Fondation Charles Léopold Mayer pour le Progrès de l'Homme
Alliance for a Responsible, Plural, and United World
Solidarity Socioeconomy Working Group

Proposals Paper
For the 21st Century

Solidarity Finance

November 2001

Coordinated by Renée Chao Beroff and Antonin Prébois
Site: http://finsol.socioeco.org

Abstract

The interventions of Microfinance Institutions (MFIs) in Northern countries create a link between savers (those who possess financial assets) and borrowers (those who lack such assets) by conferring an ethical nature to savings. The social link is created between populations with financial means (the wealthier) and those excluded from traditional financial circuits (the poorer).

In the countries of the South, microfinance programs only conduct interventions with ‘poor’ people or those excluded from traditional banking systems. For such individuals, these social ties constitute an important investment towards their integration and lasting participation in both society as a whole and the economy.

Currently, as the euphoria of Solidarity Finance is fading and the sector finds itself at a crossroads, it is essential to tackle this issue both in the North and in the South, from a social perspective that takes social ties and social capital into account.

I) The facts:

a) Popular solidarity finance experiences are based on social ties and have a positive social impact.

Numerous examples of popular solidarity finance, set up and conducted by the people themselves according to their own initiatives, values, and forms of organization, prove that social ties do in fact integrate the more vulnerable members of society or those experiencing temporary economic obstacles. It provides them with opportunities to learn how to conduct their affairs in society and in the world of business, allowing them to participate in drawing up the rules in a context that is relevant to them. By dealing with these rules and showing solidarity in turn with the other group members, people acquire or regain their roles as protagonists in society.

These social ties, forged in an atmosphere of trust and empathy, make these previously “non-bankable” people both financially and culturally “creditworthy”.

b) Microfinance Institutions copy from – but fail to practice – solidarity finance

Microfinance Institutions often borrow certain features from popular solidarity finance organizations, like establishing groups, scheduling regular meetings, setting membership quotas, and creating mutual aid funds. MFIs then proceed to impose these features on the communities in which they intervene, turning them into a guarantee on loan repayment and a vehicle for financial services, thereby creating an economy of scale. What formerly provided the basis for social capital and reinforced social ties is now used as a “technology” for granting loans.

Some Microfinance Institutions are unaware of the existing solidarity among their clients and thus fail to take social ties into consideration when organizing the system or designing their financial products and services. They believe that credit alone is enough to improve people’s situation.

However, since their inception, other MFIs have taken care to learn about the social environment in which their clients develop, to preserve the positive social ties that reinforce their social capital, and to build their financial system around the mission of social mediation. Nevertheless, with heavy pressure from the dominant forces, from the profession itself, and from lenders, these MFIs have had to abandon this alternative along the way, particularly at the crucial moment in which they incorporate as formal institutions.

c) Certain Microfinance Institutions can have limited or even negative social impact

Solidarity credit guarantee groups that get Microfinance Institutions started are far from being the place in which social ties are woven.

Impact assessments have shown that most MFIs fail to reach their target audiences and that there is little change in their clients' situation, even after several years. They sometimes even lead to decline rather than progress: conflicts within families tied up by loans, dissolution of social ties within the community, divestment to pay back MFI loans, and even recourse to usurers again in order to pay back MFI loans. In other words, the situation becomes one of greater vulnerability than before.

d) What prevents MFIs from taking social ties into account?

MFIs fail to take social ties into consideration for political, institutional, and cultural reasons.

MFIs are part of a dominant liberal system in which economic issues take precedence over social ones. As part of this same scheme, lenders tend to impose short-term profitability targets, which result in the MFIs focusing on financial objectives to the detriment of social goals.

Lack of awareness of existing social ties is undoubtedly also due to a certain indifference to information that may not seem useful at first glance. Such oversight is also due to the complexity of difficult-to-grasp social situations. MFIs therefore fail to bear the broader social context in mind when designing their strategy and modus operandi.

