Evaluation of IDRC's Project on Regulation and Supervision of Community-Oriented Financial Intermediaries (COFIs)

By
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Terms of Reference

The contract for the consultancy was dated February 10, 2004 and required a draft report by April 30th and a final report by May 20th. The consultancy involved reading COFI publications, visiting Ottawa to talk with IDRC employees, interviewing project participants in Quebec, discussing the project with professionals interested in regulation and supervision of financial cooperatives, and contacting those involved in the project overseas.

The contract laid out three objectives for the consultancy:

1. To assess the work undertaken by COFI, including the institutional setup of the project.
2. To offer reflections on the project's thematic approach and strategies in relation to other work in microfinance.
3. To identify research gaps in microfinance that might be filled by future MIMAP projects.

Project Overview

In early 2000 Laval University and 5 other cooperating institutions submitted a project proposal to IDRC on microfinance. It was approved and scheduled to begin in May but the start of the project was later postponed until November 1, 2000. The project ran for three years and officially ended on October 31, 2003. In addition to the approximately $640 thousand provided by IDRC, the Developpement International Dejardins (DID) reinforced the effort with another $130 thousand. Research was to be done in five countries: Benin, Canada, Colombia, Morocco, and the Philippines.

Three general questions were background for the project: Is microfinance useful in easing poverty? Can financial cooperatives play a significant role in poverty alleviation? What regulation and supervision (r&s) regime would best assist financial cooperatives to be more efficient, stable, and durable? The project title and the initial proposal stressed regulation and supervision.

The emphasis on poverty in the project proposal was consistent with MIMAP's program framework.[1] Those who prepared the project proposal posited that properly regulated and supervised financial cooperatives would provide more financial services to small- and medium-sized enterprises. This, in turn, would allow these firms to employ more poor people, thus connecting to MIMAP's overall objective of poverty alleviation.

The reach of the project was ambitious. The project team attempted to link so-called market approaches, financial markets, regulation and supervision, and financial cooperatives, small and medium sized enterprises, with poverty alleviation. This included modeling the operations of COFIs, modeling decisions made by firm/households, and measuring the ultimate impact of access to finance on poverty. In addition, the project team planned to prepare a research manual and sponsor several meetings on topics related to the project.

The objectives laid out in the project proposal were likewise ambitious:[2]

1. To articulate the theoretical foundations and execute the corresponding empirical tests regarding the concept of poverty alleviation through financing small and medium sized enterprises.
2. To articulate the theoretical foundations and execute the corresponding empirical tests on adequate regulation and supervision regimes for financial cooperatives.
3. To encourage a debate among regulators, donor agencies, and leaders of financial cooperatives.
4. To generate specific proposals and documentation of regulation and supervision regimes that might be used as references by policy makers
5. To document regimes of delegated monitoring that might be use by regulators of financial cooperatives.
6. To articulate the theoretical foundations and execute the corresponding empirical tests regarding adequate capital standards for financial cooperatives.
7. To encourage a debate among regulators, donor agencies, and leaders of financial cooperatives about capital standards.
8. To propose capital standards that might be used as a reference point by regulators of financial cooperatives.
9. To articulate the theoretical foundations and do the corresponding empirical tests regarding contract design and compensation packages for managers of financial cooperatives.
10. To propose improved contracts and compensation packages for managers of financial cooperatives.

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[1] The version of the project proposal that I reviewed did not have page numbers. In addition the page numbers listed in the Table of Contents do not correspond to a manual count of the text pages. It is, therefore, awkward, to cite specific page numbers in this report.

[2] These objectives are stated on approximately pages 14 and 15.

