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Reducing Defaults in Microfinance: A Case Study of Fundación Integral Campesino (FINCA) Costa Rica

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REDUCING DEFAULTS IN MICROFINANCE:

A CASE STUDY OF FUNDACIÓN INTEGRAL CAMPESINO

(FINCA) COSTA RICA

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ABSTRACT

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Thesis supervised by Dr. Clifford Bob and Dr. Daniel Lieberfeld

This study seeks to determine why some microfinance institutions have high default rates, while others have low ones. Three literature-based hypotheses regarding default reduction were tested on communal credit enterprises (CCEs) of a poverty-focused microfinance program called FINCA Costa Rica. Specifically, five CCEs in the Osa region, and one CCE (not within the Osa) created by FINCA CR. Four financially healthy CCEs that have low default rates were compared with the one that is at a high-risk for failure, to determine what exactly caused this to happen when so many variables were controlled. It is hypothesized that more group unity, better training programs, and more discipline will reduce defaults within microfinance institutions. Results show that group unity was not associated with low default rates, while better training programs and discipline were. The results also show that because of important

limitations in this study, additional research is needed in order to provide more reliable results.

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Chapter 1- Introduction

Introduction

In the 1970s, microfinance came into the spotlight as one of the most innovative ideas for alleviating poverty within the development sphere. The trend quickly grew. Microfinance programs work by offering credit to collateral-less borrowers, the poorest population that is generally not given access to these opportunities. This credit could be used for entrepreneurial activities or other activities which may reduce poverty.

Benefits of Microfinance

Generally microfinance has been hailed within the development community because it is unlike foreign aid and does not rely on the state for its existence. Some purported benefits arise by creating access to credit for the poor. The idea is that once the poor are able to access credit, they will engage and invest in entrepreneurial activities. With this line of credit, through taking advantage of market access, they are able to generate profit that will benefit them on their own, without depending on state resources. Franklin Simtowe, an African Agricultural Economist and researcher, said that there is now "enormous evidence" that market access has enabled the poor to participate as "viable actors in the economy."[1] Until microfinance came into play, foreign aid was one of the main methods of getting ahead.

Another method of getting ahead, closer in similarity to microfinance, still exists today. This method is borrowing money from moneylenders, or loan sharks.

[1] Taken from: Simtowe, Franklin. 2006. "Determinants of Intra-group Insurance in Microfinance: Empirical Evidence from Joint Liability Lending Schemes in Malawi." *Microfinance Gateway.* Germany: University of Bonn. Retrieved December 2008 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.27282). Page 1.

Moneylenders loan money to individuals with high interest rates, which sometimes comes with added stipulations. For example, they will loan money to an entrepreneur and require that person to sell their goods back to them at a very cheap price. An article in the *Wall Street Journal* describes this as a problem for poor people, not only because moneylenders charge interest rates that are so high they could almost never be paid back, but also because the borrowers are obligated to sell their goods for lower than what may be the market price in some cases.[2] In some cases moneylenders might be the only ones providing financial access for poor borrowers. Indeed, Yunus also mentions this as a problem in Bangladesh in his book *Banker to the Poor*.[3] His response to this problem was building a microfinance operation called Grameen Bank, which was the first bank to lend to collateral-less borrowers at fair rates.

Critiques of MF

One main concern of those questioning the promises of microfinance is whether it is really an alternative to foreign aid. Many proponents of microfinance would say yes. Yet the scope of microfinance tends to be small and it is of a grassroots nature. The amount of capital disbursed is minute in comparison to multi-million dollar development projects carried out by multi- and bi-lateral organizations. In addition, microfinance does not necessarily benefit those who lack market access.

In truth, microfinance can only benefit the poor when it works. Within certain programs, deficiencies exist which block the poor from receiving the intended benefits. It is important that programs minimize these deficiencies so that they can meet their development goal to help the poor overcome poverty.

[2] Gokhale, Ketaki. 2009. "A Global Surge in Tiny Loans Spurs Credit Bubble in a Slum." *The Wall Street Journal.* August 13. Retrieved May 2009 (http://online.wsj.com/article/SB125012112518027581.html).
[3] Yunus, Muhammad. 1999. *Banker to the Poor.* New York: PublicAffairs. Page 82

Critiques of MF: Default Rates

Recently the issue of defaults in microfinance has become a main target for scrutiny. Defaults are outstanding debts which are not paid on time, and loans are defaulting when the payment is one or more days late. MFIs must manage risk by lowering defaults so that they stay financially healthy. This is important because in order for all borrowers to continue to receive credit opportunities, the overall organizational health (which depends on individual behavior), must stay in good shape.

Research Question

What explains why some MFIs have high default rates, while others have low ones?

Dependent Variable and Measurement

My dependent variable is low default rates. High default rates occur when more than 10% of an MFI's credit profile is delinquent past 60 days. The 10% figure has been chosen because this is the industry standard.[4] The time frame of 60 days has been chosen based on the credit ruling for collecting late payments within FINCA CR. It is in line with that of many other Microfinance Institutions.

Hypotheses

This thesis will test three hypotheses derived from the main ideas in the literature on microfinance reviewed in chapter 2:

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[4] According to the Microenterprise Development Team Leader at World Vision. Norell, Dan. "How to Reduce Arrears in Microfinance Institutions." *Journal of Microfinance* volume 3(1). Page 117.

- Hypothesis 1: The more unified the microfinance group, the lower the level of defaults.
- Hypothesis 2: The better trained the members of the microfinance group, the lower the level of defaults.
- Hypothesis 3: The greater the financial discipline imposed on group members by administrators, the lower the level of defaults.

Admittedly, the hypotheses are not mutually exclusive, but they are sufficiently distinct that they may be tested in this case study.

Research Design & Case Selection

This project involves a brief country, regional and community history for the Osa region of Costa Rica, as well as interviews with communal credit enterprise (CCE) members of a poverty-focused microfinance program called FINCA CR. FINCA CR is a microfinance training program that trains communities to localize their own economies by forming CCEs that give out micro loans. Descriptive research will be gathered about FINCA CR and its program structure, as well as the creation of the five existing CCEs in the Osa.

I will determine the method of creation of the five CCEs, their practices, and the leadership structure within each. These five communities are good case studies for contributing to answering my research question because they all received similar program implementation yet one program has a default rate of around 71%. Comparing the four

CCEs that have low default rates with the one that has high default rates, I aim to determine what exactly caused this to happen when so many variables were controlled.

Analysis

The empirical materials that I gathered during my research include the General Accounting Balance and Credit Portfolio of each CCE. In addition, I completed 96 in-depth qualitative interviews with board members and other members of each of the five CCEs in the Osa, and one CCE (not within the Osa) created by FINCA CR which has been in existence the longest and overcome several near-failures. The accounting materials will serve as measurement tools for determining programs' default rates by measuring their last default rates reported during the summer of 2009. The in-depth qualitative interviews will serve as observational measures of two things, the actual situation in each community and the leadership dynamics that exist. I will look at the actual situation regarding each community's level of unity and group participation and the FINCA program elements being implemented. The leadership dynamics refer to the board administration that is being undertaken, for example, the structure of the board of each ECC and the information regarding who is responsible for the obligations they have.

Contributions of this Research

Some microfinance programs are unsuccessful while others lead to substantial development. The purpose of this research is to find the most efficient manner of program implementation to reduce defaults within a particular structure. By studying the consistency of program implementation in one region of a country, I seek to pinpoint a cause for the high default rate that has arisen in one of the five cases.

Limitations

One limitation concerns the subjectivity of both the data, and my interpretations of the data. Most of the data on which I based my rankings came from interviews in which subjects described relationships and feelings, or their administrative involvement. There is a great deal of subjectivity involved in the way that I ranked the groups as unified, well-trained or disciplined. Other observers might well have interpreted the subjective data in different ways. Given more resources and time, I ideally would have hired two coders to analyze the data that I used to create rankings.

Second, having only one case at high-risk for failure means that the results of this study are at best tentative. In addition, the likelihood that several of the hypothesized independent variables may be present in all three cases means that I may not be able to say for sure which one is actually causing the results. Nonetheless, the findings may strengthen the plausibility of one hypothesis and weaken that of others. This at a minimum suggests that the strengthened hypothesis deserves further testing in other places

Chapter 2- Literature Review and Hypotheses

Microfinance: A Chronological History

Modern microfinance programs first started to appear in the 1970s in Bangladesh, which is the home of Muhammad Yunus. Yunus is the founder of Bangladesh's Grameen Bank and a leader of the microfinance movement. He believes that poor people are credit-worthy, [5] and therefore that entrepreneurship can be used as a means to lift them out of poverty. Jonathan Morduch, a prominent academic in the field of economics who has done extensive research on microfinance, stated that there is a reason for the excitement about the promise of microfinance. He explained that through Grameen, Bangladesh has accomplished reaching the poor, and also women, who had been difficult to reach through other development approaches because of the country's strong, conservative Muslim culture.[6]

The idea expanded west and around the globe. Yunus's Grameen Model has now been copied by other MFIs on five continents.[7] The 1980s saw a big boom in microfinance activity in Latin America with the entrance of large international MFIs. Microfinance experiments implemented in Bolivia and Mexico gained popularity and quickly moved north. These organizations "cross-pollinated" Grameen's model, and worked so well in Latin America that they found their way into the U.S., as well as Africa and Central Asia.[8]

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[5] Yunus, Muhammad. 1999. *Banker to the Poor.* New York: PublicAffairs. Pages 24-25.
[6] Morduch, Jonathan. 1999. "The Microfinance Promise." *Journal of Economic Literature* volume 37(4): 1570-1571.
[7] Armendáriz de Aghion, Beatriz and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press. Page x.
[8] Armendáriz de Aghion, Beatriz and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press. Page x.

Microfinance was continually lauded in international development over the next two decades. It was seen as so transformative that the United Nations named 2005 the "International Year of Microcredit." Subsequently, in 2006 Yunus and Grameen Bank won the Nobel Peace Prize for their effort to reduce poverty in line with the Millennium Development Goals. This was only the eighth time a non-governmental organization had ever received the Nobel, another fact which highlights the importance of the award for international development.

Today microfinance is so well-known that micro loans can be given online by any public user. The user may lend by making a "purchase" of a micro loan through a website with a credit card, such as is done on www.KIVA.org. This user can choose which business to lend the money to and will receive regular updates each time the money is paid back. In 2009 it was even mentioned in a Christmas day *New York Times* article on how people give back during the holidays. [9]

The Scope of Impact of Microfinance

All in all, Morduch notes an agreement regarding microfinance, and recognizes that microfinance has appeared to be win-win from all sides of the political spectrum. He believes that those who lean left like how it is grassroots, and those who lean right like how it reinforces the market as a mechanism for alleviating poverty.[10] Whether it "works" is a new question up for debate, and Jude Fernando, an expert on microcredit and NGO development, agrees that academics have begun to acknowledge this.[11]

[9] Lieber, Ron. 2009. "Doing Good by Paying Forward." *The New York Times*, December 25. Retrieved December 26, 2009 (http://www.nytimes.com/2009/12/26/your-money/26money.html?_r=1&emc=eta1)
[10] Murdoch, Jonathan. 1999. "The Microfinance Promise." *Journal of Economic Literature* volume 37(4): 1570-1571.
[11] Fernando, Jude L. 2006. *Microfinance: Perils and Prospects.* New York: Routledge. Page 4.

Ultimately it appears there is not an explanation for the ever-increasing global expansion of microfinance, yet it has become prevalent in the development sphere. The Microcredit Summit Campaign (a yearly global conference) reported that at the end of 2002, over 67 million clients had been served by around 2,500 MFIs, and that over 41 million of those were defined as "the poorest" in their respective nations.[12] At the end of 2004, MFIs reported having reached over 92 million clients, and over 66 million of these were below the $1-a-day poverty line when they took out their first loan.[13] Since the World Bank recently changed their lowest poverty line to $1.25,[14] it is possible that many more than 66 million of the world's poorest have been reached by microfinance.

The Microcredit Summit's reports are a response to critics' questioning whether microfinance actually reaches its intended audience. Skeptics wondered if MFIs were "cherry-picking" their clients. One researcher implied that microfinance initiatives are not reaching the expected demographic (the poor), rather that some models with a strong focus on education are aimed more at middle-income borrowers.[15] The reasoning comes from some MFIs requiring borrowers to participate in certain "educational" programs with heavy business content, which might be chasing the uneducated away, or even making them ineligible for loans if they cannot grasp the concepts required. While global

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[12] Taken from: Armendáriz de Aghion, Beatriz and Morduch, Jonathan. 2005. *The Economics of Microfinance*. Cambridge: MIT Press. Page 3.
Original source: Daley-Harris, Sam. 2003. *The State of the Microcredit Summit Campaign Report 2003.* Washington: Microcredit Summit. (www.microcreditsummit.org/pubs/reports/socr/2003/socr03_en.pdf).

[13] Daley-Harris, Sam. 2005. *The State of the Microcredit Summit Campaign Report 2005.* Washington: Microcredit Summit. (http://www.microcreditsummit.org/pubs/reports/socr/2005/SOCR05.pdf).

[14] Author Unknown. 2009. *People to People.* Washington: World Bank. (http://siteresources.worldbank.org/DATASTATISTICS/Resources/wdi09introch2.pdf). Page 5.

[15] Chao-Beroff et al. 2000. "A Comparative Analysis of Member-based Microfinance Institutions in East and West Africa." *Microfinance Gateway*. Washington: CGAP. Retrieved October 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.29583).

reports show that the “poorest” are indeed being reached,[16] this voice of criticism is still not completely silenced.

Despite the criticisms, microfinance operations are growing in existence. Not all programs are a success or failure across the board, and it is still difficult to determine why. Literature has just now begun to merge academic studies with practitioners’ results.[17] One key question facing microfinance today is, “what exactly causes a program to succeed or fail?”

Problems in Microfinance

MFIs claim to achieve development initiatives such as income generation for the poor. While the claims may be true, a main problem is that a lack of sufficient data exists to support them. Outcomes that are being reported are not being done so consistently.

Take default rates for example. As of now there is a lack of data related to MFIs’ real default rates, which leaves them wide open to scrutiny. If the poor take out loans but default on payments then income may not be generated, and it may even end up costing them in penalty fees. Of the 460 MFIs listed on the MIX, a World Bank clearinghouse for microfinance information, 200 did not report their default figures. Of those that did report

[16] Taken from: Fernando, Jude L. 2006. *Microfinance: Perils and Prospects.* New York: Routledge. Page 3. Original source: Daley-Harris, Sam. 2003. *The State of the Microcredit Summit Campaign Report 2003.* Washington: Microcredit Summit. (www.microcreditsummit.org/pubs/reports/socr/2003/socr03_en.pdf).
[17] Armendáriz de Aghion, Beatriz and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press. Page x.

figures, the numbers ranged from default rates of 4.76% to 63.65%.[18] The two distinct problems here are a lack of default records and the immense percentage range of defaults.

Critiques of MF: Default Rates

Recently the issue of defaults in microfinance has become a main target for scrutiny. Defaults occur for many reasons including: ignorance among members of the program, lack of year-round formal employment, confusion within families about who is responsible for the loan, and hasty and improper group formation. [19] A large amount of literature on the topic shows that any of these problems may be prevalent. The main theme is that MFIs must manage risk. It is important that MFIs overcome these obstacles in order to curb default rates, so that income is properly generated and MFI reputability is upheld.

