their work.

Still, the decision to establish committees does not always reflect an ideal structure, nor is there any "right" number of committees that a board must have to justify its existence. In exceptional cases, such as FATEN, this division of responsibilities within the board helped overcome practical problems, such as the "movement" problems between the West Bank and Gaza. In its efforts to overcome these issues, the board of FATEN even tried to organize itself so that each committee has members from just one region.

A certain mix of people and expertise may concentrate the board's work better in subgroups. For example, FATEN's committee in Gaza reviewed the personnel manual, while the committee in the West Bank (with members from the banking sector) reviewed the financial manual. But these subdivisions were not permanent features of the FATEN board, as it strives to conduct its business as a unit—despite the distance between members.

### **Determining the status of staff in the spin-off process**

An important component of the spin-off process involves the transfer of program staff to new institutions. All staff working in Save the Children's microfinance programs prior to the spin-offs were allowed to choose whether to join the new institutions. Many of these employees had originally been attracted to Save the Children because of the prestige and other benefits that come with working for a reputable international organization. But some employees admitted that they had joined Save the Children's microfinance programs knowing that they would eventually spin off into their own institution.

This was especially the case in Al Majmoua. Its employees had always felt that their future in a program-based setting was finite and that, to build a career, they would need to be in their own institution. Nonetheless, as former employees of the program under Save the Children, they were guaranteed the same benefits as before by all the new institutions.

In the JWDS almost all employees were transferred at the time of the transition, while many more were hired after the transition. Many questions and concerns were raised about the quality and quantity of remuneration for these new employees relative to those who had moved over from Save the Children. In some cases the new institutions tried to go out of their way to maintain continuity in benefits by retaining similar working standards. For example, although Jordanian organizations generally work six days a week, the JWDS retained the five-day working week it had under Save the Children. In other cases the new institutions provided more benefits. For example, FATEN issued employment contracts for loan officers that had not officially existed under Save the Children.

Senior managers tried to retain one of their greatest assets—their institutions' employees—while changing their strategic outlook. As a result the institutions often found themselves changing the old corporate culture rather than building a new one. All the institutions recognized that this approach was much more difficult. They were no longer part of a larger framework, as under Save the Children, but rather were now in their own institutions. As one senior manager said, staff "needed to be in an institutional rather than a program-based framework. That required a change in thinking." Some senior managers felt that the Group Guaranteed Lending and Savings methodology did not lend itself to building such an institutional structure and may have impeded this change in approach. The consequences of this change are vast and crucial to the sustainability of all these

**The institutions often found themselves changing the old corporate culture rather than building a new one**

All three programs only gradually assumed responsibility for operational and portfolio management

institutions, because staff at all levels needed to assume more responsibility for their actions and not (as before) rely on Save the Children's infrastructure.

One important staffing issue noted by some of these institutions is the difficulty of recruiting experienced and well-trained local staff to work on microfinance. In effect the institutions—although local organizations—essentially have to maintain the salary and benefit structures of international NGOs to ensure their competitiveness in the job market and attract the best staff. This challenge affects the capacity of the three microfinance institutions to build strong middle management structures, which in some cases were found to be weak or nonexistent.

### **Transferring management information and accounting systems**

During the transition to institutional independence, all three programs only gradually assumed responsibility for operational and portfolio management. For example, in April 1997 the JWDS took over operational cost accounts. Until the end of July 1998 the JWDS technically recorded all costs incurred only to its accounts. Yet although the JWDS was responsible for implementing the program, all the revenue was booked in Save the Children's account. In August 1998 the JWDS took over portfolio management, a move that coincided with the transfer of the original Group Guaranteed Lending and Savings finance manager to the JWDS. In hindsight this seems to be a long transfer, but the management of Save the Children believed that it was too risky to transfer both operational and portfolio management functions right away.

After the transfer some of the features of the accounting system used by Save the Children, as an international NGO, were transferred to the JWDS. But these features were not appropriate for the JWDS's microfinance business orientation. For example, Save the Children's fiscal year differs from Jordan's—a difference that can create diffi-

culties when the JWDS has to report to the government. Similarly, until August 1998 expenses were treated using cash-based accounting. Today, however, the institution has switched almost 90 percent to accrual-based accounting. Still, when using grants from the U.S. Agency for International Development, the JWDS has to report on a cash basis in order to receive reimbursements.

Multiple cost (profit) centers are another innovation introduced by the JWDS. This setup makes it easy to verify the efficiency of each center that the JWDS operates. Under Save the Children there was just one cost center. In considering more decentralized operations for the future, the JWDS is thinking of turning branch offices into separate cost centers as well, responsible for profits, revenues, and costs. This reform may represent a new incentive scheme and introduce competitiveness among branch managers. For this proposal to be implemented, however, branch managers would need relevant training.

FATEN has implemented a similar structure, initially with regions and, as of March 1999, with branches considered as cost centers. At the end of each month, real income statements are produced for each branch, region, and the entire organization. These statements are used to calculate cost recovery levels. In FATEN the established benchmarks form the basis for an incentive scheme for branch managers. Everytime the institution reaches a benchmark with an average portfolio at risk below 2 percent, managers move to another level on the salary scale. In addition, FATEN has been using an entirely accrual-based accounting system since March 1999.

FATEN has also had to deal with transferring the management information system and with recruiting issues. At first FATEN and Save the Children had worked together to train a finance manager—who then unexpectedly left. At a personnel level, replacing that manager has entailed not only identifying and hiring a qualified candidate, but also waiting until the new manager is famil-

iar with FATEN's systems. At a technical level, FATEN has recognized the need to change even its most basic information requirements. FATEN rightfully decided to offer employees official contracts, but this small task requires much information. Moreover, without an official list of employees, the payroll cannot be sorted and run smoothly. Thus the finance manager position requires skills ranging from managing accounting information to identifying inefficiencies in the system. FATEN finally found a new finance manager—one who happened to be a former senior accountant with Save the Children and was familiar with FATEN's work—and he assumed his duties in May 1999.

Al Majmoua managed to hire a finance manager from the time all cost and profit accounts were transferred. This process has gone smoothly, but Al Majmoua's weakest

point is the absence of a suitable management information system. With funding support from Save the Children, Al Majmoua is developing a management information system tailored to the possible expansion of the institution and designed to provide more thorough management information.

All of these changes and innovations bring out the many complexities of the financial management of a separate institution. But there are many benefits as well: information is more transparent and enables management to make prompt and timely decisions because the management information system is more streamlined, and costs and profit sources are more transparent. Thinking in a business-like setting has encouraged further innovation in this field as well, as demonstrated by the JWDS and others as they strive to find the best possible system to address their growing needs.

## Benefits and risks of spinning off

Spin-offs provide managerial and marketing benefits to both the parent entity and the spun-off entity

The spin-off of Save the Children's microfinance programs into the JWDS, Al Majmoua, and FATEN brought to light many of the benefits inherent in such program restructuring and similar to those typically found in a corporate context. These include external market factors, marketing considerations, and the future legal, financial, and programmatic developments of the programs, especially as they relate to the programs' prospects for growth and sustainability. Added to this were numerous intangible factors and positive externalities brought about by the spin-off process, such as the building of local capacity or the regional microfinance industry. But there were caveats to these benefits as well—although all three institutions are optimistic about their futures as independent entities and seem determined to face any challenges they may encounter.

### **Institutional and marketing benefits**

A review of evidence in the corporate context supports the claim that spin-offs provide managerial and marketing benefits to both the parent entity and the spun-off entity. Usually, each of these bodies might have operated in different lines of business and different environments, each with its unique managerial and operational problems. By separating these businesses through a spin-off, management might often suspect that each entity would fare better because of better managerial decisionmaking and more efficient managerial incentives. Because the

parent institution and the spun-off firm would each have specialized management reporting to a separate board of directors, there would be a better framework for management decisions on the use of capital and human resources and the operation of the separate businesses.

On the marketing front, such spin-offs may allay fears by clients, donors, and others that these institutions were committed to and would not end participation in their industry. Spin-offs motivated by marketing considerations would be designed to separate potentially incompatible product lines to avoid institutional schizophrenia—as when, for example, the same organization deals with social services and microcredit programs, requiring the same employees to serve as social workers as well as loan officers. These roles do not always complement each other.

All three microfinance institutions, whether under Save the Children or as newly spun-off institutions, have at some point had to deal with such institutional image and marketing issues. FATEN cites an interesting example of a loan officer (promoter) who defrauded the organization. The Group Guaranteed Lending and Savings program staff handling the issue managed to persuade the loan officer and her family to mortgage their house in the name of the program. But Save the Children's field office managers were opposed to using the house as collateral or selling it to collect the stolen funds because of concerns about the effect such moves could have on Save the Children's reputation in the field. FATEN cites this incident

as a clear divide between Save the Children's missions and goals on the one hand, and the microfinance program within the same organization on the other. Microfinance institutions must develop and maintain their reputations as running lending programs whose sustained operations—and consequent benefits to other clients—depend on collecting repayments.

The JWDS has had to deal with getting similar points across to its clients. As the three spun-off microfinance institutions take firm positions in their societies, however, such image problems are starting to disappear. Moreover, the reputations of all three as lending institutions whose existence and future provision of loans depends on repayment seem to have taken firm root among their employees, clients, and partners.

### **Operational, financial, and risk management benefits**

Operational and financial transparency is another major benefit of spinning off. That the operational and financial progress of the separate businesses tends to be more visible might inspire executives to build on growth and foster improvement. There would be a clearer basis for evaluations and so a more accurate appraisal of employee performance, clients (actual and potential), and donors as well as providers of commercial funds.