Fit of The Project in The Microfinance Industry

Three elements of the project overlap with other microfinance efforts. The first is the focus on an important component of the industry, financial cooperatives. This emphasis is doubly justified: these cooperatives provide valuable financial services to tens of millions of people of modest means, but these organizations have not received their fair share of attention and support from donors who promote microfinance.[3]

The second common element is the concern with regulation and supervision. COFI's efforts focused on documenting the agency flaws in financial cooperatives that, in turn, partly justify r&s. This is a narrower focus than other recent work done on strengthening r&s in the microfinance industry. This broader work has wrestled with the problems of who should be regulated, what to regulate, information needed for r&s, and the institutional framework that should carry out this task (for examples see Arbuckle, Christen and others, Vogel, and Westley).[4]

The third overlap is doing credit-impact studies. Over the last few years an increasing portion of foreign aid has been justified by stressing poverty alleviation, including MIMAP/IDRC's efforts. This, in turn, leads policy makers to request information on how the foreign aid impacted poverty, especially in the microfinance industry where hundreds of researchers have done credit impact studies, with problematic results (see Dunn for one example).

Project Accomplishments

[3] Donors and governments have shied away from helping financial cooperatives because of bad experiences during the three decades prior to 1990. Explanations for these problems include subsidized interest rate policies, external funding that corroded cooperative performance, and macroeconomic turmoil that damaged all financial institutions, including financial cooperatives. The macroeconomic environment began to improve in many countries in the early 1990s and this allowed a more hospitable environment for financial cooperatives. At about the same time, donors mostly ceased providing external funding for lending by cooperatives. In addition, most donors and many financial cooperatives adopted interest rate policies in the 1980s that were more market determined. Together these important changes allowed a resurgence of financial cooperatives in many low-income countries, something donor employees have been slow to recognize. Some donor employees are also leery of the religious roots of many financial cooperatives. They are discomforted by advocates who extolling the merits of their cooperative model in quasi-theological terms.

[4] My impression is that the leaders of COFI assumed the best r&s model was one where a strong centralized federation did the regulation and supervision of dependent financial cooperatives. Others who work on r&s problems might disagree with that conclusion and argue that conflicts of interest in federations are a serious concern.

The most important contribution of the project was to elevate awareness about the important topic of regulation and supervision of financial cooperatives. Several meetings sponsored by COFI and a number of presentations by participants in professional meetings were important parts of this. The substantial number of requests that Dr. Fischer receives for consulting assignments on r&s problems, and the fact that Martin Desrochers was hired by DID because of his experience with r&s and the COFI project, illustrates the interest in regulation and supervision of financial cooperatives. Mexico is an example of where project participants have influenced the discussion about r&s.

Within r&s, COFI elevated the understanding and importance of agency costs in financial cooperatives. This includes developing methods to measure these costs, suggesting policy changes to ameliorate these problems, and proposing the interesting hypothesis that agency problems are a primary factor in the malfunctioning of financial cooperatives. Project work could result in highly useful measures of agency costs that might be used both by regulators and managers of financial cooperatives.

Three other products of the project are noteworthy. A half dozen or so students used information collected by the project for their theses or dissertations. Possibly, some of the students will go on to do additional professional work on r&s problems. Their publications supplement the considerable amount of additional research papers stimulated by the project. Additional publications include a special issue on microfinance of the Canadian Journal of Development Studies due out in late 2004, a manual of research procedures, numerous working papers, and several drafts of proposed journal articles.[5] The contribution of these drafts awaits the judgment of peer review.

Several potentially useful data bases are the third important product of the project. One data base includes 1,238 household interviews with borrowers and non-borrowers from Benin, Colombia, and the Philippines. Another data base contains information on financial cooperatives from Benin, Colombia, the Philippines, Bolivia, and Peru. Relatively little of this information was thoroughly analyzed by the time the project formally concluded. I assume that students and researchers will do further useful analysis of this information in the future.

Overall, the project laid the foundation for future work on the important topics of microfinance, financial cooperatives, and further work on regulation and supervision.

[5] A listing of the approximately three-dozen publications associated with the project is presented in Table 6.1 of the "Final Technical Reports," dated November 15, 2003. Nine of these articles will appear in a forthcoming issue of the Canadian Journal of Development Studies.

Problems/Suggestions/Comments

The project experienced some problems and included several elements that might be rethought before IDRC funds a second phase.