The MFIs' own institutional development also works against the consideration of social ties. The increase in the volume of credit activities, an ever-widening geographical area to cover, and centralization of large-scale funding systems makes direct contact with clients difficult, when such contact is crucial for considering social ties.

e) The need to differentiate between two types of microfinance

It is not only necessary, but urgent, to distinguish between different forms of microfinance in accordance with the MFIs' types of practice.

There are two main kinds of institutions:

1) One type of microfinance sees its role as provider of financial services, or simply a provider of loans. These institutions have generally started by working with a market segment that has been overlooked or ruled out by banks and credit firms: the "non-bankable" clients.
"Bankers" have gradually monopolized this microcredit market by infiltrating their staff, experts, and performance and reporting standards, meanwhile creating both psychological and financial barriers to entry in order to marginalize other players.
Countless lenders have finally adhered to this technocratic, bank-centered view of the sector, seduced by its reassuring professional discourse. After all, lenders are also wary of risk!
This form of microfinance promotes institutionalization in commercial banks in order to access the money market and high profitability to attract private investors. It can be defined as "pre-bank microfinance".

2) Another type of microfinance views finance as an efficient tool, but one which is necessarily at the service of human and social development. The way these microfinance professionals provide their services can make all the difference. Placing people and their social ties at the center of their mission, this form of finance always acts in keeping with the different contexts and environments, which it attempts to learn about in order to better serve and value people. The culmination of this type of microfinance is its impact on the clients' social capital and self-reliance, which in turn have an impact on the sustainability of this kind of institution.
Such microfinance can be described as "solidarity finance".

Just as banking is a profession, so too is solidarity finance, deserving to be recognized and promoted.

Today, after two decades of pioneering and successful microfinance, the field is facing its first deep crisis, as demonstrated by the mass flight of clients, inactive or non-performing groups or clients, a drop in the volume of transactions, and particularly the number of outstanding payments and defaults, which is beginning to reach alarming proportions.

Is there is a link between this “forced march” towards profitability and the impact and abandonment of social ties on the one hand and this blockage and dysfunction on the other? Is microfinance suffering from having failed to create and consolidate social capital for its clients, from not having succeeded in forging social ties between the institution and its clients?

It is vital to give some thought to the concepts themselves. What is implied by the terms “social capital” and “social ties”? Are there different types of microfinance? How can one differentiate between them? How does one define “solidarity finance”? What are the indicators with which to assess solidarity finance? Which potential measures can support solidarity finance?

II) Visions & paradigms

a) A definition of social capital and social ties

Social capital can be defined as people’s ability to cooperate and act together, using or creating the necessary social ties towards solid and sustainable shared goals. Thus, social capital refers not only to a sum of individual skills, but to a collective capital belonging to the group and allowing it to ensure its cohesion, sustainability, and action.

Social capital results from the interaction between the shared values of individuals and the institutions and structures they find to reflect their values.

Values underlie individual wishes, motivations, and interests, but are shared by all. People’s ability to act together depends on their capacity to achieve their values through collective action.

These values can be listed and defined.

Value	Definition
Power	Ability to influence decisions
Openness	Access to information
Well-being	Satisfaction of basic needs
Competencies	Skills
Respect	
Affection	Feeling of belonging
Conscientiousness	Moral correctness
Wealth	Material, intellectual, cultural, and spiritual

Social ties are the relationships and interactions that exist between individuals and groups. They can either be given (horizontal, involuntary, innate ties), such as family, religion, or neighbors, or created (vertical ties), chosen by individuals and groups to suit their interests and goals. Social ties are one component of social capital. The quality of social ties reflects the state of the corresponding social capital.

The indicators that allow us to *measure the state of social capital* may include clients’ participation in MFI decision-making and resource allocation, their ability to analyze their situation and design a project, the state of their health, safety, education, and living conditions, their skills at organizing, managing, forging relations with the governmental and political environment, negotiating with technical personnel, making the financial system their own, distinguishing between good and bad measures and decisions, opening up to long-term horizons, and integrating the tools into a territorial dynamic…

b) A definition of solidarity finance

Solidarity finance can be defined at several levels, such as its mission, vision, identity, skills, behavior, and environment.

