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FINANCIAL LIBERALIZATION, BANK RESTRUCTURING AND THE OPTIONS FOR CLIENT-OWNED INTERMEDIATION: TWO AFRICAN EXPERIENCES IN RUDIMENTARY FINANCIAL MARKETS

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Abstract

The impact of structural adjustment programs in Sub-Saharan Africa have now generated a decade long history. The impact of deregulation and privatization on the restructuring of banks and their performance is little studied, along with its implications for servicing constituencies rationed out of the liberalized banks portfolios. This paper reviews this experience of bank restructuring and the implications for the post-liberalization supply of financial services in The Gambia and Mozambique. Lessons for other African countries are highlighted for review.

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I. Introduction

Structural adjustment programs have now had close to a ten year history in many African countries. Nevertheless, the impact of deregulation and privatization efforts on the financial sector have been less fully documented and analyzed. This paper attempts to make up for this deficiency in two countries that represent opposite poles in the continuum of development in the continent: The Gambia and Mozambique. Both countries record similar levels of low income per capita (between $100 and $300) which are low even by African standards. Both economies have received substantial donor support covering their government budget and balance of payments deficits. But in other respects they reflect sharp differences: in size (1 million vs. 16 million inhabitants) and, more importantly, in economic orientation with an outward oriented private sector predominance in The Gambia vs. an inward oriented socialist economy up to the late 1980s for Mozambique.

These countries trace out different paths of financial liberalization that are instructive lessons for Africa. In The Gambia, a supply leading financial development strategy predominated until the launching of the Economic Recovery Program in late 1985. In Mozambique, a heavy handed centrally planned allocation of financial resources dominated the socialist FRELIMO government until roughly the same time. The interesting story

emerges from the mid 1980s to the present as both countries became subject to structural adjustment programs of the IMF and the World Bank and evolved through different institutional paths of deregulation and privatization. The contrast that emerges is that The Gambia has evolved through a private market solution for financial liberalization by the early 1990s while Mozambique has been compelled to work through a public sector path of reform in restructuring its supply of financial services. Both solutions bring problems in their wake and it is those problems and partial solutions that will concern us throughout the paper. Furthermore, the lessons from the Mozambique experience are considered relevant for a number of other African countries such as Angola and Ethiopia that have yet to follow the path of transition from socialist to market economies.

The first section of the paper documents the state of formal financial markets in the mid-1980s, and the paths of deregulation followed by each country. The implications of this liberalization effort are highlighted particularly with respect to constituencies screened out of formal sector portfolios following these bank restructuring efforts. The second section then reviews the state of informal finance recently documented in both countries and the role of non-governmental organizations (NGOs) in filling the vacuum left by the deregulated decline of formal financial services. Of particular interest here are the options for client-owned financial intermediaries in each country and the degree to which an NGO institutional design can overcome both the asymmetric information problems that limit the reach of formal finance and the agency problems that limit the life of NGO efforts to supply financial services to a low income clientele. The final section draws out the principal lessons learned from these different paths of financial deregulation.

II. The Gambia: From Supply Leading Finance to Complete Privatization.

The principal macroeconomic parameters for The Gambia are presented in Table 1. It can be seen that the economy deteriorated substantially from the early to the mid 1980s. Rising rates of inflation, growing budget deficits, and a low growth profile emerged by the mid 1980s. This state of affairs led the government to initiate the Economic Recovery Program that was later reinforced by structural adjustment loans from the IMF and the World Bank (McPherson and Radelet). Increasingly rigorous stabilization policies substantially reduced the rate of inflation from 1988 to the present. The liberalization thrust in these programs decisively reshaped the financial sector consisting of a large public sector development bank and the branches of three international banks. Credit ceilings on the volume of credit were phased out as more traditional methods were established to control the money supply. Interest rate ceilings were also removed and subsidized interest rates were eliminated with positive real rates of interest emerging from 1988 onwards. In short, all of the ingredients of the selective credit policies so characteristic of the former supply leading financial development strategy were terminated. Finally, a complete privatization of the supply of financial services emerged in July 1992 as the once dominant public sector Gambia Commercial and Development Bank (GCDB) sold its deposit base and a small part of its asset portfolio to an international bank (i.e., Meridien Bank). Instead of privatizing the GCDB itself, a small portion of its performing assets (balanced out with treasury bills) and all its liabilities were transferred to a private international bank that agreed to enter the banking sector under these conditions. In effect, this buyout represented an implicit deposit insurance bail out vehicle for the government as it found an international bank to

assume the deposit liabilities of a failing public sector bank that the government otherwise would have had to assume. Therefore, by late 1992, the banking sector consisted of the branches of four private international banks. The earlier experiment of creating a semi-specialized development bank came to an end as deregulation successfully privatized the entire supply of financial services for the country.

Table 1. Indices of Real and Sectoral GDP and Selected Financial Sector Indicators in The Gambia 1981-1991 (1981=100).

Year	Real Economic Growth Indices			Total GDP	GDP Growth Rate (%)	Financial Sector Variables		
	Agriculture GDP	Industry GDP	Services GDP			GDP Deflator %	Real Loan Rate: Ag. Loans	M_2/GDP
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1981	100.00	100.00	100.00	100.00		7.30	na	0.21
1982	142.38	79.40	99.53	108.93	8.9	3.37	na	0.21
1983	171.93	69.85	111.55	122.73	12.6	1.60	na	0.25
1984	135.56	83.65	113.97	117.12	-4.5	17.19	-0.38	0.22
1985	145.00	81.10	116.65	120.78	3.1	8.64	-5.17	0.27
1986	129.20	112.10	149.84	126.87	5.8	42.89	-10.05	0.20
1987	138.18	129.04	148.26	130.40	2.8	29.85	-16.18	0.21
1988	136.79	120.57	155.07	132.63	1.7	6.41	6.42	0.24
1989	133.20	125.49	165.51	138.01	4.1	13.18	9.15	0.22
1990	144.84	135.05	172.25	145.73	5.6	14.55	9.82	0.21
1991	124.62	138.70	186.25	148.80	2.1	9.90	18.82	0.21

Source: Central Bank of The Gambia, Various Bulletins. Reported in Douglas H. Graham, et al., Financial Markets in The Gambia, A Report to the USAID Mission, Banjul, The Ohio State University, Rural Finance Program, January 1993, Chapter One.

One can see the evolution of this path of liberalization along with some interesting consequences in the following tables of this section. Table 2 highlights the substantial decline in total bank credit that accompanied this process of stabilization, liberalization and privatization. Overall real credit declined by sixty percent from 1983 to 1991 (column 5).

Moreover, it is also clear that agricultural credit suffered the most severe decline of all sectors over this period (column 1). The ratio of agricultural credit to agricultural GDP declined from a range of 30 to 40 percent in the early to mid 1980s to 7 to 8 percent in the early 1990s. While the credit to GDP ratio declined for all sectors, it clearly declined relatively more in the agricultural sector. It is also of interest to note that during this overall decline in credit activity, the financial deepening indicator or M_2/GDP in Table 1 (column 8) held steady (around 21 percent of GDP) during this period. In short, there was no decline in the deposit or savings base of the banking system; only in its credit activity.