Project Design

The reach of the project was overly ambitious, especially considering the relatively small amount of money that IDRC allocated for the research. It was unrealistic to expect that all of the items in the project proposal could be modeled and fleshed out with empirical information for multiple countries, along with developing a network of researchers who would perpetuate the effort, for only about three-quarters of a million dollars.[6]

Development organizations need a grand design to sell their programs and to sustain funding. From a microfinance perspective, however, MIMAP's design is too grand. Trying to fit small microfinance research projects into this grand design could either result in bait-and-switch, or a project that is yards wide and inches deep.

While it is certainly justified to focus on projects that assist people who are relatively poor, microfinance is a weak tool for addressing poverty. From the borrowers' perspective, a loan is debt that must be repaid.[7] Borrowers only benefit from debt to the extent they can generate more income from a debt-induced investment than is needed to repay the principal, plus interest, plus the amount of transaction cost they incur in obtaining the loan. Some of these investments may turn sour and leave the borrower worse off than they were before borrowing. Additional debt may allow some individuals to capitalize on economic opportunities, but debt cannot create opportunities. It will not heal the sick, it will not provide land to the landless, it will not create a market for ones' products or services, it will not make the illiterate able to read, it will not provide law and order, it cannot form a favorable crop-growing environment, it cannot create entrepreneurship, and it will not change cultural norms that severely limit the activities of women.

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[6] By way of contrast, in 2000 the Inter-American Development Bank signed a contract with the Canadian Co-operative Association to assist with credit union development in the Bahamas. Strengthening the regulation and supervision of a small number of credit unions was an objective of the project. The contract was for three years, for one small country, and involved about as much money as the COFI project.

[7] Over the past few decades there has been a metamorphous in views toward loans. Traditionally, religious leaders and philosophers cautioned people not to go into debt. Gradually, this negative notion of "debt" has been replaced by the positive notion "credit." People generally ignore that credit and debt are opposite sides of the same coin. Advocates of microcredit programs have occasionally argued that credit is a universal entitlement and some have suggested it is an all-purpose anti-biotic for treating poverty. Providing loans to poor people is now widely seen as a noble effort even though the act of taking loans results in borrowers being in debt.

Of the two major activities in finance, lending and deposit taking, deposits have the closest relationship to poverty resolution. Historically, most people pulled themselves out of poverty through saving, not through borrowing; people for thousands of years improved their lot through savings without the assistance of loans from financial cooperatives or other non-governmental organizations. Unfortunately, COFI paid little attention to the deposit taking side of financial cooperatives, even though deposits -- not lending -- are the primary justification for r&s.[8]

Montreal Dropout

A particularly serious problem in the project was the failure of the Centre de Gestion des Cooperatives, HEC, in Montreal to fulfill its obligations on the topic of r&s. This resulted in too little work being done on the general topic of r&s, the primary objective of the project. The work on r&s that was done focused on modeling financial cooperatives, empirical work on agency problems, and presenting arguments about the superiority of the highly integrated and centralized r&s typified by the Desjardans system. Readers of project publications come away with little understanding of the unique r&s problems and arrangements that exist in the three countries where empirical work was done (for example, see Arbuckle).

Developing Research Networks

A number of countries have social science research institutions that do policy research. The Philippines Institute for Development Studies and the Bangladesh Institute of Development Studies are examples of these organizations. Typically, they employ a small number of permanent staff and hire students or temporary employees to do interviewing, or help with short-term studies. Seldom are these organizations large enough for the professional staff to specialize in topics such as financial cooperatives and their regulation and supervision.

Given these conditions, one should not expect that a small, short-term project such as COFI would create a sustained network of researchers on the topic of r&s. Researchers' interest in the topic will likely last only as long as external funds are available. People with the credentials and skills to do this type of research are often pulled into other government jobs, find employment in the private sector, or move on to work with donors. The facts that one of the three principal country investigators in the project had moved on to another institution

[8] The surfeit of rural deposits mobilized by financial cooperatives in Korea, Taiwan, and Japan over the past 100 strongly suggests a larger number of poor people benefit from attractive deposit facilities than the number who benefit from borrowing from these organizations. The successful reform of the government-owned Bank Rakyat Indonesia since the early 1980s leads to a similar conclusion: more people in rural areas benefit from depositing than benefit from borrowing.

by the time the project terminated, and one of the Laval administrators took another job with Desjardins, illustrates this point.

