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Can commercial banks do microfinance? Lessons from the Commercial Bank of Zimbabwe and the Co-operative Bank of Kenya

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During the last five years, two commercial banks in Zimbabwe and Kenya have made the decision to start microfinance operations, motivated in part by the increase in competition in the financial sector, which has encouraged them to seek new markets. This article outlines the institutional form their 'downscaling' has taken, the new loan and saving products they have introduced and their progress so far. In these cases, donor-funded technical assistance has been crucial in helping overcome considerable obstacles, including resistance to the new microfinance culture from the mainstream bank staff.

Introduction.

It is desirable and indeed essential that commercial banks should be involved in microfinance. If they are not, any impact that microfinance can have on global poverty will be negligible, for it is the privately owned commercial banks which dominate the financial markets in most countries. Currently, microfinance is being commercialised, but this still mostly involves MFIs becoming commercial banks – such as K-REP (Kenya) and BancoSol (Bolivia), or the setting up of commercial banks doing only microfinance, such as Centenary Rural Development Bank (Uganda). Most of the commercial banks that have moved into microfinance are state banks – for example Bank Rakyat Indonesia (BRI), National Microfinance Bank (Tanzania), and Banco Nacional de Costa Rica. Cases of pre-existing, privately owned commercial banks 'downscaling' and starting microfinance operations are still relatively few and far between. Although there are success stories - examples include Hatton National Commercial Bank in Sri Lanka, and a number of private banks in India through a programme started by the National Bank of Agriculture and Rural Development (NABARD)[1] - many of the commercial banks that have tried to downscale have faced considerable problems, and have not achieved impressive levels of outreach (Valenzuela 2001). If microfinance is truly to 'take off' globally, such that it is no longer dependent on donors, and no longer equated with 'development interventions', then this situation must change.

There are many reasons why privately owned commercial banks are put off entering the microfinance market, despite its apparent potential profitability, and why those banks that have 'taken the plunge' have in many cases faced problems. Commercial banks are answerable to their shareholders, who live and die by the bottom line and demand maximum returns. Most do not feel that microfinance will guarantee them this. Standards and regulatory requirements with which commercial banks have to comply, particularly regarding unsecured lending, and interest rates, are inappropriate for microfinance operations. The organisational structures, procedures, products and methodologies of commercial banks are not suited to microfinance, and changing them can be difficult, time consuming and expensive. There are significant cultural barriers to be

[1] The NABARD Self-Help Group (SHG) banking programme provides refinancing to more than 300 financial institutions, to enable them to lend to SHGs in rural areas. Most of the financial institutions are state owned banks or cooperatives, but a small but growing number of private commercial banks are participating (NABARD 2001, Seibel 2001).

overcome; staff and managers of commercial banks often still perceive the poor as unbankable, and the ways of working required to reach out to them as unbecoming for professional businesspeople like themselves (Baydas, Graham & Valenzuela, 1997). These perceptions have not been helped by bad experiences in the past with government and donor led attempts to induce commercial banks to lend to the poor through mechanisms such as compulsory targeting and provision of low cost funds for onlending.

Nonetheless, commercial banks also have a number of competitive advantages as compared to other players in microfinance. They have the necessary management expertise, systems and physical infrastructure in place, are able to accept deposits and have access to other sources of funds such as equity capital (Rhyne & Christen 1999). The experiences of those relatively few privately owned commercial banks that have successfully moved into microfinance show that with a high level of commitment, the right advice, and appropriate policies, it is possible. During the 1990s two African commercial banks, the Commercial Bank of Zimbabwe (CBZ) and the Cooperative Bank of Kenya (CBK), started microfinance operations, both with support from the British Department for International Development (DFID). The experience of both banks, so far, has been positive. Using these two examples, this article will highlight some of the constraints that commercial banks face when moving into microfinance, and consider ways in which these constraints might be overcome.

Background.

The Commercial Bank of Zimbabwe.