Table 2. **Indices of Real Commercial Bank Credit by Sector in The Gambia (1981=100).**

Year	Agriculture	Construction	Services	Other	Total
	(1)	(2)	(3)	(4)	(5)
1981	100.00	100.00	100.00	100.00	100.00
1982	106.54	93.95	99.49	79.35	95.42
1983	110.55	72.18	97.53	101.25	101.28
1984	84.57	95.42	127.47	52.36	88.96
1985	81.86	127.58	100.69	70.98	87.38
1986	66.27	133.50	77.70	47.98	68.65
1987	39.71	80.88	57.46	40.99	48.33
1988	44.05	69.89	58.93	33.42	47.13
1989	32.14	63.48	56.31	49.26	46.77
1990	19.83	43.53	53.21	46.53	39.69
1991	20.43	31.40	58.67	43.42	39.88

Source: Same as Table 1.

This relative stability of the deposit base during the decline in credit balances is consistent with the declining loan/deposit ratios recorded in Table 3. The loan/deposit ratio for private banks declined from 45 percent in the mid 1980s to 31-33 percent by the early 1990s (column 3). The declining ratio for the GCDB (column 2) began from a level

greater than one since it includes substantial borrowings for targeted credit schemes from the Central Bank (which are absent in private commercial banks). The relevant results, of course, is the low ratio recorded for private banks in column 3 since with the demise of the GCDB the banking sector since July 1992 consists only of private banks.

Table 3. **Ratios of Loans to Total Deposits of Commercial Banks in The Gambia 1986-1991.**

Year	All Banks	GCDB	Private Banks
	(1)	(2)	(3)
1986	1.43	2.50	0.45
1987	0.88	1.54	0.35
1988	0.81	1.51	0.25
1989	0.80	1.46	0.31
1990	0.71	1.32	0.31
1991	0.67	1.35	0.33

Source: Same as Table 1.

The low loan/deposit ratio for private banks raises questions about the asset structure of the banking system. On the one hand, a sharp decline in loan activity has been recorded particularly from 1983 onwards. On the other hand, the deposit base has grown along with the growth of the economy as seen in the relatively constant M_2/GDP indicator. Clearly some asset other than loans has risen in relative importance in the asset portfolio of the banking industry from 1986 to the present. To set forth the evidence on the change in the composition of assets, panel A of Table 4 restricts its documentation to that of the three private banks that dominated the banking industry in the early 1990s following the rapid decline of the GCDB from the mid 1980s. The evidence in Table 4 is clear. Short term treasury bills (i.e., government securities) rose rapidly in the portfolios of the three commercial banks in the country. Whereas in 1986 they comprised only 26 percent of total

assets in these banks, by 1990 they had increased to 50 percent of the asset portfolios of the private sector banks. This is far higher than the ratios typically recorded for government and corporate securities held by banks in developed countries (i.e., 25-30 percent). Furthermore, since total assets here are inflated by items that are not ordinarily included in the balance sheets of banks in more developed countries (off-balance sheet activities) the relative weight for T-bills in The Gambia would be markedly higher using the more restricted balance sheet base common to the banking industry in developed countries.

Probably the most revealing data in Table 4 are the relative weights of loans and advances, on the one hand, and government securities, i.e., T-bills, on the other hand. In 1986, they both represented approximately one quarter of the outstanding portfolio of assets (while other assets predominated). From 1988 onwards the relative weight of T-bills in total assets roughly grew to twice that of loans. The growths in the purchase of T-bills by commercial banks is evident in panel B of Table 4. From 1987 onwards the interest rates on T-bills rose rapidly. By the late 1980s they reached 17 to 18 percent and by 1991-92 approximately 20 percent rates emerged (when inflation ranged between 6 to 14 percent). In short, by the late 1980s T-bills became a substantially more attractive asset with a good rate of return due to policy changes introducing bi-weekly bid-auctions. In the final analysis, this risk free return clearly outweighed returns in the loan market, especially when risk is considered.

Table 4. Relative Shares of Assets and Liabilities for Private Commercial Banks and Distribution of Outstanding Government Securities in The Gambia, 1985-6 to 1991.

A. Relative Shares of Assets and Liabilities (Private Commercial Banks)

Year	1986	1987	1988	1989	1990	1991
	(1)	(2)	(3)	(4)	(5)	(6)
			(percent)			
ASSETS						
Cash	3.11	3.44	3.44	2.29	2.12	4.53
Govt. Sec.	25.18	31.44	45.85	45.54	50.35	42.81
Loans & Advances	26.34	24.85	18.62	21.27	23.87	26.60
Other Assets	45.38	40.27	32.09	30.90	23.66	26.06
Total Assets	100.00	100.00	100.00	100.00	100.00	100.00
LIABILITIES						
Borrowings	0.00	0.00	0.00	0.00	0.00	0.00
Demand Deposits	29.59	33.77	36.42	35.18	35.59	37.86
Sav. and Time Dep.	28.05	34.38	36.45	37.50	40.56	39.07
Other Liabilities.	33.68	22.12	15.84	15.24	11.29	12.62
Capital	8.68	9.73	11.30	12.08	12.55	10.44
Total Liabilities	100.00	100.00	100.00	100.00	100.00	100.00

B. Distribution of Outstanding Government Securities in The Gambia, (millions of current dalasis).

	1985	1986	1987	1988	1989	1990	1991
T-bills							
Central Bank	0	0	30.00	9.66	0.28	13.88	19.09
Commercial Banks	24.40	22.60	34.50	93.63	102.81	144.00	121.46
Public Enterprises	0	0	6.00	24.11	45.99	62.29	114.30
Nonbank Public	0	0	1.45	2.61	3.27	6.44	8.78
Total	24.40	22.60	71.95	130.01	152.35	226.61	263.63
Govt. Development Stock							
Central Bank	0	0	0	0	0	0	7.00
Commercial Banks	5.40	10.90	10.90	10.50	13.66	10.50	10.50
Public Enterprise	7.40	11.80	11.80	11.80	0	0	1.30
Nonbank Public	0.59	0.82	0.82	0.81	9.88	12.98	4.68
Total	13.39	23.52	23.52	23.11	23.54	23.48	23.48

Source: Same as Table 1.

Table 5 underscores this risk feature by comparing the rates of return to loan and non loan activity for private commercial banks in the banking industry of The Gambia from 1988 through 1990. First, the risks of lending are apparent both through the negative

returns recorded in 1988 and in the greater variance in returns compared to non-loan activity (primarily returns from T-bills and foreign exchange transactions). The returns on non-loan activity are substantially higher and more stable through time. Finally, it is of note to point out that these returns are unusually high by international standards. Rates of return on assets of one to two percent are considered high in the banking industry in developed economies. Thus the results in The Gambia are indeed unusually high. This grows out of the wide gross intermediation margins registered by banks in the country. By the early 1990s these reached 15 to 16 points between the weighted average of nominal deposit rates (including demand deposits) and asset rates (loans and securities combined). These margins are three to four times higher than those characteristic of banks in more developed financial markets and clearly reflect the higher risks of lending and the lack of competition in the banking industry in The Gambia.

Table 5. Rate of Return on Loan and Non-Loan Assets in the Banking System of The Gambia, 1988-1990.

