

MICRO CREDITS

A BUSINESS CASE FOR HELPS INTERNATIONAL (HINT), CAMEROON



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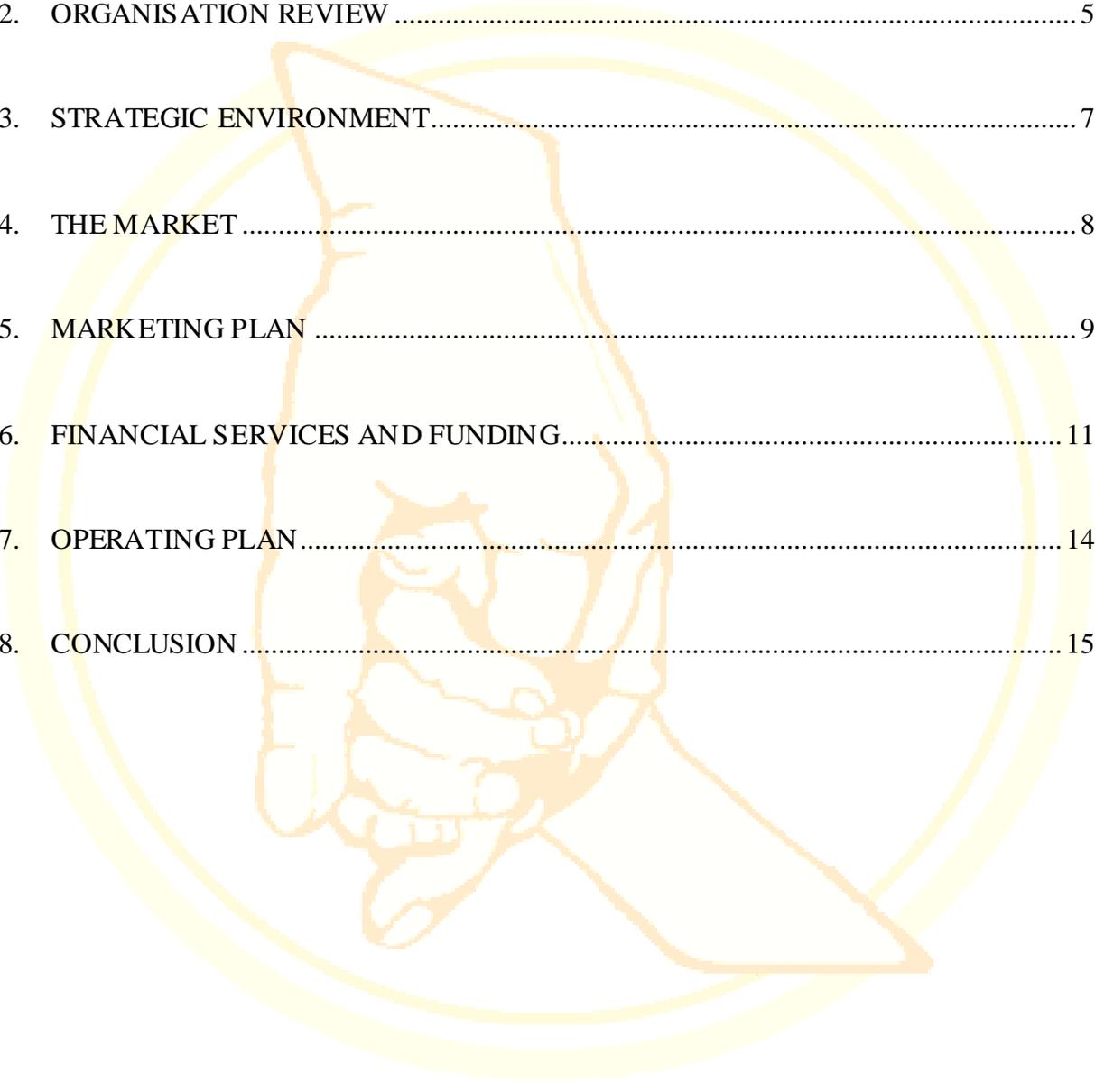
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This proposal and research have been developed with the help of Helen Savage, a volunteer currently working with Helps International in Buea, Cameroon. Though currently a nurse at the Oxford Racliffe Hospital Trust in England, Helen has had a wide experience with financial services having worked in a number of financial institutions before switching over to the medical field.