If the answer to a loan default were as simple as taking legal action to recover the loss, the missing funds would be quickly recovered and perhaps the lesson to avoid default would be quickly learned. But defaults are a problem because in many cases they cannot be collected within developing country structures. "Poor people lack the assets to back-up their loans, and poor countries lack civil infrastructure, such as adequate court systems, to collect bad debt."[20]

When one single borrower defaults on payment, the action multiplies. An individual default comes from a single borrower. The borrower has an individual default

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[18] Author Unknown. 2006. "The Risky Business of Borrower Default in Calculating MicroFinance Interest Rates." Microcapital Monitor. Retrieved October 2008 (http://microcapitalmonitor.com/cblog/index.php?/archives/139-The-Risky-Business-of-Borrower-Default-in-Calculating-MicroFinance-Interest-Rates.html).
[19] Author Unknown. 1997. "Causes of Default in Microcredit Association for Social Advancement (ASA)." *Microfinance Gateway.* Bangladesh: ASA. Retrieved October 2008 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.24650).
[20] Author Unknown. 2006. "The Risky Business of Borrower Default in Calculating MicroFinance Interest Rates." Microcapital Monitor. Retrieved October 2008 (http://microcapitalmonitor.com/cblog/index.php?/archives/139-The-Risky-Business-of-Borrower-Default-in-Calculating-MicroFinance-Interest-Rates.html).

when their payment is not made on time- by them, one of their cosigners, or group members who have promised to insure them. The problem is not just a single individual defaulting, but one single default can result in the domino effect. Once MFIs have high numbers of such individuals within their overall portfolio, they reach bad financial health. In this study defaults are being explored in the group context.

Since micro borrowers now solicit loans in amounts larger than those being offered by their MFI, some MFIs will act as a middle man between the borrower and a larger institution, and this is the case with FINCA CR. This is where defaulting will become especially scrutinized by the larger (and usually formal) institutions. If an MFI has a high default rate among borrowers, those borrowers that do have good credit and would like to solicit larger loans will be denied based on their institution's profile. Larger lending institutions measure smaller institution's financial health in order to determine if they are worthy of credit. There is a certain default rate at which the larger bank will deny credit to an applicant. This varies between 10-15%.

Reducing Defaults

The literature on defaults outlines several ways of minimizing defaulted payments in microfinance. The hypotheses in my study are derived from these main ideas. These are: creating a highly-unified structure/group sentiment within MFIs, implementing good quality training programs, and exerting discipline in financial administration. These three methods will be explored here.

Highly-Unified Structure/Group Sentiment

I define "unified" to mean that the group members are of the sentiment that they are part of a group and have obligations as a group member. Katharine Rankin, a microfinance expert, says that the theory was popularized by sociologist Robert Putnam. The idea is that characteristics of social ties such as trust will facilitate "coordinated actions," and, "when people engage in …forms of association, the argument goes, they develop a framework of common values and beliefs" that can be what holds the community together. Groups are created because members know each other; therefore they feel confident in depending on others to follow particular roles. In microfinance, these members are usually peers from the same circle of friends or community, and know each other's behaviour.

In essence, one would not be chosen by the group unless the group knew them and knew that they could trust them, presumably because they have some knowledge about the person's background and behaviour that a bank (or outside organization) would not. Groups know that their members will behave in the interest of the group. In unified groups, borrowers screen other borrowers and only trustworthy individuals may join the group.[21] Rankin states that, "the trust that emerges from common understanding will in turn generate norms of reciprocity… whereby individual opportunism leaves common property resources under-cultivated."[22]

Armendáriz de Aghion and Morduch describe the method of group success to be, "groups that trust more and cheat less will do better," and they describe the groups that

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[21] Gine, Xavier and Dean Karlan. 2009. "Group Versus Individual Liability: Long Term Evidence from Philippine Microcredit Lending Groups." *EconLit*. Working paper. Economic Growth Center, Yale University. Retrieved December 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.37881).

[22] Quote by Katharine Rankin from: Fernando, Jude L. 2006. *Microfinance: Perils and Prospects.* New York: Routledge. Page 91.

trust more as being characterized by "pre-existing social ties."[23] The logic behind this method is that borrowers are "enticed" to repay because of a "threat of social sanctions" from their group members.[24] In other words, members who know each other are more likely to encourage or shame one another into paying on time.

Being a part of the group is what gives the individuals access to credit (since they lack collateral) and in order for all members to remain in good standing, all members must be paying on time.[25]

This practice was first used for microfinance by Grameen and has been replicated by MFIs worldwide. The idea has taken many forms, which are very similar to the Grameen method. Some MFIs will only lend to groups with joint-liability mechanisms, which depend on the logic of unity (i.e., if the debtor does not pay, another group member must take full responsibility, so groups only form among individuals who knew and trusted each other previously. They must trust each other to be certain that they won't have to make someone else's payment). Grameen attributes its success rate to this method.[26] FINCA CR similarly requires borrowers to get other group members to co-sign their loan and pay in case of default,[27] but CCEs as a whole should also feel unified and

[23] Armendáriz de Aghion, Beatriz and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press. Page 103.

[24] Wydick, Bruce. 2000. "Group Lending under Dynamic Incentives as a Borrower Discipline Device."*Microfinance Gateway*. San Francisco: University of San Francisco- Review of Development Economics. Retrieved July 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.37583).

[25] Westley, Glenn. 2004. "A Tale of Four Village Banking Programs." *Microfinance Gateway*. Washington: Inter-American Development Bank. Retrieved July 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.27393).

[26] Taken from: Simtowe, Franklin. 2006. "Determinants of Intra-group Insurance in Microfinance: Empirical Evidence from Joint Liability Lending Schemes in Malawi." *Microfinance Gateway.* Germany: University of Bonn. Retrieved December 2008 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.27282).
Original source: Besley, Timothy and Stephen Coate. 1995. "Group lending, repayment incentives and social collateral." *Journal of Development Economics* volume 46(1).

[27] Quirós, Rodolfo, and Claudio Gonzalez-Vega. 2007. "Institutional transformation to create linkages that enhance rural Access to financial services: the case of the Fundación Integral Campesina (FINCA) in Costa Rica." New York: The Ford Foundation. Retrieved April 9, 2009 (http://www.ruralfinance.org/servlet/CDSServlet?status=ND0zODg1MS41MjU5OSY2PWVuJjMzPWRvY3VtZW50cyZzaG93Q2hpbGRyZW49dHJ1ZSYzNz1pbmZv).

be of the "group sentiment," since the entire group will lose dividends and will not have money to loan if borrowers do not pay. Group sentiment and trust is imperative to group members. Without trust, individuals would be rejected, because other members have no way of knowing if they would act in accordance with the rules.

Cases of unified group structures are seen throughout the literature. FINCA Nicaragua (a branch of FINCA International) and Compartamos (Mexico) have "solidarity groups." These are unified groups that they say offer more flexibility and less risk in the lending process because of the insurance that members provide each other, and are considered a key factor in high repayment rates. [28] A study from Guatemala showed that the peer monitoring inherent in the group structure was a main factor in timely repayment.[29] Another study done in India also reports that the group structure is significantly important to the high repayment rates they found. This study included statistics based on why group members repaid on time. It said that 42% of group members repaid on time because they knew the group would suffer otherwise, that 17% felt it was their moral duty, and that 8% did not want group pressure. Along with other statistics, the study concluded that 25% of the reason for high repayment rates was group accountability, and another 38% was the fact that people attend the meetings. These meetings strengthen groups' social solidarity, as they offer a place where group members can be constantly reinforcing duties and empowering members.[30]

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[28] Westley, Glenn. 2004. "A Tale of Four Village Banking Programs." *Microfinance Gateway*. Washington: Inter-American Development Bank. Retrieved July 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.27393). Page 2.
[29] Wydick, Bruce. 2000. "Group Lending under Dynamic Incentives as a Borrower Discipline Device."*Microfinance Gateway*. San Francisco: University of San Francisco- Review of Development Economics. Retrieved July 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.37583). Page 3.
[30] Bedoya, Guadalupe. 2006. "Exploratory Work in Orissa: Who is the Marginal Client for Microfinance? Why Do People Repay So Well?" *Microfinance Gateway*. India: Institute for Financial Management and Research- Centre for Micro Finance. Retrieved 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.26435). Page 16.

Based on the foregoing logic as discussed in the literature, I hypothesize that the more unified the microfinance group, the lower the level of defaults (Hypothesis 1).

Good-Quality Training Programs

Another method of reducing defaults to date is implementing good quality training programs which create more knowledgeable group members. This method was developed as evidence started to appear that ignorant group members could potentially increase the risk associated with microfinance. The idea is that having group members who are educated in small business skills increases the chance that members will follow the rules and make payments on time.

Many MFIs support the idea that borrowers need good training and support. Yunus's "plus" programs are education programs that are required by Grameen. These trainings exist because Grameen does not function on the belief that all poor people are automatically capable of bootstrap success. Supplemental trainings serve to empower group members in a way that will also benefit the MFI. Grameen will not even begin lending to borrowers until they are fully trained on financial and repayment basics and been approved by their loan officer. FINCA CR has also taken measures to improve their training program within the last 15 years in an attempt to train every member in basic business practices.[31] They believe that if every member is trained, even if they are not responsible for administration, they are capable of supporting the group member who is.

[31] Quirós, Rodolfo, and Claudio Gonzalez-Vega. 2007. "Institutional transformation to create linkages that enhance rural Access to financial services: the case of the Fundación Integral Campesina (FINCA) in Costa Rica." New York: The Ford Foundation. Retrieved April 9, 2009 (http://www.ruralfinance.org/servlet/CDSServlet?status=ND0zODg1MS41MjU5OSY2PWVuJjMzPWRvY3VtZW50cyZzaG93Q2hpbGRyZW49dHJ1ZSYzNz1pbmZv).

FINCA Peru (a branch of FINCA International) completed an in-depth study of training programs. In their study, two borrower groups were chosen. One group received financial training for 1-2 years while the other served as a control group, only making contact with the MFI when loan transactions were occurring. The training was based on practical examples of best business practices. The study found that the group that received training showed "greater business knowledge…which did translate to better business practices." The study also found that higher repayment rates were a positive impact of the training programs, and both the borrower and the MFI benefitted from their existence. Moreover, it was found that the amount of money made up in client retention and high repayment rates was double the amount of the trainings themselves- so the program could pay for itself.[32] Another study focused on rural capacity building in India implemented training programs amongst entrepreneurs who had just begun borrowing. It claimed that at the start of the study the borrowers had yet to earn income from their starting investment. At completion it attributed the 83% who had begun earning incomes, and had moved out of the "below poverty line," to the training programs.[33]

Based on the foregoing logic as discussed in the literature, I hypothesize that the better trained the members of the microfinance group, the lower the level of defaults (Hypothesis 2).

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[32]Frisancho, V. et al. 2008. "Business Training for Microfinance Clients: How it Matters and for Whom?"*Microfinance Gateway*. Québec , Canada: Poverty & Economic Policy Research Network. Retrieved June 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.30264).
[33]Soami, R., and A. Jha. 2004. "Creating Rural Entrepreneurs 2000-2004." *Microfinance Gateway*. India: SRT Rural Institute. Retrieved January 2010 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.24338).

Discipline

There is also a recurring idea in the literature that the greater the financial discipline imposed on group members by administrators, the lower the level of defaults. Armendáriz de Aguion and Morduch stated that, "a great deal of what separates failed microfinance from successful microfinance ultimately has to do with management." They also quote Woller and Schreiner in a finding saying that "administrative efficiency… and loan officer productivity [i.e. collecting payments on time and collecting late fees]" is a "significant determinant of self-sufficiency."[34] In addition, an analysis on thirteen village banks equally showed that efficiency in financial administration and loan officer productivity are determinants of financial sustainability in MFIs.[35] These indicate discipline because if administrators and loan officers are efficient, the rules are followed, and money is distributed/collected on time, and if not, late fees are paid as a form of punishment. These are the duties of administrators/money collectors- making sure that the money is where it is supposed to be.

In the microfinance literature, effective financial control means immediate feedback on defaulted payments.[36] I define financial discipline in two ways: 1) Paying on time in accordance with the rules, and 2) Paying a late fee on defaulted payments as a method of correction and training. The logic behind this idea is that by punishing delinquent borrowers the MFI anticipates and stops "the domino effect" from occurring,

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[34] Armendáriz de Aghion, Beatriz and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press. Pages 257-259.

[35] Taken from: Armendáriz de Aghion, Beatriz and Jonathan Morduch. 2005. *The Economics of Microfinance*. Cambridge: MIT Press.
Original cite: Woller, Gary, and Mark Schreiner. 2003. "Poverty lending, financial self-sufficiency, and the six aspects of outreach." Working paper, Marriot School. Salt Lake City: Brigham Young University.

[36] Westley, Glenn. 2004. "A Tale of Four Village Banking Programs." *Microfinance Gateway*. Washington: Inter-American Development Bank. Retrieved July 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.27393). Page 28.

i.e. they show other borrowers that this is not accepted. Exercising financial discipline in microfinance sets precedent for future borrowers.

One of Grameen's borrower mantras is discipline, which is emphasized for all borrowers. Grameen supports its social agenda through this methodology, which is reinforced by and derived from the "sixteen decisions" (affirmational lifestyle statements) that empower and train program participants to act in certain ways.[37] The idea is that one who is personally disciplined will be disciplined in all aspects of life. In a comparative study of Kashf Foundation and Grameen the analyst notes that at Grameen, "discipline is highly emphasized during… training, with the assigned loan officer testing and quizzing members to ensure their suitability for the program." She notes that Grameen believes that this holistic approach to discipline creates success.[38] MFIs put focus on repayment rates, and most if not all require penalty fees on late payments. This fact shows that it is apparent that both on-time payments and penalty fees are popular. But discipline must be employed in order to ensure viability of this method. Once one person pays late, and does not pay a penalty, the word spreads. MFIs put the focus on repayment rates to show the world that microfinance can work.

A study on microfinance in Italy found that individual incentives for repaying on time depend on the penalty incurred by not repaying. The study also found a direct correlation between weak credit standards and higher default rates.[39] Two microfinance analysts also did a study comparing which method might be more effective in reducing

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[37] Yunus, Muhammad. 2007. *Creating a World Without Poverty.* New York: PublicAffairs. Page 58.
[38] Syed, Nabiha. 2005. "Factors of Success: A Comparative Study of Kashf Foundation and Grameen Bank." *Microfinance Gateway*. Baltimore: John Hopkins University. Retrieved 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.24231). Page 8.
[39] Grant, Charles and Mario Padula. 2007. "Bounds on repayment behavior: evidence for the consumer credit market." *Microfinance Gateway.* Italy: Ca'Foscari University of Venice. Retrieved 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.24167).

defaults, harsh penalties or moderate consequences. It concluded that under a “wide array” of circumstances, punishments “harsh enough to ensure repayment” positively affected borrower welfare.[40]

Based on the foregoing logic as discussed in the literature, I hypothesize that the greater the financial discipline imposed on group members by administrators, the lower the level of defaults (Hypothesis 3).

Conclusion

Now that each prominent theory has been explained in detail, I will apply the hypotheses derived from them to my research question, explaining default rates. Before doing so, I will briefly describe the test communities in chapter 3.

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[40] Tam, Xuan et al. 2009. “Are Harsh Penalties for Default Really Better?” *Microfinance Gateway.* Richmond: The Federal Reserve Bank of Richmond. Retrieved 2009 (http://www.microfinancegateway.org/p/site/m//template.rc/1.9.37594).

Chapter 3- FINCA: History, Scope, and Communal Credit Enterprises

Introduction

This chapter will provide background information on FINCA CR. The organization's history and methodology will be explored, and we will read an example of successful community program implementation. I will continue by introducing the five communities of the Osa peninsula, which I will use to test my the three hypotheses later.

The Origins of FINCA CR

FINCA CR was originally a part of FINCA International. FINCA International is one of the big international MFIs that started the trend of microfinance in Latin America, and in Costa Rica. [41] The FINCA International model failed in Costa Rica because it was not able to recover payments for money that it lent. [42] The direct cause of this failure was not clear, but the funds were never recuperated. Once this model failed in Costa Rica, a groundbreaking microfinance evolution occurred.