A. All Commercial Banks	1988	1989	1990
	(1)	(2)	(3)
1. Return on Loan Assets[1]	-1.39	4.34	6.15
2. Return on Non-Loan Assets[1]	8.96	8.33	10.43
3. Return on Total Assets	4.81	6.49	8.55
B. GCDB	**1988**	**1989**	**1990**
1. Return on Loan Assets	-0.60	1.49	5.39
2. Return on Non-Loan Assets	2.16	0.90	4.10
3. Return on Total Assets	0.60	1.27	4.81
C. Other Commercial Banks	**1988**	**1989**	**1990**
1. Return on Loan Assets	-3.89	10.25	7.89
2. Return on Non-Loan Assets	14.42	14.22	15.18
3. Return on Total Assets	11.18	13.29	13.32

Source: Same as Table 1.

Thus by 1992 the evolution towards a liberalized and privatized financial sector was complete following seven years of a series of successful structural adjustment efforts. The real levels of outstanding loan balances declined over this period. At the same time, there was a rapid shift from predominantly public to private sector banking, from longer to shorter term loan contracts, from negative to positive real rates of interest, and from agricultural to non-agricultural lending, underscoring an urban bias in the newly deregulated financial market. Agricultural loans fell from 30 to 35 percent of total lending in the early 1980s to 16 percent of a much lower level of real lending in the early 1990s. Loans for trading enterprises increased from around 30 to over 45 percent of total lending over this same period. Industrial loans remained at about 5 to 7 percent over this period while loans to secure personal businesses and personal loans to civil servants held steady as a share of total lending from 30 to 32 percent for this period.

These changes might lead some to argue that structural adjustment measures were detrimental to financial development, but this is misleading. Howver, the size of the loan market was highly exaggerated in the early eighties as was the heavy emphasis on agricultural loans (primarily through the GCDB). Much of the volume of outstanding balances at that time was made up of non-performing loans that contributed to the later downfall of the GCDB. The substantially reduced financial market of the late 1980s and early 1990s more accurately reflects the size of a more solvent and sustainable loan market, once the cleaned up balances of the GCDB are removed from the consolidated balance sheet for the banking sector.

At the same time, private banks reduced the general risk of their lending by screening out more risky borrowers and allocating a higher share of their assets to T-bills. This visible risk reduction incorporates an element of crowding out through the rapid expansion of the T-bill market from 1988 onwards and the relative growth of this asset in private bank portfolios. The challenge facing Gambian authorities now is to expand and broaden financial intermediation beyond the mere transfer of the publics deposits into securities to cover the government's budget deficits. More attention must be given to the encouragement of institutional innovations to increase the supply of financial services to the admittedly riskier rural clientele that have been largely rationed out of bank portfolios through this path of deregulation and privatization. Non-governmental organizations (NGOs) are a possible option here. NGOs have rapidly grown to fill the vacuum created by the disappearance of formal financial linkages to rural Gambian markets. The degree to which NGOs can satisfactorily fill this vacuum and supply viable, self sustaining financial services to their low income constituencies is an open question that will be explored later in this article.

III. Formal Financial Reform in Mozambique: From Extreme Supply Leading Allocation to Private Sector Lending

A. Introduction

Table 6 sets forth key macroeconomic indicators for the Mozambican economy. From the late 1970s following its independence from Portugal until the late 1980s, the Mozambican economy experienced stagnation and decline. The FRELIMO regime's centrally planned socialist experiment was finally abandoned in the mid-1980s with international multilateral donor support from 1987 onwards. The period from 1986-7 to the

present represents a period of painful readjustment as the Mozambican economy attempted to introduce market reforms. This process of deregulation has been slow and frustrating, particularly in light of the marked instability and bloodshed of a bitter guerilla war that slowed down the emergence of normal business practices and secure contracts until recently. Meaningful positive rates of growth only began to appear by 1987 (column 1) and the difficult stabilization program to control strong inflationary pressures has succeeded only in bringing inflation down to the 40 percent level by the early 1990s (column 2). Financial deregulation has gradually allowed previously controlled nominal interest rates to rise; however, they have yet to eliminate negative real rates of interest (column 3). The financial deepening indicator (in column 4) is misleading in that the relatively high ratios in the early to mid-1980s only represent currency in circulation and current demand deposits. Quasi-money was largely non-existent in the Mozambican economy until the early 1990s when the widely fluctuating and relatively high inflation rates came under modest control.

Table 6. Select Macroeconomic Indicators for Mozambique, 1981-91.

	GDP Rate of Growth	Consumer Price Index (% chg)	Real Rate of Lending 6-12 mo. Agr. Loans	M_2/GDP
	(1)	(2)	(3)	(4)
1981	0.5	3.8	na	56.6
1982	-3.5	17.9	na	64.2
1983	-12.5	11.8	na	78.9
1984	1.1	14.8	na	77.6
1985	-8.2	47.7	na	65.8
1986	0.9	12.3	-55.56	66.7
1987	4.4	175.7	-22.05	38.5
1988	5.5	55.0	-17.14	38.6
1989	3.2	40.0	-16.43	36.4
1990		44.0	-18.06	
1991		42.0	-5.28	

Source: Bank of Mozambique.

The path of deregulation in Mozambique begins from a much more stagnant economic base than that in The Gambia. More importantly, liberalization efforts have been launched from a more extreme state of supply leading allocation strategies (i.e. a centrally planned regime) and from a much less promising institutional base. Private property rights and normal commercial practices have been seriously constrained by the chaotic juridical state of the FRELIMO regime as it struggles to introduce private market reforms in a reluctantly receding socialist political environment. Finally, these constraints have been exacerbated by a bitter guerilla war that has periodically wreaked havoc throughout the country, even reaching the outskirts of the capital city of Maputo. The lack of security in this war torn society clearly created barriers to the free geographic movement of goods, finance, and people. Only in the last year or two has this destabilizing lack of security gradually wound down to an apparently workable truce between the contending parties.

B. The Banco Popular de Desenvolvimento (BPD): The Struggle for Financial Survival in a Transitional Regime.

The path of financial liberalization in Mozambique occurred within a very different institutional setting from that of The Gambia. Gambian financial markets operated within essentially a private sector market economy with a strong element of supply leading finance through its principal public sector development bank. Mozambican financial institutions, in contrast, were operating within a centrally planned socialist framework. Therefore, the liberalization of financial markets in Mozambique takes on the features of a transitional economy moving from a communist to a market society. In The Gambia, one merely had to privatize a large bank, while in Mozambique, one is trying to privatize the economy. Among other things, this means the Gambian solution of bank privatization is much more

problematic, at least in the short to medium term, given the absence of any significant private sector banking activity in Mozambique. Nevertheless, it is important to identify the major issues of this reform process since it can characterize the likely future scenario for a number of "transitional" socialist regimes in Africa such as Angola and Ethiopia among others.

Two public sector banks comprise the banking industry in Mozambique. One is the Bank of Mozambique which until recently functioned as the Central Bank as well as the largest commercial bank in the country. Its clientele has consisted of all the large export companies run by the state along with many other parastatal operations for most of this period. The bank also dominated all the foreign exchange transactions until recently. By early 1992 efforts were launched to separate the commercial banking functions from the central banking activities with each eventually expected to constitute a separate institutional entity after a two year period.