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Table of Contents

1. MISSION AND SUMMARY	3
2. ORGANISATION REVIEW	5
3. STRATEGIC ENVIRONMENT.....	7
4. THE MARKET	8
5. MARKETING PLAN	9
6. FINANCIAL SERVICES AND FUNDING.....	11
7. OPERATING PLAN	14
8. CONCLUSION	15



PROPOSAL

1. MISSION AND SUMMARY

Mission

Helps International (HINT) is an NGO situated in Buea, Cameroon. Our Mission is *‘to improve the social and economic well-being and health of the poor and under privileged in our society through education, skill development and job creation’*.

It is considered to be important for all projects to fit with this mission statement. Therefore HINT has focused its efforts on creating a micro financing project to assist local groups to create and expand small businesses as research and the pilot project have shown that the empowerment especially of women is the key to sustainable growth and development. HINT’s Micro-Finance project will assist especially women and youth groups in Buea and the surrounding villages of the South West Province of Cameroon, most of whom are self-employed. These women and youth earn their living through a variety of agricultural and trading activities. They currently operate as sole traders on a very small basis and have little or no access to credit unless via informal sources.

To meet the credit need for expansion of existing businesses and the creation of new enterprises, the project will provide credit through a group lending model. We expect to see increased self-respect among groups, new business income, and more vital village economies. While credit is our priority, group meetings will also be used to help clients to address common issues and problems.

Summary

HINT’s Micro-Finance Project plans to serve 50 clients in the first year and grow to 200 clients by year three. Our primary market is poor women who may be the sole providers of family income through the impact of HIV/AIDS. Formal credit institutions deem these women poor credit risks because they lack financial acumen and security. Consequently, they have no access to business loans to help their self-employed activities grow.

HINT will bring its loan services to villages clustered around the provincial capital of Buea where our organisation operates other programmes. A field staff totalling five by the end of five years will bring a package of small scale financial services to villagers including training in the financial management of small businesses.

By the end of five years, we plan to have issued a succession of small loans to our target clientele. A brief survey of other micro-credit organisations reveals that bad debt levels run between 2% and 12.5% of the loan book depending upon lending criteria and the experience of the lender. As a new entrant into this field, we expect the initial repayment rate to reflect this and anticipate an initial 87.5 to 90 per cent repayment rate which will improve over the period of the five year plan. Research indicates that women’s groups generally have a

significantly higher propensity to repay than other target markets and we do not therefore feel that this is unrealistic. As a result of this programme, we hope to see economic growth in participating villages and an increase in the self-respect and dignity of our women clients. We project programme revenues to fully cover all project operational and financial costs by the end of our fifth year of operation.



2. ORGANISATION REVIEW

HINT is currently focused on combating poverty among disadvantaged youths by empowering them with information and communication technologies (ICTs) skills for employment and long-term income generation and a better future. More than 800 have been trained since 2003 through our 2 IT training Centres. We also run a Child Support program for orphans and children from poor homes through which we provide them with uniforms, textbooks, and school fees. More than 50 children have been helped since 2004.

Our programmes are designed to effectively fight against poverty, unemployment and computer illiteracy and are financed by income from our internet cafés, payments from volunteers and sporadic donations from individuals, families, and organisations. This allows HINT to operate in Buea and pay for necessary resources to support the less fortunate. This financing is adequate, but unpredictable. There is no steady income on which HINT can build its projects and it is an increasing challenge to find more funding for the expanding project portfolio. This is the principal reason why HINT is seeking a reliable form of income which can ensure long-term success and reduce financial dependence on its current financial sources.