FINCA International founder John Hatch met Maria Marta Padilla, the soon-to-be founder of FINCA CR. FINCA CR decided to follow FINCA International's method with one exception; they cut capital injections into village banks. Instead, they began training village banks to raise their own capital, and transformed them into legal business

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[41] Quirós, Rodolfo, and Claudio Gonzalez-Vega. "*Institutional transformation to create linkages that enhance rural Access to financial services: the case of the Fundación Integral Campesina (FINCA) in Costa Rica." Rural Finance Learning Centre.* The Ford Foundation, 2007. Web. 09 Apr. 2009. http://www.ruralfinance.org/servlet/CDSServlet?status=ND0zODg1MS41MjU5OSY2PWVuJjMzPWRvY3VtZW50cyZzaG93Q2hpbGRyZW49dHJ1ZSYzNz1pbmZv.

[42] Paxton, Julia et al. *"Case Study of FINCA Costa Rica."* The World Bank, Sustainable Banking with the Poor. 1997. Web 2008.

entities.[43] The logic behind this change is, if the money belongs to the villagers, they are more likely to take care of it.

FINCA CR is not an MFI, it is a microfinance training program. According to a FINCA CR staff member, the organization solicits grants from banks and corporations to cover the cost of its funding, and it acts as a nonprofit organization.[44] Administration costs are largely spent on field workers that move into communities and facilitate business trainings for the village banks. The village banks that FINCA CR creates and trains are MFIs.

In essence, these innovative village banks completely localize their own economies by growing their own seed capital. FINCA CR trains the village banks to sell shares of their own company to community members, and use the funds from shares to make micro loans. With the loan interest earned, the business grows, dividends are paid to shareholders, and the village MFI achieves two important initiatives. These two initiatives are reducing poverty through entrepreneurism, and in cases where entrepreneurial loans are not taken, increasing savings among the poor.

FINCA CR Methodology

The methodology has been constantly evolving since it began. FINCA CR identifies potential rural communities through their regional field workers. These regional trainers work in several communities within one province or area of the country. They can be assigned to work with anywhere from three to ten communities. They travel

[43] Paxton, Julia et al. *"Case Study of FINCA Costa Rica."* The World Bank, Sustainable Banking with the Poor. 1997. Web 2008.
[44] Interview with Luis Jimenez on August 12, 2009. Transcribed.

between these communities, and because the areas are rural, they tend to know the areas and the people well. Once they indicate that it would make sense to begin working in a community, FINCA CR gets in touch with the local development association of that community. The local development association hosts an open town meeting so that FINCA CR may present their initiative.

After this meeting interested community members, who generally include one or more members from the development association, decide to form a group to receive training. FINCA CR recommends that groups of 10-15 people (minimum) decide to start the project. Since FINCA CR works in rural communities, people tend to know each other. Furthermore, people that attend open (or any) meetings of the development association would typically know each other because of their interest in community involvement. Groups are formed between people that know each other, and they enter into the group contract because they have trust for other participants based on previous experiences. FINCA CR stresses the importance of creating a group with strong social ties, because they believe that in order for a group to be successful, they need to feel like a group and understand their obligations to the group. In other words, they too believe in Hypothesis 1. For this reason, only community members are eligible to join.

The base training methodology relies on 22 sessions (like workshops) that community members must participate in. According to FINCA CR, ideally the groups would receive one year of follow-up support from a regional field worker as well to help with the more complex details that arise in business accounting. This is completely dependent on funding. FINCA CR's funding is not consistent because it is based on grants. Grants are generally given to be used in one particular area of the country.

Regional program implementation differs based on this detail, but the core methodology, based on the 22 steps, stays the same throughout the country.

After they finish training, groups are officially inaugurated by FINCA CR. These innovative village bank businesses are referred to as Communal Credit Enterprises (CCEs). They hold an official ceremony to which the entire town is invited, and the founding members are presented the paper documents for their shares. These members are the original shareholders of the village banks, and by selling additional shares to their fellow community members they come up with enough seed capital to give a few loans. The point of the ceremony is to present the CCE to the community. The idea is that once other community members see the CCE functioning, they will gain interest and invest in shares.[45]

Scope of FINCA CR

According to FINCA CR staff, over two-hundred CCEs exist, in most regions of Costa Rica. The oldest CCE still standing has been in existence almost fourteen years.[46] New CCEs are still being formed today. To get an idea of the possibilities that exist for CCEs, one can look at an older CCE. According to FINCA CR staff, CCE Sacrín (located in San Cristobal Norte just south of the nation's capital) is a model CCE. It started around 14 years ago and has overcome several near failures. According to the group's president, the near failures occurred because of financial confusion; members felt that they could

[45] According to a FINCA CR document (training manual for Peace Corps Volunteers) and interview with Travis Bays, August 6, 2009. Transcribed.
[46] CCE Sacrín, located in San Cristobal Norte de Cartago, in the Central Valley Highlands.

not depend on FINCA CR for additional capacity building in moments of need.[47] Subsequently some of the board members became de-motivated with their positions. FINCA CR happened to receive funding for some out-of-town (and country) conferences, and invited the group members to attend. The board members report this as being the reason that they became re-motivated and fell in love with their CCE. Now it is a successful agent for economic development in its community. Before it began, San Cristobal Norte was a community comprised of mostly agricultural workers. Some were coffee farmers and some were coffee pickers. They had few economic opportunities outside of this because of a lack of capital. According to Sacrín's president, it was not a rich community.[48] According to FINCA CR documents, CCE Sacrín started by managing around $400 USD of credit and today manages around $40,000 USD of its own capital, along with owning shares in larger financial institutions, making its total assets worth more than $160,000 USD.[49] The loan default rate is minimal.

Yet not all CCEs have been completely successful, and little to no data has been compiled regarding the complete history of CCE financial failures. For this reason I chose to do a study of CCEs in one region of Costa Rica, the Osa peninsula. I was made aware that of the five communities operating CCEs in this region, four were financially healthy while one had bad financial health, shown through high default rates.

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[47] FINCA CR operated on a much lower budget when it started out. CCE Sacrín did receive 21 of the 22 trainings. They did not receive the one-year follow-up training, and in addition, reported that they completely lost contact with FINCA CR for two years after, at which time this financial confusion occurred.
[48] Interview with Luis Cordero, President of CCE Sacrin, on August 10, 2009. Transcribed.
[49] According to a FINCA CR document.

FINCA CR in the Osa Peninsula, Costa Rica

This study will examine the Osa region of Costa Rica. The Osa Peninsula is one of the most secluded regions of the country. It is located in the southwest corner of the country on the Pacific Ocean. The dominant industries in this region are eco-tourism (tourism is Costa Rica's largest single industry)[50], fishing, agricultural production (mainly palm oil) and the maritime industry. All five communities in the Osa region share some combination of these industries, and all are accessible by various forms of transportation, including car, bus and boat. In addition, all are considered to be rural communities of less than 3,000 inhabitants. Since program implementation in this area is fairly new, the five CCEs that exist in the region had been operating for less than three years when the study began.

The five CCEs are located in the following communities: Bahia Ballena, Sierpe, Ciudad Cortes, La Palma and Puerto Jimenez. Each is classified as being a young CCE; the oldest is now just over three years old. As of December 2009, each CCE has been formally inaugurated and has been giving loans for a time period of at least one year. All received program implementation via the same base methodology. That is, all received FINCA CR trainings in order to be officially formed as CCEs.[51]

CCE Characteristics

As noted above, the five test CCEs are found in communities that share certain common characteristics. In addition to these controlled community variables, the CCEs

[50] CIA World Factbook. https://www.cia.gov/library/publications/the-world-factbook/geos/cs.html.
[51] Based on information from interview with Travis Bays on August 6, 2009 (Transcribed) and my observations.

themselves share other elements, allowing me to control for potentially confounding variables. The following charts illustrate these basic characteristics of the five CCEs.

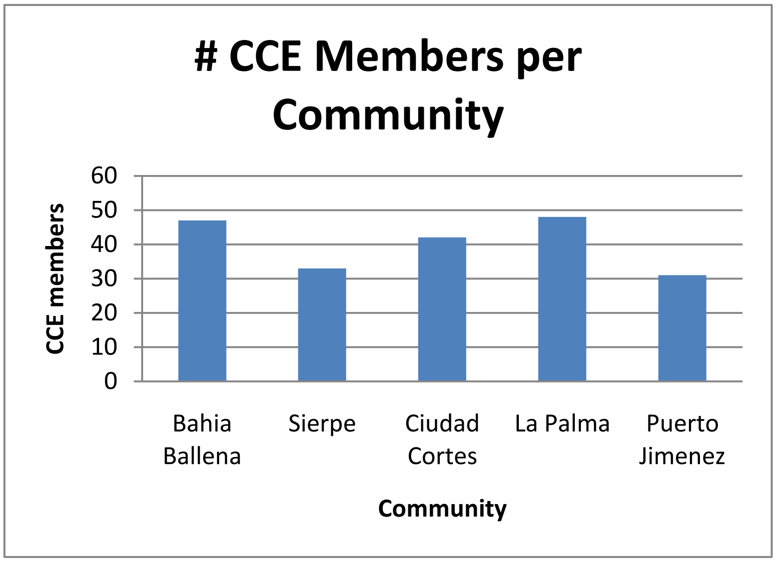

Figure 3.1 [52]

As figure 3.1 shows, all of the CCEs have a small number of participants, ranging from 31 to 48.[53] The demographics of the CCEs are similar for the most part. With one exception, the CCEs have relatively equal numbers of men and women. The exception group (CCE Golfo Dulce in Puerto Jimenez) has only five men of its 31 members.[54] In addition the majority of founding group members had ages within around 10 years of each other.

[52] Figures gathered from interviews and according to administrative board members of the CCEs.
[53]See the limitations section of chapter seven for further discussion regarding possible implications of group populations versus differences in total assets.
[54] Phone interview with Deybia Cortes, Secretary of CCE Golfo Dulce in Puerto Jimenez, on January 28, 2010. Transcribed.

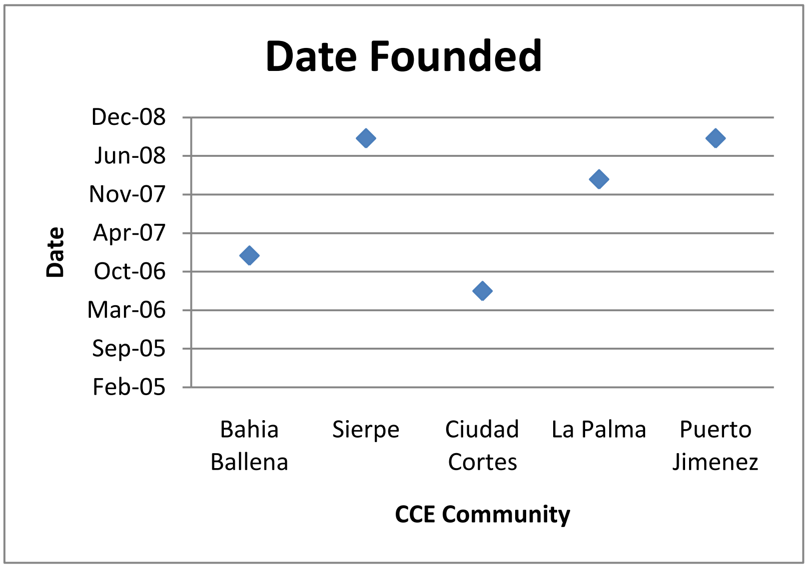

Figure 3.2 [55]

Figure 3.2 shows that each group started in the same 1.5 year time frame, from mid-year 2006 to the end of 2008. Community documents show that all CCEs started with a similar amount of seed capital, around $400-500.[56] This money was raised by selling shares valued at $10 to group members. A requisite for group membership is the purchase of one share. In each case, many founding members bought several shares.

[55] Dates are according to administrative board members of the CCEs. On this chart Ciudad Cortes appears to be the oldest of the CCEs. This CCE was improperly formed at the founding date. It existed for almost two years under bad financial administration. More information is detailed in the community descriptions.
[56] According to transcribed interviews with each board and financial documents.

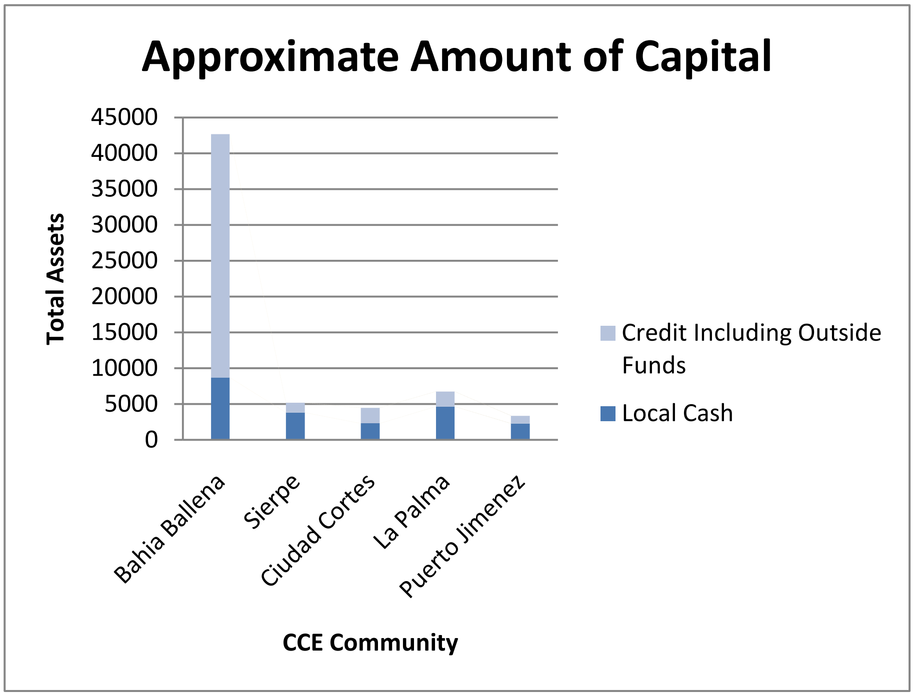

Figure 3.3 [57]

Figure 3.3 shows that the current amount of local capital ranges from almost $2,300 to just under $9,000, figures which vary for the most part according to the amount of time that each CCE has been in existence.

[57] Data gathered from General Accounting Balances. Local Cash is the capital that CCEs raised by selling shares. Outside capital becomes available when CCEs use local capital to buy shares in a larger financial institution. Once a CCE does this, it has access to bigger pools of funds which it can borrow, and in turn lend to its members. The larger financial institution in this case, EDESA, functions the same as the CCE itself. Therefore a CCE buys a share in EDESA, has access to a larger pool of credit, pays interest on money borrowed and receives dividends on its share at the end of the year. Shares in EDESA are approximately $100 each. If the other four CCEs purchase shares as Bahia Ballena did (and as they are now beginning to), they could potentially be this large within another year to year and a half, depending on how many loans they give in their respective communities.