Perhaps the most that IDRC can claim in regard to building a network is that the project alerted a number of people to the issue of r&s and reinforced this with a number of related publications. In other words, the project for a time, enhanced networking on the topics of r&s and impact studies, but had a lesser effect on developing a persistent network. The most lasting effect of good research is the knowledge and literature it generates.

Fewer Countries

Originally, the project proposed to do research in five countries: Morocco, Benin, Canada, Colombia, and the Philippines. Eventually, no fieldwork was done in Morocco or Canada. In addition, plans to incorporate results from parallel research in Mexico funded by others failed to materialize.

The fact that research was eventually done in only three countries indicates that the project's initial objectives were too ambitious, and/or that the project was substantially under funded. A follow-on project ought to have less geographic scope if it involves much primary data collection.

Overhead Rate

A disagreement between IDRC and Laval University over the percent of the project funding that was to be paid to the University for overhead stalled the start of the project for six months. Eventually a compromise was reached that transferred funds from research efforts to pay more overhead to the University. This delay later caused an extension of the project and contributed to too little data being analyzed by the time the project ended in October 2003.

The approximately 15 percent that IDRC allows for overhead is inordinately low by U.S. standards, at least, where overheads on similar university research contracts range upward from 40 percent. The small amount of overhead allowed by IDRC probably covered only the marginal costs of the university administering the contract and left little over for the fixed costs of sustaining a university. Prudent university administrators might look long and hard at any follow-up project that involves such modest overheads. It may be unrealistic to expect universities essentially to subsidize an IDRC project that involves objectives that are somewhat removed from university goals. These modest overheads might deflect university administrators from backstopping the project with support staff, providing extra office space, or buying supporting library documents. IDRC's concerns with developing research networks overseas ought to extend to institutionalizing these networks in lead institutions in Canada.

It may be useful to reevaluate IDRC's policies on overheads before initiating any new projects on microfinance.

Community Oriented Financial Intermediaries (COFIs)

The title of the project was much broader than the institutions studied by the project. I interpret COFIs as including a large variety of informal forms of finance, village banking, at least some forms of lending done by non-governmental organizations, plus financial cooperatives. The project focused entirely on financial cooperatives. I suggest that any follow-on project drop COFI from the title and use financial cooperatives instead.

Understaffed Administration

It was unrealistic to expect two people in Laval University, one with substantial teaching responsibilities, to manage effectively a complicated project that was supposed to work in 5 countries, treat questions that included dealing with three languages, plan and organize seminars overseas, and co-ordinate with eight institutions (including IDRC and DID). Consideration might be given in any future projects to reducing the scope of work and bulking up the administrative support, possibly including a full-time bi- or tri-lingual administrative assistant, plus secretarial assistance. If the project is expected to work across several languages, it might also be useful to include project money for translations and editing. It is not an efficient use of researchers' time to handle the details of a project or to do much translating and editing.

Other Literature

Participants in the project might have benefited from surveying a broader range of literature than they apparently did. Leaders of any new microfinance project ought to use electronic libraries and other information sources that are available. The Consultative Group to Assist the Poor (CGAP), for example, maintains The Microfinance Gateway that provides access to large numbers of publications on the topic of microfinance. A search of that Gateway showed 178 publications on the topic of regulation and supervision and 82 on the topic of credit impact studies. Few of these publications were mentioned in COFI documents. Leaders of any follow-up project(s) should early connect with other organizations and researchers who are working on similar topics: CGAP, GTZ, the World Council of Credit Unions, the Inter-American Development Bank, the World Bank, the Asian Development Bank, and the Canadian Co-operative Association.

It likewise would have been useful if the project compiled more information on the r&s systems that exist in the three countries where COFI did fieldwork. In the Philippines, at least, there has been a substantial amount of work done on the r&s of financial cooperatives the past few years. It would have been useful if the COFI project had referenced that work and indicated how COFI's activities contributed to the broader effort.