These benefits have been evident in the spin-offs of the JWDS, Al Majmoua, and FATEN. When the programs were part of Save the Children, their financial statements were tied to its accounting and financial system and did not precisely allocate costs or profits to each line of business. In that context it was almost impossible to accurately delineate program assets and liabilities.

FATEN, for example, has introduced separate incentives for branch managers—a move that it does not believe it could have made earlier because the organizational and financial structure of Save the Children could not have handled two salary scales. As

another example of organizational regulations impeding innovation, FATEN's management cites the issue of buying rather than renting office space, or of extending loans to its staff to buy vehicles rather than borrow them from Save the Children.

Similarly, the JWDS's recent plans for gradual decentralization provide another example where spinning off has allowed more options to be considered in operational management. As it decentralizes, the JWDS would consider offices or branches to be semiautonomous units. Standard guidelines would be developed for loan processing and approval, authority to make approvals would be delegated to branch offices, and a timely centralized information system would be maintained to keep track of individual branches.

Another potential benefit of separating from the parent organization is that it provides a clearer basis for investors and donors in identifying and evaluating the business of each institution—an advantage when additional financing is needed. By increasing market visibility for the spun-off entity's growing business, new donors and eventually private investors might be persuaded to donate to or invest in the entity. Similarly, the parent institution might benefit after the spin-off if management is able to concentrate more of its resources on removing inefficiencies and focusing on other operations.

Similar logic about the potential benefits of spinning off was noted in the discussions with the three microfinance institutions. For example, beside some small grants from other donors, much of the funding for the JWDS and Al Majmoua comes from the U.S. Agency for International Development—a result of the institutions' direct relationships with Save the Children, a U.S. NGO. Even in the West Bank and Gaza, where an additional donor was the U.K. Department for International Development, FATEN would not have obtained those funds if there were no partnership between Save the Children/U.S. and Save the Children/U.K.

**Spinning off provides a clearer basis for investors and donors in identifying and evaluating the business of each institution**

All three institutions recognize that they may have to learn to function without Save the Children's tangible and intangible assets

Some of the microfinance institutions felt that under Save the Children it was difficult to leverage funds from the wide range of donors interested in microfinance and in funding local organizations. A direct benefit of spinning off, according to these institutions, was that as independent entities they could lobby a diverse community of donors. Such efforts may help the institutions not only expand their portfolios but also increase their institutional autonomy with the potential reduction of dependence on a single donor.

In many spin-offs the parent organization and the spun-off entity have engaged in very different lines of business, with each having separate and distinct operating, financial, and investment characteristics. As a result the two institutions often have different operating or business risks. In such cases the spin-off may insulate each institution from risks associated with the other. After the spin-off the inherent risks would likely be more stable and predictable, at least partly because of the sharper focus of each institution. Each institution would be able to finance expansion on terms that are more in line with its historical and projected growth rates. While in many cases these may be positive developments, they may also create problems.

For example, FATEN stated in its bylaws that it will borrow money and use its assets as collateral. This approach would be difficult to take within an NGO or Save the Children framework. But it may make it harder for FATEN to obtain financing because each company will not be able to rely on the financial collateralizable assets of the other, possibly lowering the creditworthiness of the riskier entity.

All three spun-off microfinance institutions face this disadvantage. They each believe that they will be able to negotiate new grants or other types of funding. But they realize that Save the Children provides important tangible and intangible assets: the strong reputation of an international organization with a long history, well-developed

systems, and knowledge and experience in negotiating and administering funding that in the past helped secure large grants. If Save the Children decides to move out of microfinance operations in the Middle East, rather than recommit at a higher level, all three institutions recognize that they may have to learn to function without its assets.

### Product and services benefits

Having moved from managing programs to managing institutions, all three spun-off institutions have tried to modify their original Group Guaranteed Lending and Savings programs. The rigidity embodied by the original programs posed methodological challenges to the spin-offs. In essence, spinning off has increased the focus on the products and the clients that the new institutions wish to pursue in their continued autonomous development and with the objective of securing full sustainability.

Moreover, under the old programs there were concerns about amortization schedules, the high dropout rates for new clients, the slow growth of the programs and of average loan balances, and the inability to reach graduated clients. Such considerations have become crucial as the institutions rec-

*For the past eight years Magda has owned a shop on a busy street centrally located in the Ain El-Helwah camp in Saïda, Lebanon. Together with her husband, she is supporting a 14-member family. She sells clothes for children and women, and recently introduced a line of toiletries, deodorants, and perfumes. Magda purchases her inventory in Beirut because it is cheaper there. Every two weeks she spends about \$1,000 on new inventory. She usually makes \$50–\$60 a week in pure profit. Magda was one of the first clients of the credit program in Lebanon, and started with a \$150 loan. She has never had problems in repaying loans, but she finds that the group meetings interfere with her business. Because she works alone, she often has to close her store to attend the group meetings. This would reflect on the turnover in her business, as her clients count on steady opening hours. But for the time being she intends to continue borrowing with Al Majmoua, as there are no other possibilities open to her.*

ognize the growing competition in the market, particularly for other target groups.

Under the Group Guaranteed Lending and Savings programs, groups had to have at least 10 members. All three spin-offs are concerned that this minimum might impose unnecessarily high transaction costs on borrowers. These costs appear in real terms when meetings must accommodate 10 different schedules and in strategic terms when it is difficult to generate solidarity among such large groups. More research and institutional experience may clarify whether smaller groups may be better suited in all cases, as well as in different cycles of lending.

Similarly, biweekly payments do not always respond to the cash flows of microbusinesses. One consideration has been to design amortization schedules that better suit the needs of clients, including end-of-the-month repayments. Another consideration has been to lower the minimum loan size, given that loan sizes are not increasing over time and dropout rates are high. Initially there was concern about arbitrariness in the application of the Group Guaranteed Lending and Savings methodology with respect to loan amount and group size. In each country a specific formula was used to determine the initial loan amount. But research has indicated that in some cases women may not require the entire loan amount—and as a result much of the loan may be consumed in other, non-productive activities, eventually affecting repayment. If women redirect their loans into household consumption rather than business activities, repayment becomes a problem.

It is worth noting that Save the Children showed flexibility on these issues and introduced changes to address rigidities that were partly built into the Group Guaranteed Lending and Savings methodology. In the West Bank and Gaza, for example, loan sizes were cut to 150 Jordanian dinars from an initial 200 dinars. This adjustment was made in recognition of the deteriorating economic situation in the West Bank and Gaza. In addition,

start-up businesses have decreased in the programs' loan portfolios, as programs found through baseline surveys and market research that they were one of the reasons for high dropout rates. This is an example of learning by doing—essential for the institutional integrity of microfinance institutions worldwide.

Concerns have been raised about limitations inherent to the current client target group. In some cases women establish start-up activities that do not survive the loan cycle. While empowering these activities is an important objective of the microloans, this type of lending limits portfolio growth and quality. In some cases women have started up economic activities that disappear by the end of the cycle without an effective capitalization of some part of their “profit.” In other cases women are found to be “fronting” for men's productive activities, so women become liable for loans that they do not control. These situations not only increase the portfolio at risk of microfinance institutions but are also far less stable for the financial growth potential of these institutions (box 8).

The three spin-offs absolutely must know their clients well in order to be able to achieve the institutions' strategic goals. Al Majmoua's research and development team, for example, has focused on trying to build up its market—in terms of both quality and quantity. The JWDS, having surveyed clients who dropped out, has reduced the number of start-up loans in its portfolio.

## Conclusion

Spinning off has had a major impact on the evolution of the original Group Guaranteed Lending and Savings programs and their products, services, and clients. Each of the spun-off institutions has started off well and reached down to poor households interested in microentrepreneurial economic activity. Furthermore, each institution has produced solid programs and plans that will allow them to move steadily toward sustainability through continued growth.

**Learning by doing is essential for the institutional integrity of microfinance institutions worldwide**

Diversifying financial services will require a fundamental transformation in the institutions' operational practices

### Box 8.A focus on women and their effect on institution building

Women have generally been excluded from formal financial services for a variety of reasons. As Ledgerwood (1998, p. 226) points out:

Perhaps foremost is a cultural bias against women. At the household level, most financial decisions are made by male heads of household, although this cultural norm is shifting gradually. In addition, women represent some of the poorest people in developing countries. Their microenterprises and petty trade do not have sufficient scale to interest formal financial intermediaries. Finally, literacy requirements have barred some illiterate women from obtaining formal financial services.

In the Middle East, Save the Children's Group Guaranteed Lending and Savings programs were designed to support the economic empowerment of women by targeting them as the sole clients for financial services. This objective defined the basic platform from which all three microfinance institutions were later spun off. Since the start of the group programs

*Source:* Ledgerwood 1998; World Bank data.

and through the spinning off, Save the Children, the JWDS, Al Majmoua, and FATEN have provided loans to more than 20,000 female borrowers. Such results prove that, at least on the surface, women can be involved in economic life—despite cultural prejudices in the region.

As the three spin-offs become more autonomous and get to know their clients better, more analysis may be needed to assess the extent of real economic empowerment and to analyze whether:

- Some women serve only as a front for men's productive activities.
- Loans are redirected into household consumption rather than business activity.
- Women effectively capitalize loans.

Although empowering women may be a positive externality and an important outcome for these institutions, in the future this type of lending may bring significant limitations in terms of portfolio growth. It is not clear whether the foundations of the three spin-offs—with their current organizational and staffing frameworks—would sustain further broadening of products or clients.