- The *mission* of solidarity finance is to use financial tools to achieve sustainable and equitable development.
- Its long-term *vision* is to increase social capital.
- It involves numerous stakeholders, each of which having different methods and forms of behavior, acting in different ways, but collectively producing *an identity* that is specific to solidarity finance.

- *Skills* consist of thinking globally, being able to assemble individuals and agents around the financial activity, and knowing the needs of individual entrepreneurs and communities, whatever their economic and social circumstances.
- As a *profession*, social finance consists of financing activities and people in a framework of collective interest, working to respect social capital.
- Solidarity finance operates within *an environment* of poverty, exclusion, or difficult access to financial services.

Solidarity finance seeks to respond to the three main crises in society: humankind's crisis with itself, the crisis among human beings, and the crisis between humans and their environment. In the face of these crises, solidarity finance, *by reinforcing social capital*, in other words, by bringing society closer to people's values, helps to create the conditions for sustainable development.

III) Initiatives and innovations

The workshop on solidarity finance identified two key innovations: methodology (with the rejection of the premise of neutrality) and the necessary attempt to analyze both the advantages and costs of MFIs' consideration of social ties.

a) Intervention methods are not socially neutral

Intervention methods can play a role in either strengthening, weakening, or even dissolving social ties.

Methods that value existing solidarity and social ties between people and attempt to value them within the organization or integrate them into the mechanism by reinforcing their identities appear to stand a better chance of gaining community trust and creating an environment of harmony and security.

Those that base their products and services on clients' limitations, needs, and strategies have a better chance of exerting a positive impact on clients' living standards. Furthermore, to maintain this efficiency, it is essential to establish permanent feedback mechanisms to monitor client satisfaction.

Besides being close to clients, it is necessary to have a rigorously efficient and transparent management method: financial commitments must be upheld, both facilitating withdrawals from accounts and providing quick access to sufficient loans. Any shortcomings in this area lead inevitably to mistrust, conflict, and rupture both among clients themselves, between clients and their leaders, and between clients and the institution. Good financial management also clearly helps to maintain and reinforce social ties.

In this sense, methods that prioritize training and information of as many people as possible reinforce trust and create social capital.

Products also have an influence on social ties. Products that are defined jointly with clients and based on their demands, limitations, and strategies are adapted to their needs and strengthen their skills.

- However, according to several reports and assessments, certain products appear to be the most appropriate:

    1. Voluntary, flexible, accessible, and secure saving is a highly popular product because of its strong impact on the creation of social ties.
    2. For loans, the possibility of freely fixing the sum, duration, and repayment schedules also provides an important factor for cohesion.
    3. Clients also feel that a variety of insurance products (for example, life and health) tend to strengthen social ties, since such products ensure that clients' loved ones will not have to bear costs they cannot afford.
    4. Along the same lines, solidarity group lending funds to which borrowers can subscribe at lower costs mean that the burden of temporary non-payment does not fall on the guarantors and can thus also favor social ties.

- By contrast, there are products which we now know to be very sensitive, which can easily dissolve social ties :
    1. Compulsory regular saving or savings deducted at the source.
    2. Automatic progressive-sum loans or loans with weekly repayments.
    3. Group funds for which members have not defined the rules of usage from the outset.

b) Social ties and social capital can reinforce the efficacy, profitability, and sustainability of MFIs.

Efficacy

The efficacy of a solidarity microfinance institution can be defined as its ability to provide specially designed services and products that have a positive impact on its beneficiaries.
Experience has shown that more often than not, effective microfinance programs use a variety of methods to attempt to strengthen social ties. The efficacy of these programs is due to their proximity to the clients, the quality of services offered, and the possibilities for assessing the suitability of the proposed services and client needs.
There is thus a direct correlation between efficacy and consideration of social ties. **Solidarity finance is thus not a "welfare benefit". It is a form of finance that is all the more effective because it takes the existing social situation into consideration.**

There is no conflict between quality and efficacy in finance.

