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A Micro Approach to Microfinance: A Case Study on the Uniones de Credito y Ahorro in Rural Villages in Peru

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A MICRO APPROACH TO MICROFINANCE: A CASE STUDY ON THE *UNIONES DE CREDITO Y AHORRO* IN RURAL VILLAGES IN PERU

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Peru's microfinance market is dynamic and is comprised of a plethora of financial institutions that offer numerous microfinance services. With increasingly more institutions adding microfinance to their loan portfolio, and with no interest rate cap on microloans in Peru, what impact will this growing market have on the poor? In the past, microfinance institutions (MFIs) have had clients abuse the system, but increased transparency between microfinance institutions and new managing practices are now used to minimize adverse selection. Yet as the microfinance market expands with more large banks gaining control how are borrowers, particularly the most vulnerable, going to be impacted? This, paper evaluates the dynamics of how microfinance institutions have emerged and evolved throughout Latin America and then introduces an atypical model, the *Uniones de Crédito y Ahorro* (UNICA). Six UNICA programs from rural villages outside Cayaltí are evaluated using both aggregate loan data that measures the frequency of loan use in the village, and surveys with open-ended response questions to bring in UNICA members' perspective. With the data collected this paper attempts to understand the diverse factors that make the UNICA approach different from the traditional Latin

American model. And ultimately strives to discover whether the UNICA model provides distinctive benefits to the borrowers and the financial markets that are not provided by traditional Latin American MFI models.

To my parents, who have supported all my intellectual journeys, no matter where they led.

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Chapter 1: INTRODUCTION

Over three decades have past since the inception of microfinance as we understand it today and it continues to draw global interest since microfinance addresses issues of poverty from a unique perspective. That is, microfinance, unlike other development programs, is not easily labeled as another charity or handout project. Instead, microfinance is often viewed as a strategy to support micro business development that that in turn also addresses specific poverty reduction objectives.

Initially, funded primarily by nonprofits and development agencies, microfinance programs began as poverty assistance programs.[1] In Latin America today there is a competitive microfinance market. Large banks, cooperatives and financial institutions are becoming increasingly invested in creating and expanding microfinance opportunities for their clients. In 1992, *Banco Solidaridad (Bancosol)* of Bolivia became the first Latin American bank to be fully committed to microfinance.[2] In Peru, *Mibanco* was the first unsubsidized and privately owned microfinance-focused bank.[3] *Mibanco* has since proven itself successful: By 2008, after operating independently for twelve years, *Mibanco* emerged with the fifth largest gross loan portfolio in the Peruvian financial sector totaling $781 million with nearly 300,000 clients.[4]

As microfinance programs gain popularity with both the nonprofit and private market sectors, impact assessment on these programs is increasingly necessary in order

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[1] Marguerite Berger, Lara Goldmark and Tomas Miller-Sanabria, eds., An Inside View of Latin American Microfinance (Washington, D.C: Inter-American Development Bank, 2006) 7.
[2] Lucy Conger, Patricia Inga, and Richard Webb, The Mustard Tree: A History of Microfinance in Peru, (Lima: Universidad de San Martin de Porres, 2009) 97.
[3] Ibid. 98.
[4] Ibid. 99-100.

understand whether microfinance is an effective tool to handle issues pertaining to poverty. However, difficulties can arise, as there are a plethora of methods that can be used to measure microfinance impact. Furthermore, determining the effectiveness of microfinance is an ambiguous term, which can be defined differently by scholars, clients, banks, MFIs or international institutions.

For this thesis effectiveness is determined through an analysis of surveys and loan usage progression collected from the villages of Cafetal, Cayaltí, La Curva and Guayaquil in Peru. This thesis will focus on one microfinance model that currently is being supported by the NGO *FunderPerú*. The program is based on community created mini-banks, called *Uniones de Crédito y Ahorro* (UNICAs). Although there are numerous published case studies on microfinance programs, the UNICA model is an atypical approach to microfinance in Latin America. More specifically, the UNICA model counters the current assumption that Latin American microfinance models that depend on member self-generated capital are viewed as inefficient or not viable. This belief is based on the fact that there are numerous financial institutions competing in the Latin American microfinance market that have ample funds. These more established financial institutions can distribute a greater number of microloans than small community groups, which have to create their own capital.

Hypothesis and Research Question

The hypothesis for this study is that during the last four years the presence of UNICAs in the rural villages surrounding Cayaltí, Peru has increased access to financial services for those in the region. Of equal significance to this study, is the following question: Does the atypical UNICA model provide its members with any external benefits that traditional Latin American MFIs do not?

Also, of interest was whether the frequency of client loan usage changed in the last four years. For instance, did emergency expenditures on food or health decrease and was there a shift to loans that supported education, agricultural production, or microenterprises? Such shifts in loan patterns from personal to market enhancing investments provide evidence that over the last four years the disposable income of UNICA members increased.

Brief Review of Microfinance Terminology

Experts often neglect to clarify the difference between microfinance, microcredit and microfinance institutions. Modern microfinance refers to all of the myriad financial services that target the lower class and the poor. Thus, microfinance includes a wide array of financial services, which includes loans, savings and remittance programs.[5] Microcredit is a branch within microfinance that refers solely to the credit and loan aspect of microfinance. Other branches usually include microsavings and more recently microinsurance.

A microfinance institution (MFI) is the operating body that offers financial services to the poor. MFIs are composed of an array of complex networks including commercial banks, NGOs credit unions, finance companies and service companies. While MFIs can differ in structure, methodology, and operations they are meant to reflect

[5] Berger 2.

one common goal, which is to provide the vulnerable populations with financial services that have been denied to them by the traditional banking systems.[6]

Overview of the Issue: How to Address Issues of Poverty?

Billions of dollars are allocated for development aid agencies every year, but still 1.4 billion people continue to live in extreme poverty, defined as $1.25 a day or less.[7] Many scholars challenge development aid agencies and question whether their intervention measures on poverty alleviation programs are effective. Development aid agencies have also been criticized for their disregard to incorporate local feedback and sound management practices.