Unit of Analysis

Much of the data collection by COFI used the household as the unit of analysis. Additional information was assembled that concentrated on financial cooperatives. Given the three key ideas that were used to introduce the project proposal I would have expected that the primary unit of analysis would have been the small and medium-sized enterprises that were supposed to provide income and employment for poor people, after these firms had received loans from financial cooperatives.[9] This type of information would have allowed COFI researchers to analyze the relationships between borrowing by these firms and their employment behavior.

Advocacy

There are hints of the advocacy in the project. Work on financial cooperatives can slip into advocacy for one particular model, such as the one practiced by Desjardins. The COFI project was vulnerable to this since it included co-funding by the Desjardins group and involved researchers who were steeped in Desjardins' philosophy. The system of r&s in the Desjardin's model is quite different from the models used in many other countries, including English speaking Canada. My impression is that these other models were underemphasized in COFI's efforts.

There is much to admire about the Desjardins system and its achievements in French speaking Canada. One might argue, nonetheless, that it grew out of unique circumstances that limit its exportability: it had strong roots in the Catholic Church, it sprouted because French speakers felt excluded from English dominated banks, it became a common bond organization, and it was early involved in solving all types of problems faced by parishioners.[10] As a result, the movement evolved into a strong federation that provided a wide variety of services to dependent cooperatives with low capital requirements. The movement, however, did not penetrate much into English speaking Canada where another financial cooperative model became popular.

[9] In the 1970s and 1980s Michigan State University, under the leadership of Carl Liedholm, analyzed small and medium sized enterprises in a number of low-income countries. It may have been appropriate to include some of their methodology in COFI's research.

[10] The limits of the exportability of the Desjardins model is illustrated by the first U.S. credit union formed in St. Mary's Parish in New Hampshire in 1908. It was formed by a priest who worked with poor, French speaking Canadians who migrated to New Hampshire to work in the textile mills. This cooperative later became the St. Mary's Bank but now operates like most other credit unions in the United States. Instead of following the Desjardins model, financial cooperatives in the U.S. later evolved into largely specialized financial institutions with much more independence than in the Desjardins system.

Desjardins advocates argue for locating the auditing function within federations and oppose external r&s, the U.S. and English-speaking Canadian model. Dejardins advocates discount the conflict of interest involved in vesting promotion and r&s in the same entity. Proponents of the U.S. system stress the importance of economies of specialization, while Desjardins supporters emphasize the synergies created by having a strong, centralized federation that provides a variety of services, some of which are non-financial. Desjardins supporters argue that financial cooperatives are best disciplined by the threat of losing access to vital services from the Federation. Critics of the Desjardin model argue that capital requirements should be much higher than they are.

If a follow-up project on r&s is funded by IDRC it might be appropriate to include organizations or individuals who are supportive of financial cooperatives in English speaking Canada and who are willing to explore other models of r&s. The philosophy of the new project ought to be that the r&s problem is one that many people are trying to solve and that valuable lessons might be drawn from a variety of experiences. The perceived objectivity of researchers is diminished if they are viewed as advocates of one approach.

Location of Agency Problems

Most of the modeling and data gathering on the agency problem by COFI concentrated on managers of financial cooperatives. Clearly, the differences between the interests of managers of cooperatives and the concerns of their members are important issues. Future work on this topic might expand and consider the agency problems that exist between federations and their member cooperatives, and between an external r&s agency and the financial cooperatives they oversee.[11] This might also include questions about who regulates the regulator. In some cases this has been addressed by having someone from the central bank or from the superintendent of banks monitor the external regulator.

Credit Impact Studies

COFI spent a lot on impact studies. I received complaints from several country participants about too much emphasis being placed on these studies. They were costly to do, too commonly reported positive results, and involved serious methodological problems.[12] The costs stem from the need to collect and analyze primary information, often captured through lengthy interviews with

[11] A recent melt-down of an external r&s agency for financial cooperatives in Guatemala dramatically illustrates this agency problem.
[12] A window into recent work on credit impact can be seen in publications issued by the project Assessing The Impact of Microfinancial Services (AIMS), funded by the U.S. Agency for International Development.

individuals, firm managers, or families. Attribution difficulties and selection bias are the dominant methodological problems in credit-impact studies. If the research design involves measuring changes over time in a group of "beneficiaries" of donor assistance, it is problematic to isolate and properly attribute the effect of the aid treatment (loans) on the selected change from other concurrent negative and positive forces that affect poor people. For example, farmers may receive loans from financial cooperatives over several years and also experience an increase in their incomes. But, most of their increase in income might result from favorable weather over the time under study that boosted their yields and income. Sorting out the contributions of loans and weather to increased income is difficult. In addition, longitudinal studies are notoriously expense.