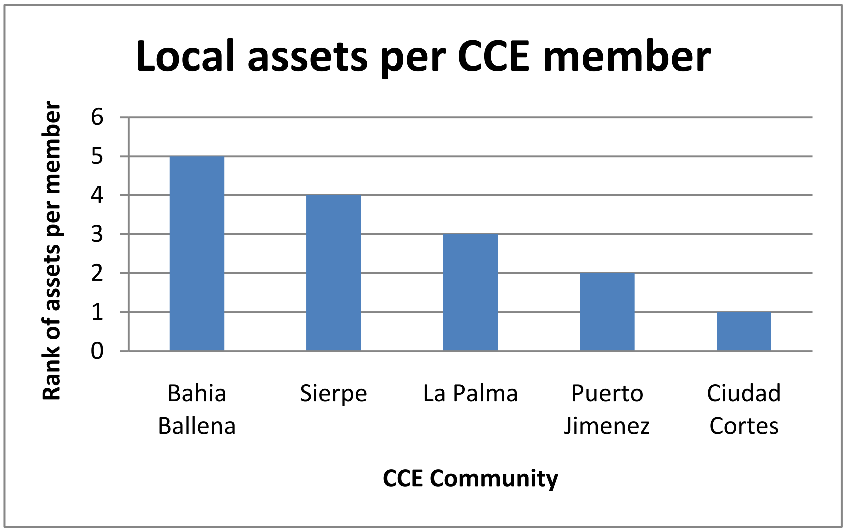

Figure 3.4[58]

Figure 3.4 shows a ranking of local assets per CCE member for each community. CCEs were ranked 1-5 based on the amount of local assets that they had per member, one being the least number of assets and five being the highest number of assets per member. The ranking showed that Bahia Ballena had the highest number of local assets per member. Possible implications of this finding are discussed in the limitations section of the thesis conclusion.

[58] Data gathered from CCE documents.

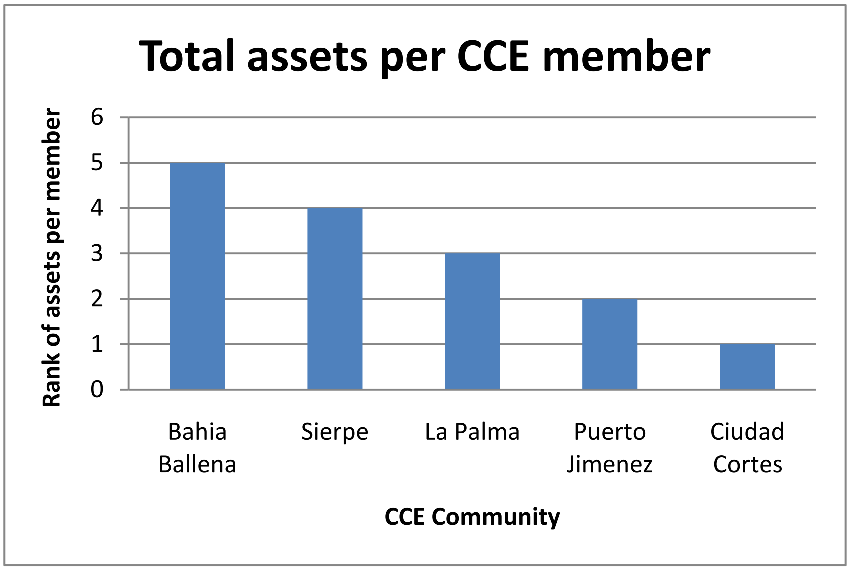

Figure 3.5[59]

Figure 3.5 shows a ranking of total assets per CCE member for each community. CCEs were also ranked 1-5 based on the amount of total assets that they had per member, one being the least number of assets and five being the highest number of assets per member. The ranking showed that Bahia Ballena had the highest number of total assets per member as well. Again, possible implications of this finding are discussed in the limitations section of the thesis conclusion.

[59] Data gathered from CCE documents.

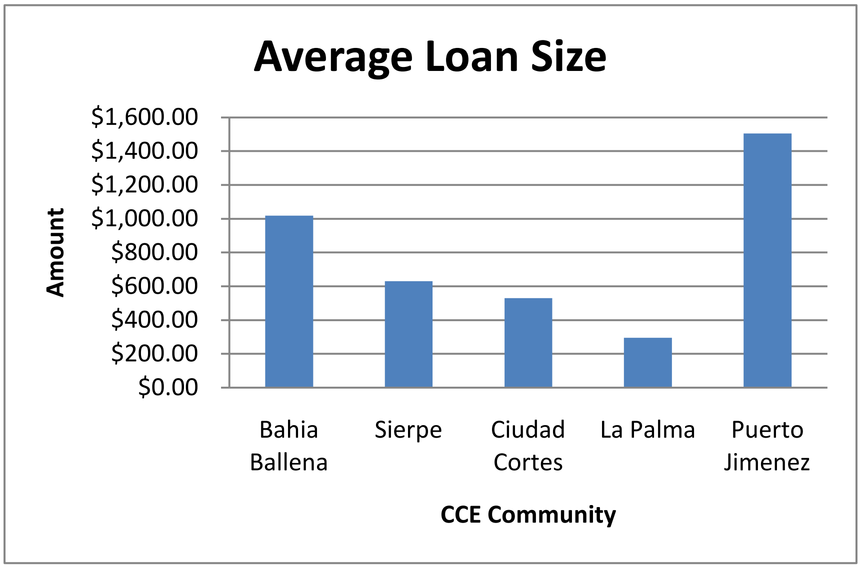

Figure 3.6 [60]

Last, figure 3.6 shows that average loan sizes in communities range from $300-$1500, so all are considered micro loans.

The five CCEs also show differing characteristics, related to default rates. Each CCE tracks their default rates on a document called the credit profile, which shows all outstanding loans and the most current payment status. The payment status can be: paid, between 1-30 days late, between 30-60 days late, between 60-90 days late, and more than 90 days late. Starting with figure 3.5, the following charts show the long-term default rates for each CCE during the months of August and December. Since I am measuring default rates, the conclusions to my hypotheses are based on these charts, as will be seen in the following chapters.

[60] Data gathered from loan profiles.

In December 2009 and January 2010, I collected default information for the month of December 2009. This additional snapshot of CCE default rates serves to add data to the study. It not only measures what happened in Bahia Ballena (the only CCE with bad financial health), but also if the other CCEs experienced default rates that may be pertinent to my hypotheses. After becoming aware of its financial situation in August, Bahia Ballena stopped granting loans. Therefore, for this CCE, all December information relates to loans whose information was shown in the August data.

The following charts illustrate differing characteristics of the five CCEs, related to the dependent variable- default rates.

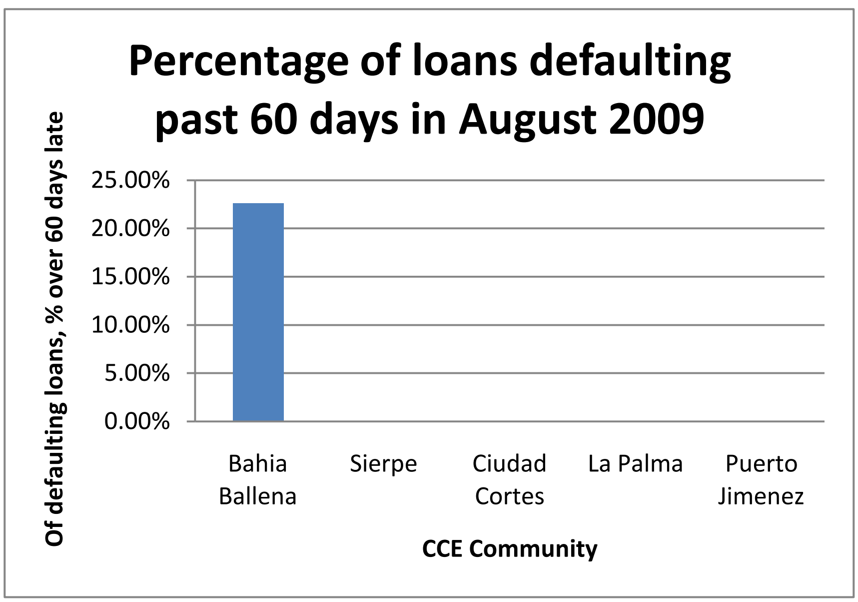

Figure 3.7 [61]

[61] In August 2009, Ciudad Cortes's 14% default rate had not yet reached the 30-day mark.

Figure 3.7 shows the percentage of defaults that were overdue past 60 days in each CCE during August 2009. Since Bahia Ballena was the only community to have long-term defaults during this month, the 22.6% figure is the only one shown.

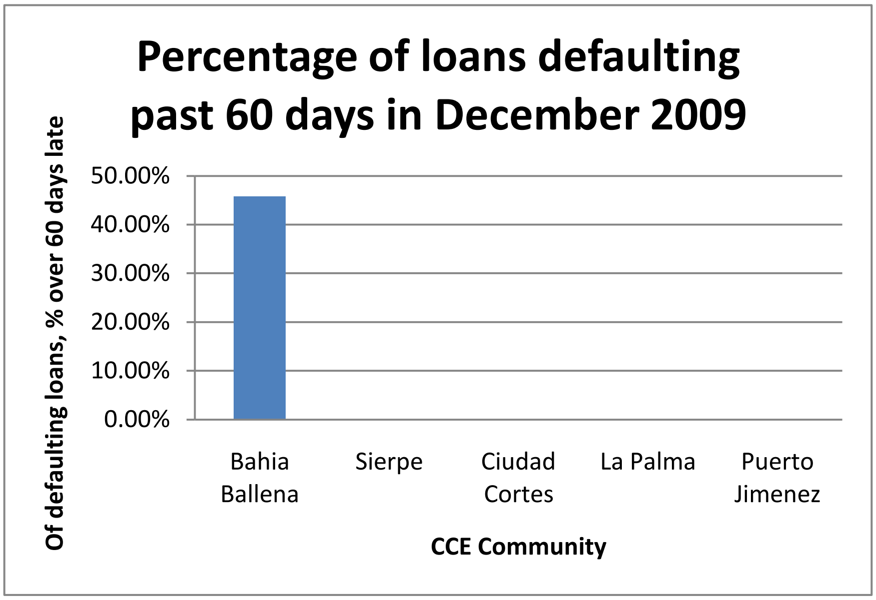

Figure 3.8 [62]

Figure 3.8 shows the percentage of defaults that were overdue past 60 days in each CCE during the same month. Since Bahia Ballena was the only CCE to have long-term defaults during this month, the 45.7% figure is the only one shown.

[62] In December 2009, the other four communities' default rates were for payments overdue less than 30 days.

Conclusion

In the following chapters I compare the group structures, training programs received, and amount of discipline employed in each CCE in order to see if any of these factors are associated with Bahia Ballena having high default rates. These hypotheses are not mutually exclusive, but nevertheless they may present interesting findings on the potential causes of high default rates.

Chapter 4- The Effects of a Highly-Unified Structure

Introduction

This chapter tests Hypothesis 1: the more unified the microfinance group, the lower the level of defaults. I start with the operationalization of my variables, and then test each of the five CCEs in order to determine if the evidence supports this hypothesis. Last, I describe the limitations of this hypothesis.

Operationalizing Hypothesis 1: *THE MORE UNIFIED THE MF GROUP, THE LOWER THE LEVEL OF DEFAULTS.*

By "unified" I mean that the group members had bonds of solidarity among each other prior to formation of the CCE. This may be because they were friends, neighbors, or members of other small-scale organizations such as their local church. CCE groups are formed on this basis of pre-existing trust and cohesiveness.

In this study I set out to measure the degree of unity for each of the five CCEs. In order to do this, I collected data on past associations, and data on attitudes toward the group. I interviewed a portion of CCE members from each community. These interviews are the source of my data.[63] Information on past association was confirmed by cross-checking with other respondents. Interviewees were selected randomly, but based on availability to participate in interviews.[64]

[63] Pursuant to IRB approval, I hold all signed consent forms in a locked box in my possession. The interviews will be destroyed following this study.
[64] See the Limitations section of this chapter for more details.

The data on past associations concerns the extent to which the CCE members knew each other before formalizing the group. I interviewed several members from each CCE in order to determine the degree of unity. I triangulated the information received in order to judge the unity of, and rank, each group in order. Questions that I asked included: How do the founding members know each other? In what capacity had they worked together in the past? [65]

The data on attitudes toward the group that I collected concerns the extent to which the interviewees believe that they are a part of a group and have obligations to that group, not just that they are participating in something as individuals and for individual benefit. To measure this aspect I administered a survey that sought to measure interviewees' motivation for joining the group. Questions (and follow-up questions) included: Why did you decide to buy shares and become a group member? Do you feel that you have responsibilities as a group member? (If it was not about being in a community group or was not clear, I responded with): Have you always been involved in community groups? If not, could say something more about why you became interested in the CCE?[66] The answers serve as a supplemental measure of the overall knowledge of group roles and obligations.

Degrees of Unity:

In order to measure the degrees of unity, I briefly explain the responses from the past association measurement questions (How do the founding members know each other? In what capacity had they worked together in the past?). Next I rank each CCE

[65] See Appendix 1 for a complete list of questions asked.
[66] See Appendix 1.

from one to five in terms of unity, one being least unified and five being most unified. The ranking is chosen based on the data given on past associations.

In order to rank the CCEs, I chose to create a breakdown of types of unity, based on different reasons for why the CCE members are unified and may have decided to start the groups. The stronger bonds are those which are characterized by spending more time together, and purposely participating in activities together. Therefore, friendship and family relation bares heavier weight on the notion of unity, and then repeated past contact or friendly involvement, and last proximity in the community. By creating rankings, I am able to compare the levels of unity to the default rates in order to see if the level of unity may be associated with high default rates.

Community History- Data on Past Association:

Puerto Jimenez was ranked one for the lowest level of unity of the five CCEs. I made several observations during my research that led me to this conclusion. First, CCE members are much more spread out than others. Most members live anywhere from eight streets to eight kilometers away from their fellow members. The president and the treasurer live eight kilometers apart.[67] Founding members here came from all corners of the community. Most were individuals that had been involved in community associations for years.

The founding members knew each other in this way or through being family of active community participants. Mario Cambronero, the CCE's president, confirmed this when he stated, "I've been involved in many different associations over the years. I know Salma, Maureen and Carlos from those. I know Estarlin because he has the mini-grocery

[67] Interview with Maureen Ortiz Mosquera on July 24, 2009. Transcribed.

store, and I generally know the other members, but we don't really spend time together outside of the CCE."[68]

The members had trust for each other based on community reputations, but this trust was more based on faith than behavioral proof. Board member Estarlin, a local grocery-store owner, explained his involvement with other CCE members by saying, "I have this grocery store and some other businesses so they keep me pretty busy. I do know most of the others on the CCE because we are all from this town, but I don't really have time to be involved in many things outside of my businesses. Now that I'm on the CCE that is changing, and I'm starting to know more people."[69]

Another store owner from the other side of town, Maria de la Cruz, told me how she has contact with other CCE members through her sales, but that she does not carry out friendships with any of them because of her heavy work load.[70] When she came to the CCE meeting she sat in an area alone, not next to any other member. At least three of the thirteen meeting attendees did the same. In addition, I encountered at least seven other members (aside from Maria and Estarlin) at the meeting who considered themselves to be less-involved community members. Maureen, the CCE's treasurer, stated that her purpose for joining the group was to become more involved and that she wanted to work closer with other community members aside from through the school where she works.[71]

Based on these observations I find Puerto Jimenez to be the least unified CCE. The CCE is comprised primarily of different professionals around the community, who

[68] Interview from July 22, 2009. Transcribed.
[69] Interview from July 18, 2009. Transcribed.
[70] Interview from July 18, 2009. Transcribed.
[71] Interview from July 24, 2009. Transcribed.

know and have high opinions of each other, but do not spend time together outside of the CCE.

La Palma was ranked two as a less-unified community. I made several observations during my research that led me to this conclusion. First, members are not friends for the large part, and few members had previously worked together as part of an association. The CCE's secretary Angela confirmed this when she said, "I wouldn't say that we are very unified. We all know each other because this is a very small town and so people know each other. I would say that we are friends because we all choose to live here, but we don't see each other frequently, we don't have coffee every day."[72] They are mainly unified because of their close proximity to each other and because they have maintained civil relations since they can remember.