The Commercial Bank of Zimbabwe (CBZ), or as it was known then, the Bank of Credit and Commerce Zimbabwe, was started in 1983 by the ill-fated Bank of Credit and Commerce International (BCCI), though the Government of Zimbabwe retained a major share. The Bank was, from the start, known for its commitment to small entrepreneurs, who formed its main clientele. After BCCI's collapse in 1991, the Government of Zimbabwe took over full ownership of what now became CBZ, and a period of significant restructuring began. The early 1990s was a period of liberalisation and hence increased competitiveness in the banking sector, and CBZ had to diversify its markets; it moved both upmarket, attracting larger, corporate clients, but also continued to focus on small businesses. It also, at this time, began to consider moving to accommodate the financial services needs of even smaller businesses. In 1997 the bank was privatised, though the Government of Zimbabwe retained 20% of the shares[2]. Currently CBZ is the third largest bank in Zimbabwe, with 27 branches around the country. It has an extremely good reputation, winning the Euromoney award for best bank in Zimbabwe in 1999 and 2000.

The Cooperative Bank of Kenya.

The Cooperative Bank of Kenya (CBK) was created in 1965 for the express purpose of providing financial services to cooperative societies that were otherwise unable to access such services from traditional commercial banks. Cooperative societies are major players in the Kenyan economy, contributing about 40-45% of the country's GDP. The total membership of Kenya's 6,500 cooperatives is more than four million. Rural members are primarily small-scale agricultural producers, and urban members low-income groups in either the semi-formal (jua kali) sector, or formal employment. Since 1994, with the onset of liberalisation in Kenya, the CBK began to

[2] Major shareholders include Amalgamated Banks of South Africa (ABSA), the International Finance Corporation (IFC), the First Mutual Life Assurance Society of Zimbabwe, and the Libyan Arab Foreign Bank (LAFB). There are a number of other smaller shareholders,and 5% of shares are held by private individuals.

diversify its markets and undertake to become a universal bank. It therefore now targets not only cooperatives but also provides consumer services to individuals, corporate and commercial banking services to large businesses, and other fee-based services such as corporate advisory, trust, share registry and custodial services.

The CBK is the 5th largest bank in Kenya, with 28 branches. However, it is both the largest indigenously owned bank as well as the most publicly owned bank with both cooperative and individual shareholders. There is no government ownership. The other four leading banks in the country are either foreign owned or controlled, or government owned or controlled.

Moving into Microfinance.

The Commercial Bank of Zimbabwe.

As part of its diversification strategy in the early 1990s, CBZ began to explore the possibility of developing a product for Zimbabwe's urban and peri-urban informal sector microenterprises. Corporate clients were somewhat wary of the bank after the BCCI collapse, and microfinance was a market as yet untapped by any of its competitors. It was also a growing market, as the informal sector was expanding due to increasing unemployment and inflation brought about by liberalisation policies. At the same time, CARE International, an international NGO with considerable experience in microfinance globally, was actively seeking to bring commercial banks into the microfinance market in Zimbabwe. Most of the commercial banks approached by CARE were not interested, but when CARE entered into discussions with CBZ, it became clear that this was an opportunity for the NGO and the bank to join forces in a mutually beneficial partnership.

Given the considerable perceived riskiness of the venture, CBZ was not prepared to make the necessary initial investment itself. Although the Managing Director was fully committed, most of the management team and the shareholders of CBZ still had to be convinced of the profitability of microfinance. There were also considerable changes that needed to be made to CBZ's organisational structure, management systems and financial methodologies to make microfinance workable. The British Government's Department for International Development (DFID) agreed to provide funding for the project, seeing it as an opportunity to demonstrate to other banks, both in Africa and globally, that they could profitably move into microfinance.

In 1995, the 'Credit for the Informal Sector Project', or CRISP, was launched. DFID funding covered start-up costs, operational costs on a sliding scale, and provided a loan guarantee fund (LGF) to cover CBZ's initial possible losses from default - CBZ took on 20% of the risk of initial loans, 40% for second loans, and the full risk thereafter. Although establishing the legal and management framework for the LGF was fairly arduous[3], without the LGF the project would not have got off the ground. It offered a degree of security to those in CBZ's management who doubted the viability of the CBU group lending methodology. It also allowed CBZ to satisfy the Reserve Bank of Zimbabwe (RBZ) loan security requirements, which allow for banks to lend up to 20% of their portfolio without security, but only provided that loan loss rates are not excessive. The RBZ wanted proof that this previously untested sector would be viable. DFID also paid for technical assistance, which was provided by CARE.

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[3] A small amount of the LGF was deposited in an interest bearing foreign currency account at CBZ, with CARE, the project manager, acting as the signatory. The balance was kept offshore in a hard currency interest bearing account denominated in US dollars, with CARE and DFID being joint signatories. Draw-downs from the LGF account held at CBZ were to be based on CBZ's report of irrecoverable debts to CARE. CARE thereafter was to request an appropriate draw down from the offshore LGF account and replenish the liquidity account at CBZ as required.