The approach used to measure credit impact in the COFI project involved the other primary methodology. This approach compares a group of individuals who receive loans, with a group that did not. This method, unfortunately, is dogged by selection bias problems. For example, one group might be composed of microentrepreneurs who have received loans from financial cooperatives. The economic results of a control group of non-borrowers are then compared with the results of those who received loans. The problem with this approach is that by its very nature lending involves selection of individuals who are creditworthy. One's creditworthiness, in turn, is determined by experience, intelligence, success in previous business ventures, assets owned, and possibly education. Only if the selection process is short-circuited, and loans are distributed randomly, is it possible to compose a control group that is like the group receiving loans.[13] Results that show borrowers perform better than non-borrowers may simply indicate that borrowers had more entrepreneurial talents to start with than did non-borrowers.

If a new project is funded on financial cooperatives, I suggest the researchers not be required to do credit-impact studies. If it is politically important to show that financial cooperatives contribute to poverty alleviation, this might be done through profiling members of these cooperatives and documenting that many of them are of modest means, particularly the depositors.

What Happened to the Big Three Questions?

Project results might have been better focused if research efforts had been more closely tied to answering the general questions raised in the introduction of the project proposal. Two of the three questions asked are important.

[13] I've seen only one study that side-stepped the selection-bias problem. This study was based on two groups of individuals, all of whom had been approved for loans. Only one group, however, actually received loans while the other, the control group, did not. The costs of screening all the borrowers and non-borrowers, and the obvious public relations problems limit the use of this approach in measuring credit impact.

Most students of development would answer the first question about the usefulness of finance to poor people in the affirmative. Hundreds of millions of poor people around the world create and extensively use various forms of informal finance, both loans and deposits, because they benefit from doing so. Likewise, millions of poor people voluntarily participate in a variety of other semi-formal or formal forms of finance, and show with their continued actions that they realize more benefits than costs from their actions. Researching this question appears to substantiate the obvious.

The second question receives less uniform answers from development specialists and merits research. Proponents of financial cooperatives might argue that large numbers of people of modest means are members of these organizations, that they hold substantial amounts of their savings there, and that many of the members benefit from borrowing from cooperatives. Proponents might also argue that financial cooperatives can be induced to lend more to targeted segments of the poor such as micro-entrepreneurs, women, and farmers. Skeptics, in contrast, argue that few members of financial cooperatives are truly poor, and that previous government and donor attempts to nudge these organizations into providing financial services to the poorest class have usually failed.[14]

There is even less consensus on the third question.[15] Across countries, the range in quality and quantity of regulation and supervision of financial cooperatives is substantial. In some cases, these cooperatives operate with little or no supervision, aside from their boards of directors. In other cases, a department of cooperatives has the legal responsibility to regulate and supervise member organizations, but often lacks the capacity or incentives to do so effectively. In still other cases a federation attempts to regulate its member organizations despite the conflicts of interest that are typically involved. In a few countries the central bank or the superintendent of banks is charged with the responsibility of regulating and supervising financial cooperatives, often doing so with little enthusiasm, and sometimes doing so through a surrogate.

Students of regulation and supervision also disagree on what types of activities should be regulated (Vogel). Should small cooperatives with few members and few voluntary deposits be forced to incur the additional costs of submitting to an external regulation and supervision regime? Is there a need to monitor externally closed-bonded cooperatives? Should regulation and supervision be concentrated on large open-bonded cooperatives that mobilize

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[14] Some of this nudging was done during the 1970s by donors who attempted to induce financial cooperatives to lend more to farmers. More recently, various donors have prodded financial cooperatives to lend more to women and operators of small businesses.
[15] The interest in regulation and supervision of COFIs is not only a north/south concern, but is also an east/west concern in Canada.

substantial amounts of voluntary deposits? COFI research shed some light on these questions. A follow-on project ought to provide even more answers.