For instance, aid programs that provide foreign goods are often criticized for stimulating artificial markets and promoting unsustainable dependency. Rachel Garst and Tom Barry's research on food aid programs in Central America revealed that food distribution programs implemented by the U.S. created more negative externalities than benefits. For example, excessive importation of U.S. food outcompeted with local farm production by providing low-priced grains that could not be grown in the recipient country, which actually altered the local diet and caused import dependency on foreign grains.[8]

James Shikwati, Founder and Director, of the Inter-Region Economic Network expresses general concern regarding development aid programs by noting that such

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[6] What is Microfinance?, 2010, GGAP.org, Oct. 5 2010 <http://www.cgap.org/p/site/c/template.rc/1.11.947/>.
[7] News & Broadcast–Poverty, Sep. 2010, WorldBank.org, Oct. 5 2010 <http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20040961~menuPK:34480~pagePK:64257043~piPK:437376~theSitePK:4607,00.html>.
[8] Rachel Garst and Tom Barry, Feeding the Crisis: U.S. Food Aid and Farm Policy in Central America (Lincoln: University of Nebraska Press, 1990) 275.

programs often allow “inhabitants to lose confidence in their abilities and opportunities but also [promote] a culture of dependence on external assistance.”[9] Furthermore, international aid programs make it extremely difficult for local populations from the recipient country to be active and competitive producers in the marketplace.[10] For aid agencies reports about their negative impact on the communities they serve can discourage funding support such as private investments, multilateral bank grants and government subsidies.

Shikwati, also, suggests that aid programs capitalize more on the skills of the local populations and find ways to allow local individuals to be productive and use their own abilities rather than flooding countries with aid products. This will enable local populations to generate their own income and become the catalyst that will lead to the “bottom- up emergences” that are needed to create markets.[11]

Negative evaluations of development aid programs pressure institutions to create and practice alternative measures that address poverty alleviation. For example, microfinance, a popular program approach for poverty eradication, is attractive because it avoids much of the traditional criticism presented against other development programs. The objective of microfinance is to address issues of poverty by expanding capital access to the poor; however, additional advantages are often linked to microfinance. By, providing basic financial services to individuals that are traditionally excluded from these sectors, microfinance is thought to build self-confidence among local community members and promote entrepreneurship, which stimulates economic growth. Thus, the

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[9] R. Kiener, "Rescuing Children," CQ Global Researcher.3 (2009), CQ Global Researcher <http://iiiprxy.library.miami.edu:2346/globalresearcher/cqrglobal2009100000>.
[10] Ibid.
[11] Ibid.

impact from microfinance is twofold: it provides aid to the impoverished populations and it stimulates a culture that enhances self-motivation and creativity within these communities. Additionally, unlike some food aid programs, microfinance programs cannot easily be accused of creating artificial markets as today's formal markets depend heavily on the formal financial sector.

Although microfinance has been praised globally, scholars have recently become more critical. Like any formal financial institution, the misuse of microfinance can foster environments with loan delinquency, default, misconduct, bankruptcy and over indebtedness. Even, when microfinance is implemented and practiced correctly it is very difficult to scientifically measure the impact it has on communities. Economist William Easterly suggests that agencies focus on programs that produce easily attainable measurable results in order for agencies to statistically determine whether their efforts are beneficial.[12] Thus, based on Easterly's suggestion, international development aid agencies need to evaluate progress, receive feedback and implement programs based on gathered data.[13] These criteria for program selection and development can prove problematic for microfinance institutions, where the method alone of how to measure progress is hotly debated. Most microfinance research is focused on subjective case study reports and comparison studies between clients and non-clients, neither of whom may provide the unbiased results required to determine whether microfinance is effective or not. In addition, there are only a few studies that incorporate randomized designed

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[12] William Russell Easterly, The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done so Much Ill and so Little Good (New York: Penguin Press, 2006)369-370.
[13] Ibid. 380-382.

studies and, most of this research focuses on the allocation of microfinance and not on the impact of these microfinance programs on local markets.[14]

Issues with Impact Assessments on Microfinance

The first study to use randomized controlled trials (RTC) that measured the impact of microcredit when introduced into a new market was conducted in 2009.[15] The overarching conclusion made by the researchers was that no measurable impact could be found between the consumption levels of individuals who had access to microfinance as compared to those who did not have access to a microfinance program. However, this study only measured impacts using very short run data collected after only fifteen to eighteen months from the program's inception. Although this short run analysis concludes that there was no impact from the microfinance program, the scholars did indicate that long run evaluations could provide different results.[16]

The results from the study are not surprising, as many MFIs notify clients and donors that microfinance should not be considered a short-term development project that quickly produces results, but rather as a long-term commitment, that provides financial access to previously excluded populations. Thus, the unsatisfactory short-term results may not be of considerable significance as measurable impacts are to be expected only after years of practice.[17] Additionally, the study only focused on Spandana, a solitary

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[14] Banerjee,Abhijit, Esther Duflo, Rachel Glennerster, and Cynthia Kinnan, "The Miracle of Microfinance? Evidence from a Randomized Evaluation."(2009) Nov. 6, 2010 <http://www.povertyactionlab.org/search/apachesolr_search/the%20miracle%20of%20microfinance>.
[15] Ibid 2.
[16] Ibid 21.
[17] While attending the first UNICA module training session in July 2010, the participants were informed that it would take at least three years for the UNICA to fully function correctly. During an interview in June 2009, with Father Naun Tapia, Director of the nonprofit organization, *La Casa Campesina de Cayambe*

microfinance organization, operating in India. The Spandana program promotes group lending and targets women.[18] The organization distributes credit to the groups and if they repay their loans they become eligible to take out larger loans in the future. Spandana like the Grameen Bank model supports group lending, which is a popular microfinance practice, but there are many other techniques that are practiced.[19] For instance, the microfinance model that will be discussed in this thesis comes from *FunderPerú,* which equally promotes membership to both sexes and provides no direct monetary funds to its members. Unlike Spandana, *FunderPerú* does not distribute microcredit to its members. Instead each group must self generate its own cash source, which is then distributed out as individual loans.

Spandana and *FunderPerú* are both examples of microfinance institutions yet their methodology is very different and could clearly result in different short and long term results. In 2007, the World Bank estimated that there were over 7,000 microfinance institutions operating around the world. With so many institutions, the variety of microfinance models and services is considerable. Therefore, generalized statements about the effects of microfinance cannot accurately reflect the impact that all microfinance institutions have on their communities.

Another difficulty that arises during impact assessment of microfinance is the usage of counterfactual data.[20] Many studies look at hypothetical changes that might have arisen had clients not participated in the microfinance program. However, an approach

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(CCC), he explained that the first ten years of the CCC's microcredit program was immensely difficult leading to many defaults and other financial disasters.

[18] Banerjee 4.

[19] Ibid. 2-4.

[20] "A Partial Marvel." Economist 392.8640, (2009): 76 Business Source Premier. EBSCO. Web. Nov. 20, 2010.

based on theoretical circumstances would not be useful for traditional cross-sectional or longitudinal impact studies. Another common method for microfinance studies is to compare two areas, one with and one without access to microfinance services. When using this method, data must be taken with caution because there often are other factors that explain why certain MFIs choose to work in one specific area and not in other area.[21]

It is apparent that the issue of whether microfinance has a positive impact on its members is unclear. More studies that focus on the long-term impacts of microfinance need to be conducted in order to gain insight on the situation. Currently, there is much debate on the effectiveness of microfinance and no consensus will be reached until more critical analysis and research is conducted on this subject.