The eldest member of the group, Esmeralda, described the civil relations connecting her to the town as, "they know me because I am from here. I also sell bread and *empanadas* at their houses, and every time there is a community activity."[73] They live in such close vicinity (this is the smallest of the five CCE towns with an area of about one km squared) that it seems this woman knew everyone in town through her bread sales.

Because this community is smaller and much closer together than the others, the members knew each other's histories, trusted each other, and attended community activities together, but they were not necessarily friends that kept up with each other daily or weekly. Ana Luisa, another founding member, described her friendship with other

[72] Phone interview from January 25, 2010. Transcribed.
[73] Interview with Esmeralda Alvarez Corales on July 21, 2009. Transcribed.

CCE members as deriving from working “together over the years in school and community activities.”[74] The group’s treasurer said, “I would say that people already know me because I am from here,” in response to how the founding members know each other. [75] My observation is that CCE members were able to remain connected over the years because of the size of their community.

Based on these observations I find La Palma to be a less-unified CCE. The basis of its relationships seems to be proximity in the community.

I ranked Ciudad Cortes at three, right in the middle of the five CCEs in terms of unity.[76] This group can be considered as generally unified. I made several observations during my research that led me to this conclusion.

The members that head the group are all retired educators who have worked in the school system together for years. They have high levels of trust with each other for this reason. The president, secretary and one board overseer confirmed that they knew each other in this way before joining the CCE. The board overseer even said that, “the group came to me [when the CCE was forming] because I am also a leader in the community.”[77] The secretary said, “We worked together at the school for years, so we know how each other work and there is trust between us.”[78] Two additional members were community educators, and the treasurer was educated by them in primary and secondary school.

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[74] Interview from July 21, 2009. Transcribed.
[75] Interview with Danilo Vasquez Mora on July 20, 2009. Transcribed.
[76] This CCE differs slightly because the “founding members” of the current administration are new. The program had an overhaul in 2009 after the original group had administrative issues in which they were not operating correctly. The issues were training-related and will be discussed in the next chapter. Interview with Betty LaTouche White on August 3, 2009.
[77] Interview with Donald Cortes Porras from August 2, 2009. Transcribed.
[78] Interview with Ligia Cruz Gomez from July 31, 2009. Transcribed.

Other members include people who stay rather involved either purposefully or through their employment. One woman works at the local bakery, and sees other CCE members (in some cases) daily when they come to pick up their morning bread.[79] I saw another two that sell pots and pans and clothes in the community, moving from door-to-door and pausing frequently to chat with community members.

On the other hand, some other members who remain from the failed administration were left with hard feelings, though this number is few. They are still part of the CCE (and participate by coming to meetings and taking loans), but they have not necessarily gained trust for the current administration. One such member declined to participate in an interview with me, and was very clear that she did not feel unified with the new group. The secretary later told me that this person comes to meetings on a regular basis to stir up issues among the new members, including questioning their implementation of the credit regulations. She said that the group handles such matters by including the person in the related discourse and questioning their own policies in order to make sure all CCE members feel that their needs are met.[80] Perhaps this is a sign of presence of unity.

Based on these observations I find Ciudad Cortes in the middle range of unity among the five CCEs. The basis of its relationships for the most part seems to be repeated past contact and friendly involvement.

Next is Bahia Ballena, ranked four for second-highest unity. I chose this ranking based on the strong bonds of friendship, family relation and past involvement between

[79] Interview with Tamara Contreras Somarriba on August 1, 2009. Transcribed.
[80] Interview with Ligia Cruz Gomez from July 31, 2009.

CCE members. Members of this CCE know each other through various other community groups. The president formerly led the town sports committee. He was also involved in other community groups such as the development association. He owns a tour company in the center of town, and employs many town members and friends. His very large family is spread all over town. Of the members that I interviewed, around one-third were related to the president by blood or marriage.

The other original founders were either a part of one of these organizations, players from the town soccer team, or family and close friends of either. Tito (Alvaro Azofeifa Machado) said, “Walter, Junior, Milton and I have always been friends, we grew up together, played soccer together. Plus, we were all good friends with Travis, and worked on the local youth surfing program [a one-time stint] so in that way we have stayed united.”[81] Milton confirmed, “We’ve been friends for years. We all grew up together. Walter told me that FINCA [CR] was having a meeting and that they wanted to start a bank, so I went to the meeting with them to see what it was about.”[82]

The community is small (around two km squared) but slightly spread out, so some of the original founding members who live near the center can be said to have been close (best friends even), while others were just connected through a past history of cooperation together. One founding member from the outskirts of town described this by saying, “I have always been involved in everything, which is why I also decided to be in the CCE. I know Walter and his family over the years.”[83]

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[81] Interview from July 12, 2009. Transcribed.
[82] Interview from July 6, 2009. Transcribed.
[83] Interview with Maria Victoria Calderon Jimenez from July 14, 2009. Transcribed.

Based on these observations I find Bahia Ballena to be the second-most unified among the five CCEs. The basis of its relationships for the most part seems to be repeated and deliberate past friendships and community involvement.

Last, I ranked Sierpe five as the most unified CCE. I chose this ranking based on the fact that over half of the founding group members are related. The original board members are close friends and family. The president and treasurer are married. The treasurer stated, “Most of us are family. We know each other and we decided to start the CCE.”[84] Their siblings constitute more than one-fifth of the founding members. In fact, this family and its close friends are so unified that they spend almost all day together. When I went for my interviews, I found them all in the same housing area. I took them outside to the porch one-by-one to complete the interviews.

Other non-related community members have strong bonds of friendship with the others, or had previously worked together. Many of them had participated in past town projects, including the development association and the tourism association. The secretary is employed by the president (in the center of town) and has a long-standing close friendship with the family. He said, “I work for Giuseppe in his repair shop. I know the Morales family because I have worked here for years and the family lives right next door.”[85] Another founding member owns a pottery-painting business, and I observed that the Morales children paint there. They also walk to school with her daughter every day.

In addition, while Sierpe can be considered spread out, the community has had past problems that have led to the further unification of two distinct groups in the area.

[84] Interview with Raquel Acuña Morales on July 24, 2009. Transcribed.
[85] Interview with Yerin Nuñez Mendiola on July 24, 2009. Transcribed.

The group that is involved in the CCE (with whom about half of the community sides) has a strong desire to be unified, stay unified, and show the community that one group can work together in a trustworthy manner that eschews corruption. Raquel described this when she said, "Many other community development projects have been corrupt in this town. Some of us know each other from these projects. Others want to be a part of a community development project done right. We are going to stay together and do the job right because we want to prove to the community that community development projects can work."[86]

Based on these observations I find Sierpe to be the most unified among the five CCEs. The basis of its relationships for the most part seems to be family relation and strong, long-term friendship

CCE Rankings:

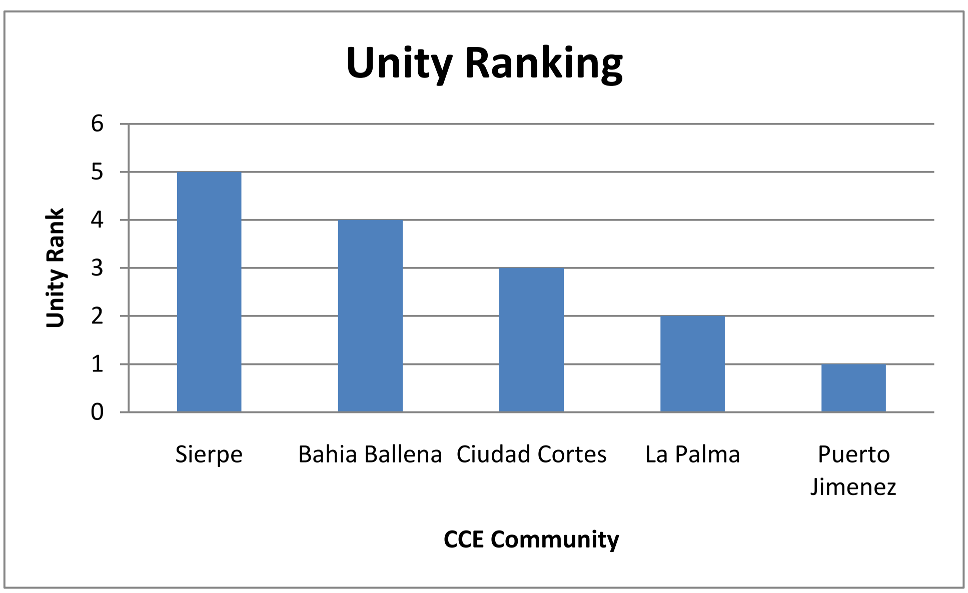

Figure 4.1

[86] Interview with Raquel Morales on July 24, 2009. Transcribed.

Survey Responses- Data on Attitudes toward the Group:

The following chart represents the survey answers from each CCE. The survey asked respondents why they decided to join the group, and whether or not they feel that they have responsibilities as a group member. The results show that all five groups' members feel a high degree of group obligation. These responses are not reflected in the community rankings, but nevertheless serve to show that an overall "group sentiment" is indeed present in every community.

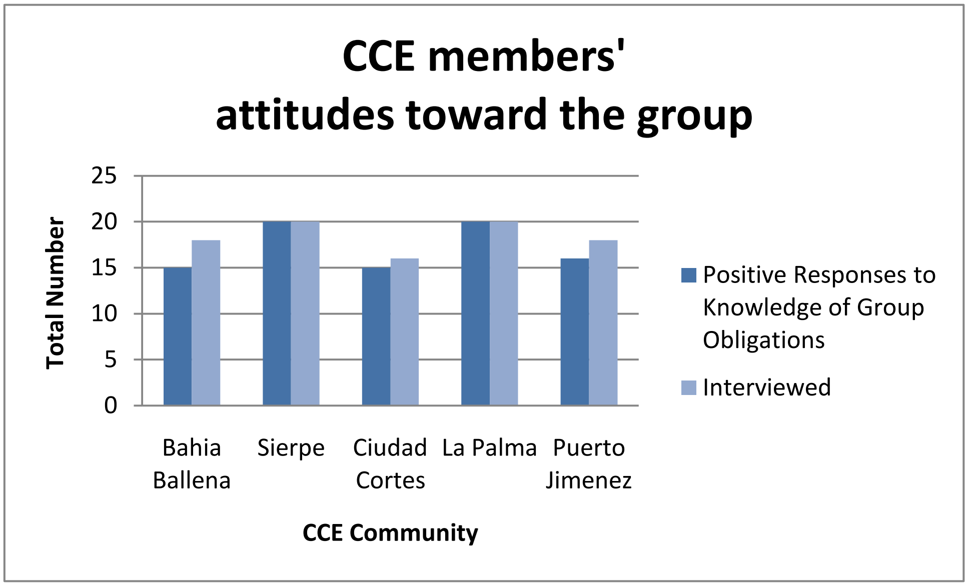

Figure 4.2

Analysis:

The first Hypothesis states that the more unified the microfinance group, the lower the level of defaults. The following chart compares unity rankings with CCE default rates:

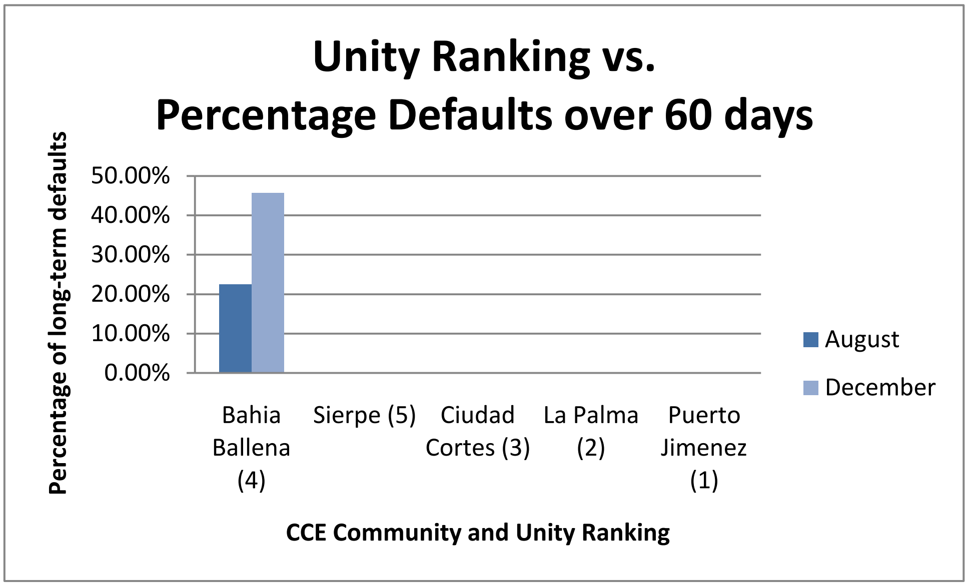

Figure 4.3[87]

Based on the foregoing evidence, higher levels of unity are not associated with long-term default rates. Bahia Ballena, which ranked higher in unity, was the only community that showed long-term defaults in both August and December of 2009.[88] I therefore conclude that this Hypothesis is not supported by the evidence gathered from these five communities during August and December of 2009.

Limitations:

The foregoing finding shows that a CCE formed from a relatively unified community may still have problems with defaults. This suggests that other factors are also involved in explaining default rates, and justifies exploration of Hypotheses 2 and 3. Before doing so, however, it is worth noting another possibility- that my finding may be a function of certain regrettable but necessary limitations in this study. This chapter, in

[87] Sierpe, Ciudad Cortes, La Palma and Puerto Jimenez did not report loans defaulting over 60 days in August or December of 2009.
[88] Data gathered from CCE documents.

common with the others, has important limitations, discussed in the conclusion to this thesis. Beyond these, this chapter has more specific limitations as well.

First, the data on which I based my conclusions about group unity may be unreliable. Although the interviewees were selected randomly, it is possible that those interviewed can be considered "more involved" or "better-known" CCE members in most cases. Later interviews with both the FINCA CR Field Worker and two Peace Corps Volunteers working on behalf of FINCA CR in the communities showed that of my random list, most participants that I ended up interviewing owned more than one share, and occasionally if not always came to group meetings. One reason for this could have been the participants' proximity to the center of the community. During my research trip, I was limited to walking and public transportation, and was rarely in possession of a bike for traveling. In addition, there may be a stronger reason for why "less-involved" members were not available for interviews- they are too busy to be more involved. Being busy could negatively affect their strong ties with the community. To develop a more accurate picture of relative community unity, I would need to interview almost every CCE member-- or administer a survey to a representative sample.

Second, my survey questions asking subjects about the degree of solidarity they felt with the group may be unreliable. As discussed in further detail in the conclusion to this thesis, these questions are inherently subjective both from the standpoint of the interviewees and from my own standpoint as a researcher analyzing the subjects' answers. In addition, it is possible that some interviewees would be reluctant to admit a lack of solidarity with their CCE—and, at least implicitly, to admit to selfish motivations for joining the group. On the other hand, some of my interviewees did make such admissions. From my observation it did not appear to be taboo to state this- perhaps because the groups are legal business entities which are formed for the purpose of giving loans and making money. Nevertheless, their responses are highly subjective, and therefore I have used them only as a supplement to the unity rankings (which have their own limitations, as discussed in the conclusion to this thesis).

Conclusion:

I conclude that the data on levels of unity gathered during August and December 2009 does not show a correlation between strong unity and lower default rates. The study would have more reliability if the data gathered were less subjective, i.e. if there were more objective proof that the relationships between town members was/was not strong. More information is needed to prove whether unity is or is not related to low default rates in FINCA CR CCEs. The information would need to represent a proper sample size of all CCEs in Costa Rica, and members who are less-involved in the CCE would need to be interviewed as well, to develop that more accurate picture of relative community unity.