Staff in each institution recognize limitations in focusing solely on poor women and are seeking to increase opportunities by diversifying products—especially through loans to individuals and to men. This process will require a fundamental transformation in the institutions' operational practices. Specifically, changing the target group might require a more analytical lend-

ing methodology. From a training standpoint, credit officers would need stronger analytical skills to assess clients' businesses and to develop basic profitability and cash-flow analysis. Further improvements would have to be made to management information systems, with updated information and increased accountability and transparency.

## The spin-off and the parent institution: strengthening ties or phasing out?

Given the complexities of the environment in which Save the Children has operated, it must be commended for its remarkable courage, innovative spirit, and—most important—dedication to developing microfinance programs. It proved that women in the Middle East can be targeted to receive microfinance services. In addition, Save the Children had the vision to plan for the sustainability of its microfinance programs through strategic changes and program restructuring. By spinning off its microfinance programs, Save the Children has helped create a pool of experienced local experts in microfinance who will be able to support the development of the microfinance industry and build institutions across the region.

At the same time, Save the Children is not solely a microfinance institution. Its broader mission and diverse activities worldwide make it a truly multisectoral organization. But while Save the Children understands the social dimensions of microfinance, in the authors' view the organization's overall mission and vision may contradict the business orientation of the spun-off microfinance institutions. Similarly, Save the Children's basic philosophy could keep these institutions from achieving their primary objective: long-term institutional autonomy and financial sustainability.

These different perspectives have posed challenges to the development of the spun-off microfinance institutions. For example, in some cases there are conflicting views on microfinance at different levels of Save the Children. In the West Bank and Gaza, for

example, Save the Children proposed a complementary services agreement to be run in conjunction with FATEN's credit program. The plan was that Save the Children would provide health and education activities as additional content for the borrowers' group meetings, while FATEN would implement business development services.

This proposal seems to have originated from within Save the Children Alliance. But a U.K. Department for International Development grant to FATEN is channeled through a subgrant agreement with Save the Children U.K., and that organization expressed concerns about the negative effect that the proposed credit program would have on women. It was feared that families would become less stable or that female borrowers would end up devoting less time to their children because they would have to attend borrower meetings or engage in economic activities that take time away from child care. In the end FATEN decided not to pursue the business part of this proposal because it was rightfully concerned about losing its focus at a time when the institution is still building its image as a credible microfinance intermediary. Social activities will still be provided and, as originally planned, directly implemented by Save the Children.

Similar concerns have arisen in other countries as well. For example, Save the Children's field office manager in Jordan wondered whether loans to female borrowers indirectly lead to less school time for adolescent girls because the girls help their mothers with their businesses. This manager suggested that philosophically a question

By spinning off its microfinance programs, Save the Children has helped create a pool of experienced local experts in microfinance

New managers have shown greater willingness to “let go” of the spun-off microfinance institutions

may be posed as to whether the microcredit program is fulfilling its objectives.

These issues are relevant and call for better client impact studies and assessments. But they are probably more appropriately addressed outside the institutional mandate of the three spin-offs as they struggle to build sustainable businesses. Asked whether they see their institution as a social service provider or a business, most staff from the JWDS, Al Majmoua, and FATEN said business—though one with a social dimension. Nonetheless, the primary responsibility for the microfinance institutions lied in improving economic outcomes to ensure the long-term survival and viability of their institutions and their clients. As programs explore different market niches, it is not yet clear how a continued relationship with Save the Children would affect a microfinance institution’s ultimate vision and mission. Save the Children does not believe that its vision and mission have to match those of the microfinance institutions it works with. Rather, it feels that in areas where there is overlap—as with lending to female borrowers—there is room to work together.

### **The spin-off process and personalities**

The spin-off process has been marked by diverse approaches and degrees of Save the Children’s involvement with microfinance institutions. In Lebanon a “hands off” approach by Save the Children’s regional manager, coupled with the dedication and strong feeling of ownership of the program by local staff, has been the key to a smooth spin-off and a continued healthy working relationship between Al Majmoua and Save the Children’s regional office. In Jordan the mix of personalities was different, and until 1998 the JWDS was controlled by Save the Children’s field office manager and staff. Without such intensive support the JWDS would not have been able to overcome its fraud and management crisis. The determination of the JWDS’s board of directors

and its dedicated staff were also crucial in this rescue effort.

The West Bank and Gaza saw a complex and ambiguous struggle for the control over and independence of FATEN. This struggle seems to have resulted from miscommunications, mishandling of personnel issues, and major differences of opinion between the key personalities involved in the spin-off process—problems that were compounded by the fraud crisis. In hindsight it appears that this situation could have been avoided or remedied if clear accountability and responsibility benchmarks had existed from the start and had been rigorously enforced. Such an approach may have led to a better understanding among all those involved in the spin-off and may have expedited the process. Finally, the spin-off of FATEN had an additional dimension not felt as pointedly by the other two spin-offs—the desire of the institution’s staff to first and foremost create a Palestinian institution, and then to create a microfinance institution.

Though the extent of Save the Children’s involvement and attempts to phase itself out has been guided by an institutional “road map,” at least as important have been the personalities of the visionaries driving this process. The further away these people were from the creation of the Group Guaranteed Lending and Savings program, the more autonomy and independence were granted to the spun-off institution. And with the rotation of senior management within Save the Children’s field offices, new managers have shown greater willingness to “let go” of the spun-off microfinance institutions.

In all three cases the relationships between Save the Children and the spin-offs, as well as their institutional development, have been affected—positively or negatively—by the professional chemistry among the key personalities involved on both sides of the spin-off. Yet the importance of personalities seems to have been overplayed. Perhaps better institutional communication between field offices would have eased the process. Too often certain personalities in

the field were excessively relied on at every level, from Save the Children regional and field office managers to boards of directors to staff within institutions. As a result the departure at this stage of senior staff within the JWDS, Al Majmoua, or FATEN could seriously jeopardize the future of these young institutions.

Spinning off ultimately should be about institutional development. Thus the focus at every level must be on building institutional relationships for the future rather than on relying on personal relationships that may or may not continue throughout the process. It is not clear whether this idea has been fully grasped within the spun-off microfinance institutions, particularly within some boards of directors.

### **Building relationships for the future**

One of the biggest challenges in the transformation process is to develop a working relationship between Save the Children and each spin-off that benefits both parties and solidifies the bridge between them. In the absence of a proper definition of this relationship, and because of the expectations that Save the Children had for this process, it has not fully capitalized on the experience and knowledge that the spin-offs have gained in autonomously managing their Group Guaranteed Lending and Savings programs and new institutions.

This shortcoming may have resulted from several factors. As recognized by all those involved, spinning off was not very methodical or strategically thought out beyond a short- or medium-term prospective. In addition, despite several regional workshops, it did not seem as if much communication or collaboration had occurred between Save the Children's field offices in the three countries. The spin-off process in one country rarely benefited from experiences gained or lessons learned in the process previously conducted in another country.

Moreover, within the larger Save the Children umbrella, at a certain level there

seems to have been institutional ambivalence about microfinance in general. From the outset of the spin-off process Save the Children viewed microfinance as a route to reaching female entrepreneurs and building local institutional capacity. As the programs underwent institutional transition and the new institutions began to explore broader markets and evolve operationally, Save the Children's goals and the new institutions' goals may no longer mesh. This may lead to potential clashes as the visions of each diverge and outgrow the founding platform designed by Save the Children.

Finally, Save the Children is constrained in real terms in microfinance investments. For example, it cannot take a full equity stake in its investments. As an alternative, Save the Children is exploring the option of registering a legally separate entity, a subsidiary that would not face such legal constraints and may be able to become a full shareholder in investments. As explained by the organization's management, such a move "is tied to the desire of Save the Children to have a say in the evolution of their investments, rather than to exert control."

In all three countries the relationship between Save the Children and the spin-offs requires further clarification and better definition beyond the legal obligations involved in the subgrant agreements. Most important, specific roles should be defined as to whether Save the Children remains a parent institution, a donor, an equal partner, a stakeholder, or even a competitor. These issues are currently the subject of intense discussion among all involved parties.

The JWDS, Al Majmoua, and FATEN see mutual benefits from a continued relationship with Save the Children. But for such a relationship to be mutually fruitful beyond the funding issues involved, each spin-off will have to address:

- The nature of the relationship.
- The consequences such a relationship may have on the spin-off's ability to broaden its target group and better serve its local market.

**The relationship between Save the Children and the spin-offs requires further clarification and better definition**

For a continued relationship with Save the Children to be mutually beneficial, the spin-offs need to better understand and define their needs

- The types of technical assistance the spin-off would require from Save the Children.
- The type of networking arrangement.
- The role the spin-off envisions for Save the Children.

To address these issues, the spin-offs need to better understand and define their needs. At this stage the JWDS, Al Majmoua, and FATEN may overestimate their ability to deal with certain issues—such as lobbying for donor funds, negotiating grants, and performing administrative tasks—not because they lack capacity (though that has yet to be tested) but because they still have a lot of work to do in building their basic administrative and organizational models and getting systems up and running. Even more important, much more effort needs to be urgently invested by spin-offs to better understand their client base. In addition, that their reputations are still in their infancy should not be neglected in connection with lobbying among donors.

Save the Children, for its part, needs to clarify the form in which liability stemming out of subgrant and grant agreements can be distributed among the parties, and define the responsibilities toward donors for the performance of the spin-offs. Save the Children also needs to better understand the needs of these institutions—as well as assess its capacity on whether and to what extent it can provide the needed assistance. A crucial issue for Save the Children is determining what it can offer the spin-offs beyond funding arrangements.