The Banco Popular de Desenvolvimento (BPD) is the other major bank in the country. Though smaller than the Bank of Mozambique, it nevertheless has an extensive branch network throughout the country consisting of 10 large branches and 148 offices and limited service deposit collection posts. This gave it an advantage to service an agricultural clientele. At the same time, it was expected to promote development, as its title implies, and thus had a large component of long term loans in its portfolio in the mid 1980s. The focus of this section will be on the BPD. Its attempts to adjust to the structural adjustment mandates of the IMF and the World Bank from the late 1980s onwards more accurately trace out the travails of liberalization in a development bank scenario in Africa in a more

focused manner than would the experience of the Bank of Mozambique in which the devolution of central banking functions necessarily complicate the institutional issues of interest here.

Table 7 sets forth the evolution of the BPD portfolio from 1985 to 1991 for some data and 1988-91 for other indicators. The most revealing change is the rapid shift from a public sector clientele to private sector borrowers as the mandate to reduce its losses was incorporated into bank policy. Whereas in 1985 roughly 95 percent of the portfolio consisted of parastatal firms, collective farms and other state entities, by 1991 this relative weight had declined to 11 percent. Thus, the various measures to inculcate a more market oriented set of economic policies and economic organization from the mid 1980s to the early 1990s spurred the BPD to privatize its clientele. Since the privatization of state enterprises has been a long drawn out process, the private sector clientele consists largely of first time borrowers from the pool of recent small and medium scale entrepreneurs moving into business ventures for the first time. At the same time, it moved out of the riskier agricultural clientele and into the allegedly more remunerative private commerce and service trades. The data on term structure is misleading from 1985 to 1988 since the heavy incidence of short term loans for these years documented in Table 7 were in effect constantly renewed loans to state enterprises (at the governments command). Only from 1989 onwards with greater administrative autonomy and the freedom to no longer loan to bankrupt state firms do the data on term structure accurately reflect the true rise in short term loans to its increasingly private sector clientele. Finally, it should be noted that these portfolio shifts were associated with a smaller level of real lending compared to mid-1980s.

Table 7. Percent of Total Approved Credit Allocation in the Banco Popular de Desenvolvimento (BPD) by Term Structure, Sector, and Legal Jurisdiction (1985-1991)

SELECTED CATEGORY	1985	1986	1987	1988	1989	1990	1991
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. TERM STRUCT.							
Short-term	94.77	93.06	72.45	71.27	39.59	53.18	84.63
Long-term	5.23	6.94	27.55	28.73	60.41	46.82	15.37
2. LEGAL JURIS.							
State	94.56	91.59	81.60	66.60	26.24	20.96	10.82
Cooperative	3.35	3.21	3.91	1.21	0.63	1.03	1.64
Private Bus.	2.09	5.19	14.48	32.19	57.65	78.02	87.53
3. CCADR (war veterans loan fund)					15.48		
4. SECTOR							
Agriculture				56.37	33.78	44.90	26.34
Industry				41.20	40.90	31.90	17.01
Commerce and Serv.				0.59	5.57	15.45	46.80
Construction				0.30	0.07	0.00	2.89
Transports				1.54	4.19	7.74	6.96
CCADR					15.48		

Source: Derived from BPD files and reported in "The Banco Popular de Desenvolvimento and Formal Informal Financial Market Linkages in Maputo, Mozambique," Report to the USAID Mission, Maputo, March 1993.

This evolving profile of the BPDs portfolio reflects reasonable banking behavior in light of the gradual liberalization of financial market controls over this period. Ceilings on the volume of credit were relaxed by the early 1990s. Selective credit policies with interest rate ceilings were generally relaxed until the multiple tiers of administered interest rates were collapsed into a smaller number of categories over this period. Throughout this period, the bank was reallocating its lending from lower interest rate agricultural loans into higher interest rate commercial and service sector loans to earn a higher rate of return. Finally, in April 1992 all mandated interest rate differentials were eliminated across sectors.

In essence, from 1989 onwards the bank was largely free to reallocate its portfolio to maximize its risk adjusted return within a greatly liberalized financial market.

Performance indicators in Table 8 present an interesting contrast to one of the indicators highlighted in the data on The Gambia. It is clear that the BPD has a much higher loan-deposit ratio and loan to asset ratio than those recorded in the liberalized banking system of The Gambia. By 1992, the BPD had generated a high 63 percent loan to asset ratio (compared to 25 percent in The Gambia) and commensurately a high 71 percent loan deposit ratio (compared to 33 percent in the Gambian private banking system at the same time). In short, the BPD is much more of a lending institution than are the banks in The Gambia.

In line with this behavior it is relevant to note the visible trade-off between liquidity and loans as a share of assets in the BPD. From 1988 through 1990 the BPD recorded high liquidity ratios and relatively low loan to asset ratios. Whereas in 1991 and 1992 the liquidity ratio dropped to 13 and 8 percent (from a 40 percent level in 1990) the loan to asset ratio increased from 51 percent in 1990 to 60 and 63 percent in 1991 and 1992 respectively. Liquid assets in the BPD earn no interest. The bank, once freed from the Central Bank credit ceilings levied on the volume of credit prior to 1991, quickly moved into more interest earning loan activity. However, the lack of a remunerative short term securities market, such as exists in The Gambia, prevents the BPD from diversifying its portfolio. Thus it is presented with a Hobson's choice, namely, maintain high liquid reserves that earn no interest and lose their real value through inflation, or, increase loans beyond an acceptable risk threshold in the loan market.

Table 8 General Financial Ratios and Performance Indicators for the BPD from 1988 to 1992.

Indicators	1988	1989	1990	1991	1992
I. GENERAL FINANCIAL INDICATORS					
1. Loan-Deposit Ratio	0.53	0.51	0.59	0.67	0.71
2. Loan-Asset Ratio	0.46	0.44	0.51	0.60	0.63
3. Deposit-Liability Ratio	0.87	0.88	0.87	0.89	0.89
4. Liquidity Ratio	0.41	0.46	0.39	0.13	0.08
5. Debt-Equity Ratio	45.08	33.07	41.98	43.78	39.86
II.SELECTED PERFORMANCE INDICATORS					
1. Gross Return on Assets	0.03	0.03	0.04	0.05	0.06
a. Gross Return on Loans	0.05	0.07	0.07	0.07	0.07
b. Gross Return on Non-Loans	0.00	0.00	0.01	0.01	0.04
2. Net Return on Assets	0.00	0.00	-0.00	-0.01	-0.01
3. Delinquency Ratio	0.45	0.31	0.27	0.22	0.24

Source: Same as Table 6.

This pressure to move more aggressively into the loan market has taken its toll on the BPD. Its net return on assets in Table 8 has been zero or negative for the past five years. This grows out of the need to write off the backlog of non-performing loans on its portfolio in recent years. Since most of the defaulted loans documented in the high ratios of II-3 of Table 8 are comprised of the state enterprise clientele from the former era, one might think that the mere transformation from a state to a private sector clientele represents a solution to the bank's problems. Unfortunately, a random survey of the loan repayment status of 136 recently selected private sector clients in the Maputo branch of the BPD indicates that close to 50 percent of this clientele are in a state of arrears (Graham and Silva Francisco, pp. 42-3).