Chapter 5- The Effects of Good-Quality Training

Introduction

This chapter tests Hypothesis 2: the better trained the members of the microfinance group, the lower the level of defaults. I start by describing the training program in detail, and then operationalizing my variables. Interviews with CCEs that received inadequate trainings will show consequences that may occur. Next I test each of the five CCEs in order to determine if the evidence supports this hypothesis. Last, I describe the limitations of this Hypothesis.

The "22 steps"[89] of FINCA CR's training:

In the context of FINCA CR, good-quality (or ideal) training includes the completion of 22 steps, and a one-year follow up training where a facilitator attends the CCE meetings on a regular basis to provide extra mentoring on needed subjects.[90] The 22 steps are the basis of training for the CCEs. They are 22 workshops that constitute the process of becoming a CCE. Their purpose is to train community members in skills needed to run a CCE. The steps are completed once a week in three-hour sessions. The workshop themes and descriptions are as follows:

1. <u>Introductory notes</u>- general information about the upcoming training workshops, explanation of trainer and participant responsibilities, introduction to the 22 steps

[89] From FINCA CR document: FINCA CR manual for Peace Corps Volunteers.
[90] Interview with Luis Jimenez on August 12, 2009. Transcribed.

2. Informative presentation- participants learn about CCEs and doubts are discussed, recognition of the value of CCEs and participants' official agreement to start process

3. Organizational regulations- overview of general CCE regulations, participants' personalization of their CCE's guidelines, functions of the board

4. The regulation of shareholder equity- basic functions of shareholder capital, CCE members create equity regulations

5. Program regulations for "Education Investment Program" for youth- introduction to education investment program, creating program regulations

6. Credit regulations- rules on granting credit to shareholders

7. Introduction to constituent meetings- official creation of the CCE, first official meeting as a CCE, members join by buying shares

8. Administration of credit- giving the first loan, shareholders familiarize with the process from solicitation to administering the credit

9. Basic administration- what is needed to be a good administrator, S.W.O.T. analysis (strengths, weaknesses, opportunities, threats)

10. Annual operating plan- creation of the plan

11. Administrative documents- fundamental elements of board meetings, basic agendas, meeting minutes, book of shareholders and agreement journals

12. Auxiliary accounting- importance of accounting systems for CCEs, basic knowledge of the accounting system

13. Control of capital- importance of shares, keeping records of monthly capital

14. Control of "Education Investment Program"- familiarization with the youth savings program, registration of technical records

15. Financial reports- basics, utility and process of accounting systems, income statements, balance sheets

16. Effective CCE meetings- managing reunions and their obstacles

17. Working as a team- concepts and roles

18. Board reports- responsibilities and quality of board action, practice CCE meeting (general assembly)

19. The stoplight- evaluating the program, diagnosis

20. Preparation for inauguration- details

21. Inauguration- present the CCE to the community, formally pass out shares

Once all trainings are completed and the group is officially inaugurated as a CCE, they begin accepting loan solicitations and granting credit on a regular basis. Under the latest methodology, the one-year follow-up trainings occur when funding is allotted for them in the project grant. FINCA CR just developed and sharpened the methodology within the last two years, so any CCE older than this may have received what is now considered average to inadequate training. [91]

Follow-up trainings:

FINCA CR follow-up trainings are intended to last for one year after CCE inauguration. Their purpose is to assist CCE administrators (the board) in any area in which they may need extra support. Trainings occur every one-to-two weeks at the time most convenient for both the facilitator and all other members, which is generally at the

[91] Interview with Luis Jimenez on August 12, 2009. Transcribed.

CCE board meetings. One day a month the CCE holds an assembly meeting where all members are encouraged to attend. On this day the trainings are right before the meeting, and largely consist of filling in gaps in the financial statements on which the board will report.

Follow-up trainings are more like mentor sessions than classroom sessions. There is no planned agenda unless the board decides to create one with the facilitator. The facilitator stays at the board meeting, watching how it is conducted, and answers any needed questions. If an area of doubt arises, the facilitator will know whether the board and other CCE members need a quick reminder or another entire session on the subject. Typically the area of most need is financial administration, since accounting concepts are new to most participants. CCE Sacrín believes that the follow-up sessions are highly necessary in order for a CCE to reach a level where it can operate on its own. They stated that FINCA CR does not have enough availability to assist all CCEs in areas of need, so without the follow-up trainings by the facilitator, most CCEs do not know how to manage operations correctly.[92]

Consequences of Inadequate Training:

The previous training received by Ciudad Cortes serves as a further example of the value of quality training for CCEs.[93] The CCE's original group did not receive all 22 steps. According to Touche, the former treasurer, less training was given and it was sporadic and lacked follow-up. The trainer did not adequately explain accounting

[92] Interview with Luis Cordero, President of CCE Sacrín, on August 10, 2009. Transcribed.
[93] As stated in Chapter 3, this CCE was improperly formed at is founding date. The CCE was completely re-trained by FINCA CR with new members taking over board duties.

concepts to the group. German Soto confirmed this fact.[94] As a result, the group did not maintain proper accounting practices. Since they had a lack of knowledge about collecting interest on loans and giving dividend pay outs at the end of the year, neither of these was done.[95]

Board members of CCE Sacrín claimed they also went through a period of insecurity in financial administration. They also claim to have received inadequate training when they first formed in the mid-1990s. Because of confusion about accounting concepts and how to manage CCE growth in the community, there were times when the CCE was not properly managing the money. They believe that it was a result of a lack of training. They also said that after two years of lost contact with FINCA CR, the CCE almost fell apart, so they got in touch with FINCA CR again and were able to convince them to fund another training program. The three board members who explained this history think that the extra training and motivation from FINCA CR is what turned the CCE around.[96]

These two examples illustrate the importance of good training and the consequences of inadequate training. I now compare the trainings that occurred in the five communities in the Osa. By determining the quality of training that was received, I am able to compare the evidence and determine whether training is associated with high/low default rates.

Operationalizing Hypothesis 2: *THE BETTER TRAINED THE MEMBERS OF THE MF GROUP, THE LOWER THE LEVEL OF DEFAULTS.*

[94] Interview from August 4, 2009. Transcribed.
[95] Interview with Touche on August 3, 2009. Transcribed.
[96] Interview with 3 board members of Sacrí n on August 10, 2009. Transcribed.

By good-quality training I mean a complete training in business skills which will create more knowledgeable CCE members (the 22 steps), and in addition, one year of follow-up training to ensure that members fully grasp the proposed concepts. In this study I set out to measure the quality of training that each of the five CCEs received. In order to do this I collected data from CCE board members about the trainings that occurred. I interviewed a sample of CCE members from each community, and these interviews are the source of my data. Questions included: Did you complete FINCA CR's 22 steps? What type of support did you receive after that? (And if they received follow-up training), What were the trainings like? [97] Information on the training received was confirmed by cross-checking with other respondents, FINCA CR headquarters and the Director of the Osa region. I triangulated the information in order to judge and label the quality of training that occurred in each community.

In order to label the training, I chose to create a breakdown of quality levels depending on the amount of time that CCEs spent with their facilitator and give them numerical values from one to three. The more time that CCEs spent with the facilitator, the higher the possibility is that they gained a firm grasp on the concepts. Since FINCA CR deliberately aims for one year of follow-up training, this is considered high quality. A significant amount of follow-up training below one year is considered average, and anything less inadequate. This is because both FINCA CR and the most successful long-standing CCE in Costa Rica believe that a significant amount of follow-up training is a bare necessity for a CCE's success.[98] Therefore, completion of the 22 steps and 10-12

[97] See Appendix 1.
[98] Interview with Luis Cordero, President of CCE Sacrín, on August 10, 2009. Transcribed.

months of follow-up training is considered good-quality training (Value: three). Completion of the 22 steps with six to nine months of follow-up training is considered average (Value: two). Completion of the 22 steps (or less) with six months or less of follow-up training is considered inadequate (Value: one).

CCE training:

Bahia Ballena was labeled as having received inadequate training (value of one) based on the lack of follow-up training received. This community did finish the 22 steps but received no official follow-up. A Peace Corps small-business volunteer was living in the community at the time, but was not able to act as a good resource since he wasn't officially trained by FINCA CR. Later he was hired as the Director of the Osa (for FINCA CR) and told me, "FINCA CR did not train Bahia Ballena like they were supposed to. The group was formed under an older form of the new methodology, but technically they still should have gotten follow up training."[99]

The president explained this further by saying he, "did finish the 22 steps but they [FINCA CR] left us out after that. Sometimes we needed help and called FINCA but they were not available. Accounting was a new concept to us and it is difficult for Ronald [the treasurer] too. Maybe we weren't totally prepared to go alone."[100] Indeed, when I initially found the treasurer in town I requested the most updated accounting balance and credit profile. They had not been completed in over six months. Ronald spent all day (8am-9pm) at the CCE office working on them. When I left to head to the next town they were

[99] Interview with Travis Bays on August 6, 2009. Transcribed.
[100] Interview with Walter Brenes on July 14, 2009. Transcribed.

still not completed. He told me that there were things that he didn't understand which he would need help with in order to have them completed. The Osa Director did help him and I just barely received the document before I left the country- over a month later.

Ronald explained his training, saying, "I went to the 22 meetings but they [FINCA CR] left me by myself after. My reports are always late because it is so time consuming and I don't understand some things. Sometimes I called FINCA CR for help but they don't have time to help me, or they are not in the office. I have to take other jobs to support my family so I can't always call during the day."[101] From my observations it seemed that other board members were feeling animosity towards Ronald because of their current financial situation, since he gets paid to be the treasurer. I inquired about the salary and was informed that it was less than $40 a month- a very small sum in Costa Rican terms. The board wanted to hire an outside administrator to complete the reports, but they could not afford one because so many payments were late. Training that was not received could potentially have been extremely beneficial to this community. At the least, if after further training Ronald could not grasp the concepts, the facilitator would have known that an administrative change with additional financial training was needed.

Based on these observations I find Bahia Ballena to have received inadequate trainings. The CCE received no follow-up training in conjunction with the 22-step methodology.

Sierpe was labeled as having received average-quality training (value of two) based on the fact that it received only about 7 months of follow-up training, which were completed by two separate facilitators. The Director of the Osa (Travis Bays) completed

[101] Interview with Ronald Guzman on August 6, 2009. Transcribed.

the 22 steps and five months follow up, and Matt Meade completed the next two months of follow up. Then the one-year point had passed but FINCA CR was not employing anyone in the region.

Fortunately, as several members on the board have prior accounting experience, bookkeeping is not as much of an issue for this group. I spent a while at the president/treasurers house during my stay. Though they only received average training, I saw the treasurer complete the monthly reports with much ease, though she did state that she had one question that she would need to take up with FINCA CR the next time she saw a representative. She stated, “I knew some of the information because we run [a] business, but some of the accounting trainings were new for me. Travis was coming since January but then he got married and hasn’t come back.”[102] I asked Travis about this and he told me that the project money had run out, and that he was waiting for another grant to come in before going back.[103] A board overseer also confirmed, “I knew most of the information already since I have been on the development association. Some of the information was new- like the accounting for CCEs. Travis was helping, but I know he hasn’t been back in a while.”[104] It seems that though the CCE did not received ideal training, the members’ past experience with bookkeeping has benefitted them.

Based on the above observations I find Sierpe to have received average training. The CCE only received follow-up training just above an inadequate level.

Ciudad Cortes was labeled as having received average training (value of two) based on the fact that it received only about 8 months of follow-up training, which were

[102] Interview with Raquel Morales on July 24, 2009. Transcribed.
[103] Phone interview with Travis Bays on July 25, 2009. Transcribed.
[104] Interview with Jose Abarca on July 27, 2009. Transcribed.

completed by two separate facilitators. Cortes underwent the same facilitator changes as Sierpe, and since the new group was formed on month before Sierpe, they received one more month of training.

The CCE's treasurer described the status of the group's accounting knowledge when he said, "I have a high school degree so I know I can learn the information. But I still need help with accounting. Sometimes the numbers don't match up and since Travis left us I have to call FINCA [CR] but they can't always help me. Also it is not easy to explain things over the phone. It is better when someone is here to explain it to me. Travis hasn't come back since May but hopefully he can come soon to help me."[105] The secretary also confirmed by saying, "We need help with the interest and with the dividends so Travis can help us with that when he comes."[106] Both asked me to speak with Travis and mention this request to him.

During my short stay in Cortes, this accounting request was not answered. The group was able to give me an updated report, but with one exception. One loan that carried over from the past administration was not listed because until the CCE spoke with FINCA CR, they did not know the proper procedure to follow for interest collection.[107]

Based on these observations I find Ciudad Cortes to have received average training. The group was still not confident with accounting practices after 8 months of follow-up training.

La Palma was labeled as having received good-quality training (value of three) based on the fact that it received FINCA CR's 22 step methodology, and one year of

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[105] Interview with Geovanny Herrera on August 4, 2009. Transcribed.
[106] Interview with Ligia Gomez on July 31, 2009. Transcribed.
[107] According to CCE documents and Geovanny Herrera.

follow-up training. Matt Meade was a Peace Corps Volunteer who was formally trained by FINCA CR and started this CCE. He was in the community for over a year after the inauguration and the CCE was his primary Peace Corps project. His presence is deemed by CCE members to be one reason for their understanding of policies.

The president of the group said, “We did the 22 steps and Matt always comes to the meetings. Matt has been with us through the whole process. He has been helping us since we started and we have changed the treasurer so he always works with the treasurer. He comes to the meetings and helps us when we need it.”[108] The secretary expressed the same in saying, “We did the 22 steps and Matt was with us. Matt always comes to the meetings to make sure everything is going like it is supposed to, so if we have a question we just ask him there.”[109]

I saw evidence of this during my stay in La Palma. I attended a group meeting. The setup was informal, but members behaved professionally with their peers. During this meeting, the group was to report to attendees on the current state of the credit profile, and grant funds to the newest loan applicant. The group which had been in follow-up training for over nine months at this point had a question for Matt about the sum of monies to be awarded pursuant to the amount of shares and co-signers that the applicant had. Matt gave an on-the-spot mini-training to all attendees on the issue. They expressed understanding at the end of the training.

Based on these observations I find La Palma to have received good-quality training. The CCE completed FINCA CR’s ideal methodology.

[108] Interview with Alban Sequerra on July 22, 2009. Transcribed.
[109] Interview with Angela Batista on July 19. 2009. Transcribed.

Puerto Jimenez was labeled as having received good-quality training (value of three) based on the fact that it received FINCA CR's 22 step methodology, and one year of follow-up training. Matt Meade also formally trained this CCE and spent one full year after its inauguration working on follow-up training with them. He did ten months of this year with the Peace Corps and the other two as the Regional Osa Facilitator. I was in town during month ten of the follow-up training.

The president, secretary, treasurer and board overseers all mentioned that Matt was a help to the group. The treasurer said, "Matt always helps me and comes to the meetings. Sometimes he helps me outside of the meetings."[110] Board Overseer Estarlin also said, "Matt always comes to the meetings and makes sure that things are operating right."[111] My observation is that Meade's main role was more that of an overseer during this time. At a town assembly meeting, he sat on the edge of the room. He did not instruct the group until they expressed doubt and looked to him for help. My observation is that they seemed to be on the brink of self-sufficiency.

Based on these observations I find Puerto Jimenez to have received good-quality training. The CCE completed FINCA CR'S ideal methodology.

[110] Interview with Maureen Mosquera on July 24, 2009. Transcribed.
[111] Interview from July 18. 2009. Transcribed.