The Cooperative Bank of Kenya

The CBK's decision to increase its provision of financial services to the low income and microenterprise sectors of the economy was, like CBZ's, made in the light of increased competition due to liberalisation, and the need for diversification. Although CBK had been serving this market indirectly through the cooperative societies, the decision was made to provide services directly to individual borrowers, which would entail quite a different approach. In 1998 CBK prepared a new business plan for its existing Small and Micro Credit Unit that spelled out in detail the strategies that the bank intended to follow. While continuing to wholesale funds to financial intermediaries such as cooperatives, the Small and Micro Credit Unit would also start its own direct lending on a pilot basis.

While the CBK itself was prepared to meet most capital and recurrent expenditures and to provide the loan capital, it sought funding for the technical assistance that it needed to develop new products and methodologies, and to make the necessary institutional changes. DFID agreed to provide funding for this, and Bannock Consulting was contracted as the technical assistance provider.

While the CBK was in the process of preparing for the launch of the microfinance programme, it suffered a severe blow with the terrorist bombing of the American Embassy in Nairobi in August 1998, as the bank's headquarters were immediately adjacent to the embassy. In order to help the bank through this crisis, and to ensure that the microfinance programme could continue, USAID agreed to pay for study tours aswell as cover some capital expenditure. The microfinance programme was launched on a pilot basis in two branches during the first quarter of 1999.

Organisational Structure and Human Resources.

The Commercial Bank of Zimbabwe.

CBZ's microfinance programme was operationalised through the establishment of a microfinance unit, known as the 'Community Banking Unit' (CBU), which was housed within CBZ's credit division. The CBU has its own dedicated loan officers, administration and head office staff, but shares counter staff with CBZ. It also shares an MIS system with the mainstream bank, uses, for the most part, CBZ infrastructure, and makes use of CBZ administration departments such as audit, marketing and human resource development. The CBU factors a 10% administration fee into its accounts to cover the costs of the various services and resources it avails from CBZ. The CBU head office was set up in CBZ's main head office, and plans were made to set up units in four CBZ branches. In practice, however, it proved necessary to pilot the scheme in one branch, then open in subsequent branches after the pilot had proved itself. Although some senior staff were convinced of the value of the scheme, there was considerable initial resistance to the project among other mainstream CBZ staff. They did not at first take CBU activities and clients seriously, resulting in lack of co-operation, and delays with start up activities and every day operations. Over time CBZ staff have become more amenable to the idea of the CBU and it is becoming much easier for the two to co-exist and indeed co-operate.

Of the four branch level units opened by December 2000, three were incorporated into existing CBZ branches; the CBU staff have their offices in the branch, with deposit and withdrawal transactions taking place through CBZ tellers. One CBU uses separate premises for account opening and discussions with clients, though deposits and withdrawals are still made in the main branch. This separation took place to reduce the congestion created in the branch by the large

numbers of CBU clients. There was also initially some friction between CBU clients and mainstream CBZ clients, but this is no longer a problem. It should be noted that much of the interaction between CBU staff and clients takes place outside the branches in the businesses and homes of the clients.

An existing CBZ employee was taken on as the manager of the CBU – a man who had been with the bank for 13 years, most recently working as the manager for personal and small business loans. All the CBU field officers were recruited from outside; some are ex-teachers and some were recruited from other MFIs operating in Zimbabwe. There is not as yet a formal induction programme for newly recruited staff, though all new recruits go through a process of on the job training through a three month attachment to an existing loan officer. CBU staff are responsible for the entire CBU loan cycle, from client identification to loan approval, monitoring and recovery. Though currently paid through donor funding for the CBU, the staff are CBZ employees, and as such are eligible for normal bank staff salaries (which are considerably higher than those offered in the MFI/NGO sector), in addition to other benefits such as loans and pension plans. The CBU does not currently operate an incentive system for its staff (generally accepted as being good practice in microfinance), though it does plan to in the near future. It remains to be seen how this will affect CBZ/CBU staff relations.

The Cooperative Bank of Kenya.