In order to evaluate the role these selected six UNICA programs played in the rural villages outside Cayaltí, this study focused on four interest areas. These areas include the following; (1) microfinance loan usage by type of loan (2) Basic household services; (3) social capital; (4) and financial literacy. In order to examine these four areas, three data sources were used, *FunderPerú's* aggregate loan database, research based on a convenience sample of 40 UNICA participants administered in 2010 and 2006 and participation in two five day UNICA training sessions, which provided detailed information on the UNICA program and community implementation strategies.

The aggregate loan data, which evaluates 1,710 loans, was compiled within six of the oldest UNICA programs and illustrates the frequency of loan usage and changes over the past three to four years. The fieldwork with follow-up surveys and open ended response questions provide a comparative analysis on how the original UNICA members'

[21] "A Partial Marvel"

socioeconomic status in 2010 compares to their socioeconomic status in 2010. Finally, after attending two week long UNICA training sessions in Peru where I received training about the loan program and methodology, I was better able to interpret these surveys to highlight the broader social impact from these selected UNICA programs. Based on these selected case studies and my analysis of the loan data, the *FunderPerú* model provides important support to these communities to enhance their financial literacy and social capital.

An important contribution of this research is that it will contribute to the dearth of scholarly work in the area of microfinance in Peru. In addition, this research should contribute to a better understanding of how to improve implementation of this type of microfinance model in similar rural communities. Furthermore, since there is no clear documentation of research on the *FunderPerú* model in journals aimed at English speaking audiences, my study provides valuable information to the broader English speaking academic and financial community, which may stimulate deeper interest in alternative microfinance strategies that could address microfinance program needs in the United States as well as Peru.

Chapter 2: THEORETICAL BACKGROUND

Brief History of Microfinance in Latin America

Modern microcredit gained mass attention in the 1970's when Muhammad Yunus established the most recognized microfinance institution, the Grameen Bank in Bangladesh. It began as a simple experiment in which Yunus gave small loans to impoverished villagers. He soon realized that with these tiny loans individuals were finally able to buy the raw materials needed to expand, or in some cases, start their own business and help them break out of the cycle of poverty. In 2006, Yunus was awarded the Noble Peace Prize for his work in microfinance.

During this time, microfinance projects also began to proliferate in Latin America. Pioneers of Latin American microfinance programs include Brazil's Project Uno in 1972, which offered entrepreneur capital-based microloans, and *Fedecrédito*, a cooperative in El Salvador, that issued loans through group guarantees.[22]

A differentiating factor between the microfinance model in Latin America and the now famed Grameen Bank model is their opposing stance on the participation of development aid organizations. Yunus was very critical of organizations like the World Bank and initially refused funding from them because he felt that multilateral aid institutions did not allocate their money efficiently and tried to force their partners to operate in accordance with the World Bank's standards.[23] However, in Latin America multilateral aid institutions have participated in microfinance development since the early 1980s when the Inter-American Development Bank (IDB) began channeling funds to

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[22] Berger 9-10.
[23] Muhammad Yunus and Alan Jolis, Banker to the Poor: Micro-Lending and the Battle Aagainst World Poverty (New York: PublicAffairs, 2007; 1999) 143.

bank programs targeting microloans to entrepreneurs in fifteen Latin American countries one of which was Peru.[24]

Additionally microfinance programs in African and Asian regions traditionally concentrate on targeting the poor where-as Latin American models often market themselves to populations that lack credit services.[25] The recipients of Latin American microfinance programs may not necessarily be poor. As a result, Latin American microfinance programs typically developed in urban areas and focused primarily on improving credit opportunities rather than savings.[26]

Peru's Microfinance History

During the 1980s and through much of the 1990s many Latin American countries were struggling to manage their extreme foreign debt. The arrival of the new millennium came with little promise, and in extreme cases, such as Argentina, national governments defaulted on their foreign debt. This serious economic downturn was devastating to the formal financial systems. Multiple banks, cooperatives, credit unions and government financial institutions collapsed during this time.[27]

In Peru, the 1983 economic crisis was twofold. First, the government restructured and postponed of all its foreign debt payments.[28] International institutions such as the World Bank and International Monetary Fund (IMF) disapproved of the Peruvian

[24] Berger 11-12.
[25] Ibid. 2.
[26] Ibid. 11-12.
[27] Conger 16.
[28] Conger 16.

government's actions and responded by withdrawing their financial support.[29] It took over a decade for Peru to reestablish its relationship with the IMF and World Bank.[30]

Land devastation in northern Peru caused massive crop failures from the Southern Oscillation (also known as *El Niño*), which further exacerbated the crisis.[31] That year, Peru's inflation doubled and national output was reduced by nine percent.[32] While the debt crisis created a need for microfinance institutions it was not until the 1990s that microfinance programs surged in popularity. One cause for this change was that in 1990 the newly elected President Alberto Fujimori issued political reforms that opened international trade and reduced subsidized government banking.[33] These new measures made microfinance programs an appealing project for international aid donors.[34]

Today, according to the Microfinance Exchange Inc. Web portal (MIX), which is the largest supplier of international data and information pertaining to the microfinance industry, Peru has 65 registered MFIs, which is more than any of the nineteen other registered Latin American countries.[35]

Peru's microfinance market is dynamic and encompasses a plethora of financial institutions that offer numerous microfinance services. These include banks, finance companies, Municipal *Cajas*, rural banks, *Entidades de Desarrollo de la Pequeña y Micro Empresa* (Edpymes), credit unions and non-governmental organizations (NGOs).[36] These microfinance providers abide by different national and international regulations

[29] Ibid.
[30] Ibid.
[31] Ibid.
[32] Ibid.
[33] Ibid. 21.
[34] Ibid.
[35] MIX Market | Financial Data and Social Performance Indicators for Microfinance , Nov. 19, 2010. <http://www.mixmarket.org/>.
[36] Conger. 25.

and provide various financial services. For instance, banks can provide all financial services and are fully regulated by the *Superintendencia de Banca, Seguros y AFP (*SBS), the government regulator for banking supervision.[37] Rural banks are also SBS regulated institutions that can provide credits and receive deposits, but they cannot provide checking accounts.[38] Edpymes are non-government regulated organizations, which provide microcredit but cannot accept deposits.[39] Credit unions are similar to banks, but their regulatory control is monitored by the National Federation of Cooperatives of Peru rather than the SBS.[40]

