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SANDUQ: A MICROFINANCE INNOVATION IN JABAL AL-HOSS, SYRIA

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Abstract

Jabal al-Hoss is one of the poorest areas in Syria where UNDP has supported the establishment of self-reliant local financial institutions, *sanduq* (*sg*.) lit. *savings box*: a novel concept in centralized banking system. The sanadiq (*pl.)* are self-managed and autonomous in their decision-making, which has included the adoption of financial practices consistent with local values. The start-up is self-financed through member share capital, from which small loans are given for up to three months. Whenever initial financial intermediation is satisfactory, UNDP provides an additional capital injection, thereby increasing outreach, loan sizes and loan periods.

Between September 2000 and December 2002, 22 sanadiq were established, comprising 4,691 members, with shareholder equity of US$ 130,000. UNDP contributed $370,000 in equity. The repayment rate as of 31 December 2002 was 99.7%. Return on average equity was 17%, almost half of which (46%) was paid to shareholders, the balance (54%) retained as capital. Loans permit farmers to bypass trader-moneylenders and sell their produce at a higher price; laborers turn into farmers; and microentrepreneurs use quick-turnover repeat loans for new investments and rapid business growth.

Special attention is given to women who constitute 41% of the membership, most of them illiterate. They opted for integrated sanadiq, in which female members participate in management committees. They find access to loans easy, as sanadiq do not require physical collateral. Loans are used by younger and older women to do business of their own, eg, fattening sheep, raising cows, opening small shops and renting land to plant cash crops. The additional income is used for business growth and family support. It is not rare that women – many with large families – are the better entrepreneurs, focusing on high-yielding activities outside traditional agriculture.

In 2002 first steps were taken towards the establishment of a network which will provide apex services and initiate the dialog on a legal framework; and of a central fund (Sanduq Markazi) supervised by the Central Auditing Agency. During phase II, 2003-2007, with support from the Japanese Government and UNDP, the focus is now on the expansion and legal consolidation of the network of sanadiq. There are also plans for extending such networks throughout Syria as a strategy for rural development, poverty alleviation and employment generation. (*For further details and a pictorial view see www.undp-hoss.com*)

1. The view of the people

You can tell a bank or microfinance institution by its customers. Here are some of them:

Aminah is 40 years old and has 10 children. Her husband owns 2 ha of farmland. In January 2001, Aminah joined the new sanduq in Bnan, paying SP 1,000 ($20) for a share. With a loan of SP 25,000 ($500)[1], she opened a store for household electrical equipment in front of her house. From the income, she bought additional stock, took out some money for the family, and repaid the loan after six months. Meanwhile she has received a second loan which she invested in the growth of her store.

Riad used to be a migrant worker, with his family home in Batraneh. He sold the earring of one of his daughters to buy a share and became a sanduq member. This convinced the sanduq committee of his seriousness, and they gave him a six-month loan of SP 40,000 to buy a cow. He is now working his way out of poverty, expecting that both the sanduq and his own income will continue to grow in parallel.

In early 2001, *Rabuaha* took a six-month loan of SP 20,000 from the sanduq to buy a calf. From wages received as a farm laborer, she repaid the loan in monthly instalments on time. She raised the calf and now, two years later, owns a cow and a calf: assets reportedly worth SP 100,000. By selling milk from the cow and making cheese and yoghurt, she is able to finance half of her household expenditures. What matters to Rabuaha is access to a loan; the murabaha rate is relatively unimportant, given the profitability of her investment.

In February 2003, *Hajeh* took a four-month loan of SP 50,000, which she repaid in a lumpsum upon maturity. She bought 15 lambs for fattening at a total cost of SP 45,000. She had to buy the water and the fodder and sold the lambs after four months for SP 52,500, barely braking even. She said she would have made a profit had she received the loan for a longer period and sold the lambs after six months. The sanduq committee, with advise from project staff familiar with sheep fattening, should either have refused the loan or granted it for a longer period. It is her daughter *Mariam* who learned from her mother's experience. She just took a six-month loan of SP 50,000 and bought 10 female sheep. To repay the loan, she will sell some when they are pregnant and others after the birth of a calf. Inspired by Rabuaha, she expects a substantial profit and a gain in assets, keeping some of the sheep for further breeding.