There is a perception among some that Save the Children has limited capacity to directly provide technical or management assistance in microfinance to the Middle East spin-offs. An illustrative comment came from one of Save the Children's field managers: “we have the capacity to monitor and control [the spin-offs], but we cannot help them.” In spinning off its Group Guaranteed Lending and Savings operations in the region, Save the Children transferred all of its institutional microfinance knowledge and microfinance expert per-

sonnel to new institutions. But no proper feedback channel was established from the start for Save the Children to benefit from what are in some cases steep learning curves. In the long run and in a perfect world, this might be regarded as the ultimate success, because local capacities are being developed to reduce dependence on international assistance. The reality of the development business, however, creates a financial incentive for Save the Children to maintain ties to the spin-offs.

To build the capacity that Middle Eastern microfinance institutions expect, considerable dedication and focus will be needed if the experiences of other networks—such as ACCION International or FINCA—are to be taken as examples, and if Save the Children wants to create a network that can offer real gains to its members (box 9). Save the Children is acutely aware of this issue and is recruiting a microfinance expert to provide technical assistance to institutions across the region. This expert's duties will include backstopping in cases of fraud, supporting spin-offs' directors in undertaking new projects (such as developing a management information system and new products), monitoring the accuracy of indicators, and introducing a standard set of indicators.

Another idea is for this expert to play a coordinating role or even serve as the beginning of a Save the Children technical unit in the region. Whether this move would be sufficient to reengage Save the Children in a way that is respected and needed by the spin-offs remains to be seen. As noted by many of the spin-off staff interviewed in the region, “things would have been different if Save the Children had this capacity.” By not resolving its institutional ambivalence, by rapidly decreasing its comparative advantage, and by not clarifying its role sooner, Save the Children has strained its relationships with the new institutions—leading to a sentiment that its involvement may not be needed. As one of our interviewees stated, “all three [spin-offs] are way

**Box 9. What does it take to build a successful microfinance network?**

The Secretariat of the Consultative Group to Assist the Poorest (CGAP), within the framework of support to retail microfinance institutions, has provided funds through networks as well as through direct retail funding, technical assistance, and business planning support. The rationale for funding retail microfinance institutions through network or wholesale organizations was based on the benefits derived from economies of scale, the network knowledge of affiliates, and more agile response.

But CGAP also found that the benefits of building capacity through networks are difficult to verify. Many of the desired results—such as strengthening of the network and better outreach and sustainability of network members—

*Source: CGAP 1998.*

will likely emerge only in the long term. Still, CGAP's experience offers important lessons. Efforts to build capacity through networks should include:

- A human element: strong, professional network leadership and technical competence.
- An ability to leverage appropriate outside resources and expertise.
- An excellent relationship with network members.
- A focused, member-driven agenda.
- Value-added, demand-driven services, as evidenced through cost recovery.

Any capacity-building proposal must be owned by network members rather than by the headquarters or network head.

Save the Children's management believes that it has learned valuable lessons and wants to continue doing so

past Save the Children in microfinance expertise in the region.”

**Building networks: pros and cons**

This discord has brought to the fore an interesting dilemma that raises a deeper institutional issue. Should an international NGO such as Save the Children be a microfinance provider in the field? Or should it focus on building its international or regional capacity to provide technical assistance to the microfinance institutions that it creates? Or should it create a conceptual agreement explaining why both local and international institutions should engage in microfinance together?

Save the Children has asserted that it wants to be a player in microfinance, and it places enormous value on its financial and institutional investments in the spin-offs. Some of the success of the JWDS, Al Majmoua, and FATEN reflects efforts that Save the Children has made in introducing these programs to the region. Thus in many ways Save the Children's desire to have an ongoing relationship with these institutions represents its deeply held conviction that no matter what happens with these spin-offs, it will always be held responsible by donors for the outcomes. In addition, besides concerns

for continued quality, this desire reflects Save the Children's interest in earning more credit for these institutions' success, as well as in increasing its understanding of the spin-off process for similar ventures around the world. Save the Children's management believes that it has learned valuable lessons and wants to continue doing so.

In an attempt to maintain these mutual relationships, and in an effort to reengage, Save the Children has for more than a year been negotiating with the JWDS, Al Majmoua, and FATEN about their future ties. Save the Children has envisioned creating a regional network or defining a conceptual agreement of cooperation with the spin-offs. It has planned to offer its own technical assistance to these institutions or to help find other experts when it cannot. It has proposed building on both the technical and strategic quality of management. Save the Children plans to prepare annual reviews for each spin-off that will look at financial and other systems. On the strategic side, Save the Children hopes to ensure quality management while increasing the number of clients each institution serves. Save the Children would also lend its international reputation and engage in promotion of the spin-offs. In this framework the institutions would loosely oblige themselves

to remain under Save the Children's umbrella, would provide technical assistance to programs in other regions according to Save the Children's requests and needs, and would recognize the affiliation with Save the Children in all its activities.

Some of Save the Children's proposed networking arrangements do not seem to go beyond what microfinance institutions could do on their own. Still, it is legitimate to ask whether the spin-offs would do these things—such as collaborating and exchanging experience, holding annual meetings, and searching for technical assistance—given the daunting institution-building tasks still facing all three. Regardless, the issue of establishing a network of affiliates has been fiercely contested by the institutions precisely because of the unresolved

issues that can be summarized in two questions often exchanged in these discussions: What do you need? And what can you offer? Misunderstandings and miscommunications seem to continue.

Taking a broader view, however, it is clear that more fruitful relationships can and should be developed. Save the Children has a lot to offer the spin-offs. The key would be to focus on what Save the Children knows and does best. Assistance and training in administering grants, negotiating funding, supporting management, training and developing boards of directors, and exchanging regional experience, for example, could be fields where Save the Children would have comparative advantage to remain a long-term strategic partner for these institutions.

## The role of donors in spinning off

In recent years microfinance has benefited tremendously from its newly prominent position on the development agenda. Nearly all donors—whether local, bilateral, or multilateral government agencies or local or international NGOs—support microfinance activities by providing grants, lines of credit, lending guarantees, or technical assistance. Donors are the main funders of microfinance services and in most cases effectively provide the funds for onlending.

Thus the approach that donors take to microfinance and the requirements that they set for microfinance institutions can greatly affect the development of this industry and the future of many microfinance institutions. Donors can also significantly affect spun-off microfinance institutions in the effects that they have on the transition to complete institutional independence.

### Donor policies and strategic interests in microfinance

Most microfinance institutions work with more than one donor, often developing separate products to meet each donor's requirements—requirements that tend to reflect different strategies and different donor interests. For example, the three Middle Eastern spin-offs have received indirect grants from the U.S. Agency for International Development (USAID), U.K. Department for International Development, Irish Aid, Canadian International Development Agency, and others. These funds are channeled to the institutions through subgrant

agreements with Save the Children, which places it in the unique position of being a program creator and a microfinance donor. This funding relationship involves many complexities for the institutional development of microfinance institutions, such as the allocation of responsibilities for performance and compliance with various donor directives.

Each donor obliges the institutions to use funds in accordance with the negotiated grant agreement. For example, USAID funds are to be used in a manner consistent with the agency's microenterprise policy directive. One such agreement, typical of this directive, requires that (among other things) spin-offs:

- Demonstrate a willingness and ability to set interest rates and fees on loans high enough to cover the full long-run costs of lending on an opportunity cost basis.
- Commit themselves to maintaining firm control over delinquency and losses.
- Commit themselves to attaining full financial sustainability and expanding the availability of financial services to micro-entrepreneurs and other poor people.
- Promise that women's access to credit will be encouraged and promoted under the grant and specify that women will be the sole borrowers.
- Adopt standard reporting requirements.

The requirement specifying that women be the sole borrowers, following on that of the original Group Guaranteed Lending and Savings programs, has continued throughout the subgrant agreements signed between Save the Children and the three spin-offs. The agreement transferring the outstanding

The approach that donors take to microfinance can greatly affect the development of this industry

Donors and institutions must make strategic choices from the start of spinning off

portfolio from Save the Children to FATEN, for example, requires that FATEN continue “to extend and develop programs in the same spirit and orientation as the [Group Guaranteed Lending and Savings] program in order to provide support and assistance to needy women and children.”

Since becoming independent all three institutions have conducted market research to review the opportunities for developing new products—such as individual loans and loans to much smaller groups than mandated under the Group Guaranteed Lending and Savings programs—and broadening their target client base. If these institutions were to broaden their lending landscape to include men, the move would have to be approved by Save the Children and ultimately by the original donor, USAID, because it would be perceived as a major change to the original methodology. In principle, all three institutions are free to obtain donor funds from other sources and negotiate any kind of agreement they desire, with no limitations on their target markets or methodologies. But doing so could create confusion, depending on the stated mission or image of each organization.

Consider, for example, the JWDS, whose primary goal is to “provide poor women entrepreneurs with access to financial services on a sustainable basis.” Given the market opportunities to expand its target clientele, it may have to rethink its original design and eventually start lending to men. This move would, however, imply a major change in the JWDS’s methodology and staffing structure. For example, group-based lending may be less appropriate for men, so the JWDS would have to embark on individual lending. Such a move requires credit agents trained with more analytical skills than are now available, because agents must be able to examine the profitability of individual businesses and perform (at least) simple cash-flow analysis. Moreover, because all of the JWDS’s credit agents are women, it would have to consider hiring male credit agents as well.

Such changes would require proper analysis, market research, and product testing to ensure that the JWDS is ready and able to provide such services to a broader market. In addition, the name of the institution could have to change as well, to reflect this market broadening and to attract more male borrowers. Because these changes would mean a major deviation from the JWDS’s original stated mission, they would require the approval of the board of directors as well as Save the Children—which, ultimately, is the institution that would have to comply with the donor policies negotiated in the subgrant agreement (box 10).