Whilst HINT is a new entrant to the Micro-Finance field and hence lacks considerable experience, its strength lies in its knowledge of the local community and its needs. Existing projects have enabled HINT to forge strong links with community groups and it is through these links that the microfinance scheme was launched on a small scale in May 2006. A series of about 25 small loans have been made to two local groups (a group of women and a group of youths) which have enabled us to train support staff and also to test our operational plan, reporting system and field management structure. Out of these trust groups, the women's group was able to pay back 91% the loans completely while the other was able to pay back 89% of the total amount loaned giving a total success rate of 90%. The interest rate used was 14.2%, which is small in comparison to most micro credit programs. HINT uses the lowest feasible rates in order to ensure that the loans will be a means of investing in development rather than becoming a burden for the people who receive the loans. The results of this pilot project have encouraged HINT to work on a larger micro financing project. In order to increase the scale of this project HINT wants to increase the total investment capital to CFA 2 million (US\$ 4,000 or GBP 2,000) for micro financing before December 2007. We now feel equipped to expand this venture and seek new investment capital to achieve this objective.

In this paper, we will discuss the options available for obtaining this capital and the methods used for making this project beneficial for HINT, its partners and its micro credit beneficiaries.

SWOT Analysis

Strengths

The organization offers a number of strengths which we believe can accelerate the project. They include:

- A successful pilot project.

- Strong reputation with local government and banks;
- Excellent accounting staff able to take on additional financial management;
- Already established in target villages. Good relationships with local leadership and village chiefs;
- Good reputation within communities;
- High staff morale evidenced by high turnover.

Weaknesses

We are aware of the following weaknesses, some of which we will address immediately to prepare for the project launch.

- Current staff and management have limited experience in microfinance;
- Current managers have limited time availability. HINT must reassign an existing staff member;
- Mix of welfare and business goals may lead to improper decision making as the Loans Committee do not know whether to be social workers or business developers.

Opportunities

- A source of sustainable and reliable financial income;
- Fit with mission statement;
- Reduced dependence on foreign investment;
- Commitment from beneficiaries;
- Ability to upgrade clients existing economic activities;
- Provision of services geared to the needs of clients.