From the outset, the CBK had decided that its microfinance programme should be mainstreamed into its operations in order to optimise the use of its physical infrastructure – its systems as well as its network of branches. The programme was set up in an existing department of the CBK – the Small and Micro Credit Unit (now known as the Micro Credit Unit, and dealing exclusively with microcredit – a new, separate unit for Small and Medium businesses has been set up). Recognising, however, that in practice such integration may not be feasible, given the prevailing institutional culture of the bank, it also decided to test the programme in three separate microfinance agencies (very small outlets located in high density MSE areas). New staff were hired to work exclusively for the microfinance programme to work as credit officers, but existing bank staff – branch managers, head office managers etc. – took on managerial responsibility for the new products.

Integrating the programme into the CBK posed considerable challenges in the early stages. The institutional culture was stifling not only in individual branches, but also at the Head Office level. The Managing Director was always quite supportive of the programme, having seen successful microfinance in practice during exposure visits to Indonesia and Bolivia. Most of the bank's management team, however, were highly skeptical, especially since repeated bad experiences in the past with government and donor sponsored programmes. These staff often seemed to be preoccupied with other priorities or challenges that prevented them from working on issues related to the microfinance programme. Sometimes these other concerns were legitimate, for example ensuring that the bank was Y2K compliant rather than worrying about fine tuning the Micro Credit Unit's MIS reports, but often they seemed more like excuses.

The branch managers were highly skeptical as well. However, one particular senior branch manager had been keen to take the risk and the programme was piloted in his branch. The programme's success after one year of operations made it much easier to identify other branch managers who were willing to participate in the programme. In short, as the microfinance programme proved to be viable, support across management cadres of staff became more widespread and integration became much easier.

As the CBK microfinance programme aimed to be entirely integrated into mainstream banking operations from the outset, a substantial amount of training was required for staff at all levels of the bank, both at the head office and in the branches. Building the capacity of the staff is a lengthy process that takes time to bear fruit. For example, credit officer recruits undergo both classroom and on-the-job training, where they are seconded to branches already running the microfinance programme, to work alongside experienced credit officers. In the early years, the size of the programme (the number of experienced credit officers) therefore limits the pace of its expansion (the training of new recruits). The capacity of the head office is also constrained; the best head office supervisors come from among the best credit officers, and it takes at least a year for a credit officer to have sufficient experience to move to a supervisory role. While this approach to staffing takes time, the hand-on experience gained by the credit officers in the field is generally more valuable than any experience that could be sourced in the market. Moreover, the provision of a career path serves to retain qualified staff in a labour market where trained staff at this level can easily find alternative employment.

As a commercial bank, the CBK has to contend with some human resource issues that competing MFIs/NGOs rarely face. For example, labour laws and the strength of the bank unions mean that banks often prefer to increase the value of existing staff, rather than bringing in new staff.

Products and Methodology.

The Commercial Bank of Zimbabwe.

The CBU lends primarily through solidarity groups. Loan sizes range from Z$5,000 to Z$75,000, or US$85 to US$1,290, and can be taken for between six and 18 months; first time borrowers are restricted to the smaller, shorter term loans.

Recently the CBU piloted an individual loan product, in response to demands for larger loans from clients, who had 'outgrown' CBU group loans, but not yet 'graduated' to mainstream CBZ loans. Individual loans are offered only to successful repeat borrowers, with loan sizes ranging from Z$30,000 to Z$100,000, or US$520 to US$1,720, for between 12 and 18 months. Individual loan borrowers are required to pledge tangible business assets.

There is some concern that, as larger loans are offered, the CBU may begin to shift away from smaller borrowers. While efforts will be made to keep loan sizes small, the main objective of the project is to develop microfinance operations that are profitable, so that the CBU will continue into the future. The appropriate loan size will ultimately depend on what is profitable. Even if average loan sizes do rise, CBZ will still be reaching considerably lower than other commercial banks involved in microfinance; globally US$500 is considered very small for commercial banks[4], and CBU loans are well below this.

Loans are priced at 5% over the prime lending rate[5]. Borrowers also have to pay a small loan application fee. This rate matches those offered by CBZ only on its safest, most well secured loans. Higher risk loans, such as consumer loans, carry rates of up to 9% over the prime lending rate. Given the nature of the CBU portfolio, the costs involved, and the nature of the borrowers (who tend to run small, relatively high and rapid turnover operations), the CBU has decided to

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[4] A 1997 USAID study showed that commercial banks' microfinance lending involved loans on average less than US$1,400 (Baydas, Graham & Valenzuela, 1997, p31).