Gaps for Possible Future Research

Financial cooperatives are a vital segment of the microfinance industry, but they receive relatively little research attention, compared to other non-governmental organizations. Looking at the microfinance industry in total, three important interrelated research gaps exist: deposit mobilization, regulation and supervision, and developing standard bookkeeping procedures that facilitate better governance, regulation and supervision. All of these gaps apply to financial cooperatives. IDRC might consider funding up to three coordinated projects on these topics. Deposit mobilization is the most direct link between IDRC's objective of alleviating poverty and the proposed projects.

Deposit Mobilization

As Vogel and others have pointed out, deposit mobilization is the forgotten half of microfinance. Most microfinance conferences focus mainly on lending, a huge majority of non-governmental agencies that do lending do not accept voluntary deposits, and many poor people, especially in rural areas, have extremely limited deposit opportunities. A few research studies and a handful of development efforts, nonetheless, strongly suggest that many poor people can and will augment deposits if they have the opportunity and incentives to do so.

Financial cooperatives have the potential to fill an important portion of the deposit-taking gap that exists in many low-income countries, thereby benefiting more people of modest means. Two factors support Canadians taking the lead in deposit mobilization. First, Canadians have a vast amount of experience in developing highly successful financial cooperatives under two models. Second, unlike large lending programs, deposit mobilization efforts require small amounts of external funding, a feature that fits with Canada's limited resources for development efforts. To the extent that IDRC's projects must link to poverty alleviation, providing poor people access to attractive and safe deposit services could be the rationale for a new project that focuses on deposit mobilization.

A new project on this topic might include a careful review of literature, case studies of programs that successfully mobilized deposits, and an analysis of factors that discourage these activities. It might also be helpful to study the types of savings services provided by informal finance, especially self-help financial groups (for example: tontines, chit funds, susus, stokvels, and tandas). In a number of countries these informal organizations are major competitors of financial cooperatives, especially for deposits. Understanding the advantages and types of services provided by these groups may assist financial cooperatives to offer more attractive deposit products and services.[16] Additional studies might be done on the costs of mobilizing deposits and managing them.

Regulation and Supervision

Deposits are the primary justification for regulation and supervision, especially the deposits of poor people. It is immoral to encourage poor individuals to place their deposits in organizations that are not properly governed, regulated, and supervised. In most countries r&s problems in financial cooperatives are unresolved. On the one hand, financial cooperatives can play an important role in mobilizing deposits. On the other hand, as the COFI project documented, these cooperatives have several features that require heightened concerns about regulation and supervision when they handle large amounts of deposits.

Due to the ambiguities in ownership arrangements cooperative leaders may not always act in ways that are in the best interest of all members -- the agency problem. Also, when cooperatives have a federation, and regulation and supervision is vested in the federation, conflicts of interest may arise when the federation acts as both a promoter and a regulator. Federation leaders may also be susceptible to the agency problem. In addition, financial cooperatives have a proclivity to become dominated by borrowers at the expense of shareholders and depositors.

The status and effectiveness of regulation and supervision across low-income countries varies substantially. It is unlikely, therefore, that a single r&s prescription can be successfully applied everywhere. Further research on this topic might include a review of the state-of-the arts in r&s. How many countries have mixed r&s systems? How many countries vested most r&s in a federation? How many countries require at least some financial cooperatives to submit to r&s by a banking authority? How many countries effectively have no r&s system for their financial cooperatives? Research might also include case studies of r&s models that work well, systems that have improved effectiveness, systems that failed, and cases that are accidents waiting to happen. What are the strengths and weaknesses of each of these models? When is it important to stress r&s and when is it not worth the cost?

Research on this topic should provide recommendations on how to move forward and improve existing systems. What are the best ways to diminish or control agency and conflict of interest problems? How does one build political support in a country for the legal changes that may be necessary to allow the formation of a more effective r&s system?