The bank has been able to survive this unsatisfactory state of affairs until now because of periodic capital injections by the government (to cover the losses incurred from failed state enterprises) and the fact that 96 percent of all deposit liabilities consist of non-

interest bearing current accounts. Given the lack of any effective competition from the other bank (i.e., the Bank of Mozambique also has only a negligible share of interest earning time deposits among its liabilities), depositors have few options. The real losers in this situation are the net savers in the public at large who have no way to earn even a nominal, much less a real rate of interest on their deposits. Savers will never be able to be properly serviced with remunerative interest earning accounts until the bank learns to manage risk and screen borrowers effectively for its loan portfolio. Currently, the BPD is able to operate in part because of the relatively costless excess liquidity at its disposal from the liability side of its balance sheet. Finally, the high debt equity ratio (roughly 40 to one) suggests that depositors are at risk from a grossly undercapitalized bank. The government of Mozambique is finding it difficult to muster any additional funds currently to recapitalize the bank to a level that would reduce in any substantial way the risk currently faced by depositors.

The rapid growth of private sector clients from 1988 to the present reflects an entrepreneurial response to the gradual relaxation of price and marketing controls by the government. Moreover, the BPD has clearly played a nurturing role in making debt finance available to these embryonic entrepreneurs. Nevertheless, many untested new businessmen and women are launching these ventures in an unstable market setting where commercial contracts and business practices are rudimentary, supplier and client marketing networks are poorly developed, and all parties are subject to unforeseen policy risks introduced by the government.

In short the BPD, as an important financier of these recent initiatives, has been unable to avoid a high risk private sector clientele with a high likelihood of default given

the risks associated with their projects in this uncertain environment. Finally, the lack of mortgage collateral and the absence of low cost legal sanctions to enforce contracts has exposed the bank to serious risks of delinquent loan behavior. Not surprisingly, the institution has suffered an unacceptably high level of arrears.

There is no immediate privatization solution to the development bank problem in Mozambique as there was in The Gambia. Nor, as we shall argue shortly, is there an NGO intermediation option as there is in The Gambia. One has to work through a damage control program within the bank itself. Promising steps to follow in the Mozambique bank have much in common with those laid out by Caprio, Atiyas and Hanson for financial institutions in transitional economies, namely, address the deficiency in information and human capital, and design internal incentive systems to deal with the agency problem (Caprio, Antiyas and Hanson).

C. Lessons Learned for Banks in African Transitional Economies

- Evidence from Mozambique suggests that banks in transitional economies in Africa need to establish a more effective information management system than has been characteristic of their past practices. Essential here is the creation of a risk management team supported with ample resources and responsibility to document performance of the portfolio on a regular and systematic basis. This should entail a "loan tracking" methodology on the loan repayment status of all outstanding loans Moreover, loan repayment status should be correlated with borrower characteristics (sector of activity, size of business, first time borrower, etc.) and loan characteristics

(term, loan size, collateral, interest rate, etc.) to generate a risk profile for current and future creditworthiness criteria used in loan evaluation exercises.

- These banks should hire in new personnel that are computer literate and have some economics training and/or meaningful business background. This new human capital should form the basis of the risk management team outlined above with this new human capital in place. The bank should computerize all its activities to better implement more effective management control, rapid check clearing facilities, portfolio and asset management, and risk management strategies.
- In addition to the risk management team discussed above, transitional economy banks in Africa should set up an allied market intelligence unit to document key prices of outputs (products and services) and inputs for all the major markets represented by clients in the bank's portfolio. This should entail periodic field visits to selected business sites and markets by team members to actually collect and up-date this data at the ground level instead of relying too much on unreliable government generated data.
- Allied to this market intelligence effort should be an effort to determine the cost effectiveness of alternative forms of collateral to establish the most appropriate guarantee for contract enforcement with different types of clientele. For example, instead of traditional mortgage property collateral that might be difficult to enforce, banks might identify secure accounts receivable for a client (i.e., ensured sales contracts with established buyers) that could act as an acceptable collateral substitute.

- To reduce the risks of non-performing loans, transitional banks should limit direct lending to non-corporate, private agricultural producers except for established clientele with good repayment records. Instead, the bank should focus on lending to larger wholesalers of agricultural inputs, on the one hand, and agricultural product buyers on the other hand. These traders are currently underfinanced and are able to offer more reliable guarantees and meet loan repayment schedules better than small sized agricultural producers. Traders are better positioned to sort and screen these clients (for their input contracts or forward contract purchases of farm products). In short, they suffer from much less imperfect information and transaction costs than do banks.
- Finally, these banks should decentralize management authority sufficiently to make key branch managers and the principal loan officers under their jurisdiction more accountable for the performance of the loan portfolio generated and administered under their auspices. Among other things, these officers should have immediate and continuing access to the information generated by the risk management teams (on the current portfolio) and the market intelligence units (for the economy). This information should be incorporated into their loan evaluation exercises. Loan management criteria should be established that rewards good portfolio performance with bonuses and restricts pay raises and promotions for those responsible for a poorly performing portfolio (vis-a-vis the bank-wide average). These steps of decentralized profit centers and performance base salaries should mitigate the agency problem at the middle management level.

IV. Informal and Semi Formal Finance in Rudimentary Markets: The Options for Client-owned Intermediaries in Mozambique and The Gambia.

A. Introduction

As seen in the above section, financial liberalization encouraged a restructuring of the formal banking industry to provide financial services in a more market oriented fashion in The Gambia and Mozambique. Empirical evidence from both countries, however, show that, pari-passu, this created a substantial decline in the supply of financial services (conventionally defined) from the formal banking sector. Both the development bank in Mozambique and commercial banks in The Gambia find it costly and risky to provide financial services to small scale businesses and farmers. Nonetheless, liberalization and privatization has led to increased private sector trading activity and the growth of many small scale businesses thereby creating an increased demand for financial services in both countries. A need has developed to fill the vacuum created by the retreat of the formal banking sector from farming and small scale finance. Semi-formal and informal financial mechanisms have traditionally been active suppliers of financial services to these more risky low income constituencies. Several different forms of semi-formal client owned institutions have emerged, especially in The Gambia, and informal financial markets are present in both countries. This section describes the functioning of informal and semi-formal financial markets and their relative success in filling the void created by the restructuring of the formal banking sector in The Gambia and Mozambique.

B. Informal financial markets:

1. Market Vendor survey :

Informal financial services are widespread in Africa, particularly among friends, neighbors and self-help groups. Also, trader credit through supplier and client marketing networks can play a valuable role in extending the frontier of finance from a rural clientele. The evidence on informal financial contracts in the marketing networks in our two countries, however, raise some questions concerning the degree and range of services supplied through these channels. Several recent studies by OSU highlight some of these issues.

A total of 66 fruit and vegetable retail traders in 5 markets around Banjul and 73 retail traders from 6 markets around Maputo were sampled in these recent OSU related studies. These surveys were carried out in late 1991 in Maputo and in early 1993 in Banjul. Table 9 summarizes the operational characteristics of these retail traders in these two peri-urban areas. The majority of the traders were women and did not produce the commodities in which they traded. A substantial majority of the transactions with suppliers were effected through spot market transactions (immediate cash payment). Short term supplier credit was only available to a limited extent. Some modest levels of supplier credit and informal loans from friends and relatives were used in financing these trading activities, however, the major portion was through self-finance. Finance for these largely women traders was largely generated through participation in rotating savings and credit associations rather than through savings accounts in banks. In addition, kafo groups and moneykeepers also supplied savings mobilization services for the market traders in Banjul. Furthermore, cash rather than cheques were the principal form of payment to consummate market transactions in both countries. This limitation of the check clearing payment system, together with the lack

of deposits and loans from banks indicate the limits of the formal financial system in servicing retail traders. Regarding the downstream client end of the business in Banjul, the majority of the buyers were non-regular in nature. Regular buyers like smaller traders, hotel suppliers and restaurants constituted only 20% of the traders' portfolio. While regular client buyers were able to some extent to obtain products on short term credit, the majority of transactions involved immediate payment in cash.