[5] At the end of 2000 this gave an interest rate of 64.5% per annum. In recent years the prime rate has been changing more and more frequently, reflecting the parlous state of the country's economy. The frequent fluctuations make it extremely difficult for the bank to offer a consistent product to customers.

increase the rate to 7% over prime on commencement of phase II. A 10% charge is added to the interest rate of all amounts in arrears, plus an 'advisory and counselling' fee for any required extra follow-up visits. Initially, cases of default were handled by CBZ's main recovery department but this proved to be ineffective; the impersonal, letter-based methods used being inappropriate for CBU clients. CBU officers resorted instead to more direct methods based on the group methodology, writing warning letters to fellow group members, and strictly upholding the rule that no group member in a group with a single defaulter can take further loans. A more difficult problem is when default arises due to the ill-health or death of a client – particularly given that Zimbabwe has the second highest rate of HIV/AIDS infection in the world. Over time this problem is bound to become more serious as more people become ill. CBU staff are exploring the possibility of adding an insurance premium to the cost of loans to cover death-related defaults.

The CBU offers a savings product; all borrowers are obliged to open a CBU account in order to be eligible for CBU loans. CBZ savings accounts, however, are already fairly attractive to poor people, with very low minimum balance requirements, so those people who want simply to save have no particular incentive to move their account to CBU. Efforts are currently underway to make the CBU account more attractive in order to attract a higher number of 'savers only'. This is being done both to boost the funds available to the CBU to onlend without having to draw on mainstream bank funds (for which it has to pay the market rate, in the books at least) and also in recognition of the fact that many poor people require savings facilities as much, if not more, than they require credit. One constraint to raising additional deposits is the current economic crisis in Zimbabwe; the inflation rate in early 2002 was 115% ; persuading people to save in such conditions is difficult.

Currently CBU only serves an urban and peri-urban clientele. As part of the second phase of the project, a concerted effort will be made to reach out to the rural poor. This is likely to be a considerable challenge, given CBU's current way of working, in which although the staff spend much of their time with clients 'in the field', the urban 'field' is relatively close to the branches, and the branch remains the centre of daily operations. Phase two will involve research into potential ways of reaching out the rural poor, focusing on developing partnerships with NGOs/MFIs and co-operatives already active in rural areas. If a way can be found for CBU to provide the rural poor with financial services in a profitable way, then this will no doubt form a large part of its activities in the future. Profitability will remain paramount, however; rural operations will only continue if costs can be covered.

The Cooperative Bank of Kenya.

The CBK's 'direct' microfinance programme consists of an individual loan product (Biashara Plus – or 'business' in Kiswahili) and a savings product (Haba na Haba – 'little by little'), both of which were largely modelled along the lines of Bank Rakyat Indonesia's world renowned products. Biashara Plus loans range from Kshs. 6,000 up to Kshs. 300,000, or US$75 up to US$3,800. While there is no minimum loan size, the Biashara Plus is generally targeted towards the upper end of the microenterprise market – somewhat above those targeted by NGOs. There are already a number of NGOs serving the US$100-625 range with group lending schemes. The CBK therefore decided to pursue the market niche above that, especially since it opted to do individual lending only, believing that bankers are trained to analyse cash flows, not manage groups. Borrowers availing the Biashara Plus are mainly from urban and peri-urban areas.

Initial loan terms are generally six months, with longer terms available to clients with a good credit history with the bank. Collateral requirements are very flexible, generally including a

hypothecation of goods (for example borrowers pledge a combination of household and business assets to secure loans). While collateral is taken, lending is cash flow based and collateral is viewed more as a measure of clients' goodwill. Notwithstanding, the bank does seize collateral in a very timely manner if borrowers who are late with repayments do not respond to follow-up visits.

The Haba na Haba savings produce is targeted towards the full range of low income households. Unlike other CBK savings accounts, it requires only a very low minimum balance - only Kshs. 1,000, or US$12,75 - and has no monthly fees of restrictions on withdrawals. Unlike the Biashara Plus, which was introduced in stages, as the necessary staff were trained, the Haba na Haba was introduced bank-wide almost immediately, as its administration did not require specially trained staff. However, advertising for the Haba na Haba has been very limited as the CBK awaited the outcome of a parliamentary attempt to fix interest rates and margins for all commercial financial institutions[6]. It was not keen to bring in such a high volume of small accounts if it could not earn sufficient margins to cover its administration costs. Despite deliberate 'soft-selling', however, the Haba na Haba product has become one of the CBK's fastest growing deposit products.

