GRADUATION WITH RESILIENCE TO ACHIEVE SUSTAINABLE DEVELOPMENT (GRAD)

GRAD was a five-year USAID-funded project designed to help the Government of Ethiopia find sustainable solutions to chronic food insecurity. The project supported households enrolled in the government's Productive Safety Net Program (PSNP) access microfinance, improve on- and off-farm productivity, and improve links to markets. GRAD also promoted women's empowerment and improved nutritional practices, and helped develop climate change adaptation strategies. CARE Ethiopia led a consortium that included REST, ORDA, CRS/MCS, Agri Service Ethiopia, and SNV. The project was implemented in 16 districts in Tigray, Amhara, Oromia, and SNNPR from December 2011 to December 2016.

GRAD Learning Brief #8

VESA-MFI Linkage Model

The background/problem: Overall, loan repayment rates in GRAD were high, usually exceeding regional standards. However, the Southern Nations, Nationalities, and Peoples Region (SNNPR) has a long history of low loan repayments rates, which proved true for GRAD as well. Overall, only 56% of MFI loans to GRAD households in SNNPR were repaid on time. This challenge is due in part to capacity constraints in the micro-finance sector, weakness of repayment enforcement mechanisms, and public misperceptions after decades of government and NGO-provided loans. Relatedly, micro-finance institutions (MFIs) with limited resources find it very difficult to assess the creditworthiness of households living in remote rural communities.

The GRAD approach to financial inclusion: GRAD's approach started with building the productivity and credit-worthiness of PSNP households. The project formed Village Economic and Social Associations (VESA), which are self-selected groups of approximately 20 members each. VESAs serve as the foundation for a variety of economic and social activities. Members agree to save together on a weekly or biweekly basis and eventually to take small loans from those savings. Each VESA is governed by group bylaws describing the rights and obligations of members, including roles and responsibilities of a management committee. All transactions are conducted at meetings in front of the members and accounted for through a simple record-keeping system. GRAD created 2,861 VESAs and supported their members through tailored capacity development allowing them to identify and engage in viable business opportunities, access inputs, and apply basic business and financial management skills. By building these capacities, GRAD helped project households become more productive and therefore attractive to the private sector, including financial service providers.

BOX 1: VESA linkage with Meklit MFI

Linking poor households to the formal financial market is always a challenge, as MFIs are often skeptical of their ability to repay and recognize the higher administrative costs implied. To address this challenge, GRAD partnered with Meklit MFI to test a linkage model in the Guraghe Zone of SNNPR. GRAD provided its package of capacity building support to VESAs while Meklit identified and selected 23 of the strongest VESAs and provided loans to each. Each VESA's Management Committee then provided loans to qualifying members, as guided by the group bylaws and based on applications submitted by individual members.

The VESA-Meklit MFI linkage enabled these VESA members to obtain first-time access to credit and resulted in **extremely high repayment rates - above 99% - compared to a rate of barely 40% for loans made through Meklit's solidarity group approach**. This strengthened Meklit's confidence and it provided subsequent loans to the same groups, again with a 100% repayment rate. This model has helped Meklit MFI expand its client base at a minimal cost.

GRAD's work linking households with financial service providers: GRAD worked with selected financial service providers to improve access by chronically food insecure households to financial services. In SNNPR, GRAD established partnerships with Omo, Sidama and Meklit MFIs to facilitate credit services to target households. Initially, the stakeholders agreed that that MFIs would use a group solidary lending model, whereby a group of 3-5 people self-selected and were organized to take responsibility for repayment of all loans provided to the group. Although the group solidarity model has been successfully applied in other regions (particularly in Amhara and Tigray), in SNNPR the model did not work well due to weak peer pressure, distorted perceptions about the sources of loans, and the impact of previous credit programs that did not emphasize repayment. As a result, repayment rates in SNNPR ranged from below industry standards (69%) to completely unacceptable (21%). This significantly affected MFIs' overall portfolio quality and discourage them from working with additional PSNP households.

The VESA-MFI linkage model: To respond to those challenges, GRAD explored alternative lending models to strengthen loan repayment and restore trust between financial service providers and PSNP households. CARE has successfully implemented a model in Rwanda, Kenya, Tanzania, Malawi and Uganda whereby MFIs provide loans to village savings and lending associations (what GRAD refers to as VESAs), rather than directly to individuals, In 2015, the project piloted the VESA-MFI linkage model, as described in the text box. On behalf of their members, the management committees of the selected VESAs signed contracts with the MFI, and took responsibility for screening individual members, providing loans, monitoring and supporting utilization, collecting the loans on time, and ultimately repaying the total loan to the MFI. VESA members were able to obtain loans for the first time through this modality.

Advantages for MFIs and households: Typically, MFIs have limited insights into rural communities and do not know which potential clients will be creditworthy. The VESA-MFI linkage model solves the information gap by transferring responsibility for evaluating borrowers, managing loans, and collecting repayments onto the VESA itself (through its management committee). Those committees know the members well and can determine who will make good use of loans and what amounts should be provided. Based on the near 100% repayment rates that resulted, the model proved itself to be a useful alternative, allowing rural financial service providers to reach out to poor households with negative credit history in cost-effective ways. This paves the way for formerly excluded households to participate in commercial activities and progress towards PSNP graduation.

Box 2: Lessons Learned from VESA-MFI Linkage Pilot

Based on the practical experiences outlined above as well as feedback from numerous stakeholders, GRAD learned that the VESA-MFI linkage model:

1. **Empowers the community**: This model provides an opportunity for VESA groups to feel empowered as they assume responsibility for managing loan disbursement and collecting repayments from members on behalf of financial service providers.
2. **Provides fast and flexible access to financial services**: The business process is managed at the group level, which speeds up the process of loan disbursement, monitoring and repayment collection, significantly reducing the cost of travel and waiting time at MFI branch offices.
3. **Leads to high repayment rates**: Repayment rates for VESA-MFI loans were nearly 100%, far higher than for loans using the group solidarity model. These high repayment rates enhanced the MFI's portfolio quality.
4. **Creates long-term access for poor households**: As a result of good repayment of loans, the MFI was encouraged provide additional loans to these VESAs, enabling their members to continue and expand their businesses on a sustainable basis.
5. **Expands MFIs' client base and improves efficiency:** Since the MFI deals directly with management committees rather than individuals, the cost per client is significantly reduced, even as the outreach expands. This enables an MFI to expand its client base at a relatively low cost. The linkage model can be replicated wherever projects or government create and support well-managed groups.