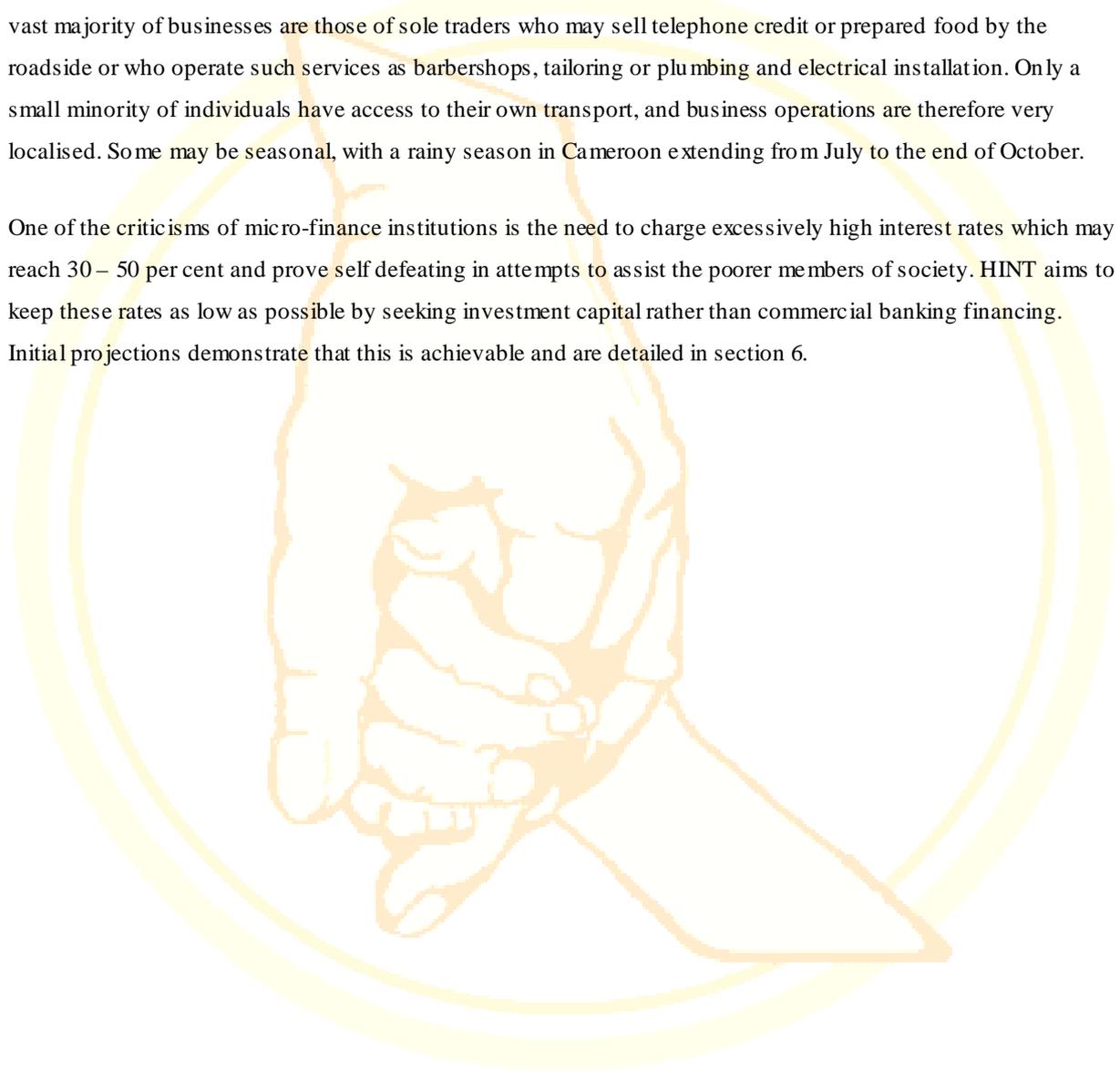
Threats

- Loan default rates (best practice: 2-5%, Grameen Foundation);
- High interest rates (30-50%);
- Making people dependent on development capital rather than ensuring access to regular capital in the future;
- Complexity of process which may deter potential borrowers e.g. requirements for legal registration, personal guarantees, property title, and security; or complex marketing schemes or production plans which overwhelm the people they are trying to reach.;
- Excessive documentation, repeated visits to HINT, and endless waiting for loans which cause hardship to impoverished borrowers;
- Provision of credit ill-suited to the needs of the poor- too much credit extended for too long;

3. STRATEGIC ENVIRONMENT

Buea is the Provincial Capital of South West Cameroon and former capital of the Anglophone area of Cameroon before reunification. In common with much of Cameroon it has suffered from considerable underinvestment by the Government, in both industry and infrastructure over the last 25 years resulting in high levels of unemployment and under-employment. Whilst inflation is relatively stable, devaluation of the currency in the early 1990s and cuts in the salaries of government employees mean that many people barely make an adequate living and manage to support their often large families only by growing and selling much of their own food. The vast majority of businesses are those of sole traders who may sell telephone credit or prepared food by the roadside or who operate such services as barbershops, tailoring or plumbing and electrical installation. Only a small minority of individuals have access to their own transport, and business operations are therefore very localised. Some may be seasonal, with a rainy season in Cameroon extending from July to the end of October.

One of the criticisms of micro-finance institutions is the need to charge excessively high interest rates which may reach 30 – 50 per cent and prove self defeating in attempts to assist the poorer members of society. HINT aims to keep these rates as low as possible by seeking investment capital rather than commercial banking financing. Initial projections demonstrate that this is achievable and are detailed in section 6.