These examples show the inherent instability and institutional insecurity of donor-sponsored programs and institutions in

#### **Box 10. Decisionmaking in the Save the Children–JWDS partnership**

Like any autonomous organization, the JWDS ultimately chooses what it will and will not do. But within the partnership between Save the Children and the JWDS—through which Save the Children provides funding for Jordan’s Group Guaranteed Lending and Savings program—Save the Children has set parameters for JWDS operations. Save the Children is committed to supporting programs committed to best practice microfinance. In addition, as the prime recipient for donor funding, Save the Children has a fiduciary responsibility to ensure that donor regulations are upheld by subgrantees.

To meet both of these objectives, Save the Children imposed limitations on JWDS changes to its methodology. To some extent these limitations are perfunctory—they are quite limited, and Save the Children typically approves any reasonable change immediately. As the JWDS’s experience has increased, Save the Children has cut back these limitations to affect only the most important areas of methodology. In practice the JWDS has almost complete flexibility in modifying loan operations or testing changes to loan methodologies. As intended, the JWDS generally perceives Save the Children’s contributions as facilitative rather than obstructive.

*Source:* Save the Children.

microfinance. They also highlight the strategic choices that donors and institutions must make from the start and bring to the fore a key issue: practitioners and donors should be aware of what the other is doing. Practitioners should know which donors support an approach consistent with their own, so that access to funding does not mean changing the philosophy of their organization.

### **Reporting requirements: standard monitoring or interference?**

Reporting requirements are another important aspect of the relationship between donors and microfinance institutions. Because most funding for the three spin-offs comes through subgrant agreements with Save the Children, a direct grantee of USAID, reporting is channeled through Save the Children. The reporting requirements for the three institutions vary but typically involve monthly financial reporting, quarterly progress reports, and a final report expected on the completion date of the subgrant.

Recent negotiations of a grant agreement with the JWDS offer a more peculiar picture when it comes to donors requiring microfinance institutions to go beyond standard reporting—and give an interesting example of donors crossing the line between monitoring and interference. The USAID contractor on this grant required daily or weekly reporting, a requirement that by itself would have imposed unnecessary administrative burdens on the young microfinance institution. In addition, however, this contractor insisted on nominating its representative as a member of the JWDS's board of directors (though without voting rights).

This anecdote raises an important point about donor approaches to reporting requirements. Under a standard, hands-off approach in which responsibilities are defined in legal documents, there is no need for donors to take a stake in the board of directors of an independent institution. Moreover, intrusive and excessively controlling involvement may eventually suffo-

cate a program and undermine its institutional independence.

The situation in Jordan was even more complex because the contractor involved, on behalf of USAID, is one of the main funders for several of the JWDS's competitors. Giving the contractor a presence on the JWDS's board of directors could create a serious conflict of interest because this donor would be able to “look into the kitchen” of several competing institutions. This kind of involvement is extremely unproductive and is not in the interest of the long-run development of the microfinance industry.

### **Achieving targets and facing pressure to grow**

Microfinance is often wrongfully perceived as a panacea for poverty alleviation—not least because microfinance has become so prominent on the development agenda. Indeed, widespread donor interest in microfinance could lead to an oversupply of funds for onlending and, consequently, overwhelming pressure to disburse funds. This may translate into pressure on programs to expand and develop extensive branch networks (even when not justified by market conditions) despite limited institutional capacity to take on these funds and embark on expansion. Such pressure may have irrevocable consequences for young institutions.

Donor pressure is evident on both ends of the growth and expansion spectrum in Jordan, Lebanon, and the West Bank and Gaza. For example, donor microfinance activities in Jordan emphasize achieving targets and quantitative performance goals. Such pressures come at a time when the JWDS would benefit from having breathing room to strengthen its systems and streamline controls—particularly given the fraud that plagued the program in 1998 and that resulted in management resignations and institutional restructuring.

At the other end of the spectrum, donor pressure is essentially absent in Lebanon. This lack of pressure has given Al Majmoua the

**Intrusive donor involvement may undermine a spin-off's institutional independence**

**Fast growth and durability are often incompatible**

liberty to lend at a slower pace. In fact, Al Majmoua is experiencing stagnation in its loan portfolio, but it has developed a stronger focus on building corporate structures. Rather than engaging in actual outreach to the market, it has been active in training staff, redesigning the program, analyzing the market, developing a public relations campaign, and experimenting with new loan products. Whether this strategy will prove successful remains to be seen, but Al Majmoua has developed an image of a serious corporate business with a recognizable logo and a clear vision. At the same time, however, Al Majmoua cannot afford to become too inward looking and test every possible approach. Now is the time to deliver services.

FATEN's case is more complex because the pressure to grow essentially came from within. Targets were set by staff working with management in the field. For example, the microcredit program's September 1997 proposal for additional USAID funding projected that by the end of fiscal 1999 the program would provide nearly 50,000 new loans to female microentrepreneurs, have 20,000 active borrowers, and be fully sustainable. Donors were more concerned about the fast growth that the program embarked on without recognizing the weaknesses in its systems.

Between November 1997 and April 1998 FATEN's outstanding loan portfolio nearly doubled. Because the institution could not bear the burden of such growth, opportunities for fraud arose—almost leading to the meltdown of the program in 1998. Still, there is a balance to strike between growth and systems. FATEN and the JWDS saw too much growth and too few systems; Al Majmoua appears to have seen too many systems and too little growth.

Growth is one of the most complicated issues in microfinance. Managing growth—both by donors and by program or institution managers—requires finding the right mix between depth and breadth to balance outreach with viability (Churchill 1997). Rapid growth is not inherently bad. But it can be, as with the JWDS and FATEN. Rapidly

expanding microfinance institutions are likely to experience premature growth, which occurs before an institution's systems are in place and when procedures are not sufficiently tested. In either case the institution will ultimately suffer from increases in delinquency and desertion—as demonstrated in Jordan and the West Bank and Gaza. System weaknesses came back with a vengeance to undermine both institutions' achievements.

Fast growth and durability are often incompatible (Hawkins 1987). Thus institutions should not perceive the pursuit of growth as a tradeoff between quality and quantity. The only tradeoff may be in short-term outlooks—where the higher profits that come with more clients may be the main concern, rather than the cost of installing proper systems. In the long run, however, if profit is an institution's sole objective—rather than investing in systems, standardizing procedures, and strengthening policies—such “growth” may jeopardize the institution by contaminating the loan portfolio with high delinquencies, poor customer service, or fraud.

Rapid initial growth, despite the early perception of success and boost in morale, will ultimately undermine the institution. But healthy growth, based on a balance between quality and quantity, is sustained over time and is durable. The natural rate of growth will depend on an organization's preparedness and ability to learn. Microfinance institutions need to gain a sense their natural growth and be prepared to slow things down (Churchill 1997). It is management's responsibility to sense the natural, inherent growth rate of the program and to adhere to it. A founder's job is not to lead staff to new heights. Rather, it is to moderate the changes that will be required of everyone as the business grows (Hawkins 1987).

Microfinance practitioners too often succumb to donor pressure and believe that donor targets must be achieved at any cost—even at the expense of portfolio quality. Donors do not emphasize enough that the issues at stake should never require a long-term tradeoff. Rather, the need for comple-

mentarity needs to be made clear throughout the process. If lending goals are achieved at the expense of capacity building, the end result may be a highly contaminated portfolio, a long period of convalescence after fraud or delinquencies, and slow (if not absent) growth of the remaining healthy loans. Additional consequences include institutional instability and the ruined reputation of a microfinance institution. Donors should insist on targets, but targets should be reasonable and require high portfolio quality.

### How can donors help?

Donors can play an invaluable role in developing the microfinance industry (box 11). The key to successful donor intervention is to identify areas—such as building capacity and establishing a policy dialogue—where donors may have real advantages and that are often in need of resources. Donors can also play an instrumental role in influencing policy reforms and supporting efforts that lead to a stable macroeconomy and financial sector, promote a proper legal environment in which microfinance institutions can develop, and encourage entrepreneurialism.

Donors can help disseminate knowledge about and present different approaches to

microfinance institutions in regions where they have worked. In this way donors can provide an excellent source of learning for microfinance providers. Sharing these experiences among practitioners and other donors would be extremely valuable for developing the microfinance industry in the Middle East and North Africa.

In many countries donors and practitioners have already set up informal networks to share their experiences, influence policies, and set industry standards. But much more needs to be done to promote donor coordination; duplicating or counteracting one another's activities will not help create a consistent strategy for microfinance based on market segmentation and comparative advantage. Inadequate coordination can quickly undermine the efforts of good microfinance providers—as evidenced by the many cases where donors and governments have distorted microfinance markets by subsidizing interest rates, making it difficult for other microfinance providers to compete (Ledgerwood 1998).

### The role of microfinance institutions in donor relations

Relations between microfinance institutions and donors should be equal partnerships. In

The key to successful donor intervention is to identify areas where donors have real advantages and that are in need of resources

#### Box 11. Essential elements of donor policy for microfinance

Donors need to pay close attention to several issues as they formulate support for microfinance.

- *A commitment to efficiency.* If operational efficiency can be achieved in most parts of the world and in a range of geographic and economic settings, donors should expect that any microfinance program they support will reach operational efficiency in a reasonable period. Donors should select organizations for support that have a credible commitment to reaching operational efficiency.
- *Interest rate policy.* Donors should insist that the organizations they support price their services at levels that support financial viability. In particular, programs must adjust adequately to the potentially erosive effects of inflation.