In implementing its microfinance operations, the CBK has experienced some challenges in finding the right balance between standardised policies, procedures and products, and adapting the product, policies and procedures to fit local contexts. From the perspective of the bank as an organisation, standardisation is essential, but some staff at the branch level have wanted more flexibility to implement the programme in the way that seems appropriate to their particular local context. Over time increased flexibility has been shown to result in higher rates of arrears; the branches have thus learned the value of strictly maintaining uniform policies and procedures.

Outreach, Profitability and Projections.

The Commercial Bank of Zimbabwe.

CBZ's Community Banking Unit (CBU) began lending in June 1996. By December 2001 the CBU had four operational branches in three cities, with nine loan officers. Performance is summarised in the table below:

CBU loans	
Total Amount Disbursed	US$1,690,000
Total No. Loans Disbursed	8,205
Average Loan Amount	US$175
Portfolio Outstanding	US$569,000
Total No. Loans Outstanding	3,194
Average Portfolio at Risk (>30days due)	7%
CBU savings	
Total No. Savings Accounts	9,519
Total Amount Deposited	US$983,000

At the start of the project a higher target for outreach had been set; however, in practice the portfolio grew slower than expected, for a number of reasons. Firstly, lending started somewhat

[6] The Donde Bill is a law passed by parliament and assented to by the President on 6th August 2001. While it has yet to become operational, it seeks to set minimum deposit rates on all interest bearing accounts to 70% of the treasury bill rate, and maximum lending rates on all new loans at 4% above the treasury bill rate. At the current treasury bill yield of approximately 10%, that would translate into minimum deposit rates of 7% and maximum lending rates of 14%.

later than planned, as it took some months to set up the legal and management arrangements for the project, particularly the Loan Guarantee Fund (see below for detail). Secondly, as mentioned, resistance to the project among some mainstream CBZ staff meant that the project took longer to take off than expected. Finally, it took some time to find good staff in the first place, and the lack of a formal induction programme slowed down the pace at which they could take on a full portfolio. Progress was also hampered by staff ill health and the death of one of the first loan officers.

As the crisis in Zimbabwe has worsened, demand for loans has remained as high, if not higher, than ever. Rapidly increasing unemployment is leading more and more Zimbabweans to rely on informal sector enterprises to survive. Given the deteriorating situation, however, it is becoming more and more risky to lend to the informal sector, and the CBU has recently had to curtail disbursements in order to maintain a healthy portfolio.

In December 2001, CBU operational sustainability was at 102% and financial sustainability at 95%. Ratios had earlier risen up to 115%, but recruitment of additional staff who do not yet have full portfolios has resulted in a temporary drop in sustainability. Although the programme is viable, the process of hiring new staff and investing in new branches – each of which takes two years to break even - cuts into short term profits, which means that additional funding is required to enable the CBU to expand and eventually become entirely sustainable in the future. DFID has approved a further phase of funding for this purpose, due to start in 2002[7].

It is envisaged that by the end of phase two of DFID funding the CBU will have made a further 40,000 loans, reaching out to 15,000 new clients. This rapid increase should be possible as the CBU has now established its operational systems, has developed experience in microfinance methodologies, and can quickly set these up within the existing mainstream CBZ network. Crucially, CBZ mainstream staff have by and large accepted the CBU as a valid part of CBZ banking operations and are keen to cooperate with and support its implementation. When the second, and final, tranche of DFID funding comes to an end, the CBU will be in a position to continue profitably in the future.

The Cooperative Bank of Kenya.

As of December 2001 the CBK was offering Biashara in 14 locations around the country, with 30 credit officers. As the table below shows, the programme is growing rapidly; the number of clients grew more than 100% in 2001 and the outstanding portfolio, and disbursements, grew more than 200%.

[7] the current situation in Zimbabwe means that the process of DFID's approving and implementing phase 2 of the project was considerably delayed.