Quality of training received (one to three) in communities:

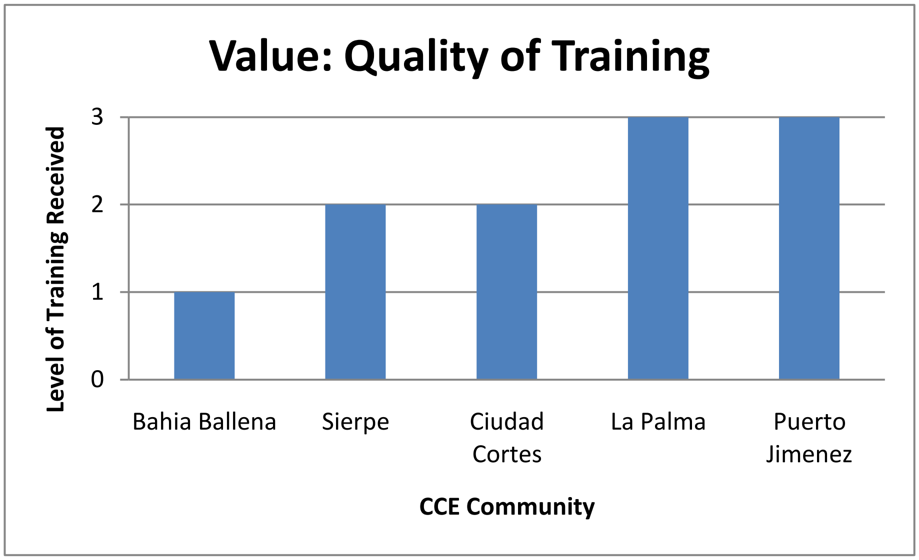

Figure 5.1

Analysis:

Hypothesis 2 stated that the better trained the members of the microfinance group, the lower the level of defaults. The following chart compares training values with CCE default rates:

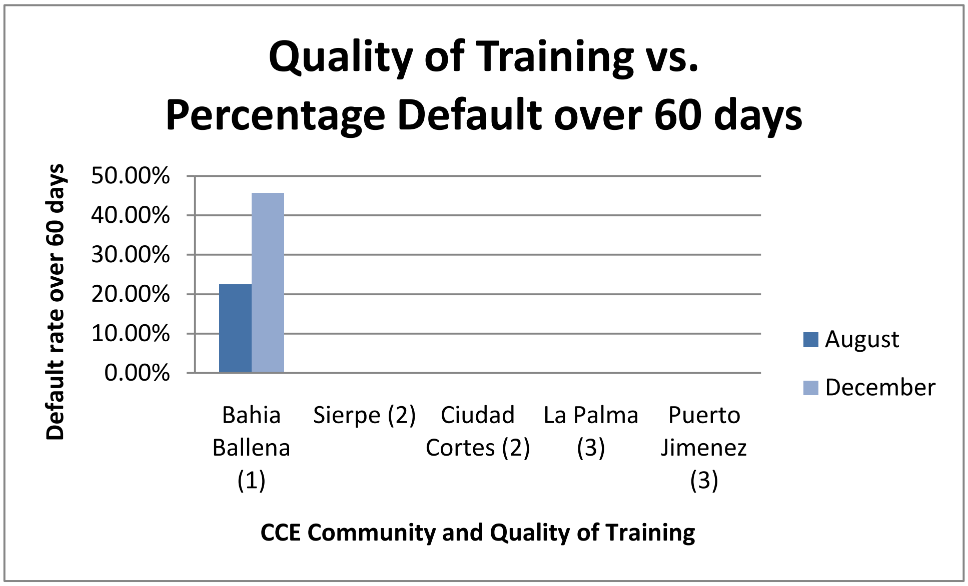

Figure 5.2 [112]

Based on the foregoing evidence, good-quality training is associated with low default rates. More specifically, it appears that follow-up training (even an average amount) is associated with low default rates. Bahia Ballena was the only CCE of the group to receive inadequate training and was the only CCE to show default rates over 60 days (not once, but twice) in its credit profile. I therefore conclude that this Hypothesis is supported by the evidence gathered from these five communities during August and December of 2009.

Limitations:

The foregoing finding shows that a CCE formed from a well-trained community may limit the chance of defaults. Still, other factors may also be involved in explaining

[112] Sierpe, Ciudad Cortes, La Palma and Puerto Jimenez did not report loans defaulting over 60 days in August or December of 2009.

default rates, which justifies exploration of hypothesis 3. Before doing so, however, it is worth noting another possibility- that my findings may be unreliable, a function of the regrettable but necessary limitations in this study. Again, this chapter, in common with the others, has important limitations, as discussed in the conclusion to this thesis. Beyond these, this chapter has more specific limitations as well.

First, CCE members managing financial administration may have different levels of education. This could affect CCE accounting. More educated individuals could be more likely to grasp accounting concepts. In truth, it seems that those CCEs whose members had prior accounting experience were in less need of serious help from a facilitator. This could affect the reliability of my study because, if it were true, financial health could be less related to training than prior knowledge.

Second, there was no way for me to measure the amount of attention that CCE members gave the trainings. Board members are selected by the seventh of the 22 steps. There is the possibility that after this was done, only the treasurer put his full attention toward accounting-related topics. If other peers did not grasp the concepts, they were probably less likely to be able to support their treasurer when an issue arose. This lack of attention could affect the reliability of my conclusions. The trainings could have been sufficient based on members' previous education. There is the chance that members may not have fully supported each other to the best of their ability.

Conclusion:

I conclude that more training, specifically a significant amount of follow-up training (over 6 months), is associated with lower default rates. For a more reliable conclusion, I would need a sample of CCE default rates after each CCE is further-removed from training and has been on its own for at least one year. In this way I would be able to make a more reliable comparison of the five CCEs.

Chapter 6- The Effects of Discipline

Introduction

This chapter tests Hypothesis 3: the greater the financial discipline imposed on group members by administrators, the lower the level of defaults. I start with the operationalization of my variables, and then test each of the five communities in order to determine if the evidence supports this Hypothesis. Last, I describe the limitations of this Hypothesis.

Operationalizing Hypothesis 3:

By financial discipline I mean paying on time in accordance with the rules, and paying late fees on defaulted payments as a method of correction and training. Discipline must be imposed to ensure that operations are run properly and to set precedent for future borrowers. CCE administrators are primarily responsible for discipline as their task is to manage the group's money. All CCE members have interest in discipline because if money is not repaid, there is the risk that it could become a long-term issue where the money becomes difficult to retrieve, in which case there would be no money to pay shareholders' dividends.

In this study I set out to measure the degree of discipline for each of the five CCEs. In order to do this, I collected data on whether or not members understand credit rules; and whether or not they follow them. This information concerns the extent to which the CCE administrators collect loan payments on time, and punish borrowers who do not pay on time.

I interviewed a portion of CCE members from each community in order to determine the degree of discipline imposed, and these interviews are the source of my data. Interviewees were selected randomly, but based on availability to participate in interviews. The information was confirmed by cross-checking with other respondents. I used this triangulated information to judge the discipline of, and label, each group. Questions were: Does the board follow the CCE credit regulations? Have late payments ever occurred within the group? What action does the group take when there are cases of late payments?[113]

Degrees of Discipline:

In order to measure the degrees of discipline, I briefly explain the responses from the questions (Does the board follow the credit regulations? Have late payments ever occurred within the CCE?). Next I will rank each CCE from one to five in terms of discipline, one being least disciplined and five being most disciplined. The ranking is chosen based on the data on group behavior towards credit regulations.

In order to rank the CCEs, I chose to create a breakdown of types of discipline, based on different reasons for how CCE members deal with payments in accordance with the set credit regulations. Higher discipline is characterized by knowledge of obligations during cases of default, and a serious commitment to take fast action and require penalty fees. Therefore, obvious and deliberate expression of these characteristics bares heavier

[113] See appendix 1.

weight on the notion of discipline. Next follows knowledge of obligations with a lack of assertion (meaning a positive statement or declaration), and then disregard for credit regulations. These measures are subjective because they are based not only on members' statements regarding discipline, but also the ways in which they expressed them. By creating rankings, I am able to compare the levels of discipline to the default rates in order to see if the level of discipline may be associated with high default rates.

Community Discipline- Data on Group Behavior towards Credit Regulations:

Bahia Ballena was ranked one for the lowest level of discipline. I made several observations during my research which led me to this conclusion. Two board members were defaulting on payments and four of their immediate family members were also defaulting on payments.[114] In addition, board members admitted to not collecting money or completing financial reports for the group.

Three of the four board members admitted to not following the credit regulations. One had moved away from the community and never been replaced. The president stated, "We have cases of late payments. We don't follow the credit regulations. Ronald is supposed to collect the loan payments but it doesn't work because people don't take him seriously. He is not very sure of himself so he accepts people's excuses… I just don't have time for the board." [115] Ronald (the treasurer) explained in more detail, "No, we don't follow the credit regulations. The board left me with the financial responsibilities. I get paid but it is only [about] $40 USD a month. That is not enough money to support my

[114] According to CCE documents.
[115] Interview with Walter Brenes on July 14, 2009.

family, so I have to take other jobs too. That prevents me from being able to go around collecting the money. When I get there [to collect money], people say they don't have the money at that moment, this is why we have such a big problem." [116] The Osa Director told me that the group rarely meets, and that most members are not even aware of how many loans are overdue.[117] Evidence from all of my other community interviews proved that almost every CCE member was out of the loop on current issues. There had not been a board meeting or a general assembly in over six months.

Not only do most members not know about the current default rate, but many believe that it is acceptable to pay later if they did not have money at that point in time. "The current economic situation" was a common excuse among members for why they may not pay on time, but I was later able to confirm that most of them were still employed, and that their co-signers were also employed. One member stated, "Sometimes we can't pay on time, so we just pay later when we have the money. It's okay if we pay later. Also sometimes we don't have money to pay the penalty, so we give what we can." [118] Another local member suggested that the worldwide economic situation was not affecting people's ability to pay, but that she believed that too many community members have this crisis "in their mind." [119] She is a local business owner and reported that she did not feel losses during this time period.

Based on these observations I find Bahia Ballena to be the least-disciplined CCE. The CCE does not follow credit regulations or even meet as they are required. Group

[116] Interview with Ronald Guzman on August 6, 2009.
[117] Interview with Travis Bays on August 6, 2009.
[118] Interview with Zeneida Brenes on July 9, 2009.
[119] Interview with Grace Granados on July 10, 2009.

members are not aware of the financial situation, nor have they wondered why the group has ceased to hold town assembly meetings.

Ciudad Cortes was ranked two for the second-lowest level of discipline. I made several observations during my research which led me to this conclusion. My observation is that there is a strong knowledge among board members of their responsibilities, and that this CCE seems to take their operations seriously. At the same time, there was one case of a lack of assertion- related to confusion on what amount needed to be paid on a loan. I believe that this group knows the rules and obligations, but that more assertive action needs to be taken in financial management.

Board members feel that they follow the credit regulations. The president, secretary and treasurer all expressed knowledge of board obligations and recognized that they follow the credit regulations. All mentioned what they would do in the case of a late payment, and the president said that it had happened in the past, and that they did follow the proper procedure for collecting the money.[120] At the same time, both he and the treasurer expressed an incidence of uncertainty regarding the payment process. The president stated, "We have had late payments, but when that happens it is our first responsibility. Right now we have a late payment, a result of confusion because we switched the board and there was confusion about how much she [the debtor] had to pay. She doesn't pay the late fee because this is a special case." [121] This board had been in operation (and this loan had already existed) for over six months at the time of this statement. Second, the treasurer said, "If there is a late payment my first job is to go

[120] Interview with German Soto Elizondo on August 4, 2009. Transcribed.
[121] Interview with German Soto Elizondo on August 4, 2009. Transcribed.

cover it. There is a fee of [about] $1USD per day if they don't pay on time. We have to collect this too because it takes time to go collect money from someone's house." When I inquired about the confusion regarding the one loan, he said that he would need to talk to a FINCA CR member to figure out how to cover it, and that for now they would not charge late payments or collect money from this person.[122] He had not called FINCA CR requesting help- he seemed to be waiting for FINCA CR to become available to him.

Based on these observations I find Ciudad Cortes to be the second-least disciplined CCE. While the group does have a clear knowledge of the credit regulations and charging of penalty fees, I observed a lack of assertion when there was a case of confusion.

I made the decision to skip the third rank. This is because I felt that two communities overwhelmingly expressed good discipline, and that they were tied for the fifth rank. Also, the community which would have ranked third was also highly disciplined. For this reason, I moved it to rank four.

La Palma was ranked four for discipline. I made several observations during my research which led me to this conclusion. This CCE had a strong knowledge of board-member responsibility and knowledge of procedure for processing late payments. The group mentioned knowledge of incentives to stay financially disciplined. In addition, the Peace Corps volunteer (Matt Meade) that trained this CCE attended every meeting that occurred the subsequent year. I believe that his constant reinforcement of the credit ruling is likely to have had a strong effect. One group member even expressed that they gained

[122] Interview with Geovanny Murillo Herrera on August 4, 2009. Transcribed.

the value of discipline from time spent with Matt. While this group expressed financial discipline on-par with the most highly-ranked CCEs, I kept it a rank lower because the group seemed to obviously express that Meade was a reason for why they were disciplined; they did not explicitly take ownership of the value of discipline.

The president stated, “Yes, we follow the credit regulations. Matt is very strict with us about that. We have to be transparent so that we can get more shareholders, more capital, keep giving more loans, and grow.”[123] One board overseer confirmed this by saying, “Yes, we follow the credit regulations. Matt is with us and he taught us about being transparent. If someone doesn’t pay then the whole group knows, because we meet every month to talk about the finances.”[124] Both of these important CCE members knew the regulations, yet mentioned Matt as a factor in the group’s discipline, rather than expressing it as their duty.

Later in December I contacted the group’s secretary, Angela Batista. I asked for an explanation of the current default in the credit profile during the month of December. She told me, “We have a late payment now, and we are looking for the person to collect the money. They shouldn’t pay late. They will have a penalty on the payment.”[125]

For these reasons I find La Palma to be a CCE with good discipline, ranked in position four. The group did clearly express discipline, and even gave an example of charging penalty on a late payment.

Puerto Jimenez and Sierpe are tied at rank five for having the most discipline of the CCEs. I felt that they both expressed high levels of discipline and were assertive in

[123] Interview with Alban Fonseca Sequerra on July 22, 2009. Transcribed.
[124] Interview with Carment Gutierrez Bolaños on July 19, 2009. Transcribed.
[125] Phone interview from January 25, 2009. Transcribed.

doing so. I made several observations during my research which led me to this conclusion, and will begin by describing Puerto Jimenez.

Board members in Puerto Jimenez described credit regulations in detail and were much more professional than all of the other groups in financial reporting. Their meetings were formal and documents were completely prepared beforehand (something that was lacking- even if only to a small degree- in other communities). I observed that this professionalism aided their ability to be exceptionally assertive.

The president, secretary, treasurer, and both board overseers knew the credit regulations. The president said, "If someone pays late then we have to get the money as soon as possible. No one can pay late."[126] The treasurer said, "If they pay late then they have to pay a fee. We have to be transparent, so everyone will know if someone pays late."[127] They also expressed FINCA CR's number one reason for why groups should be financially disciplined—"the money belongs to all of us."[128] This is a main theme that was reiterated to me by several FINCA CR employees. FINCA CR believes that with this sentiment, CCE members feel more incentive to make sure that the money is where it should be. During my stay in Puerto Jimenez, I was able to attend a CCE assembly meeting. Over 15 CCE members were in attendance, and the treasurer and president were announcing the most recent financial reports. At this meeting it was announced that the first CCE member ever was 8 days late on their loan payment. Over 13 members discussed how to proceed with the situation. One CCE member challenged the group to give the debtor a chance to come up with the money without paying a penalty. [129] The rest

[126] Interview with Mario Cambronero Cambronero on July 22, 2009. Transcribed.
[127] Interview with Maureen Ortiz Mosquera on July 24, 2009. Transcribed.
[128] Interview with Sinai Medina Lopez on July 22, 2009. Transcribed.
[129] This member was Aggnette Bellanero. She also had a loan with the CCE at the time of this incident. In addition, in her individual interview with me she admitted to having financial/credit problems, and that she used part of her loan to

of the CCE members quickly reminded her that anyone who pays late must pay a penalty, and that extra time cannot be given under any circumstances, because then all CCE members would feel that they had this right.