In Peru, the majority of microfinance based NGOs are members of the Consortium of Private Organizations to Promote the Development of Small and Micro Enterprises (Copeme).[41] Copeme members are self-regulated, but are responsible to practice sound microfinance practices.[42] The early stages of Peruvian microfinance programs depended heavily on government subsidies, but today, Peru's microfinance industry is considered one of the least subsidized in Latin America.[43] As a result, the Peruvian microfinance programs are highly competitive and many MFIs focus on profit maximization. In 2009 it was estimated that there were over 200 Peruvian regulated and unregulated microfinance providers.[44] It is also estimated that one in every three small rural and urban businesses is a recipient of microcredit.[45] Although Peru has more

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[37] Ibid.
[38] Ibid.
[39] Ibid.
[40] Ibid. 25.
[41] Copemes: MIX Market | Financial Data and Social Performance Indicators for Microfinance, Nov. 19, 2010 <http://www.mixmarket.org/networks/copeme>.
[42] Ibid.
[43] Ibid. 14.
[44] Ibid.14.
[45] Ibid.

microfinance lenders than any other Latin American country, 53% of the total Peruvian population, about 28.8 million live below the poverty line.[46]

Neoclassical Economic Principles Applied to Microfinance

Milo Bianchi, explains that the umbrella term, neoclassical economics covers an array of today's economic topics including "…scarce resources, optimization, rationality, focus on marginal tradeoffs and relative prices, methodological individualism, the use of calculus and a general equilibrium conception of the economy..."[47] Although today when scholars discuss economic issues they are typically referring to neoclassical economic theory often such theories do not hold true in the microfinance world. For instance, economic theory suggests that increased competition in microfinance markets create a more favorable environment for the consumer by forcing interest rates to be reduced and by providing better microfinance assistance to the client, however, in practice excessive competition does not necessarily enhance microfinance services and in some cases, loan delinquency actually increases.[48] This result occurs because MFIs, unlike traditional banks, which can take legal measures to enforce payment, have to use different approaches to ensure payment. Since most microfinance clients do not have land titles or collateral that is deemed worthy to collect, MFIs depend on their own influential authority over clients. For instance, MFIs often threaten to stop services if payments are late. However, if there are multiple MFIs, clients are less compelled to abide by MFI

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[46] MIX Market | Financial Data and Social Performance Indicators for Microfinance , Oct. 19, 2010 <http://www.mixmarket.org/>.
[47] Milo Bianchi and M. Henrekson, "Is Neoclassical Economics Still Entrepreneuless?" Kyklos Blackwell Publishing (2005), Nov. 21, 2010 <http://onlinelibrary.wiley.com/doi/10.1111/j.0023-5962.2005.00292.x/abstract;jsessionid=5F5D4F0D28F68E7300FB31ADD136BF1A.d02t02>
[48] R. Sengupta and C. Aubuchon, "The Microfinance Revolution: An Overview Review," Federal Reserve Bank of St. Louis (Jan.1, 2008) 23.

regulations as they can easily seek new microloans from other institutions.[49] For instance, in Bolivia access to microloans is significant; however, many clients have misunderstood or abused the system and are finding themselves over-indebted.[50]

When microfinance systems are not monitored, it is not uncommon for micro-entrepreneurs to hold multiple loans. Elisabeth Rhyne refers to this act of obtaining excessive loans to pay off other outstanding loans as "bicycling loans."[51] While some entrepreneurs are capable and justly are in need of multiple loans to fund their projects, the vast majority borrowers do not fall into this category and eventually find themselves in a financial crisis. Some MFI's in Bolivia such as *ProMujer* have since taken an active role to prevent working with these types of people by categorizing clients with other MFI's loans as ineligible for program participation.

Another contradictory example is found in the "diminishing marginal returns principle" which proposes that initial capital input will always yield higher marginal return on output and as capital accumulates, the marginal rate of return from output decreases.[52] (Figure 2.1) For instance, if a baker buys an electric mixer for $150 his production output of baked goods will increase greatly since he no longer has to mix all his dough by hand. A year later the baker spends $150 on sheet trays, and a rolling pin. These new products will contribute to a higher total production of baked goods. However, it is important to note that although total production increases, the rate of return

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[49] Ibid. 23.

[50] Catalina Robledo, "Managing the Risk of Growth in Microfinance – A Case Study of Bolivia," The MicroBanking Bulletin.17 (Autumn 2008), . Microfinance Information eXchange, Ince. <http://www.mixmbb.org/Publications/001IND/01IND.ANLS/01IND.ANLS.MBB/MBB%2017%20Autumn%202008.pdf>.

[51] Elisabeth Rhyne, Mainstreaming Microfinance:How Lending to the Poor Began, Grew, and Came of Age in Bolivia (Bloomfield, Conn.: Kumarian Press, 2001) 145.

[52] Beatriz Armendáriz de Aghion and Jonathan Morduch, The Economics of Microfinance (Cambridge, Mass.: MIT Press, 2005) 6.

on output decreases as more capital (baking supplies) is accumulated. Logically this makes sense because in the beginning a baker might only be able to make one pie per hour but after he/she purchases an electric mixer his/her production rises to five pies per hour. As time goes on the baker continues to increase his/her capital and thus output rises to 12 pies per hour. After the baker purchases a rolling pin and new measuring cups his/her production only rises to 13 pies per hour, which is not a very dramatic change in output.

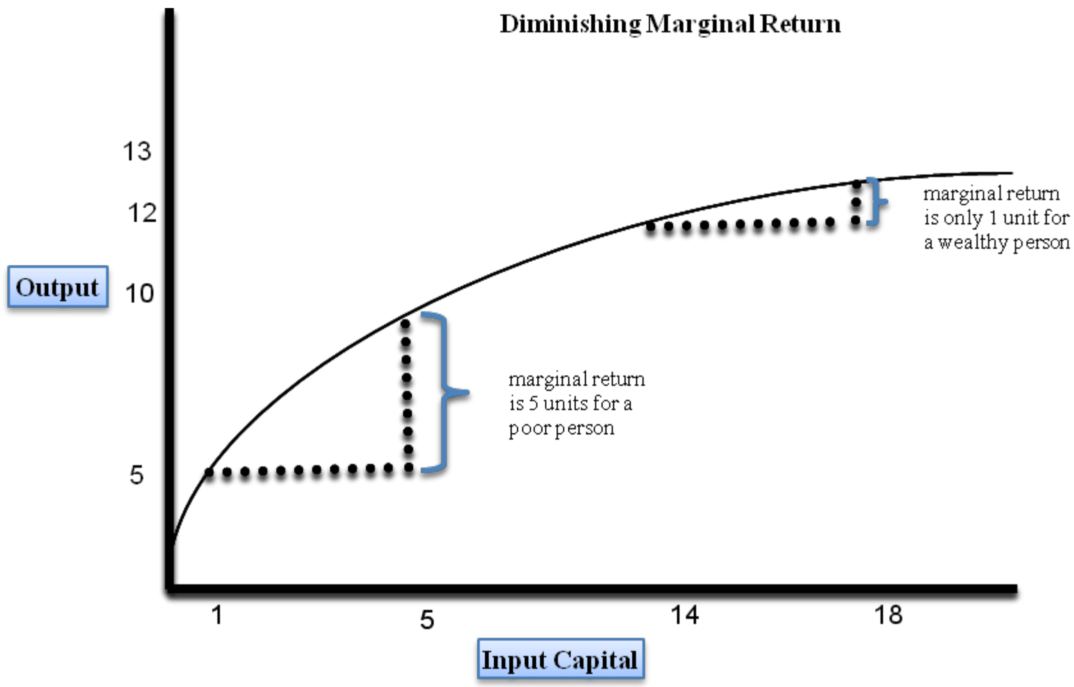

Figure 2.1[53]