CBK's Biashara Plus loans	
Total Amount Disbursed	US$4,170,000
Total No. Loans Disbursed	3,861
Average Loan Amount	US$1,080
Total Amount Disbursed (during 2001)	US$2,916,000
Total No. Loans Disbursed (during 2001)	2,256
Average Loan Amount (during 2001)	US$1,292
Portfolio Outstanding	US$1,219,000
Total No. Loans Outstanding	1,451
Average Portfolio at Risk (>7days due)	3%

The programme has proven to be financially viable for the CBK and at present, it fully covers both its direct and allocated indirect costs. However, as for CBZ, the degree of profitability is affected, in part, by the rate of expansion. It typically takes approximately one year for each branch to fully cover its costs – two to three months of start-up and training time and nine to ten months of lending operations. Hence the more branches added to the programme, the slower the rate of growth in profit, at least in the short run. For example, the four most recently opened branches, all opened during the last quarter, are still in a loss position.

Most importantly, the CBK management – both at the Head Office and the branch level - and the Board of Directors, are pleased with the progress of the programme thus far. Branches are keen to join the programme, and the Directors are keen to see the Biashara Plus loan in all branches as soon as possible (aside from a handful of branches designated as corporate branches). Moreover, the success of the programme has caused the CBK senior management to re-evaluate the way it views its business in general, on issues relating to retail credit delivery (particularly small and medium enterprise lending), MIS reporting, financial costing and profit centre accounting, human resource management policies (recruitment strategies, performance targets and incentive plans) etc. As with CBZ, this support from the management team across the CBK is what poises the programme to continue expanding rapidly in the future.

Lessons Learned.

Getting Started.

The experiences of both CBZ and CBK show that for commercial banks to move seriously, and successfully, into microfinance, they need initially to have at least one 'champion' within the bank who has the clout, and the determination, to push the idea forward. This person, and later the bank as an organisation, must be driven not only by a genuine conviction of the potential profitability of microfinance, but also a belief that the move into microfinance may be a necessary strategy for the bank's long term survival. Other banks that have successfully moved into microfinance have not only recognised its potential profitability, but have generally also been driven, like CBZ and CBK, by a need to diversify, due to increased competition in the banking sector (Valenzuela 2001 p26).

Once a commercial bank has decided, for the 'right' reasons, to move into microfinance, but is reluctant to go it alone, the case of CBZ and CBK show the value of donor support in the form of the provision of quality technical assistance. The technical assistance should cover not only the microfinance methodology and products, but also, crucially, organisational issues, particularly

related to the interface between microfinance operations and other bank departments. This is complex and can be very problematic. Microfinance operations must be able to benefit from the physical infrastructure and systems of the bank, while maintaining adequate independence and flexibility to operate in a way quite different from the rest of the bank. Banks need to make considerable adjustments in the way they work, involving not only structural, but also cultural changes. This is an area in which many microfinance experts – including those called upon to provide technical assistance to banks - are weak, their forte being the interface between a financial service provider and its clients, rather than the financial service provider and a wider 'parent' organisation.

The use of guarantee funds is plagued with problems, both due to the legal complexities involved, and some have cast doubt on the success that such funds have in persuading commercial banks of the viability of character-based lending (Valenzuela 2001 p31). In the case of CBZ, however, the existence of the LGF seems to have been a crucial factor in the successful operation of the project. In the event, very little of the LGF was actually utilised, but its existence was central to overcoming the hurdle of initial scepticism among CBZ management. CBZ has now established a loan loss provision of 5% of outstanding loans for the CBU, which has reduced the need for the LGF in the future. Clearly CBZ management are now becoming more confident that microfinance can achieve high repayment rates, but they would not have got to this stage without the LGF being there in the first place.

Patience is a Virtue.

The cases of both CBZ and CBK show that there can be a fairly lengthy 'transition' period during which a commercial bank adapts to the introduction of microfinance operations. Adaptations need to be made not only in terms of developing workable procedures and systems, and building up a cadre of qualified staff, but also in terms of overcoming resistance from mainstream staff. Depending on the prior focus of the bank, it can take some time for the necessary changes to take place for the bank staff to get used to microfinance, with its very different way of working. Donor support may be critical to help banks to get through this transition period.

In the case of CBK, the transition process has been relatively rapid. CBK already had a history of working with low-income groups, and it did not adopt a radically different way of working when it started its microfinance programme. The bank was therefore prepared to take on much of the expenditure for the microfinance programme itself, and it has not taken long for most staff to be convinced of the value of the programme. CBZ on the other hand, when it moved into microfinance, had to learn how to deal with a clientele with whom it had not previously worked, and also had to learn a completely different way of working, given its decision to use a group based lending methodology. In the case of CBZ therefore, DFID funding for start up and operational costs has been critical in enabling the CBU to get through its 'slow start' and establish itself within the bank. Clearly, the level and nature of donor support that is appropriate will depend on the particular situation in question; it is not possible to determine one particular type of intervention that will work in all cases.