Table 9. Operational Characteristics of Informal Financial Market Transactions among Market Vendors and Microentreprenuers in Peri-Urban Areas of Maputo and Banjul.

Operational Characteristics	Traders		Microbusinesses	
	Banjul	Maputo	Banjul[a]	Maputo
	(1)	(2)	(3)	(4)
1. No. of sample	66	73	153	21
2. Gender (% of total sample)				
a. Female	70	95	29	15
b. Male	30	5	71	85
3. Type of transactions with suppliers (% of contracts in the sample)				
a. Credit, consignment & advance payment				
b. Immediate payment	19	45	32	7
c. Average length of credit and consignment transaction (days)	81	55	68	93
	4	2-4	20	NA
4. Type of transactions with regular buyers (% of contracts in the sample)				
a. Advance payment[b]				
b. Credit[c]	56	NA	62	0
c. Immediate payment			56	5
d. Average length of credit transaction (days)	44	NA	38	95
	2	NA	4	7
5. Participation in informal groups (% of sample)				
a. Rotating savings and credit	42	55	24	3[b]
b. Moneykeepers	26	0	12	0
6. Instruments used in transactions (% of contracts)				
a. Cheques to suppliers	0	0	NA[e]	20
b. Cheques from buyers	0	0	NA	2
c. Cash to suppliers	100	100	NA	80
d. Cash from buyers	100	100	NA	98

Source: OSU survey 1993, Little et al., 1992, Graham et al., 1993 (a), Baydas et al., 1993.

a Represents percentage of all entrepreneurs.

b Represents advance payment from buyers to samples traders and entrepreneurs.

c Represents credit from sample traders and entrepreneurs to buyers.

d Number of savings accounts.

e Although form of payment was not explicitly explored in The Gambia study, field impression indicate an overwhelming use of cash for spot market transactions. Only a handful of larger bakeries and metal working establishments used checks.

2. Microenterprise survey:

The microenterprises in Maputo covered 21 microbusinesses selected in early 1992 for a case study from the clientele of the Banco Popular de Desenvolvimento (BPD). The study in The Gambia covered 153 microbusiness operators in early 1992. Table 9 summarizes the operational characteristics of the microentrepreneurs sampled for the study. In general, supplier credit was non-existent in Maputo compared to Banjul since many suppliers were foreign who demanded payment up front before shipping goods into the uncertain and insecure environment in Mozambique. Similarly, loans to clients were almost non-existent in Mozambique compared to The Gambia. In general, transactions involving credit, consignment and advance payment require either a long-term established relationship among the contracting parties or a stable market to reduce delinquency. The lack of credit transactions in Mozambique compared to The Gambia indicates that Mozambican markets are far more unstable and risky than the markets in The Gambia which suggests the country is still in the "early" stage of the transition process. One must remember that Mozambique at this time was still experiencing great risk in commercial transactions due to its civil war and, at the same time, the lack of appropriate legal and institutional reforms have held back the expansion of contracting among third parties. As a result, Mozambican businesses are largely self-financed. Furthermore, participation by microentrepreneurs in ROSCAS and non-rotating savings and credit associations were limited compared to retail traders (see line 5 (a) and (b) in Table 8). This is not surprising since ROSCAs are logically drawn upon to facilitate short term working capital needs for traders working in close proximity and daily contact. They are a less useful vehicle for widely dispersed independent producers.

As is the case of market vendors, cash is the principal means of payment in both countries. Some use of checks is seen in the Maputo survey. This no doubt is influenced by the fact that the sample in Maputo was drawn from clients who already had loans from the BPD, the country's development bank. The sample from Banjul was drawn from a random geographic sample. In 1991, only 2.5 percent of the Banjul sample were able to obtain a loan from a formal financial institution (Graham et al., 1993).

The above findings raise several questions: why is credit not a major part of this retail world and why are interlinked operations, so common in Asian countries, relatively absent here? Also, why is there a lack of a regular and established clientele? Finally, how are contract enforcement problems managed in these informal financial markets? Informal financial markets are better equipped than formal banks to mitigate moral hazard and enforcement problems implicit in credit transactions. Their capability to offer loans to non-bankable clients is a manifestation of their ability to gather and utilize local 'information' about their agents. Information is, however, costly and requires geographical proximity and long-term relationships. Indeed, the availability of local inexpensive information, enforcement mechanisms, and a good policy environment are preconditions for active informal financial markets. Yet, the limited role of informal financial markets at this level of trading activities in both countries suggest that they are not yet successful in dealing with these problems. This is, perhaps, due to the fact that there are few transactions that involve regular contracting parties. Furthermore, in Maputo, markets are still emerging, following its socialist past, in which private markets and conventional commercial contracts were severely circumscribed. In Banjul, this may be due more to frequently changing clientele.

High mobility among agents in a risky environment increases information and enforcement costs thereby impeding an active informal financial market.

The limited role of informal finance in servicing these marginal private sector constituencies leads to certain implications to the formal banking sector. In general, informal financial markets are dynamic and respond to the developments in the formal banking sector. If agency problems impede the informal financial markets to provide viable and efficient services to the retail market vendors, formal financial markets stands little chance in supplying financial services to this sector.

Transactions at the level of retail market vendors essentially involve quick turnover and frequent contact among the transacting parties. This would be facilitated by an easily accessible and cost efficient financial market to smooth out transactions. However, formal financial markets in these two countries are seldom accessible to these retail traders to facilitate their operations. Inflexible deposit requirements such as current account deposits with high minimum deposit requirements in The Gambia and lack of access to other liquid asset facilities in both countries create barriers for these traders. Furthermore, high loan rates and tangible collateral requirements increase transaction costs and create barriers for accessing bank loans for these traders in The Gambia. It is, perhaps, too difficult to achieve financial deepening down to this level of retail trading with the current rudimentary stage of the banking industry in many African countries. Whereas informal markets can service the short term working capital needs of retail traders, there is still a demand for term loans to finance capital investments and an equally important demand for remunerative and flexible deposit services. The present status of formal banking in countries like Mozambique

and The Gambia offers little hope as a source of financial services for small scale businesses. The rapid emergence of semi-formal financial agents are perhaps an indication of an unmet demand for financial services by both formal and informal financial agents. These semi-formal institutions are increasingly being discussed as possible viable alternatives to service the growing demand for financial services by small farmers, small traders and microentrepreneurs.

C. The Semi-formal financial market

Semi-formal financial markets are organized but outside the purview of Central Bank regulations. Credit unions, Cooperatives and NGOs usually constitute the set of semi-formal institutions in developing countries. In general, cooperatives are unviable and inefficient in both countries under study here while credit unions are underdeveloped in The Gambia and absent in Mozambique. NGOs have been active in promoting income generation activities for some time in The Gambia. It was expected that this past operational experience at the village level would generate a comparative advantage for NGOs to also supply cost efficient financial services through reduced information costs. Furthermore, it was expected that the implementation of credit and savings programs with other developmental activities would reinforce the income generating activities in NGO service areas. Several international donors, therefore, became eager to support NGO initiatives as an alternative institution to provide financial services to marginal clientele.