A sanduq (*pl.:* sanadiq) is a local microfinance institution owned and managed by the people. Aminah and Riad are two of 4,700 people who, between September 2000 and December 2002, have joined a sanduq. Nearly 3,000 have received a loan, invested it profitably, and repaid it on time. What they appreciate most is the ease and convenience of access to loans within their own community. The loans have permitted farmers to bypass trader-moneylenders and sell their produce at a higher price; laborers have turned into farmers; and microentrepreneurs have used short-term repeat loans for rapid business growth and marketing innovations. Many more members are waitlisted, while funds are in short supply.

[1] Exchange rate: 1 US$ = 51.5 Syrian Pounds

2. Sanduq[2], a self-managed financial institution in Syria

The area: Jabal al-Hoss with its 157 villages is one of the poorest areas in Syria. The villages are known for the beauty of their houses in the shape of mud domes; but life is harsh, given the rocky surface of the land and the dry climate. Yet there is more of a potential than meets the eye, waiting for an accessible source of finance.

Objectives: *Rural Community Development in Jabal Al-Hoss* is a joint project of the Ministry of Agriculture and Agrarian Reform of the Syrian Arab Republic and the United Nations Development Program. It was approved in 1998. Implementation started in 2000. The first Sanduq was established on September 1, 2000. The primary objective is the establishment of sustainable local financial institutions owned and managed by the people themselves. If successful in Jabal al-Hoss, which is one of the most disadvantaged areas of Syria, it will serve as a model for all of Syria and perhaps the wider NENA region. Its wider objective, or *development goal*, is community development, encompassing income and employment generation through diversified agricultural and non-agricultural income-generating activities (IGA), and the overall improvement in the people's lives.

Goal:

Sustainable access of low-income people to financial services and income-generating opportunities.

Objective:

Establishment of a sustainable network of self-reliant local microfinance institutions (sanadiq) with a full range of financial services to their members.

Market segment and target population:

Low-income people, the underemployed and the unemployed - men, women and youth.

Basic principles: Through numerous interventions including investments in infrastructure and education, the government has created a favorable environment for development. It is now up to the people themselves to mobilize their own personal, financial and institutional resources and initiate a continual process of economic and social development. Four principles are fundamental: self-reliance, autonomy, sustainability and outreach to the poor:

- Self-reliance is based on the mobilization and ownership of local resources:
  - *Cultural self-reliance,* based on the concept of the sanduq as an ancient community-based financial institution
  - *Organizational self-reliance,* based on sanduq self-governance by local men and women through elected committees

[2] ***Sanduq*** (sg.; plural: ***sanadiq***) has several related meanings: a box; a box to store valuables; a fund; a communal or group fund; the community or group holding the fund; a local financial institution, or microfinance institution (MFI), holding a fund. In this project, the term ***sanduq*** refers to an autonomous microfinance institution, which is owned and managed by its members.

- *Financial self-reliance,* based on the self-financing of the sanadiq through share capital paid-up by the members and retained earnings, derived from adequate, non-subsidized financial margins and insistence on full repayment of loans

- *Autonomy* is based on self-selection of member-owners, in the choice of financial products, in the determination of margins and in lending decisions
- *Sustainability* is based on the establishment of operationally and financially self-sufficient local financial institutions, together with a regional association and a regional fund
- *Increasing outreach to the poor* is achieved through growth in the number of members, expansion in the number of sanadiq, growth of resources, and dissemination of the approach among other agencies and areas throughout Syria.

From the onset, the project has set clear signals towards self-reliance through the concurrence of the following events at the time of constituting a sanduq: registration of members; payment of share capital; selection of a management committee; disbursement of loans from the paid-in capital in the presence of all members – adhering to the zero-cash principle and avoiding moral hazard.