For these reasons I've ranked Puerto Jimenez at five, tied with Sierpe as the most-disciplined CCE. I observed that this group has a strong knowledge of, and dedication to, credit regulations, and that they are assertive in expressing this among the group.

Last, I ranked Sierpe at five for being another of the most-disciplined CCEs. I made several observations during my research which led me to this conclusion. These observations are that the board members know the rules and regulations very well, express assertion in managing group finances, and that they understand that capital belongs to the group, and is every member's responsibility.

The president struck me as a good implementer of rules. As stated in an earlier chapter, he owns his own business where he already exerts financial discipline. In an interview he told me that, "if it [a late payment] happens we are going to go to collect the money. They can't pay late because we want this CCE to serve the community. They have to pay on time; we are going to be very strict about that so that people know. If they don't pay on time, they have to pay the penalty."[130] In a separate interview his wife the treasurer agreed, stating, "We are serious and we let people in the community know that we are serious… we are here to work and make the CCE work."[131] One board overseer went further, letting me know that the CCE has let shareholders know that late payments

pay off part off a credit card with higher interest. While this is allowed in CCEs (members can take out loans for any personal reason), it showed that this group member could have potentially been trying to buy time for her fellow member in case she may have one day needed some time herself. In this case, the group may have deterred her impetus to do so. Interview from July 18, 2009. Transcribed.

[130] Interview with Giuseppe Pagano on July 24, 2009. Transcribed.

[131] Interview with Raquel Morales on July 24, 2009. Transcribed.

are not acceptable, and reminded me that, “the money belongs to all of us, so we have to protect it in this way.”[132]

I believe that because of the past history of Sierpe being split because of rumors of corruption (mentioned in an earlier chapter); this group has a strong incentive to make sure that the rules are followed. They expressed their seriousness several times throughout my week in Sierpe. Over 15 members attended the financial meetings in this town as well- making both Puerto Jimenez and Sierpe the most-attended CCE meetings that I observed. I believe that this is a result of strong CCE management, because board members are able to keep the group motivated and reminded of why they must continue to attend meetings.

For the above reasons Sierpe is also ranked five as one of the most-disciplined CCEs. I observed that this group is extremely dedicated to its operations, and making sure that all things remain in order and transparent to not only all CCE members, but also the entire community.

[132] Interview with Jose Antonio Araya Abarca on July 27. 2009. Transcribed.

CCE Degrees of Discipline:

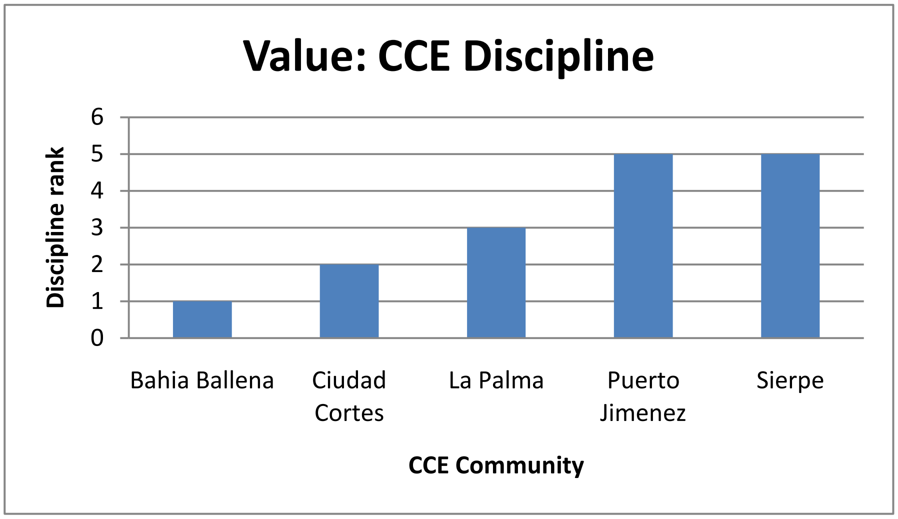

Figure 6.1

Analysis:

The third Hypothesis states that the greater the financial discipline imposed on group members by administrators, the lower the level of defaults. The following chart compares degrees of group discipline with CCE default rates:

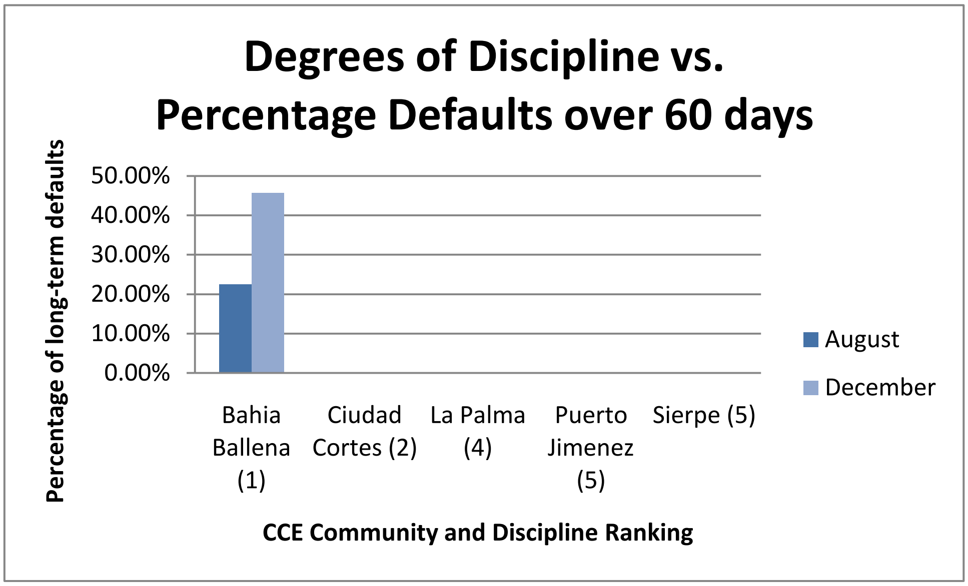

Figure 6.2 [133]

Based on the foregoing, greater financial discipline imposed on group members by the administration appears to be associated with prevention of long-term defaults. The data gathered during August and December of 2009 showed that discipline is a deterrent of long-term defaults. No disciplined CCEs had problems with recurring defaults.

Limitations:

The foregoing finding shows that discipline is associated with prevention of long-term defaults. This conclusion remains tentative, however, due to the limitations of this study. Aside from the common limitations found in the thesis conclusion, this chapter has more specific limitations as well. The main limitation is that I lack more long-term data, which would show a clearer correlation between discipline and higher or lower default rates.

[133] Sierpe, Ciudad Cortes, La Palma and Puerto Jimenez did not report loans defaulting over 60 days in August or December of 2009.

Second, the reliability of my findings is weakened because it depends on CCE members having told me the truth about their financial procedures. I am lacking actual proof that CCEs charge their members late payments. If I had access to all financial records since the first default, this would be easier to tell. The only data that was available to me were monthly reports which stated the current financial status of each CCE and borrower- proving whether group members paid on time. I have no tangible proof that late payments were charged.

Conclusion:

I therefore conclude that this hypothesis is supported by the evidence gathered from these five communities during August and December of 2009. Further financial evidence is needed to prove that CCEs have actually charged penalty fees, in order to remove this subjective factor from the study. Also, more information is needed to determine whether good financial discipline will be related to long-term default rates. Without knowing the future of the December 2009 default rates, it is difficult to compare the four CCEs that had low default rates with Bahia Ballena.

Chapter 7- Conclusion

Introduction

In this study I set out to determine what explains why some MFIs have high default rates, while others have low ones. I studied five CCEs (all MFIs), which were good case studies for contributing to answering my research question because they all received similar program implementation yet one program had a default rate of around 71%. Comparing the four CCEs that had low default rates with the one that had a high one, I aimed to determine what exactly caused this to happen when so many variables were controlled. I compared group structures, training programs received, and amount of discipline employed in each CCE in order to see if any of these factors were associated with Bahia Ballena being at a high risk for failure. I tested three literature-based hypotheses to arrive at the following conclusions.

Analysis

In chapter 4, the data gathered during August and December 2009 did not show a correlation between unity and lower default rates. The only CCE with long-term default rates ranked among the highest in unity. Of the other four CCEs, the lowest-ranked showed zero long-term defaults.

In chapter 5, the data showed that insufficient training was associated with long-term defaults. I found that more training, and specifically a significant amount of follow-up training (over 6 months), correlated with lower default rates. The only CCE that received below-average training was the only CCE with high default rates.

In chapter 6, I found that greater financial discipline imposed on group members by the administration appeared to be associated with prevention of long-term defaults. Specifically, all four CCEs that claimed to have exercised discipline were financially healthy. The only CCE that had financial problems appeared not to be disciplined.

Given the findings, although they are somewhat inconclusive because of the limitations in this chapter, I conclude that hypotheses 2 and 3 are most associated with financially healthy CCEs. Therefore, CCEs which are better-trained and more disciplined are likely to have low default rates. I found that unity did not correlate with low default rates.

Limitations

One main limitation in this thesis is that my overall sample size is not representative of the total number of CCEs in Costa Rica. My findings offer a snapshot of one small region in two brief and possibly unrepresentative periods of time. This means that my small snapshot of the Osa peninsula cannot definitively represent my hypotheses or FINCA CR's program as a whole. In addition, the fact that there is only one failure community in the study makes it difficult to draw conclusions. It is possible that with a larger sample of CCEs on the national scale, my results would have been different.

The rankings of assets per CCE member in chapter three noted that while CCEs had relatively similar numbers of total members, Bahia Ballena showed a much larger amount of total assets. The asset figures are one of the few pieces of hard data that I have, and they correlate very closely with the default rates that I observed. If my data is correct—and clearly further investigation to confirm this relationship is needed--it suggests that higher default rates correlate both with higher local assets per member and with higher total assets per member. In the thesis, however, I did not investigate possible hypotheses explaining this strong correlation but instead investigated hypotheses in which correlations were weaker. This suggests that my hypotheses may have highlighted matters of secondary rather than primary importance in explaining defaults. (Related to this point, see below for discussion of possible hypotheses for future research.)

In this study, based on my observations with CCE Sacrín in San Cristobal Norte (the exemplary CCE), few members and large assets does not necessarily correlate with high default rates. Sacrín has roughly the same amount of members as Bahia Ballena, and much more capital assets. Their treasurer (who works alone, just as the treasurer in Bahia Ballena) manages a credit profile of over $160,000. Based on this observation I believe that what happened in Bahia Ballena was more a result of insufficient training, which caused uncertainty on the part of the administrators.

Another limitation concerns the subjectivity of both the data and my interpretations of the data. Most of the data on which I based my rankings came from interviews in which subjects described relationships and feelings, or their administrative involvement. Little of my data is purely observational. None of the interview data is backed up by hard evidence, such as actual records of CCE activity, including proof of friendships or proof that late payments were charged penalties.

There is a great deal of subjectivity involved in the way that I ranked the groups as unified, well-trained or disciplined. Other observers might well have interpreted the subjective data in different ways. Given more resources and time, I ideally would have hired and trained two coders who would have independently analyzed the data and made the rankings. If they had differed in their analysis and rankings, I would have used a third coder to break the tie. Instead, I based rankings on my own subjective interpretation of the data.

Policy Implications

First and foremost, because there were so many limitations in my research, it is clear that more research is needed to test the reliability of my conclusions. In particular, my negative findings concerning hypothesis 1 contradict a wealth of social scientific data on the importance of prior solidarity to a group's functioning. Further research that might replicate or refute my findings is therefore needed.

Of particular importance would be researching the strong correlation I observed (but did not investigate or confirm) between a CCE's default rate and either its local assets per member or its total assets per member. If correct, this correlation might be explained by the hypothesis that the lower the ratio of administrators to assets, the higher the chances of default. The logic behind this hypothesis is that larger amounts of assets require more financial monitoring. This means that as groups grow, they would need to hire more administrators, or have their existing administrator dedicate more time to financial monitoring. Yet in FINCA CR, CCEs seldom can afford to increase the number of administrators or the amount of time worked. If further testing found this hypothesis to be correct, then having less administrators managing more assets might increase the risk of defaults. Conversely, more administrative monitoring could lower the risk of defaults.

More generally, I would recommend further research about the causes of defaults in MFIs.

To the extent that we can rely on the conclusions in this thesis, several more specific recommendations can be considered. First, MFIs could concentrate less on the internal factor of unity, and more on the approaches to CCE (or group) management. The approaches to management depend on external factors.

In the external realm, education of the MFI members is critical. This finding means that MFIs need more extensive systems of education for their members, and in the case of FINCA CR this would mean the 22 steps, as well as more than six months of follow-up training. For other MFIs (since there are different training structures in every organization), I suggest monitoring and evaluations for training programs. Evaluations would show whether training needs further support or more longevity in order to achieve the best results. The correlation between better-trained members and lower default rates shows that better-trained members are better equipped to manage their team, and are more knowledgeable of the consequences of not following credit regulations. This implication may represent a problem given that education and training programs are so expensive. Full training requires funding that is sometimes not available.

Second, MFI administrators must exercise discipline. Discipline means requiring members to pay on time and charging a penalty fee for late payments. The correlation between bad discipline and high default rates shows what can happen when MFIs lose control of their finances. This finding means that MFIs must be selective in choosing their administrators, ensuring that they are extremely dedicated to discipline and also understanding of why that is important. Given that it can be difficult to know whether an administrator will take initiative once in position, MFIs should create minimum requirements for administrative positions, including experience above just being known as “trustworthy” in their community. Perhaps prior administrative or money-handling requirements are appropriate. This implication also applies to MFIs worldwide, not just FINCA CR.

Conclusion

More research is clearly needed to help reduce the number of defaults in MFIs. Notwithstanding the limitations in this study, it would be particularly worthwhile for researchers to conduct further studies about the effects of unity, training, and discipline on default rates. It seems possible that if both the external and internal factors discussed here are more seriously considered, MFIs might have a better chance of maintaining low default rates and meeting their purposes to reduce poverty and increase savings.

This conclusion is important for MFIs worldwide and is not limited to FINCA CR. At this point, over 92 million people have been reached by microfinance, but it is unclear how many of their lives have actually improved.[134] Microfinance will only serve the needs of the poor when it is truly working. Therefore determining the most effective program implementation, particularly regarding default rates, is of great importance.

[134] Daley-Harris, Sam. 2005. *The State of the Microcredit Summit Campaign Report 2005.* Washington: Microcredit Summit. (http://www.microcreditsummit.org/pubs/reports/socr/2005/SOCR05.pdf).

Appendix 1

Questions for Interviewees:

1. What is your name?

2. How long have you been a member?

3. How do the founding members know each other?

4. In what capacity had they worked together in the past?

5. Why did you decide to buy shares and become a group member?

6. Do you feel that you have responsibilities as a group member?

7. (If it was not about being in a community group or was not clear, I responded with): Have you always been involved in community groups? If not, could say something more about why you became interested in the CCE?

8. Did you complete FINCA CR's 22 steps?

9. What type of support did you receive after that?

10. (And if they received follow-up training), What were the trainings like?

11. Does the board follow the CCE credit regulations?

12. Have late payments ever occurred within the group?

13. What action does the group take when there are cases of late payments?