- The promotion of social capital in the context of microfinance leads to considerable added value in terms of efficacy:

  1. For the Microfinance Institution, it reduces transaction costs and reinforces the institution's sustainability.

  2. For clients, it shortens the gap between the bank's anonymity and the poorer clients' culture. It increases information, develops competencies through exchange, and promotes participation.
     It increases the social and economic impact of microfinance.

- The use of social capital in the context of microfinance opens up new perspectives, such as:
  the possibility of increasing the value of the social capital of self-help groups in order to subsequently tie them into formal financial organizations. But these institutions must respect the self-help groups' own values.

- Still, the use of social capital can have a limiting effect on the MFI's institutional development.
  Grass-roots community-based projects allow social capital to develop but encounter restrictions when the time comes to move into a more commercial phase and to change scale.

Social ties represent a common interest for the MFI and its clients. In effect, improving social ties prevents the MFI from losing its sense of direction in terms of its actions.

Profitability
An MFI's profitability is assessed by comparing its costs and its resources. In the issue of solidarity finance, it is vital to know if the consideration of social ties increases or reduces the institution's costs.

It appears that the integration of social ties into microfinance programs generates both additional costs and savings.

- Increased costs related to social ties:
  1. group training (training during group development, personal development, informal training);
  2. assessment of social ties and follow-up; and
  3. consideration of social ties (that is, the time to be devoted to each client must be evaluated and compared to the number of clients per credit agent).

- Cost reduction related to social ties:
  1. improved portfolio quality;
  2. increased client loyalty;
  3. client participation in follow-up;
  4. lower-cost savings opportunities;
  5. repayment discipline due to appropriation of program by clients; and
  6. increased productivity of credit agents based on client and group training.

The balance between the costs and the savings associated with social ties appears to evolve over time. Initially, consideration of social ties entails a heavy cost. The creation of social ties and social capital between the institution and its clients **is a slow process. Only after some time (several years) do the institution's costs begin to fall.**

Sustainability

Consideration of social ties obviously involves considerable costs for MFIs. But social ties also provide a guarantee of efficacy and sustainability for MFIs. In fact, an institution that focuses its action on social ties consolidates its stability and is less vulnerable to change and crises. It also has a better chance of taking relevant action in the context in which it intervenes.
The MFIs' imperative of short-term financial profitability (often imposed by lenders) thus clashes with its efficacy and long-term sustainability, which increases the social capital.
The pressure by professional financiers to obtain financial returns in five years poses a major risk for solidarity finance.

- A short-term profitability target for MFIs poses numerous risks for the institution and its clients:

  1. exclusion of difficult-to-reach clients and remote areas;
  2. loss of both perspective, awareness of mission, and identity within the institution;
  3. loss of experience and know-how by the MFI team;
  4. loss of the institution's long-term feasibility; and
  5. loss of feasibility for clients and groups.

Financial balance is a necessity. The difficulty lies in the fact that the compatibility between obtaining good economic and social returns can only be envisaged in the long term.

Aside from its specificities, if solidarity finance must face additional costs in comparison to pre-bank microfinance institutions, it must find a way to fund them, especially in the MFI's first few years of life.

The key question is, of course, who should bear these additional costs.

One has to differentiate between one-off costs and recurrent costs. One-off costs can be more easily financed by one-off external financiers. Durable sources of financing must be found for recurrent costs.

- Bearing recurrent costs

1. Recurrent costs can be borne by the **clients or groups** (for example, by including the additional costs in the calculation of interest rates or by organizing clients to participate voluntarily in training or management-related activities). Here, there is a risk that clients will bear excessive costs and the financial services will become economically unfeasible.