The program has a number of distinguishing **microfinance characteristics:**

- Initial capitalization through member share capital: *Local capital mobilization first!*
- Multiple share-ownership
- *UNDP capital injection only after satisfactory performance as a local financial intermediary*
- Flexible lending; no standarized loan terms; loans may vary in terms of size, loan period, instalment periods, and purpose
- Profit margin of 2.5% per month according to the Islamic banking product *Buying & Selling (murabaha)*
- Profits as a source of income to cover the costs of loanable funds or their opportunity costs; administrative costs; provisioning for bad debts; member dividends; and retained earnings
- Personal guarantees, group guarantees, or physical collateral
- No deposit mobilization during the initial phase until Sanduq staff can handle liquidity management competently;
- Integration of women in the sanduq with equal rights.

The role of UNDP:

UNDP has assisted the Ministry of Agriculture in designing, testing and revising the approach. When the initial performance of a sanduq is satisfactory and the loans made from the share capital are repaid on time, UNDP provides an additional capital injection. If a sanduq does not function properly, the capital provided is to be refunded. Through guidance and training by project staff, the sanadiq evolve as institutions which are self-managed and autonomous in their decision-making.

3. Results

The first nine sanadiq were established in September 2000. Between December 2000 and December 2002, the sanadiq in Jabal al-Hoss grew rapidly, with a stunning performance in terms of repayment and profitability[3]:

- Number of sanadiq: from 9 to 22 + 1 central fund
- Number of shareholders: from 1010 to 4691
- Share capital: from SP 1.9m to SP 6.5m
- Total capital (incl. UNDP grant): from SP 6.2m to SP 25.0m
- Number of loans outstanding: from 92 to 1020
- Amount of loans outstanding: from SP 1.8m to SP 31.8m
- Repayment rate end-2001, 2002: 100%; 99.7%
- Return on average equity 2001, 2002: 12.3%; 17.0%

Table 1: Sanduq performance, 2000-2002 (amounts in million SP)

	12/2000	*12/2001*	*12/2002*
Number of village funds (sanadiq)	9	20	22
Number of shareholders	1,025	3,455	4691
Percent female	*35%*	*40.5%*	*41.0%*
Capital (in million SP):			
Share capital	1.9	4.64	6.48
Percent female	*33%*	*39%*	*40%*
UNDP equity grant (*cumulative*)	4.3	14.55	18.50
Retained earnings	-	0.58	2.73
Total capital	6.2	19.77	27.71
Borrowings from Central Fund		4.1	7.2
Total loans outstanding (year-end):**			
Number	92	830	*1020*
Amount in million SP	1.79	20.40	*31.81*
Total income	0.07	1.82	4.69
Total expenditure	0.00	0.22	0.66
Net return	0.07	1.60	4.03
Repayment rate		100%	99.7%
Return on average equity*		12.3%	17.0%

* (Equity on 1 Jan. + Equity on 31 Dec)/2. Average equity would be more accurately calculated as the arithmetic mean over twelve monthly values.
** Including loans financed through borrowings from Sanduq Markazi.

Women are given special attention as owners and users of the sanadiq. In Jabal al-Hoss, women have opted for integrated sanadiq. During phase I, they had their women's committee; in Phase II, each sanduq is headed by a single committee of two men and one woman. Through training and access to finance, women have established their own enterprises, improved their earning capacity, and, in a number of cases, escaped unemployment and premature marriage.

[3] The project costs are not included in the profit and loss statement.

Female participation rates have increased substantially between Dec. 2000 and 2002, in terms of both ownership and borrowing – proving that non-targeting institutions can reach women with commercially oriented services in significant numbers:

- Female shareholders: from 35% to 41%
- Share capital: from 33% to 40%
- Number of loans outstanding: from 13% to 33%
- Amount of loans outstanding: from 6% to 29%.

There are four **sources of funds** according to their origin: internal resources, derived from share capital, retained earnings and savings deposits from within each sanduq; liquidity exchange within the network of sanadiq; donor resources from UNDP; and bank borrowings.
In the current stage, the only two sources of loanable funds of any significance are share capital and a UNDP grant. Retained earnings, derived from the profit margin, are expected to be of increasing importance as time progresses. Monthly collection of the profit margin increases liquidity and improves repayment morale. Short loan periods and repayment in regular installments increase the turnover of loanable funds and thereby create additional liquidity for loans to members.