- *Reporting standards.* Donors should insist that supported organizations report on their performance using generally accepted standards in a way that makes subsidies transparent. Donors should also be prepared to offer technical assistance to organizations that lack the capacity to do so.
- *Frontier issues.* Donors have an important facilitating role in helping top-performing institutions make the transition to full independence. Among the interventions that may be called for are policy dialogue with governments on supervisory standards for microfinance, technical support to transforming institutions and to those who wish to develop savings services, and support for identifying and securing equity investors.

Source: Christen and others 1994.

reality, however, this is often not the case. Especially during a microfinance institution's start-up phase, it is often completely dependent on one donor for funds for onlending and technical assistance. This nurturing relationship may be beneficial at first. But over time the microfinance institution must decrease its donor dependency to avoid being "hijacked" by the donor to serve a certain (political) agenda back home.

While the ultimate constituency of the donor is usually the government it represents, the ultimate constituency of the microfinance institution is its clients. Initially a microfinance institution could decrease its dependence on one donor by trying to secure funds from other donors while maintaining its stated objectives, target groups, and methodologies. Over time the institution could mix its sources of funds with commercial funds so that it can even-

tually manage a financially sustainable microfinance institution that does not depend on donors.

Many microfinance institutions in the Middle East maintain a donor-dependent mentality. They appear to accept every condition (even ridiculous ones) from donors simply to gain access to funds. Microfinance institutions tend to forget that donors need them as much as they need donors, and the negotiating position of a microfinance institution is usually better than it believes. Microfinance institutions should learn to take clear methodological and institutional stand. They should also formulate clear and transparent objectives, a vision, and a strategy. Such institutions will find that donors may initially be taken by surprise but that they may be more than happy to accept the microfinance institution's terms and conditions because they help ensure that the donor's funds will be used well.

## Fraud and its effects on spin-offs

**A**lmost every microfinance program has experienced fraud. Yet there is almost no literature on fraud in microfinance and few frank discussions of it in public settings. In fact, microfinance institutions are often reluctant to talk about their experiences with fraud—though their peers could learn a lot from such an exchange. Wherever there is money, there is an opportunity for fraud. Moreover, that an organization has not experienced fraud does not mean that it is immune to it. As microfinance institutions grow, their portfolio sizes increase, and their operations become more complex, the size and incidence of fraud tend to grow as well (Valenzuela 1995).

There is no evidence linking the spin-off of Save the Children's microfinance programs to the fraud that subsequently plagued JWDS and FATEN. But fraud has had significant effects on the spin off process. Fraud remains a somber issue from which the JWDS and FATEN are still recovering. Its effects were devastating and threatened to destroy the fledgling institutions. But in the process both institutions learned valuable lessons early in their institutional development that may have made them stronger and so contributed to their long-run stability. In this sense, then, a brief overview is warranted of the fraud episodes that shook both programs to the core.

Several features make microfinance institutions vulnerable to fraud:

- Weak information systems and changes in information systems.
- Weak or nonexistent internal controls.
- An absence of internal or external auditors.

- High employee turnover among managers, administrators, or loan officers.
- Insufficiently standardized products and provision of multiple loan products.
- Cash handling by loan officers.
- Rapid growth, which can make it difficult to cultivate the integrity required among staff (Valenzuela 1995).

Some of these features were evident in the JWDS and FATEN. In both cases it appears—though this conclusion would have to be borne out by much more thorough research, if not a separate study—the fraud was carried out by loan officers (box 12). The problems were compounded by insufficient supervision, weak checks and balances, and the absence of proper follow-up. Had better systems been in place from the outset, the risk of fraud would have been minimized.

The JWDS and FATEN have learned that fraud is usually not immediately evident through the portfolio at risk or arrears. Rather, it was detected through internal systems that began to crack under rapid growth. These experiences highlight another important lesson: the key is to know the exact amount of repayments expected on each repayment day, to verify whether these repayments were received, and to react promptly to one- to five-day delinquencies, particularly constant ones. When repayments are due on one day and disbursements are due on the following day, such cash flow can veil delinquencies with some loan officers. Thus it is crucial to monitor these indicators and to closely supervise loan officers.

The fraud in both Jordan and the West Bank and Gaza was systemic and occurred

**As microfinance institutions grow, the size and incidence of fraud tend to grow as well**

Most fraud cases in microfinance institutions involve loan officers

**Box 12. Examples of microfinance fraud cases involving loan officers**

Most fraud cases in microfinance institutions involve loan officers. These cases may involve fictitious loans, “ghost” borrowers, kickbacks from clients for receiving a loan, or cash theft, either from petty cash or loan repayments. The examples in the table below are drawn from actual fraud cases from around the world.

<i>Example</i>	<i>Detection triggers</i>	<i>Amount lost</i>
A loan officer in a rural program makes fictitious loans. Repayments come from new loans, though those loans soon become delinquent. An accountant is often colluding with the loan officer.	The central office notices an increase in delinquency and investigates.	\$100,000
A loan officer sets up 18 fictitious loans for personal use. The loans become delinquent.	A high-volume branch is selected for an ambassador’s visit, or a client selected for a visit does not exist.	\$2,500
A loan officer in a remote rural area disburses and collects loans in cash. The officer keeps some of the repayments and claims that he lost loan payment receipts. Most clients do not demand receipts.	The loan officer is under suspicion because of sloppy paperwork. Delinquency increases and the central office investigates.	\$3,000
A loan officer, in collusion with a supervisor and regional internal auditor, sets up ghost groups in a “successful” high-growth branch. Loans are repaid from new loans.	A tip from another staff member.	\$900,000
A loan officer collects repayments from clients, keeps half for himself, and records that only half of repayments were made.	The internal audit department reviews reports daily and discovers insufficient payments from the clients of the loan officer.	\$500

Source: Valenzuela 1995.

in fast-growing institutions marred by lax internal administrative controls and staff supervision. Even minimal supervision was missing—otherwise the problems could have been detected much sooner. In addition, other shortcomings of the Group Guaranteed Savings and Lending programs were transferred to the new institutions without realizing their potential effects.

In the West Bank and Gaza, for example, the original Save the Children program lacked contractual employment arrangements for loan officers. Furthermore, FATEN did not establish a proper chain of responsibilities from the beginning, so in the end it was almost impossible to determine the level of accountability for cases of fraud (box 13). Finally, in Jordan the reluctance

of managers to deal with the problem and to take a firm stand with loan officers caught in the act made the situation worse. In fact, if the JWDS’s board of directors had not taken over the program and operationally managed it for three months (following the resignation of the executive director), this spin-off probably would not have survived. Efforts are still under way to clean the contaminated portfolio and collect the remaining funds, in order to prevent future outbreaks.

In addition, complaints have emerged that the experience in Jordan, where fraud was detected first, was not communicated transparently among the three spin-offs or within Save the Children’s field offices. As one of the interviewees in the West Bank and

### Box 13. Fraud in the West Bank and Gaza

At the end of April 1998, while preparations were being made to spin off Save the Children's microfinance program into FATEN, the program in the West Bank and Gaza had 9,600 clients with \$1.8 million in outstanding loans. Just six months earlier the program had 5,700 clients, so it was clearly on a steep expansion curve. In March 1998 alone 2,200 loans were issued for \$600,000.

But at the same time, signs of fraud were becoming evident. Monthly reports indicated large delinquencies among some credit promoters (loan officers). Central management heard of a fraud case in the south, but it thought that the case was being handled by branch management. Another case appeared in Nablus, but it did not seem serious at first. Then, in May 1998 the supervisor for the southern area was instructed to conduct an audit. This audit rang alarm bells because half of the loans—worth \$18,000—had been taken by one loan officer and one client. Central management then suspended the issuing of new loans until proper checks were conducted in all areas.

These additional checks revealed fraud of enormous magnitude. Such fraud could only persist because of growth. New loans, disbursed each month, were used to repay the fake loans. Hence the loan portfolio did not show arrears because there were no arrears. Only when money supply stopped was there no cash to repay the fake loans. In the end FATEN determined that it had been defrauded of \$708,000.

Most of the fraud started in early 1998, when lending was skyrocketing. The fraud spread quickly, indicating considerable failings in the system. Internal controls and supervision were extremely poor. Area supervisors were not doing their jobs, and branch managers failed to sufficiently check the area supervisors. When the fraud was discovered, the program had about 70 credit promoters. An important shortcoming—and one unique to the Palestinian program—was the absence of signed employment contracts between Save the Children and credit promoters. As a result credit promoters did not feel any legal liability toward Save the Children and, even more important, did not

identify with or feel loyalty toward any institution (whether FATEN, which was just being created, or Save the Children). About 20 credit promoters—nearly a quarter of the credit staff—were involved in the fraud.

Due to the extraordinary efforts of its capable managerial staff, however, FATEN has overcome these problems and collected many of the defrauded funds. By March 1999, \$204,000 had been recovered, of which \$114,000 was rescheduled as loan payments with new interest rates, late payment fines, and legal fees. The guilty credit promoters signed confessions stating that they owe FATEN the new totals and gave FATEN post-dated checks as guarantees. FATEN is determined to collect all the money due, and continues to make progress in collections and rescheduling.

Because of this experience, FATEN has moved to a very centralized structure, one that involves some rather cumbersome procedures. Since June 1998 many changes have been introduced. Recruitment policy was amended, different incentives were introduced, new credit promoters were hired, and the issue of contracts was solved. To avoid the formation of ghost groups, FATEN moved from disbursing in the field to disbursing in branch offices. Immediate actions follow for any late payment. The manual paper trail is followed and updated daily. For example, since July 1998, when lending began again, more than 97 percent of payments have either been paid on the same day or one day before. The other 3 percent are paid within no more than four days.