Fitting In.

The way in which microfinance operations fit into the institutional set up of mainstream commercial banks is complicated, and often difficult. This is true whether the decision is made for microfinance operations to be fully integrated into mainstream bank operations, or whether microfinance operations are to be kept rather more separate. Total separation is unlikely to be a realistic option in most cases; it will not usually make economic sense for a bank to set up a

parallel branch network. One of the main advantages that existing commercial banks have, after all, compared to new MFIs, is that they have the necessary infrastructure already in place. Full integration is also likely to be challenging in many ways; evidence from around the world shows that the internal set up of commercial banks generally does not favour the integration of a microcredit product, and that some sort of separated subsidiary works better (Valenzuela 2001 p24, 27). The success of CBK in integrating its microfinance programme to date, however, shows that in some cases full integration does make sense. CBK's success is likely due in part to the bank's existing commitment to the low-income sector through its history of working with and through co-operatives. In the case of CBZ, as it develops, the CBU continues to work out where it really fits in CBZ, and where it will fit in the future. The CBU is likely to maintain a certain level of separation from CBZ in order to retain and focus on its own particular way of working without being constrained by the larger bureaucracy of commercial bank operations. At the same time, the future vision of CBU is that it will remain an integral part of CBZ, at least in terms of ownership and identity. Allowing the institutional home of microfinance operations to evolve over time is clearly the only way, in some cases, to determine what the best arrangement will be in the long term.

Both CBK and CBZ have faced challenges in integrating the human resource requirements of microfinance operations with those of a mainstream commercial bank. Apart from the training needs, the established career patterns and labour rules pertaining to commercial bank staff do not always fit with the requirements of a microfinance programme. For example, the personal relationship between credit officers and clients is absolutely core to successful microfinance operations. This can conflict with the need for the bank to provide all its staff with adequate and equal career opportunities; as staff are promoted and move up in the organisation, clients experience changes in credit officers, which can negatively affect portfolio quality. Another issue is payment; bank staff are often paid considerably more than staff of MFIs or NGOs, and they receive more generous benefits such as pension plans. Commercial banks have to be ready to deal with these conflicts as they arise.

Operating Environment.

Both CBZ and CBK have suffered from events in the external economic and political environment. While MFIs/NGOs are also subject to the external operating environment, commercial banks, as licensed financial institutions, and with other business interests to consider, are particularly affected by changes in official policy. In Zimbabwe, uncertainty about which way the government will turn next on financial policies has made life extremely difficult for banks – as for example, when government monetary policy in late 2000 artificially, and therefore temporarily, dramatically brought down interest rates. In Kenya, though the potentially disastrous policy 'reform' act has been temporarily stalled, some form of legislation is likely to emerge, which will apply to all licensed financial institutions, not MFIs/NGOs, which operate under separate, special licences. While commercial banks are, clearly, more vulnerable in some ways to the policy environment, they are also likely to have more influence when it comes to pushing for change in those policies.

Conclusions.

There are still very few cases of privately owned commercial banks downscaling to microfinance for purely business reasons. Nonetheless, this situation seems to be changing, if slowly. Perhaps one of the most important reasons for this is the effect of liberalising markets; as local banks face increasing competition from new, start-up local banks, and foreign banks entering the market, they are obliged to seek alternative markets to survive.

The examples described in this paper show that even when commercial banks do make the strategic business decision to move into microfinance, it may prove harder than expected to realise their goals of scale and profitability. They have to undergo quite daunting organisational and cultural changes, involving substantial investment of time and resources, and requiring considerable commitment and perseverance. Once a solid foundation has been built, however, with all relevant players convinced, and the appropriate structures and policies in place, the evidence suggests that there is scope for rapid and profitable expansion.

The decision to move into microfinance must be made by commercial banks themselves, based on their perceptions of market opportunities. Once that initial decision has been made there is an important role for donors and technical service providers in working with commercial banks to overcome initial hurdles and bridge the transition period by providing appropriate advice and financial support. Ultimately, however, donors will not be able to fund all commercial bank downscalers; it is important that the support they do provide to some banks has a demonstration effect, convincing other commercial banks that it makes good business sense to invest in the time and resources necessary.

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