Products: During the initial phase, the sanadiq have not accepted deposits. This is reasonable, because the committee members lack the required training and experience in liquidity management. In due course, the following **savings products** may be offered:

- unremunerated deposits for safekeeping for a fee,
- passbook savings (limited number of withdrawals, eg, one per month or week);
- time deposits.

Deposits that are available as loanable funds may share in profits at rates to be determined (varying perhaps from 0.25% to 1% per month).

The project has adopted *flexible lending* (in terms of loan sizes, loan periods, installment periods, loan purposes) at a single profit margin. This is reasonable during the initial period. With growing experience (presumably not before phase II), the project may either continue this single-product practice; or introduce differentiated products.

Repeat loans and loan sizes: Lending limits have been set as follows, increasing with each loan cycle from 1st to 4th: SP 50,000; 75,000; 100,000; 150,000. There are two risks associated with high and rapidly increasing lending limits: a lack of attention to small loans; and a tendency to set loan sizes in excess of the repayment capacity of borrowers. Indeed, most loans are in the SP 10-50,000 range; there are few small loans below SP 10,000 (US$200). Small non-agricultural IGA have received little attention.

There have been demands for higher limits during the first cycle. This would not be prudent. The loan limits are on the high side and will require tight monitoring by project staff. Short loan periods permit a rapid increase in loan amount: probably soon in excess of funds available. With 3-month loans, a borrower can reach a loan size of SP 150,000 within a single year. Larger loan amounts during the initial phase are incompatible with the notion that Jabal al-Hoss is one of the poorest areas of Syria. The daily wage in the informal rural economy may serve as an indictor of the local value of money: SP 100 for women, SP 200 for men. Project management may be well advised:

- to give more emphasis to small loans below SP 10,000, particularly in new sanadiq and during the first cycle
- to examine the potential for small loans to adolescents (including loans for IGA to girls of 16-18 years of age to prevent early marriage)
- to give preference to loans with regular installments (possibly from other sources of income), rather than loans with lump sum repayment upon maturity
- to monitor carefully the progression in repeat loan size, avoiding any automatism (every loan has to be examined by its own merits, which is current project practice).

In the case of short-term emergency loans, a **fee** (not below SP 100) may replace the profit margin. But this requires careful deliberation between project management and the sanadiq central committee. *Small emergency loans*, perhaps at a fixed fee rather than a profit margin, would be decided upon by the management committee on a daily basis on the spot. Such a product would require a small emergency fund with cash-on-hand in the sanduq's safe.

Life insurance for members and possibly their family members greatly contributes to social security. It also serves as loan protection when a borrower dies. The fee may be built into the profit margin. The international credit union movement has worked out the terms.

Loan purposes: Loans have been confined by the project to productive purposes. This means that the sanduq does not offer assistance in cases of emergency or for educational and consumption purposes. This might drive some people into the hands of moneylenders, who always get precedence in repayment. It is justified, particularly in this phase, to limit larger loans (eg, above SP 10,000) to productive investments, but not small loans. A sanduq should be *a microbank for all financial needs:* be flexible with regard to loan purposes and permitting small loans up to SP 5,000 or 10,000 for non-productive purposes if approved by the management committee.

Rural microenterprises and income-generation activities (IGA): The scope of loan purposes has been narrow. Most loans have been invested in agriculture and livestock: cow raising or sheep raising for milk or sheep fattening. During the initial phase, there is a pronounced tendency to invest in known and tested technologies. With increasing sanduq competence and member confidence, there will be an increasing demand for more innovative opportunities.

One example is the *mushroom miracle.* At very low costs, project management has introduced mushroom-growing in the traditional conical houses of Jabal al-Hoss. The technology has been spreading rapidly. About one ton of mushrooms has been grown and marketed in early 2001. Despite this success story, management has to be aware of its limitations in terms of staff and resources. The promotion of rural microenterprises and IGA exceeds the capacity of the project. Establishing autonomous local financial institutions is a tremendous challenge which requires full concentration of time and resources. Apart from exceptional interventions as in the case of mushrooms, project staff can only assist in the coordination of agencies , including the IFAD project, which promote IGA training and marketing.