2. They can be borne by either **public or private** lenders. This should be the case, especially considering that social ties are of public interest. Evaluation capability it thus needed to prove the suitability of investing public money in social ties.
   It should be possible to create national funds backed by lenders.

IV)Proposals

Reinforce the empirical evidence base for the added value of solidarity finance

Conduct more in-depth research on the impact of microfinance on social ties. Perform impact assessments of microfinance programs on social capital in a number of specific cases (well-known MFIs), covering the full range of methodological approaches. On the basis of these cases, identify the methods and tools that strengthen or weaken the creation of social capital. Draw up performance indicators for the reinforcement of social capital and social ties.

Perform a cost-benefit analysis of MFIs that reinforce social capital

Conduct a rigorous cost-benefit analysis for MFIs related to investments in reinforcing social capital. **Define the scope in which such analyses can be applied to solidarity finance, in terms of public interest and social utility.**

Provide a professional definition of solidarity finance

Define solidarity finance in terms of specific competencies, professional activities, and management and operational standards. Translate these standards into professional regulations in order to create a new type of financial institution within the framework of banking legislation.

Raise the visibility of the solidarity finance concept on the international stage

Dialogue with lenders: raise their awareness concerning the concept, help them differentiate between various forms of microfinance, and foster their interest in solidarity finance and in the creation of incentives for MFIs and reinforcement of social capital. Whenever necessary, persuade lenders to accept longer amortization periods in order to achieve financial sustainability when MFIs are clearly acting in the general interest.

Obtain fiscal incentives for solidarity finance through national policies

Grant fiscal incentives for solidarity savers and solidarity lending mechanisms that favor such initiatives by increasing social capital and promoting a sustainable and united society.

Expand the network of "allies" of solidarity finance

Hold dialogues in the FINSOL forum and use the Internet to present case studies in this forum. Provide examples of real "faces" in solidarity finance to help identify and increase the visibility of those involved in such projects. Link this network to others with similar concerns.

Promote solidarity finance among all the stakeholders

Organize the promotion of solidarity finance through publications and participation in international conferences and seminars. Organize lobbying. Aim to reach both decision-makers and people out in the actual field of solidarity finance to create alliances around quality finance activities.

Integrate solidarity finance into a systematic approach towards an economy of solidarity

a) Integrate solidarity finance into the overall proposal of an economy of solidarity. An economy of solidarity proposes a new perspective for social change in which values play a crucial role. The central element here is the contribution of solidarity. Financial solidarity thus integrates naturally into this global project and can contribute with its understanding of social capital.

b) Integrate solidarity finance into the economic chain (production, financing, distribution, consumption), represented by the various workshops on economy of solidarity.

c) In collaboration with the other stakeholders in the economy of solidarity, establish new relations with political authorities. A common point among various stakeholders in the economy of solidarity is the role of institutional stakeholders in the development of an economy of solidarity and the necessary redefinition of relations among political institutions.

V) Strategies and players

Stakeholders in the reinforcement of social ties and social capital include the clients, MFIs, governments, and lenders.

a) Clients

– On the individual and group level, *clients and grass-roots communities* themselves can reinforce social ties by clearly defining their goals, aspirations, and values, by demanding their rights and rejecting exploitative relations.

b) MFIs

– At the local level, *credit agents in the field or MFI credit agents* can reinforce social ties by facilitating group development processes, encouraging communities and groups to analyze their situations, helping them draw conclusions and implement their decisions, and offering individuals and groups opportunities for exchange and interaction.

– At the regional and national level, *MFI management* can reinforce social ties by strengthening the staff's field skills in working with groups, designing programs that support group and community aspirations, and allocating resources to group development.

– At the national level, *national MFI networks* can reinforce social ties by promoting benchmarking for non-financial criteria related to reinforcement of social capital, drawing up performance standards for MFIs committed to creating social capital, and promoting these performance standards within the profession.