These changes have slowed growth—FATEN spent most of 1998 collecting loans and restructuring and testing systems—and some of its best clients are dropping out because they find it difficult to attend branch disbursement meetings. FATEN's challenge now is to internalize these changes and integrate them at all levels of management. It has yet to find a more definitive operational model that will allow it to operate in a highly effective and decentralized fashion. Although it has good prospects, FATEN is still recovering from the fraud crisis.

**FATEN is still recovering from its fraud crisis, but is stronger because of it**

Gaza said: "The Jordanian staff were forbidden to talk to us about it at the workshop. We could have learned more about it."

The causes of and vulnerabilities to fraud must be carefully kept in check. The

key challenge for microfinance institutions is to maintain effective control without excessive costs or burdensome procedures as the program grows. In addition, it should be recognized that fraud can never be entirely

eliminated. It can, however, be reduced and kept firmly in check by addressing the system weaknesses that create opportunities for fraudulent activities. Staff morale and a team culture and ethics have to be continuously nourished, particularly as an institution expands. The spin-offs' experience show that it is important to respond swiftly and decisively when fraud becomes apparent. Otherwise, other staff may be encouraged to engage in fraud as well. Finally, senior managers should be aware of new types of fraud

that may occur as an institution develops new products, diversifies its market, and becomes more sophisticated.

As the three spin-offs experiment with their products, clients, and administrative and organizational models, fraud should not be taken lightly. The JWDS and FATEN are trying to perfect and fully implement administrative structural changes that have already been introduced and that will not allow for any laxity in internal controls and could detect these problems sooner.

## Lessons and recommendations

**T**he spinning off of the JWDS, Al Majmoua, and FATEN has been complicated and difficult. Still, it has taught Save the Children—and to some extent, the entire microfinance industry—some important lessons. These lessons can be used to draw recommendations for organizations that are considering spinning off their microfinance operations, as well as for Save the Children and the three Middle Eastern spin-offs.

After Save the Children began programs providing loans to microenterprises, the idea developed for the programs to act as catalysts and organizational forerunners for institutions specialized in providing finance. In hindsight, a clearer design from the start on the long-term institutional structures of these programs might have benefited Save the Children and the spin-offs during the transition.

Another important consideration for these spin-offs turned on the preparedness of each program to become self-operating in every regard. As part of Save the Children, most of the programs relied on it to perform many tasks—from disbursing staff salaries and benefits to running management information systems. While one can never prepare for everything, proper contingency planning through strategic planning workshops and “how to” workshops could have preempted some issues that have marred the relationships between Save the Children and the spin-offs.

The same can be said about some “psychological” issues they may not be easily predicted but for which people can be prepared. Judging from the Save the

Children spin-off experience, the chance of success with spinning off and of eventually achieving institutional autonomy appears to be higher when the original creator (or sometimes manager) is gone or not involved. Such a setup leaves more space for the spin-off to seize on its independence and learn on its own, even if by making mistakes.

Save the Children has pointed out that the issue of organizing each institution’s board of directors should have been given more attention. Initially it was assumed that merely transferring management would ensure a continued vision. But boards play key roles in spin-offs and merit much more attention. Board member development and training could have been higher on the agenda of both Save the Children and its spin-offs. Continuous attention needs to be paid to ensure that boards of directors remain involved and responsible for the future of these institutions. Save the Children is committed to providing additional board training in 1999–2000.

Properly defining from the start the relationships between Save the Children and the new institutions would have preempted some strains as the spin-offs ensued. But this effort is necessarily tied to the parent institution’s long-term strategy for the spin-off, to the parent’s expectation that the new microfinance institutions will soon take on lives of their own, and to the parent’s continued feeling of responsibility for the success or failure of the new institutions.

Save the Children and the spin-offs agree that perhaps many of these issues would have inherently been addressed—or

**A clearer design from the start might have benefited Save the Children and the spin-offs**

International NGOs should consider starting out microfinance operations as independent institutions rather than as parts of a larger organization

altogether avoided—if from the outset the lending operations were lodged in a sole-purpose, independent microfinance institution rather than in a program-based setting. Recognizing that managing an institution is not the same as managing a program could have placed a greater focus on enhancing the spin-offs’ institutional (as opposed to program) capacity to manage more products and services, mobilize resources, and enhance management information systems.

### **Recommendations for organizations contemplating a spin-off**

Most microfinance programs in the Middle East and North Africa are part of larger programs. Not all of these programs can or should be spun off. Spinning off is a strategic choice and makes sense only if it is done in the context of another strategic choice: achieving full sustainability. Many programs do not want to make the strategic and difficult choice for full sustainability because it requires a business orientation that is often incompatible with the visions and choices of their founders. Such programs may be better off doing “business as usual” under a parent organization. Over time, however, their funds will dry up and the programs may disappear because they did not aim for sustainability. Still, during their existence they may have provided a useful, albeit temporary, service.

Save the Children’s experience provides useful lessons for other multisectoral international or local NGOs wishing to engage in microfinance. Doing so is also a strategic choice, and international NGOs wishing to make this choice should realize that it requires substantial up-front and ongoing investment in their ability to help local organizations develop sustainable microfinance programs. This is a long-term commitment requiring long-term investment in capacity and systems that not only increase but also change over time. Not every NGO should engage in microfinance simply because donor funds are available.

Some may be better off excelling in their original core operations. International NGOs engaging in microfinance halfheartedly do not contribute to the healthy and competitive development of the microfinance industry.

International NGOs (such as Save the Children) that have made the strategic choice and commitment to develop microfinance in their countries of operations should consider starting out microfinance operations as independent institutions rather than as parts of a larger organization. This approach allows the new institutions to build and enhance their institutional capabilities from the beginning. Instead of relying exclusively on the larger organization to manage the daily chores of its business, such sole-purpose new microfinance institutions may increase their capabilities through “learning by doing” and allow their systems to grow with the number of borrowers.

Further collaboration on other important issues—such as providing technical assistance, exchanging expertise (in both directions), and training staff, managers, and boards of directors—can foster an even healthier working relationship with the parent institution as well as highlight the independence of newly formed institutions. This type of arrangement might benefit a new institution by forcing it to deal with the everyday problems of building independent and self-reliant entities from the start. Moreover, it could allow the parent institution to be more involved in developing the vision rather than the technical aspects of these programs.

The establishment of new institutions—including setting up and selecting the board—is often marred by bureaucracy and difficulties, as witnessed in the spin-offs into the JWDS, Al Majmoua, and FATEN. At the same time, the lending had to continue, which placed additional strain on the organization because they were simultaneously engaged in institution building and microlending operations. Starting out as an independent institution may relieve some of

this strain because the first phase can be devoted to developing appropriate institutional arrangements and capacity and to building strong systems. The second phase could then more easily handle program growth and expansion.

### **Developing a corporate culture in a new institution**

Starting out as an independent institution may also preempt such difficulties as trying to change the corporate culture transferred from a program-based setting. As noted, one of the biggest challenges in spinning off is getting the staff of the new institutions to shift from a program-based to an institutional attitude. This crucial metamorphosis affects the technical aspects of day-to-day operations and alters the strategic approach of each institution.

This shift offers a number of benefits. It allows and even compels staff to assume a more analytical role, whether in terms of reassessing lending methodologies and target groups or in determining whether to move to individual lending or use the institution's funds for onlending. Spinning off has increased local capacity by investing in local practitioners who will be the microfinance experts of tomorrow; clearly, the entire region's microfinance industry benefits from such local initiatives. On a more personal level, staff who had been under Save the Children programs have begun to feel a greater sense of belonging in their careers, and professional opportunities will only increase as the spin-offs develop. Each of these lessons not only benefits individual institutions but also improves future partnerships with other organizations.

#### *Choice of legal form*

If the choice is made to pursue full sustainability and this choice is the underlying reason for spinning off microfinance operations and for creating a new microfinance institution, in the long run an

NGO legal form is not recommended. NGOs lack legal accountability and transparency and so cannot access the commercial funds required if the institution is to away move from donor-subsidized operations and dependence.

If possible, new microfinance institutions should register under a legal form with identifiable owners that are personally or institutionally liable and take an equity stake: for-profit company, nonprofit company, financing company, microfinance intermediary (if available as a legal form), non-deposit-taking bank, and so on. In this way the full sustainability goal will be embedded in the institutional form and governance structure from the start and will preempt potential complications, such as the need for re-registration, image changes, and so on.

#### *Board of directors*

The choice of legal form also affects the selection of board members. Playing a role on the board of an NGO is different from being a liable board member of a company (even if limited). "NGO board members do not usually fulfill the board's fiduciary role by assuming responsibility for the institution's financial resources, especially those provided by donors" (Ledgerwood 1998, p. 112). NGO board members are often bound only by the feeling of moral responsibility and the sense of having a personal reputation at stake. NGOs generally do not have shareholders. Instead, management usually selects board members, as in Jordan and Lebanon. This approach may lead to a conflict of interest if management selects board members who conform to its interests.

Thus board members should be selected based on their wide range of expertise and experience—including financial, legal, managerial, and private sector. Of utmost importance is the board's ability to critically analyze management's plans and provide effective guidance. Board members' independence and selection based on expertise rather than personal interests or political

**Board members should be selected based on their wide range of expertise and experience**

agendas (or those of senior management) are crucial to board performance. In addition, board members should be given extensive training on the microfinance business and on the role they are expected to play as institutions evolve.

#### *Executive director and management team*

When assessing the director's role, attention should be paid to his or her personal attachment to and interests in the institution. At one extreme the commitment and personal dedication of the director can only help foster the institution's development—especially during the early stages. But this personal attachment can be risky if it is allowed to dominate or influence the vision of the entire institution.