NGO activities can be classified into five different categories. The level of NGO participation in these categories depends upon the political and economic environments of the host country. The five categories are:

(i) Refugee survival services;

(ii) Development grant initiatives (to provide social and community wide facilities and infrastructure);

(iii) Development lending activities for income generating objectives. Services are directed to individual clientele through grants and loans. Expectations of loan repayment is usually not very high;

(iv) Brokering services between a marginal clientele and a bank to facilitate access to loans. These reduce transactions costs for low income clientele and lending institutions;

(v) Financial intermediary role to provide financial services explicitly or as part of other services to the community.

Based on the above categories, the level of NGO participation in The Gambia and Mozambique can be ranked as follows:

Table 10 NGO Activity in The Gambia and Mozambique by Category of Service.

Categories	The Gambia	Mozambique
Refugee services	0	3
Development grants	3	1
Development lending	3	0
Brokering services	1	0
Financial intermediary services	2	0

Ranks: 0 = No participation; 1 = Modest activity; 2 = Active participation; 3 = Very active participation.

Table 10 indicates that NGOs are more active in providing refugee services rather than financial services in Mozambique compared to The Gambia. This clearly grows out of the pressing need to deal with the human tragedy derived from the civil war that has torn

the country apart for the past ten years. Also, other NGO services grow most rapidly in a liberalized economy and in a democratic policy environment. The relatively more liberal and open society in The Gambia has stimulated a response from several NGOs to create an alternative supply of financial services for their marginal constituencies. Their diverse operational philosophies, however, have resulted in heterogenous financial technologies that send mixed market signals and create market segmentation. Indeed, the entry of NGOs in the rural financial markets of The Gambia to overcome the lack of government services and the limited reach of formal financial services has led to a number of cases of market failure (Graham et al., 1993). This raises the question whether NGOs can develop into viable semi-formal financial institutions. An examination of the NGO experiences in The Gambia can shed some light on the role of NGOs as financial intermediaries and help us derive policy implications for the financial sector in newly liberalized economies in Africa.

Principal-agent problems are allegedly low for NGOs compared to formal lenders such as banks due to informational advantages gained from their operations at the grass roots level. However, problems inherent to rural financial markets remain in terms of developing incentive compatible contracts, contract enforcement and effective monitoring of agents. Lack of regulatory guidelines for NGOs in The Gambia combined with lack of legal support to enforce contracts offer weak incentives for the development of sustainable financial programs by NGOs. The majority of these programs are frequently designed as an opportunistic response to donor signals with little emphasis on program viability and sustainability. The problems can, however, be minimized through appropriate organizational design. We review the operational characteristics of four different NGO programs that

currently provide financial services in rural Gambia. The evidence on their performance offers insights into the organizational features conducive to a sustainable supply of financial services.

NGOs became active participants in Gambian financial markets in the 1980s as a result of economic liberalization and the concomitant decline in formal financial services. Currently, 14 national and international NGOs provide financial services supplying nearly 20% of total agricultural loans (Graham et al., 1993). The operational strategies of these several NGOs range from the classic supply leading model to more unsubsidized institutions. Table 11 summarizes the operational strategies and performance indicators of four representative NGO designs observed in The Gambia. Indeed, the designs can be arranged in a continuum based on their level of subsidization.

At one extreme in column one of Table 11, Action Aid, The Gambia (AATG) represents a typical supply leading model that is supported by external funds and offers subsidized loans to a targeted clientele. At the other extreme in column four, the Village Savings and Credit Association (VISACA) offers untargeted loans at market rates using locally mobilized resources and attractive deposit services. The middle section of the continuum is composed of Gambia Womens Financing Association (GWFA) that offers only unsubsidized loans using external funds and no deposit services, and the Association of Farmers, Educators and Teachers (AFET) that mobilizes local savings to a large extent to provide unsubsidized loans that are linked to savings held by the beneficiaries.

In general, the evidence in Table 11 suggests that the sustainability of a program largely depends on its ability to: (i) generate internal funds through deposit mobilization by

offering attractive interest rates to fund loans; (ii) cover operational costs without external subsidization; (iii) mitigate risks due to covariance in incomes through geographic and portfolio diversification; (iv) reduce agency problems through an increased stake of the depositor-savers and the local loan approval committee; (v) develop appropriate collateral substitutes in the absence of tangible collateral held by the population; and (iv) recover loans. If performance indicators such as loan recovery rate, marginal clients served and services offered are a reflection of the efficiency of a program followed by an NGO, the VISACA stands out in Table 11 as the best model to attain sustainability.

Table 11 **Operational Characteristics of Selected NGO Designs in Providing Financial Services and their Performance Indicators: The Case of The Gambia.**

Items	NGOs			
	AATG[1]	GWFA[2]	AFET[3]	VISACA[4]
	(1)	(2)	(3)	(4)
1. Status	Intl.	Natl.	Natl.	Hybrid
2. Sponsors	UK[5]	WID of WB[6]	DANIDA[7], US embassy	CIDR/KFW[8]
3. Organizational design features				
a. Operational philosophy	Encourage income generating activities and local organizations	Increase access - production loans - women	Improve access to financial services through village banks	Provide unsubsidized financial services
b. Source of funds for financial services	External	External	Mostly local savings; some external	All local savings
c. Financial services offered	Credit, Compulsory savings	Credit	Credit and Savings	Credit and Savings
d. Geographic coverage	Rural	Urban	Rural	Rural
e. Target clientele	Women and Farmers	Women	Microbus.women and youth	Untargeted
f. Mode of reaching clientele	Mostly kafo groups some and Individuals	Individuals	Mostly kafo groups	Mostly individuals and some kafo groups
g. Target enterprise	Agrl.	Petty trading	Veg. gardens and Microbus.	Untargeted

(cont.)

Table 3. (continued) Operational Characteristics of Selected NGO Designs in Providing Financial Services and their Performance Indicators: The Case of The Gambia.

Items	NGOs			
	AATG[1]	GWFA[2]	AFET[3]	VISACA[4]
4. Terms and conditions and instruments used				
a. Principal Type of loans	Short term, In-kind loans	Short term, cash loans	Short term, cash loans	Short term, cash loans
b. Type of saving accounts	Compulsory fixed deposit held in central office	None	Fixed deposits held in central office	Current and fixed deposits held in local units
c. Loan int.rate (%/yr)	12	24-25	24	40-60
d. Savings int.rate (%/yr)	0	--	15-18	20-40
e. Collateral	Group liability	Third party	Guarantors and 3/4 savings	Animals, farm implements and jewelry
5. Subsidy component				
a. External technical assistance	High	Moderate	High	Moderate
b. Operational costs	High	High	Moderate	None
6. Performance Indicators (as of 1991)				
a. No. of loans issued	246 indiv; 53 kafo groups	66 indiv.	1343 indiv.	1266 indiv.
b. No. of savings deposits	NA	0	NA	485 indiv.
c. Ave. short term loan size ($)	25	580	28	37
d. Repayment rate (%)	42	92*	72	95
e. Percent of women clients	63	100	82	52
7. Agency Problem	Severe	Unclear-probably serious	Moderate	Low

1 AATG: Action Aid, The Gambia;
2 GWFA: Gambia Women's Financing Association;
3 AFET : Association of Farmers, Educators and Trainers
4 VISACA : Village Savings and Credit Associations
5 UK : United Kingdom
6 WID of WB : Women in Development division of the World Bank
7 DANIDA : Danish International Development Aid
8 CIDR/KFW :

Source: Graham et.al, 1993.