<u>Where social ties are still alive and strong</u>

In rural environments, in countries of the South, in grass-roots neighborhoods, among certain sectors of society, and in certain occupations, social ties are still alive and acting as a social network for communities. Social ties act as real-life laboratories for initiatives and schools of democracy and individual and collective management.
Microfinance institutions should be taken into consideration within these contexts. They need to find the best modus operandi for at least preserving these ties and ideally reinforcing them by widening the scope of solidarity, particularly in the economic and financial spheres.
Financial institutions which – out of ignorance or indifference – weaken the social ties in these contexts by their methods or products should be considered irresponsible and disrespectful businesses, and should be boycotted.

<u>Where social ties have been destroyed (through war, dictatorship… growth and wealth?)</u>

In countries ravaged by civil war, where dictatorships have deliberately destroyed any form of grass-roots organization and even family trust, social ties have suffered serious damage.
In the cities, in the countries of the North, where economic development has led to individualism, or simply where solidarity between people has been replaced by a greater or lesser degree of institutional solidarity, social ties may also have suffered a serious blow.
In these contexts, microfinance institutions should be highly familiar with the environment in which their clients live, the relationships between people, their fears, the barriers, and the life strategies. They must take these factors into account in order to design a system that is adapted to this context: off-the-shelf models, standardized products, and organizational models to which all clients must adapt should all be abolished.
A combined research/action approach should be taken together with the people to gradually discover ways of working that can restore people's self-confidence and trust in others, allowing them to take responsibility and rediscover the value of shared goods and collective service.

<u>Where social ties have become weakened</u>

In numerous intermediate cases, social ties have not been destroyed but have been gradually weakened.

In these contexts, microfinance institutions should attempt to pinpoint the indications of any remaining solidarity as well as the organizations that best display these underlying values. MFIs should take these organizations into account when designing their models and products, to encourage them, value them, and make them the basis for the social and economic dynamics to which microfinance can make a useful contribution.

c) Governments and lenders

Social ties constitute the social capital and source of security for the most vulnerable and underprivileged sectors of society.
By serving these communities and reinforcing their social ties, financial institutions take part in a public interest mission.
Reinforcing social ties means paying special attention to the identification of clients, discovering the existing solidarity in their environment, taking these factors into account when designing potential services and products, and following up on the impact of financial and non-financial services on social ties. This work provides positive returns in the form of client loyalty and operational results, even though it may not be profitable in the short term.
These are the reasons why recognition and support are necessary.

- How can governments and lenders support solidarity finance institutions?

1. <u>By including reinforcement of social ties in their policies for supporting the sector</u>

Governments and lenders should explicitly incorporate solidarity finance awareness into their policies. They should include reinforcement of social ties among the essential elements for "good practice", and ensure that the institutions they support respect such criteria.

<u>2. By translating these practices into performance indicators to be monitored and reported</u>

Along with the financial performance indicators that currently monopolize the rating systems, the introduction of performance indicators for reinforcement of social ties should redress the balance when judging the overall performance of institutions.

<u>3. By helping differentiate between pre-bank microfinance and solidarity finance</u>

Solidarity finance institutions should be recognized as having different vocations and practicing different occupations, and should be evaluated differently. They should also be given different support, depending on the importance of the public interest mission in their activities.
Research should thus be commissioned on potential ways of calculating the costs of reinforcing social ties or the additional cost of taking social ties into account in comparison to a more traditional form of microfinance services provision.

<u>4. By setting up a national fund for solidarity finance</u>

These funds, backed by the state, private and public lenders concerned with social ties, and participating microfinance institutions, will finance this additional cost, while creating a benchmarking mechanism for the field. A list will be published annually describing the most respectful and innovative institutions in the reinforcement of social ties.

d) Lenders and support institutions

Lenders and support institutions can reinforce social ties at the national and international level by providing institutional support for MFIs, giving financial and technical assistance, and promoting the creation of social capital as a "good practice" in the microfinance sector.

Beyond the issue of social responsibility, a cost-benefit assessment will provide a more complete picture of the financial advantages and disadvantages of institutions investing in their clients' social capital.