Kets de Vries (1985) documents such cases for corporate entrepreneurs and suggests that an entrepreneur's attention to detail—which is a virtue in the start-up phase—can be crippling if he or she continues to exert such control when the organization grows. An entrepreneur who cannot let go of the reins even when faced with the company's demise must have a need that is greater than the desire to see the company succeed. The same is true of the parent organization that finds it difficult to let go of the institution it helped create.

Executive directors undoubtedly need to concentrate on strategies and goals when they head programs. But this need is even more intense when they become leaders of their own institutions. Their attention to the operational and technical aspects of their business cannot be understated, but their role in more strategic decisions of the institution and in team development becomes even more important. Also documented is the need to have strong senior management team (rather than one or two key individuals) and to build the ranks of middle management. The need to think from an institutional rather than a program-based perspective cannot be overemphasized.

### **Life after spin-off: defining responsibilities for the parent organization**

In a corporate context, parent firms often emphasize their most important businesses. After a spin-off the parent firm is expected to be able to provide maximum support to its remaining businesses without being concerned about the spun-off entity. But because of the donor environment in which Save the Children operates, it has often said that it believes it would be held responsible for these institutions' ongoing operations. This is the main reason Save the Children wants to continue to have a working relationship with these institutions and have a say in their development.

Perhaps the performance issue is overemphasized and Save the Children needs to better define its expectations, responsibilities, and liabilities—both among the spin-offs and with donors. As the new microfinance institutions take on lives of their own and call for equal partnership treatment, Save the Children needs to draw distinct lines between its real and perceived responsibilities for operations that it may, in effect, no longer control.

More important, there is an inherent contradiction in Save the Children's larger organizational structure that affects relationships at various levels within the organization itself and with the spin-offs. By design, technical expertise is to be concentrated in the Economics Opportunities Unit based in Washington, D.C., and responsible for the organization's worldwide effort in this field. But the spin-offs, through subgrant arrangements with donors, technically report to the field office line hierarchy. Still, while the Economics Opportunities Unit plays only an advisory role, it is ultimately held accountable for developments on the ground. Moreover, the Economics Opportunities Office and the field offices often hold divergent views on the development of the spin-offs and on the nature of Save the Children's involvement. This divide highlights the need for the par-

The need to think from an institutional rather than a program-based perspective cannot be overemphasized

ent institution to speak in one voice and to better align reporting requirements, advisory functions, and ultimate accountability.

This divide raises several questions as well. Should the Economic Opportunities Unit be the focal point for the spin-offs? Or should that role be played by field offices, which maintain a multisectoral focus and are no longer staffed to provide technical assistance in microfinance? Should there be a local technical or coordinating position in the region to respond more closely to the needs of the spin-offs? Some of these alternatives are being reviewed in recognition that this structural conflict must be resolved, as it will have a profound effect on the spin-off process and on the development of all parties involved in this venture.

Finally, these concerns go back to the need to define the framework that is to guide the relationship between the parent institution and the new independent institutions. Such a working relationship should benefit both parties if it is to solidify the bridge between them. It can be based on overlapping interests and mutual incentives and benefits, but it should be determined by all parties in recognition of their expectations and needs. A two-way channel for exchanging experiences between the microfinance institutions and the parent, and among the spin-offs, could contribute to such a relationship and to the institutional development of the new institutions.

Save the Children recognizes many of these issues. In subsequent microfinance

work it has applied many lessons from spinning off the JWDS, Al Majmoua, and FATEN. In Georgia, for example, it immediately introduced Group Guaranteed Lending and Savings as a separate institution rather than as a program. In January 1997 it registered Constanta, a local microfinance institution, as a nonprofit NGO to provide female entrepreneurs with sustainable large-scale access to financial services. Due to changes in the laws governing NGOs, in January 1999 Constanta re-registered as Foundation Constanta. The institution's charter outlines its mandate and the responsibilities of its five-member board of directors. All assets, liabilities, and staff from the NGO were transferred to the new legal entity.

Constanta distributed its first loans in October 1997, after Save the Children hired a consultant to train Constanta's first five loan officers. During the training Constanta's loan officers manual was prepared, and it has since been updated. Under Georgian law, because it is considered a non-formal financial institution Constanta is providing lending services but no savings services. Constanta has already achieved 90 percent operational sustainability, has formed 319 borrower groups with 2,879 active female clients, and has maintained a delinquency rate below 1 percent of the outstanding portfolio. Save the Children is drafting a proposal to provide a full-time expert based in Tblisi, Georgia, to provide timely technical assistance to Constanta.

**The relationship between the parent organization and the spin-off should benefit both if it is to solidify the bridge between them**

## Annex Recent economic strides and challenges in Jordan, Lebanon, and the West Bank and Gaza

**J**ordan ranks as a middle-income developing country, with a per capita income of about \$1,500 at the end of 1997 (annex table 1). After a five-year boom with average annual growth of about 5.5 percent, Jordan is experiencing recessionary contractions, with economic growth having slowed to 1.0 percent in 1996 and 1.3 percent in 1997. Real GDP growth in 1998 is estimated to have been 2.2 percent but is expected to rise to at least 3–4 percent by 2001, with inflation in the 2–3 percent range. The Jordanian dinar is officially pegged to the U.S. dollar, producing an average exchange rate of 0.708 dinar to the dollar.

The public sector dominates the Jordanian economy. Government services remain the largest contributor to GDP, accounting for 18.6 percent in 1997. Large public consumption and capital spending

have translated into external debt of more than 96 percent of GDP, making debt the main structural challenge facing Jordan.

World Bank research indicates that between 1992 and 1997 measured poverty declined in Jordan, from 14.9 percent of the population to 11.7 percent. In 1997 there were an estimated 538,000 poor people in a total population of 4.4 million. Moreover, poverty was less deep in 1997 than in 1992, with the poverty gap index at 2.5 percent, down from 3.8 percent. But given recent economic contractions, poverty and unemployment appear to be on the rise.

Since the war ended, *Lebanon* has initiated an ambitious program of reconstruction and economic stabilization. In 1993–96 the acceleration in government capital spending and stabilization efforts were associated with high economic growth, with

**Annex table 1. Economic and social indicators in Jordan, Lebanon, and the West Bank and Gaza, 1997**

Indicator	Jordan	Lebanon	West Bank and Gaza
Population (millions)	4.4	4.1	2.6 <sup>a</sup>
Annual population growth (percent)	3.7	1.8	3.7
Labor force (millions)	1.2	1.4	0.6
Labor force, female (percentage of total)	23	22	12
GDP at market prices (billions of current U.S. dollars)	7.0	14.9	3.4
GDP per capita (U.S. dollars)	1,516	3,692	1,361
Annual GDP growth (percent)	1.3	4.0	0.9
Unemployment (percent)	15.0	8.5	20.3
Inflation (percent)	3.1	8.5	7.6
Average exchange rate (local currency per U.S. dollar)	0.71	1,539	3.47 (new Israeli sheqels); 0.71 (Jordanian dinars)

a. Excludes East Jerusalem. If East Jerusalem is included, the total population is 2.9 million.

Source: World Bank data and staff estimates; Palestinian Central Bureau of Statistics; Central Bank of Jordan; Banque du Liban and Lebanon's Central Administration of Statistics; IMF, *International Financial Statistics 1998*.

growth averaging 7.4 percent a year (El-Erian and Fennel 1997). The government has restored political stability, taken steps to rebuild Lebanon's economy and physical infrastructure, and supported private sector development. The exchange rate has stabilized, and inflation has dropped from 120 percent in 1992 to 8.5 percent in 1997. In 1996, however, real GDP growth fell to 4 percent, adversely affected by the Israeli bombings and a slowdown in construction activity. In 1997 GDP growth remained at 4 percent, but in 1998 was forecast to be about 5 percent. GDP per capita in 1995 was \$2,700—a remarkable increase from less than \$1,000 in 1990 (Porter 1999). Today GDP per capita is more than \$3,500.

Fifteen years of war caused significant damage to Lebanon's middle class, creating a new class of poor who joined the traditionally deprived. Target clients for microfinance institutions such as Al Majmoua include the 28 percent of Lebanon's population living under the poverty line of \$760 (measured in 1996). Poverty is worsened by gender discrimination and social deprivation. Among economically active groups, women have lower wages and fewer employment opportunities. But female microentrepreneurs support their families at various levels: 35 percent contributed a significant amount to the main income, and 24 percent are household heads (Porter 1999).

The *West Bank and Gaza's* economy suffers from a number of structural imbalances, many due to adverse political circum-

stances. Although GDP growth was strong in 1994—reflecting the high expectations created by the 1993 peace agreement between Israel and the Palestinian Liberation Organization—the Palestinian economy saw a steady decline in economic activity in 1995 and 1996, and stagnant growth in 1997. Per capita income declined continuously, falling by an average of 6 percent a year between 1994 and 1998, so that in 1998 per capita income was 22 percent below its level in 1994. The link between growth and employment is crucial in the Palestinian economy and reflects employment levels that are highly sensitive to the ability of workers to enter Israel. By 1995–96 unemployment, underemployment, and consequent poverty became major problems. In 1995, for example, given a poverty level of \$650 per capita per year, about one-fifth of Palestinians were poor. In Gaza, where employment is especially sensitive to Israeli border closures, the incidence of poverty exceeded 36 percent at the end of 1995, coinciding with local unemployment rates above 30 percent.

Recent economic developments have been positive, however. In 1998 job creation accelerated and unemployment fell to 13 percent, down from 20 percent in 1997. Furthermore, labor force participation increased throughout 1998, peaking at 42 percent in the fourth quarter. Strong employment growth suggests that economic output grew an estimated 3–4 percent (in real terms) in 1998.

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