Thus, as illustrated in figure 2.1, poor entrepreneurs who can only invest a small amount of capital obtain a higher marginal rate of return. The wealthier entrepreneurs who invest in more capital will have a lower rate of marginal return to capital. If the

[53] Ibid.

concavity of the diminishing returns curve is assumed to be true, poor entrepreneurs should have less difficulty making loan repayments because their marginal rate of return on their investments is higher than that of wealthier individuals.[54] Therefore, seasoned investors should seek out investment opportunities in impoverished regions like Nicaragua and Ethiopia rather than wealthier ones such as Japan or Germany.[55]

However, this is not case. In fact the opposite occurs, banks would much rather loan out to rich entrepreneurs in wealthy nations than poor entrepreneurs in impoverished nations. One reason for this paradox is that the diminishing marginal returns curve does not take risk into account.[56] Levels of risk are much higher in low-income countries and require investors to constantly pay close attention to the socioeconomic state of the country, which makes investment costs in these regions very expensive.[57] But if poor entrepreneurs can pay higher interests rates because they receive higher rates of marginal return there should be a way to reach an equilibrium in which high enough interest rates would compensate for the costs of investing in high-risk countries.[58] One school of thought argues that government enforced usury laws on interest rate caps prevent lenders to charge the market rate high interest rates needed to cover risk cost in these low income regions. However, that argument oversimplifies the situation.[59] There are two main problems that lenders face, which are adverse selection and moral hazard.[60] Adverse selection is when there is no way to distinguish between risky or safe borrowers.[61] High risk clients are more likely to default loans and thus should be avoided or charged higher

[54] Ibid. 6.
[55] Ibid. 7.
[56] Ibid.
[57] Ibid.
[58] Ibid.
[59] Ibid. 7-8.
[60] Ibid. 8.
[61] Ibid.

interest rates by lenders. Moral hazard occurs when clients take advantage of the creditor by evading loan repayments.[62]

Microfinance lenders are on the forefront of discovering nontraditional banking methods to minimize these two issues because MFIs lend to individuals who traditionally would be excluded from the finance sector either because they are too poor or have no credit history.[63] Thus, microfinance lenders create new ways to measure whether a person will be a promising candidate for a loan. As a result, much of microfinance theory is centered on methodologies that will reduce either adverse selection or moral hazard, which underpin contract theory in finance economics.

Joint Liability, Group Lending Theory

Joint liability, also referred to as group lending, occurs when the responsibility of loans is mutually shared among a group of individuals.[64] Joseph Stiglitz and Hal Varian suggested that joint liability stimulated self-monitoring among the entire group and inhibited adverse selection.[65] Loan distribution is contingent on the loan repayment performance of the entire group. Thus, those members that instigate moral hazard are often penalized or ejected from the group. Group lending has become common practice for MFIs because joint contracts are seen to reduce moral hazard among members and adverse selection without driving up costs for the financial institution by forcing the groups to handle and address member risk factors rather than the MFI officers.[66]

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[62] Ibid.
[63] Karen E Klein, "Domestic Microfinance Steps into the Credit Breach" BusinessWeek Jun. 10, 2010, Nov. 17, 2010. < http://www.businessweek.com/smallbiz/content/jun2010/sb2010064_156475.htm>
[64] Armendáriz 109.
[65] Ibid.
[66] Ibid. 124.

However, contrary arguments for joint contract presented by Greg Fisher point out that group lending might foster "free riding" individuals who do not abide by sound ethical practices because they know the other group members will be forced to cover all monetary costs and this will induce the free rider effect.[67] Free riding also can arise if a member does not trust his/her fellow members and therefore, decides to deceive his/her group before any other member attempts to cheat the group. The last extreme occurs when there is an overabundance of trust among group members and they scheme together against the MFI and unanimously refuse to repay their loan.[68]

Although problematic issues can arise in joint contracts, evidence has shown that compared to individual contracts, which require higher interest rates because risk costs are covered by the lender and not a group, default rates are much higher for individual loans than in group lending.[69] Nevertheless, some scholars find that joint liability contracts unfairly penalize members. Often if one member defaults then the whole group is disqualified from receiving any further loans.[70] However, Armendáriz and Morduch have found that in Latin America, the typical challenges faced by group lending is reviewed on a case by case basis rather than strictly adhering to the set rules.[71]

Another concern for scholars is whether microfinance systems can withstand periods of social, political, or economic instability. For example, in 1999 Bolivia's economic crisis was greatly felt by the microcredit institutions as clients rapidly were faced with over indebtedness while the demand for new microcredit was deflating

[67] Ibid. 117.
[68] Ibid.
[69] Ibid. 112.
[70] Ibid. 126.
[71] Ibid. 127.

rapidly.[72] Debtor associations (union organizers that focused on gaining debt forgiveness for borrowers) emerged throughout Bolivia and portrayed credit lenders as exploiters of the poor.[73] Debtor associations strived to obtain complete debt forgiveness for their supporters but only in a few cases did they succeed in nullifying borrowers' debt. As a result of the social pressure made by debtor associations, microfinance institutions have since adjusted their terms of agreements to include "extending their grace periods, lengthened terms, and annual interest of two percent."[74]

Perhaps, another important political example, of the impact of social pressure on microfinance terms is what occurred in Nicaragua. In January of 2009 Nicaraguan MFI clients protested the high interest payments on microcredit and loans by initiating the *No Pago* movement.[75] President Ortega fueled the movement by publicly supporting citizens to protest against MFIs, or as Ortega called them, "usury offices." The *No Pago* movement criticized MFIs for charging above market interest rates to their clients.[76] Many left leaning governments' associate high interest rates with a means to further exploit the poor rather than to improve their economic status. However, the World Bank defends high interest rates of MFIs by noting that operating expenses are far greater when lending to individuals who do not have formal credit.