4. THE MARKET

It is easy to imagine that poor people don't need financial services, but in fact they are using these services already, in informal ways. They invest in assets such as domestic animals, building materials, and things that can be easily exchanged for cash. They may set aside corn from their harvest to sell at a later date. They keep cash under the mattress. They participate in informal savings groups where everyone contributes a small amount of cash each day, week, or month, and is successively awarded the pot on a rotating basis. Some of these groups allow members to borrow from the pot as well.

However widely used, informal savings mechanisms have serious limitations. It is not possible, for example, to cut a leg off a goat when the family suddenly needs a small amount of cash. In-kind savings are subject to fluctuations in commodity prices, destruction by insects, fire, thieves, or illness (in the case of livestock). Informal rotating savings groups tend to be small and rotate limited amounts of money. Moreover, these groups often require rigid amounts of money at set intervals and do not react to changes in their members' ability to save. Perhaps most importantly, the poor are more likely to lose their money through fraud or mismanagement in informal savings arrangements than are depositors in formal financial institutions.

Formal financial institutions were not designed to help those who don't already have financial assets and for the majority of Cameroonians living a hand to mouth existence and trying to make ends meet with a small business:

- There is no money to open a savings account with
- There is no collateral to secure a loan with
- There is no credit record as they may never have been formally employed and have never taken out a loan before
- Some may even be unable to complete the necessary paperwork as they are illiterate.

Increasingly therefore, and in common with the experience of other countries, they rely upon microfinance institutions (MFIs).

5. MARKETING PLAN

As research strongly indicates that women's groups are the most reliable form of borrower and the key to economic growth, our primary target clients include all self-employed females living in target communities with a focus on women with income of less than CFA 300,000 (US\$600) per year. Since a dominant share of our target communities includes individuals with the above profile, we expect considerable demand in each village. As previously stated, HINT already has strong links with its target communities through its existing projects in the areas of ICTs, Child Support, HIV/AIDS Education and other medical outreaches and has entered the Micro-Finance market via these routes. HINT will continue to target these groups and aims to achieve this via two principal means.

Firstly we are already receiving referrals from our initial groups and from existing HINT projects. We expect our reputation as an organised and effective lender to encourage increasing amounts of new businesses from this source as our reputation is enhanced, borrowers introduce friends and our groups expand in size.

Secondly, we have other community contacts via community group leaders known to HINT who will raise awareness of our offering in their communities. As our business becomes more established we will approach the Ministry of Agriculture and the Department of Women's Affairs, who maintain details of farming projects and women's groups throughout Southwest Province who would also benefit from our services. Before visiting a community HINT will talk to local community leaders to enlist their goodwill. If they approve the programme, we will enlist their help in promoting it within the communities.