In summary, the emphasis on locally mobilized resources to supply loans and the use of local personnel to screen applicants have helped the VISACAs to reduce monitoring and enforcement costs. Furthermore, their attractive savings programs that are flexible, remunerative and accessible with minimal transaction costs provide incentives for savings mobilization and induce an incentive compatible environment for contract enforcement on borrowers. In addition, their use of both tangible collateral and effective collateral substitutes to supply loans to asset-poor members and enforce contracts contribute towards their success in loan repayment. The VISACA model is clearly a pareto improvement over the other NGO models in The Gambia. However, it is still susceptible to systemic failure due to its design as a village unit rather than as a broad network that could mitigate covariant income through geographic diversification. Furthermore, there is limitations to locally available resources that can be mobilized in VISACAs. Hence, VISACAs' loan portfolio is constrained by the economic activities of the region in which they operate. However, the model underscores the positive impact of local savings on the portfolio performance of the village banks.

V. Summary and Conclusions

The conclusions drawn from this study are several. First, it is clear that stabilization and deregulation was a necessary condition for both economies to eventually work themselves out of growing economic stagnation from the late 1980s onwards. Second, it is also clear that deregulation of markets and a need to clean up the balance sheets of insolvent development banks led to a decline in the real levels of outstanding credit from

the levels established during the period of supply leading finance in the early to mid 1980s. This, however, was to be expected given the high level of non-performing loans inflating the credit data for the earlier era. Third, it is clear that there is a sectoral incidence in the reallocation of the portfolio of formal financial markets as agricultural lending declines relative to non-agricultural lending. Again, this is not surprising given the fact that the major unsustainable component of the earlier supply leading era lay in its parastatal servicing of a rural clientele. Fourth, the initial starting conditions shape the paths and final impact of financial deregulation. When the country has incorporated its supply lending financial development strategy within an already existing private banking sector (as in The Gambia), the options for the privatization of the bank or of most or all of the future financial services is feasible. However, when the previous supply of financial services occurred within a centrally planned socialist regime, (with no effective formal private sector), the path of deregulation will more closely parallel the experience of a transitional regime moving from a communist to a market society in which there is still a role for public sector banks. The challenge here is to secure more viable public sector financial institutions while the more market oriented government reduces inflation, deregulates financial prices, reduces subsidization, and establishes property rights and effective contract enforcement mechanisms. In the short to medium term, one is privatizing the economy (i.e., the new clientele of the bank) rather than the bank itself.

In the meantime, riskier but potentially remunerative low income clientele, particularly rural clientele, are screened out of formal financial sector portfolios, as seen in both of the countries under review here. In short, the formal sector banking institutions

have the resources, but not the information or the contract enforcement mechanisms to service this clientele, while informal market operators in general lack the resources but have the local information and better contract enforcement vehicles for these clients. Nevertheless, field research in both countries underscored the limited degree of informal financial contracting through supplier and client marketing channels. At least for these two countries the strategic link that appears underfinanced in these networks are the larger wholesaler, importer agents who are struggling to replace the former parastatal enterprises in the privatization of input marketing channels in the liberalization programs.

Finally, it would appear that semi-formal financial institutions can play a positive role in servicing the demand for financial services from this low income rural clientele. In The Gambia, several NGO initiatives are underway to fill the vacuum left by the downscaling of government subsidized credit delivery vehicles in rural areas. Local NGOs presumably have a comparative advantage over formal banks in the quality of local borrower information. However, they do not necessarily have the means to deal with effective monitoring and contract enforcement at this level. The evidence to date strongly suggests that local deposit-savings mobilization is essential to ensure a proper organizational incentive for effective monitoring and contract enforcement. Therefore, NGOs that emphasize this frequently forgotten half of rural finance as the principal source of funds for on-lending will have a greater likelihood of success in building viable local intermediaries. Deposit services in village banks or savings and credit associations generate valuable services of safekeeping, liquidity reserves and returns on savings. Liquidity reserves are particularly important for rural clientele to manage risk and smooth consumption. Subsidization is

legitimate in these cases for initial start up costs and technical assistance support over a period of time. However, unsubsidized market rates should prevail for deposits and loans, otherwise subsidized loan rates will come at the expense of a lower return for net savers in these institutions, weakening the base for local deposit mobilization.

Two important research agendas grow out of this review. First, it is necessary to document more fully the numerous NGO (semi-formal) experiments currently operating in Africa. Some are designed with both a savings and credit dimension for individual client services (like the VISACAs); others are also designed with a savings and credit dimension but for groups rather than individual clients (i.e., the Grameen Bank model) while yet others are designed only through the credit dimension by drawing upon a merchant-moneylender partner on a commission basis to issue and collect on loans. Country or region specific conditions may favor one organizational form over another. What isn't clear is how successful each has been in incorporating local information for lending decisions, the terms and conditions of their financial services, and the monitoring and contract enforcement mechanisms adopted to ensure institutional viability. This field research on semi-formal financial intermediaries could complement the important work that Udry and Eswaran and Kotwal have done on state contingent contracts on credit as insurance in agrarian economies. The profession has been enriched by recent scholarship on the multiple roles and functions of informal contracts and the way in which they substitute for missing markets. The literature, however, is more sparse on the recent experience of semi-formal financial intermediaries and the degree to which they can resolve the information and contract

enforcement problems necessary to expand the frontier of finance in rural African and open the possibility for linking formal and informal financial markets in Africa.

The other major research agenda concerns the most feasible organizational reforms for public sector development banks. It would be unrealistic to think that a number of African countries would be able to have any formal financial institutional pressure without continuing to draw upon these institutions in the medium term to supply formal financial services. This is particularly pertinent for former socialist regimes in Africa gradually working themselves towards a market economy. The task is to redesign these institutions to achieve greater institutional viability. First, domestic savings mobilization can expand the range of financial services beyond that of credit alone and, at the same time, create a local constituency concerned with the solvency of the institution. Decentralized management is an additional reform that allows locally recruited managers to trade on their stock of local knowledge to reduce information asymmetries in the selection of borrowers. Delegating responsibility and accountability to local branch managers can work if these branches can be developed as profit centers and managers are rewarded with performance based salaries. These features can create incentives for local managers to sort and screen clientele careful and engage in more diligent monitoring effort.

Reforms of this nature apparently succeeded in Indonesia. For Indonesian development banks, however, the more densely populated Indonesian society reduce transaction costs and the risks of covariant incomes for these banks due to more diversified village and regional constituencies. African banks servicing a rural clientele will not be able

to enjoy the same cost economies and risk diversification due to operating in more sparsely settled and less economically diversified rural areas.

In summary, country specific research on the current state of development bank restructuring could offer insights into the role of initial conditions and subsequent organization strategies hindering or facilitating feasible reforms viability. These findings could identify information and human capital deficiencies and weaknesses in the rules of governance and institutional autonomy, areas in which donor assistance and resources could make a contribution in pushing the reform process along more promising paths in collaboration with host governments.

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