[16] At least in Peru, some financial cooperatives have absorbed techniques used by self-help financial groups, locally called tanamoshies or panderos.

Numerous organizations are currently interested in the r&s of financial cooperatives. This includes donors such as the World Bank, the Inter-American Development Bank, and the Asia Development Bank. WOCCU, GTZ/Germany, the Canadian Co-operative Association, and a number of policy makers in low-income countries are likewise wrestling with how to better regulate and supervise financial cooperatives in low-income countries. At least one university in the U.S. – the IRIS center in the University of Maryland – works on governance and regulation issues. This widespread interest creates the opportunity for a university to take the lead worldwide on the topic of r&s for financial cooperatives in terms of both research and policy dialogue. That effort might be spearheaded by IDRC assistance.

If IDRC funds another project on r&s it might be appropriate for researchers to seek supplemental funding from both DID and the Canadian Co-operative Association. This might result in researchers considering a range of r&s models. Project researchers should also reach out to other individuals who have interest or experience in developing r&s systems for financial cooperatives. This might involve sponsoring conferences and workshops where individuals with diverse experiences in r&s can share ideas and suggest research topics. As interest expands in the topic, it might be appropriate to design an intensive, annual short-course that individuals who are interest in r&s problems could attend.[17]

Standard Bookkeeping

Efficient and effective r&s is built on information. It is difficult and expensive to evaluate the performance of financial cooperatives that do not have standard accounting systems. One of the objectives of a new IRDC funded project might be to promote standard chart of accounts among financial cooperatives, with supporting rules of accounting. This would lead to more transparency and comparability. These accounts and rules are useful to strengthen governance of cooperatives and are vital for effective r&s. Some of this research might be focused on cases where new information systems were successfully implemented and cases where the conversion was only partially successful.

Switching to a new, possibly more complicated, bookkeeping system is costly and usually forces boards of directors to change the way they evaluate the performance of their cooperatives. For these reasons, managers and members of boards of directors often resist switching to a new bookkeeping system. Researchers might play a role in this by studying ways to encourage the conversion to more regulation-friendly bookkeeping systems. In at least one case, in Honduras, cash grants were used to induce cooperative leaders to adopt and use new standard chart of accounts.

[17] This course might be modeled after the course on microfinance that Robert Christian runs in Boulder, Colorado each summer.

Concluding Comments

Representatives of the two organizations that funded COFI, IDRC and DID, were generally satisfied with its results, but looked forward to further written output from the project. IDRC was considering a follow-on project to COFI, suggesting they felt COFI was useful and opened doors for further promising research. The three colleagues who headed research efforts overseas likewise were generally pleased with their participation in COFI.

My overall evaluation of the project is positive. I concur that r&s of financial cooperatives is an extremely fertile area for research. COFI made a valuable contribution to microfinance by calling more attention to this important topic. Several important problems, however, limited the productivity of COFI. Trying to adapt the project to MIMAP's grand design spread the original plans for the project too broadly over too many countries, and with a budget that was far too small to allow researchers to fulfill their original objectives. Haggles over modest overhead rates and too little administrative infrastructure further hampered the project. The project contributed most to understanding one aspect of the r&s problem, the agency issue in cooperatives.

The primary weakness of the project was, in my opinion, that far too much time and effort was spent in collecting household information from borrowers and non-borrowers to document problematic credit impact. This resulted in too little time and effort being expended on answering important questions raised in the original project proposal: do many poor people benefit from membership in financial cooperatives, do small businesses that borrow from cooperatives hire more employees, and what r&s structure would allow these cooperatives to perform better, especially regarding services for poor individuals?

Overall, IDRC appears to have gotten substantial value for the relatively small amount of money it invested in the important topic of r&s of cooperatives. I therefore suggest that IDRC consider three closely related microfinance topics for possible follow-on funding: deposit mobilization, a more focused project on r&s of financial cooperatives, and a project on stimulating adoption of standard chart of accounts in financial cooperatives. This expanded commitment to microfinance might then justify IDRC/MIMAP adding staff with appropriate experience and interests to backstop these efforts.

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