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[72] Rhyne 144-147.
[73] Rhyne 146.
[74] Rhyne, 147.
[75] Elyssa Pachico, "*No Pag*o Confronts Microfinance in Nicaragua," North American Congress on Latin America (2009) NACLA Dec. 16, 2009 <https://nacla.org/node/6180>.
[76] Ibid.

Behavioral Economics Theory

Behavioral Economics is a combination of both psychology and economics. Often real markets do not reflect results that neoclassical economic theories suggest, thus behavioral economics attempts to explain why contradictory outcomes occur.[77]

In microfinance such contradictions prevail for many reasons. Behavioral economics takes into account that people will not always base their actions on results that yield greater utility. In reality individuals often procrastinate, seek instant gratification rather than long-term sustainability and at times lack willpower. This reality is particularly prevalent in financial situations such as in microfinance.[78]

As a result, scholars who address effectiveness of microfinance using only neoclassical economic models cannot fully gauge the impact microfinance has on communities. For instance, scholars often suggest that if poor people are disciplined and save a small portion of their income, then they can actually save enough money equivalent to their desired MFI loan amount and could avoid interest payments and save valuable time by not attending MFI meetings.[79]

However, across all social classes disciplined saving is difficult and those that are able to save typically have support from strong financial devices. Behavioral economics suggests that financial mechanisms that require people to save part of their income either for a loan repayments or for deposits creates structures for individuals and provides them with consistent and useful ways to protect and conserve the money that they acquire.[80]

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[77] Armendáriz 170.
[78] Ibid.
[79] Ibid. 171.
[80] Ibid. 170-171.

In summary, there are three important strands of literature developed to understanding individual risk, behavior and other market considerations in the literature of microfinance. These include the following: contract theory where adverse selection and moral hazard are monitored, group lending theory, and behavioral economics.

Based on the following analysis it is clear that although MFIs broaden accessibility of traditional financial programs to the poor their approach to incorporate the poor into the financial sector requires many nontraditional methods. Thus, in order to fully understand the impacts of microfinance researchers must address microfinance studies from more than just the traditional financial or economic perspective.

Chapter 3: METHODOLOGY AND LOAN USAGE

The *Uniones de Crédito y Ahorro* (UNICA) Model

FunderPerú's ideology was originally constructed in Honduras. It began in 1993 when the *Fundación para el Desarrollo Empresarial Rural* (FUNDER) was founded under an experimental project *Proyecto de Consolidación de Empresas Campesinas de la Reforma Agraria en Comayagua* (PROCORAC). By 1998 FUNDER was operating in Honduras as an independent organization targeting rural entrepreneurship, microfinance and the development of local agriculture and microbusinesses.[81]

In 2004, Dr. Enrique Neuhausser, the founder of the FUNDER model expanded the FUNDER program to the Lambayeque region in northern Peru. Initial funding came from Peru's development bank, *La Corporación Financiera de Desarrollo* (COFIDE) and development program, *El Programa Inclusivo de Desarrollo Empresarial Rural* (PRIDER). By 2008 *FunderPerú* also started to receive funding support from the local organization *Los Andes de Cajamarca,* which enabled operations to begin in the Cajamarca region. *FunderPerú* embodies the same methodology as *FunderHonduras,* however there is one small difference; In Honduras the community micro banks are referred to as *Cajas Rurales*, whereas in Peru this term was already being used to describe a different type of financial institution thus, *FunderPerú* changed the name to *Uniones de Crédito y Ahorro* (UNICAs).[82]

81 FUNDER: *Fundación Para el Desarollo Empresarial Rural*,Web. Nov.08, 2010. http://www.funder.hn/
82 *FunderPerú.* Module 1: Training Course VIII. San Vicente Lodge, Cajamarca, Peru. July 12, 2010.

The UNICAs' primary objectives are to: 1) stimulate savings 2) increase credit access to rural families 3) to create support networks within the families.[83]

The first phase to complete these objectives is the successful implementation of UNICAs. The presence of UNICAs is believed to provide the support that many poorer families traditionally lack by providing them with an outlet where they can increase savings and apply for microloans. With facilitating financial services to these UNICA members they not only become educated about savings and loans, but are also able to borrow money to cover an array of expenses including, but not limited to, education, health, basic food or investment in microenterprise or small agricultural production.[84]

FunderPerú's first UNICAs began in rural communities outside of the coastal city of Chiclayo. Outreach was focused on rural areas that could be reached relatively easy by *FunderPerú's* staff members, called monitors. Communities from the Zaña Valley and Túcume Valley were the first areas to receive *FunderPerú's* UNICA training courses.[85]

FunderPerú's training approach to starting UNICAs is that their target audience, typically the rural poor are more receptive to new ideas expressed by their neighbors rather than by strangers. As a result, *FunderPerú* only trains a few individuals on the microfinance model. Those community members who support the model must then actively convince and train their neighbors on how to create an UNICA.

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[83] *Módulo I: Manual Elaborado Por FunderPerú. Organización Administración y Contabilidad de Uniones de Crédito y Ahorro* (UNICAS) (2010) 5.
[84] "Module I: Training CourseVIII." *FunderPerú.* San Vicente Lodge, Cajamarca, Peru. July 12, 2010.
[85] Jorge de la Torre Barboza. Private Interview. Coordinator of Microfinance and Rural Development, *FunderPerú.* Chiclayo, Peru. July, 8 2010.

The process begins with two months of rural community outreach by the monitors. Most people are suspicious, but those who are genuinely interested in learning the model are invited to attend the three session training course that meets for one week once a month with all their expenses paid. Although there are no direct costs to attend the courses it is still an immense commitment for many because each session lasts five days. The opportunity cost for attending sessions often include sacrificing a week's worth of pay, which for many is unfathomable. Nevertheless, those who do manage to travel and attend the retreat find themselves with three meals a day, snacks, lodging, hot water, indoor plumbing, school supplies and copies of the course material. In return, those who commit to the program typically attend classes from 9:00am to 5:30pm for the five days of training.[86]

Session one is entirely focused on explaining how UNICAs are formed and the professional standards that need to be implemented in order for a group to succeed. For instance, during the July 2010 course session at the San Vicente Lodge outside of Cajamarca there was an entire lecture on the importance of punctuality. While culturally punctuality is not highly valued, the monitors stress that punctuality is one necessary factor for UNICAs to become successful and enable the monthly meetings to be productive and efficient. One measure that many UNICAs use to discourage tardiness is imposing fees to anyone who arrives late.[87]

Session two is dedicated to calculating different types of interest rates. Each training session is comprised of 20-40 people with a wide range of educational levels. For those who are illiterate and have poor math skills, understanding the basic equation for

[86] Module I: Training Course VIII
[87] Ibid.

calculating the interest rates requires days of practice.[88] Below is an example of how monitors teach individuals how to calculate the total interest for a 100.00 *nuevo soles* (S/.) loan for a two month interval at five percent a month.