Loan appraisal and the transfer of lending authority to the sanduq committee: Loan appraisal is jointly carried out by the sanduq management committee and the project, usually within a week or less The final decision lies with project management. This is necessary during the initial phase, as the sanduq committees lack experience. However, with the increase in number of sandiq and loans, this will place an unduly heavy burden on project staff. In the interest of institutional autonomy, criteria for the transfer of lending authority to the sanduq management committees need to be established (eg, one year of successful lending experience, adequate bookkeeping skills). In addition, the transfer of full lending authority to sanduq management committees will also require effective auditing and supervision services by an association of sanadiq.

Arrears prevention is of crucial importance. Prevention is far more effective than therapy. On principle, *no arrears are accepted:* a payment one day late is a late payment and recorded as such! The delinquent borrower is to be contacted immediately. Monthly charges on late payments above the usual profit margin (*penalties*) are common in the world of (micro-) finance, but may not be acceptable in Syria. Legal action is only to be taken later, say after a period of 1-3 months. Before legal action is taken, the feasibility of loan rescheduling may be examined, though this is full of moral hazard.

Adequate loan terms and conditions prevent arrears: starting with small loans; setting initial loans and installments at a size that uses the existing potential of repayment (from already existing sources of income); increasing repeat loans in size depending on repayment performance; short loan periods; monthly or weekly installments, combined savings and installment collection service; timely disbursement.

Securitization through guarantees and collateral is of tertiary importance. It may include: personal guarantees and group guarantees, plus informal collateral for the poor up to a certain loan size; and personal guarantees and physical collateral for the non-poor and above a certain loan size. *Loan protection* may be provided through life insurance. *Credit guarantee schemes* are usually ineffective and create moral hazard.

4. Impact

Levels of impact assessment*:* Impact of the MoA/UNDP intervention is expected at several levels: (a) on the development of sustainable rural financial institutions; (b) on IGA, income and employment, which together are core elements of development at the community level; (c) on empowerment, including (d) women’s empowerment; (e) on women’s IGA and microenterprises; (f) on youth and employment; and (g) on policy.

Impact on institutional development: Two years is too short a period to study the full impact of the intervention. In the now developed countries, it has taken decades, not years, to establish networks of sustainable microfinance institutions. So far there have been only promising and no discouraging signs. The sanadiq have started to fill a demand which government-owned centralized institutions have found difficult to respond to: the demand for easy and timely short-term microcredit at low borrower transaction costs. At the same time, there are other signs of a positive impact on rural finance: local moneylenders have complained that demand for their services has dropped and that their business is suffering.

The new sanadiq are doing well: Membership continues to be on the increase, loans are being fully repaid, and a substantial surplus is being achieved from which dividends and retained earnings are being derived. Management committee members are gradually acquiring the competence to manage their financial institutions. The good news are traveling to neighboring villages: many are on the waiting list for assistance to establish their own sanduq.

Impact on IGA, income and employment: Sustainable financial institutions with effective services are a necessary, but not a sufficient condition for growth and development. Jabal al-Hoss is one of the poorest and most disadvantaged areas of Syria. Evidence of the positive impact of microcredit should therefore not immediately be expected. Under such unfavorable circumstances as in Jabal al-Hoss, maintenance of an adequate level of subsistence is already an achievement – in fact a big one at times of drought.

Yet, anecdotal evidence of the profitable use of microcredit by men and women in the villages has already emerged. There is also evidence of the importance of small-scale short-term financing for microenterprise experimentation: successful in the case of the *mushroom miracle.* However, new microenterprises do not always succeed; and new microentrepreneurs, male or female, gain experience not only through business success but also business failures. It is therefore important that loans are small and short-term so that failures ignite, rather than stifle, entrepreneurship and innovation. This is of particular importance in an area where the environment is harsh and microbusiness innovations have been few. These aspects of impact will require thorough study over the years to come.