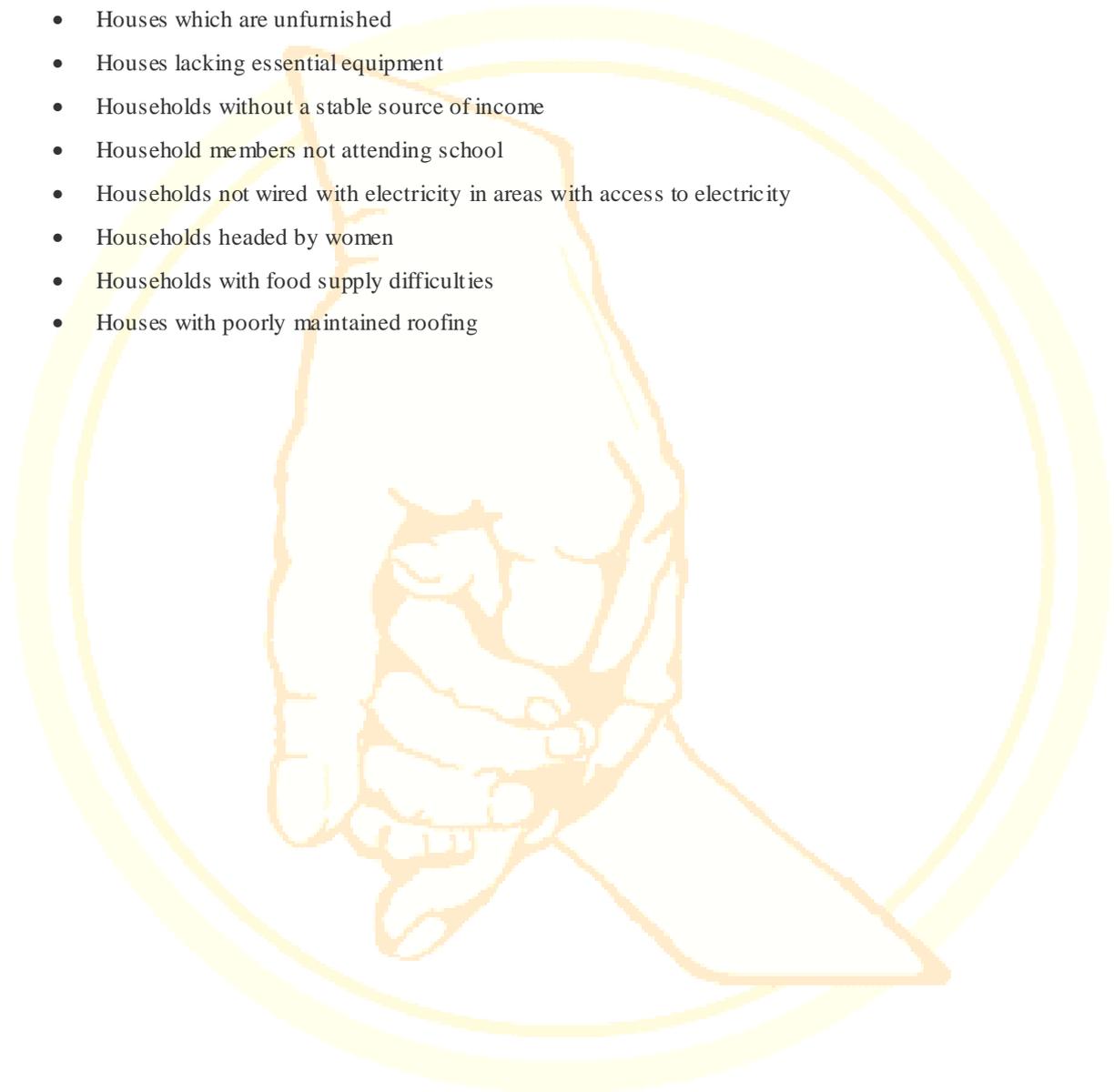
A new microfinance project cannot serve every community that demonstrates need. In order to support long term success we have devised a series of selection criteria which will be used in the identification of new markets and these are detailed below:

- We will choose only communities with good access, demonstrated interest, committed and capable local leadership, and real potential.
- Communities will be less than two hours away from the HINT office in Buea.
- Seasonal transport problems mean that all communities served need to have year-round access as Micro-finance requires contact throughout the year
- Community size will be assessed. In rural areas, it takes as much time to work with a small village as a large one. Communities with less than 40 households may lack sufficient population for an effective programme.
- Communities will be clustered where possible. The closer the communities are, the easier it will be to service them. Also, if communities are tightly clustered, smaller communities can be considered as viable candidates. Density also facilitates learning between communities and larger group training and lowers cost.

HINT will increase awareness of the availability and operation of the Micro-Credit finance scheme within identified communities via local information meetings and has produced guidelines for the formation and operation of credit groups which are designed to support the meetings and enhance understanding.