Capital x Time x Interest [89] / Base	=	S/.100.00 x 2 months x 5(%)* / 100**	=	$10.00 total interest charged

Example 3. 1 *Interest rates are represented as whole numbers in the calculation process.
**** Base converts to 3,000 when calculating daily interest rates.**

After this phase attendees are taught how to fill out the workbook documents, they must understand how every loan is distributed and understand the repayment process. UNICA members are taught how to use three types of interest rates to accommodate different types of clients. Regardless of the type of loan interest rate fees are always required to be paid monthly by the client. That noted the UNICA has a standard repayment option with fixed quotas. There is the pay-all option, which is mostly used by agricultural workers, where the borrower only pays the monthly interest rate fee and then at the last month he/she pays the full loan back in addition to the final month's interest fee, which is usually when farmers harvest their crops. Lastly, the UNICA can have a decreasing interest rate for a loan that is recalculated after each month. This is usually used for large loans so the borrower does not get discouraged with the interest charges.[90]

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[88] "Module II: Training CourseVIII." *FunderPerú*. San Vicente Lodge, Cajamarca, Peru. Aug. 9, 2010.
[89] *Módulo II: Manual Elaborado Por FunderPerú. Organización Administración y Contabilidad de Uniones de Crédito y Ahorro* (UNICAS) (2010) 16.
[90] "Module II: Training Course VIII."

The third and final session, presents information on how to redistribute back the interest earned on the UNICA shares and savings that may accumulate at the end of the year. There is also an emphasis on the proper methods to distribute loans to nonmembers and using collateral as one way to ensure a loan. Throughout the training session they are given information on how to address unforeseen problems such as loan delinquency, death, crop failure, or illness. After the three weeks of training sessions attendees are encouraged to use their new knowledge to start their UNICA program.[91]

UNICAs are traditionally comprised of 10-30 families from the same community. These families need to be interested in facilitating their own source of capital and to promote family savings since funding comes entirely from within the community. Each month the UNICA's social capital increases, as members are required to buy shares. These shares are then lent out as microcredit to community members that need additional money. The UNICA's growth is contingent on the purchased shares, interests paid and savings deposits. A unique aspect of the UNICA model is that no monthly meeting is concluded until all the money acquired that month from shares purchases and quota installments are redistributed out in the form of new microloans. This tactic not only helps to minimize theft or corruption but also, ensures that the following month the UNICA's capital funds will grow with the new interests gained from the recently distributed credits.

Another benefit from the presence of UNICAs in rural communities is that UNICAs often stimulate more competition among the other credit facilitators. For example, UNICAs can lend to anyone so, they have a tendency to cut out the need for loan sharks and moneylenders or at the very least force credit facilitators to match their

[91] Ibid.

interest rates to the UNICA's which, on average is a 4-6 percent monthly interest rate. Although this interest rate appears very high for Latin America most microloans are only for a few months. Furthermore, for this study the average loan of the six UNICAs from four years of operation is S/. 209.55 or $74.83.[92] This average indicates that these loans are very small and even microfinance focused banks such as Peru's Mibanco would not be able to offer a loan of this size as their minimum amount for a microloan begins at S/.500.00 or $178.57.[93] Therefore, while these interest rates are high, their competitors' are likely to have similar interest rates if not higher. Furthermore, because the interest paid is added on to the shares the money stays within the hands of the members rather than being redirected to a bank or loan shark.

Today, *FunderPéru* has over 500 UNICAs operating in Lambayeque and Cajamarca. Their estimated capital is $707,832.00.[94] According to *FunderPéru's* data base, UNICA membership is of comprised 7,377 families.[95] The total reported social capital defined as the shares purchased by only members is $707,832 and total loans distributed is equal to $910,183 (Table 2.1).[96] On average interest charged on a loan or the active interest rate is approximately five percent per month. For those who invest in the UNICA their savings also earn an average interest of two percent per month, which is the passive interest rate. In Lambayeque, which is where the majority of the UNICAs

[92] Currency conversions are based upon the United States' Treasury Reporting Rates of Exchange of September 2010, which reports the exchange rate of $1.00 = S./ 2.80. However, Peru has a floating exchange rate, thus currency conversions from earlier years in this paper are approximations not an exact exchange rate.
[93] Mibanco - El banco de los Empresarios de la Micro y Pequeña Empresa , Nov. 3, 2010. <http://www.mibanco.com.pe/nucleo.aspx?nompag=comphtml/capital.htm&tp=interno&id=es&usel=Micapital>
[94] *FunderPerú: Desarrollo Empresarial Rural*. Microfinance a Tool for Sustainable Development, 2010. Print.
[95] Ibid.
[96] Ibid.

exist, the total capital generated among the families is over half a million dollars (Table 2.2).

Combined Performance of All UNICA Families Calculated in U.S. Dollars.[97]

Date	Number of UNICAs	Families	Capital	Number of Loans
Jan-2007	**140**	**1200**	**$45,664.00**	**310**
Jan-2008	**250**	**3270**	**$123,571.00**	**643**
Jan-2009	**372**	**5426**	**$302,187.00**	**1,260**
Jan-2010	**478**	**6906**	**$581,887.00**	**1,983**
Jul-2010	**505**	**7377**	**$707,832.00**	**2,199**

Table 2. 1

June 2010: Aggregate Performance Tracking of UNICA Families in Lambayeque
Since 2005 Calculated in U.S. Dollars.[98]

Number of UNICAs	Families	Capital	Savings	Accumulated loans	Total Number of loans	Total interest Charged	Default Rate
350	**5340**	**$517,142.28**	**$47,500.00**	**$2,920,714.00**	**29,242**	**$452,142.86**	**0.1%**

Table 2. 2

FunderPerú does not use any of its own funds to allocate loans to UNICA members. Instead funds are used for operational expenses such as, employing monitors who conduct monthly visits to the UNICAs, providing free training courses and conducting outreach. Since *FunderPerú* does not allocate loans there is great flexibility in the operating structure of the actual UNICAS because the UNICA members are the distributers and collectors of loans and quotas. Thus, during the first training session it is emphasized that all UNICAs make their own decisions regarding interest rates, meeting times and general regulations pertaining to membership. *FunderPerú's* role is to offer basic finance training, suggestions on how communities might organize and provide information regarding how older UNICAs continue to be successful. However, each

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97 Ibid.
98 Enrique Neauhausser. Borrador Para Discusión: Propuesta de Desarrollo Empresarial Rural en el Entorno de Ccochaccasa (*FunderPerú* June 2010) 3.