Impact on empowerment: Indebtedness, which results from access to microcredit, does not as such constitute empowerment. Of crucial importance is of course whether microcredit leads to an overall growth in assets and disposable income. This has not always been the case in well-publicized microcredit schemes elsewhere. In microfinance, empowerment should primarily be defined in terms of ownership of microfinance institutions and control over decisions. In this sense, the establishment of sanadiq has established new and unprecedented forms of empowerment in Jabal al-Hoss: the sanadiq are owned by the share-holding villagers themselves; and they are managed by villagers who were democratically elected. Through competence training in financial management for sanduq committee members, empowerment continues to grow.

Impact on women's empowerment: In a similar vein, women are given the opportunity of owning and managing sanadiq. Within the framework of their cultural traditions, they have opted for integrated sanadiq: first establishing their own women's sections, then participating in the management committee. Women have participated in sanadiq as owners from the very beginning: at a rate slightly above one-third. During the first two years, the proportion of women members has increased from 35% to 41%; women's share capital from 33% to 40%. However, the quality of participation has changed profoundly from passive to active: The proportion of female borrowers has increased from 13% to 33%; the proportion of women's loans outstanding from 6% to 29%.

Impact on women's IGA and microenterprises: Women in Jabal al-Hoss are part of families which usually comprise several economic activities as part of a single integrated household headed by a male. There is a division of labor between men and women, but no separation of household economies. Women's membership in sanadiq may serve two distinct purposes: access of the household to more than one small-scale loan at the same time for family investments (eg, tractor accessories); and finance for women's own IGA. There has been evidence for both, but more for the latter. Notable are some cases of explicit female entrepreneurship in the presence of male inertia within the same family. Female entrepreneurship – always within the confines of culturally approved family limits - appears to be a topic deserving further in-depth study in Jabal al-Hoss.

Impact on youth and unemployment: Young and adolescent men and women are included among the members of sanadiq. Access to credit to finance IGA of adolescent women has been identified as crucial in preventing early marriage and childbirth. The potential of the sanadiq in promoting income and employment among youth and preventing juvenile unemployment deserves focal attention.

Impact on policy: Policymakers are paying attention to the sanadiq as an institutional innovation in Syria. If the project succeeds in establishing an interagency committee to prepare a legal framework for microfinance/microbanking institutions and institutionalizing a policy dialogue with nation-wide implications, the project's impact on policy would be yet another dimension to be monitored in the future.

5. Lessons learned and future perspectives

Lessons learned:

The project *Rural Community Development in Jabal al-Hoss,* with its emphasis on microfinance and income & employment generation, is considered as one of the most successful projects in Syria. It has demonstrated on a pilot scale that:

- poor people can mobilize their own human and financial resources;
- as shareholders, they finance and manage their own local financial institutions;
- as borrowers, they invest short-term loans in a wide range of income-generating activites, gain business experience, and repay their loans;
- in increasing numbers, women have participated in the *sanadiq* as owners, managers and users.

Significance for Syria and the region:

With its dual emphasis on microfinance and microenterprise development, the project has opened up new avenues for the development of self-reliant local financial institutions and self-reliant farm and non-farm enterprise. Embedded in the cultural tradition of sanadiq which are known throughout the region in the Near East and North Africa, the pilot experience in Syria is likely to be of relevance for other countries within the region.

Challenges and opportunities:

Microfinance is a young industry in Syria, facing a number of challenges and a wide range of opportunities:

(1) ***Regional expansion:*** How to expand the number of sanadiq to all 157 villages of Jabal al-Hoss
(2) ***Consolidation of sanadiq:*** How to fully qualify the sanduq management for operational and financial autonomy
(3) ***Association of sanadiq:*** How to integrate the sanadiq and the support functions of the project into a sustainable institutional infrastructure with apex services to sanadiq
(4) ***Central Fund:*** How to integrate the sanadiq into the national financial system through a *sanduq markazi* as a institution of liquidity exchange and refinancing (established in 2002, under voluntary supervision by the Central Auditing Agency)
(5) ***Regulatory framework:*** How to protect the sanadiq and their apex organizations through an appropriate legal framework, prudential norms and effective supervision
(6) ***National expansion:*** How to expand networks of sanadiq in rural and urban areas throughout Syria.

Meeting these challenges will require close cooperation between government agencies, donors and private organizations.