Following the meetings HINT will conduct individual interviews to gain a greater understanding of the communities needs. This process will also serve as an opportunity to determine the relative wealth or poverty of the potential clients. The following indicators will help to identify the poor from the less poor:

- Houses which are unfurnished
- Houses lacking essential equipment
- Households without a stable source of income
- Household members not attending school
- Households not wired with electricity in areas with access to electricity
- Households headed by women
- Households with food supply difficulties
- Houses with poorly maintained roofing



6. FINANCIAL SERVICES AND FUNDING

As previously explained HINT wants to create an investment capital of CFA 2 million and appears to have this from available funds. However, the project's long-term financial sustainability depends on charging an interest rate which (a) covers operational costs (including the cost of loan defaults); and (b) covers the cost of capital including interest on borrowed capital and the cost of inflation on owned capital. All successful microfinance operations worldwide charge higher than market rates but in keeping with its mission, HINT's aim is to charge a rate which will ensure financial sustainability without incurring excessive cost for its clients. We have assumed a variety of financing methods in order to assess the level of interest rate chargeable to borrowers which would be necessary to break even. There are four options of generating funds.

Local bank financing

We take a loan at a local Cameroonian bank. This loan has an expected interest rate of 20% .

Foreign financing

We ask a development bank for financing. They will lend money for the micro credit program at an expected interest rate of 8%.

Development loan

We get a development loan from a foreign development organisation. We pay back the money in 5 years but without any interest payments.

Grant

Instead of borrowing money which needs to be repaid, we will get a grant from an organisation willing to donate it.

In order to get support for the latter route, which is obviously the most attractive financing option, we will have to establish a program in which organisations can participate as non-profit shareholders in the microcredit program. HINT will focus its efforts on getting grants and 0% interest loans in order to reduce the cost of capital. This must allow HINT to reduce interest rates to 15-20% in order to make sure the beneficiaries can profit from the loans.

The following tables detail our break-even calculations. Under Option 1 we will have to make regular payments and pay interest. This example will use an interest rate of 20% and a loan of 1.8 million CFA. The amortisation will be linear over five years. Similar principles apply to the remaining options.

Loan: CFA 1.8 M (assumes a 10% contribution from HINT)

Interest rate: 20% per year

Amount to pay back: CFA 602 K per year (CFA 3.009 M total)

In order to make this approach viable, we must lend all funds to the participants in the micro credit program. Based on our research of the current micro-finance market and as a new entrant, we have based our assumptions on experiencing the highest level of default reported, at 12.5 per cent. We have used a six-month repayment period for each loan. This means our 2 million can be lent twice in the first year. Table 1 shows the interest rates which need to be charged in order to break even. In order to generate a positive cash flow out of this project, interest rates would need to be above the given rates.

	Option 1	Option 2	Option 3	Option 4
Financier interest rate	20%	8%	0%	0%
Annual repayment	602	467	400	0
Bad Debt (12.5%)	500	500	500	500
Present value 4M	3,500	3,500	3,500	3,500
Future value needed	4,602	4,467	4,400	4,000
Necessary interest rate	31.5 %	27.6%	25.7%	14.3%

Table 1: First-year break-even interest rate of financing options (*000s CFA) assuming loan turnover x 2

Table 2 shows the effect on interest rates payable of extending the term of the micro-credit loans to 12 months.

	Option 1	Option 2	Option 3	Option 4
Financier interest rate	20%	8%	0%	0%
Annual repayment	602	467	400	0
Bad Debt (12.5%)	250	250	250	250
Present value 2M	1,750	1,750	1,750	1,750
Future value needed	2,602	2,467	2,400	2,000
Necessary interest rate	49%	41%	37%	14.3%

Table 2: First-year break-even interest rate of financing options (*000s CFA) assuming loan turnover x 1

From the data in both tables one can conclude that the chargeable interest rates are too high for Options 1 and 2 to satisfy HINT's goals. Option 3 may be feasible if the term of the micro-loans remains short in order to obtain optimum use of capital. In order to keep interest rates more in line with its target aspirations however, HINT will have to rely on 0% loans and grants in accordance with Option 4. HINT would aim to reduce the interest rate further over the course of the five year plan by focusing our efforts on reducing the percentage of loans which are not repaid. If successful, either a reduction in interest rates or an increase in capital available for loans will be achievable; or indeed a combination of both.

In order to meet the needs of its clients, HINT intends to provide micro-loan and savings services to individuals within Trust Groups to use for working capital and the purchase of small fixed assets (such as tools). The operation of these groups and rules pertaining to them is detailed in our Operational Guidelines, a copy of which is available if required. Below we have listed the basic description of our loan product.

- Loan ceilings are the following: CFA25000 (\$50), CFA 50000 (\$100), CFA 75000 (\$150), CFA 100000 (\$200).
- Loan terms are initially six months. Market research indicates that clients should be able to pay back loans within this period.
- Interest is 20 per cent flat.
- Payments will be collected by Group Treasurers on a weekly basis.



7. OPERATING PLAN

The beneficiaries will be as previously described. They will be expected to use the financing in order to start small businesses which will generate a small but sustainable income. In order to make sure the beneficiaries will make the right investments, information meetings will be organized by HINT. In these information meetings, HINT will provide training on the basic principles of banking and business

The beneficiaries will be organised into credit groups which have a communal responsibility for the weekly payments. Each group will appoint a Leader and a Treasurer who will manage group finances, recommend support or decline of loan applications to the HINT Loan Committee, and be spokespersons for the group. The credit groups will meet every week to discuss their businesses and exchange ideas and best practices and in these meetings the treasurer will collect the loan repayments. Social pressure within the credit group will make sure beneficiaries will repay their loans. If any of the members does not repay their loan, the other group members are responsible for repayment. If a credit group fails to repay the loans, its members will no longer be eligible for loans in the future. When the group payments are collected, the group treasurer will pay these to HINT together with a summary of receipts which HINT will use to update central records. The treasurer will need to keep accurate records of his/her group members' transactions and advise HINT of those members who are failing to meet their repayments. Full details are enclosed in the Operational Guidelines.

Research demonstrates that successful financial services products in the informal sector, are governed by common guidelines. The main lessons derived which have been used as the basis for HINT's plans, include the following:

- **Work directly in the community.** Staff will be in close contact with villages and poor neighbourhoods attending regular weekly meetings with Credit Groups;
- **Simplify application procedures;**
- **Extend Credit quickly.** Our aim is to respond within a week;
- **Do not require records and complex business plans.** Because only a small percentage of small traders keep written records of any kind, successful programmes refrain from asking for records or plans from the borrower. For HINT's purposes the individual will only retain a loan repayment card. Their credit trust group will maintain principal financial records in conjunction with HINT;
- **Do not request guarantees.** HINT's use of Credit Groups where business owners are mutually responsible for repaying loans will substitute effectively for conventional guarantees. The individual's reputation in the community is more important than security;
- **Work with existing economic activities,** no matter how small, or work with start-ups appropriate to the community;
- **Extend small, short-term loans** primarily for working capital on simplified terms. These "test" the client's commitment to repay, and also allow the client to see whether or not a loan will, in fact, help the business grow. These loans will have frequent (weekly, bi-weekly) repayments;
- Provide larger loans based on successful repayment

8. CONCLUSION

HINT is an established Non-Government Organisation with an established presence in its chosen fields. In order to meet the needs of its clients and in line with its mission, it needs to continue to expand its range of projects designed to enhance the lives of the poorest members of the community.

In order that it may plan strategically for the long term, HINT also needs to secure established, regular income streams in addition to the sporadic donations which comprise the bulk of its current income.

This is partially achieved at present through the activities of its internet cafés and IT training programmes.

HINT considers that a properly financed Micro-Finance project would meet its dual needs effectively. It would enable HINT to assist members of the community to develop their businesses and household income streams whilst also providing the organisation with the means to sustain and expand its operations to achieve its aspirations in a more strategic and focused way.