UNICA is a self-governing body so they ultimately decide which suggestions to incorporate and which ones to disregard.[99]

The UNICA program is not a short-term response to economic development relief. In fact, during the first module it was announced that it takes a minimum of three years for a group of participants to fully understand and to correctly implement the UNICA program. However, there are no start-up costs to participate in the program as *FunderPerú* provides the training sessions and monthly monitor visits for free.

Presently there are 160 UNICAs operating in the Andean region of Cajamarca. On the northern coast in the Lambayeque region there are over 350 UNICAs and in Honduras where the program first began, there are over 2,000 UNICAs.

Methodology

My research is twofold. The first part consists of tracking the loan usage of these same six UNICAs over the past three to four years to see whether there are any trends or changes in the motives for why people want to take out loans. The second component comprises of a micro case study on 40 UNICA members in the northern region of Peru from the same six UNICAs.

FunderPerú granted me access to their database, which was recently digitized, and tracks all UNICAs' loan information. With access to loan recipients, loan amounts, loan disbursement dates, motive for loan, repayment installments and interest rates, I was able to track the loan usage of six of the oldest UNICAs and see whether there were any common trends, such as an increase in agricultural and business based loans as the UNICAs matured.

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[99] "Module I: Training Course VIII."

By aggregating the types of loan frequencies and comparing the different loan usages I was able to capture a snapshot of how funds are allocated in these six different UNICAS. However, it should be recognized that the aggregation of this total does not capture the unique difference of UNICAs in other locations.

I had little prior knowledge or experience in northern Peru and thus, I decided rather than conducting my own surveys without having adequate knowledge of the region I would use the same survey that had been used in 2006 by monitors of *FunderPerú.* Using the exact same surveys would enable me to carry out a comparison analysis of those same UNICAs members and identify if any loan usage trends that may have evolved in the lives of these families since the introduction of UNICAs into their communities.

Difficulties that arose while conducting these surveys included that I was limited in who I could interview. In addition, I could only search out members who had previously filled out the surveys four years ago. Also, I had to decide whether I would interview individuals who answered the original survey, but presently were no longer members. I eventually decided I would interview anyone who had previously filled out the survey regardless of his or her current status within the UNICA. For instance, the UNICA, *La Tabita* in the community of Cojal no longer exists, but I conducted interviews with all the ex-members I could find in order to broaden my insight on how ex-members have progressed since their last interview in 2006. Also, I interviewed ex-members of existing UNICAs to see if being outside of the UNICA had any negative or positive impacts on them.

Loan Usage Findings

In the early twentieth century, Cayaltí, Peru was a growing affluent town due to the presence of a sugarcane plantation. However, the Revolution of 1968 led to new agrarian reform, which broke up the plantations and created the Agrarian Production Cooperatives (APC).[100]

This transfer in power from plantation owner to the field workers was poorly executed and shortly after this switch the APC in Cayaltí, like many others, went bankrupt. Today the abandoned plantation buildings stand as a reminder of the wealth and affluence that this desert town once represented.

The six UNICAs where I conducted my research are in four rural communities a short mototaxi ride outside of Cayaltí. With no paved roads and no cars operating as taxis the only way to arrive to the communities is by mototaxi, a motorcycle that has a small trailer connected to the back used to hold passengers.

The largest village, Cojal is comprised of 100 families. Cojal had three UNICAs, however, currently only two remain active. Both the villages of Cafetal, which is comprised of nine families, and Guayaquil, which has 28 families have only one active UNICA. The last village, La Curva is comprised of ten families. La Curva's UNICA had temporary suspended its meetings after a negative incident occurred, but in August 2010 reformation was beginning. These four villages share the same dry desert environment and are surrounded primarily by sugarcane, cornfields, and legumes. The loan usage data was selected to complement the interviews of the convenience sample. In summary, the loan usage data reflects information from four active UNICAs, one recently reemerging UNICA and one UNICA that no longer exists.

[100] P. Klaren, _Revista de Indias_ 65.233 (2005) 44-46.

The data is grouped into twelve-month intervals in accordance to the month of the UNICA's inception rather than simply by the calendar year. For instance, the UNICA *Semillas del Progeso's* "YEAR 1" starts in November 2005 and ends in October 2006 where as the UNICA *La Tabita* "YEAR 1" begins a month earlier in October 2005 and ends in September 2006. This grouping is used to address two important factors. First this type of grouping accounts for seasonality, which plays a critical role as these four communities depend heavily on agricultural production. Secondly, it made for better transparency of data and facilitated a clearer understanding of the results. For instance, in 2005 many UNICAs only had a few months where loans were distributed while in the year 2006 there are twelve whole months of loan data. Thus comparing 2005 to 2006 is not viable. A limitation of this approach about grouping the data not in accordance to calendar year is that environmental, political, or social movements that cause changes in loan usage will not be noted easily in this format.

Vulnerable UNICAs: *La Tabita* and *La Semilla del Progreso*

Although hundreds of UNICAs have emerged in Peru over the past few years, UNICAs are not a flawless system. UNICAs require collaboration, self-supervision, reliability, integrity and a large time commitment from all their members, which can be difficult to execute. For instance, in Cojal the UNICA *La Tabita* fell apart after three and half years. The last recorded loan was in November 2008. Explanations for why *La Tabita* failed generally focus on two reasons. One view was that membership consisted of primarily younger adults who immigrated to urban Peruvian cities to find a stable form of income. Eventually there were simply too few members in the UNICA to make it operate correctly.[101] The second theory proposed that too many of the *La Tabita's* members were from the same family and that unannounced private meetings were occurring within the family members. This unethical behavior triggered many members to leave *La Tabita* and eventually there were no longer a sufficient number of individuals to continue the UNICA.

Only 98 loans were documented over the course of 36 months in *La Tabita* and there do not appear to be any immediate obvious trends.[102] However, as illustrated in Bar Chart 1 (Figure 3.1) a high percentage of the loans are documented for travel use specifically in the first 24 months. Additionally *La Tabita* is the only UNICA in the group of which, average age for a loan recipient is below forty years old. Lastly, only twelve loans were used for agricultural purposes and three for business investments. Typically if an individual invests in a microbusiness or in agricultural production, there is an incentive to stay connected to the region of investment, as they are committed at least for a period of time until they reach a return on their investment.

Thus, in studying the data more thoroughly, it does appear that there is some evidence to support the idea that members were perhaps too young and readily decided to seek employment outside of the community. *La Tabita*'*s* average loan size was S/.146.36 or $52.27 (Table 3.1). This average loan size is lowest of the six UNICAs. Perhaps such low funds available for microloans discouraged members from starting up microenterprise or agricultural endeavors. Also, it is critical to note that the majority of the microloans were indeed being issued to one set of family members. Therefore, although there is no clear consensus with regard to what the true factors were that led up

[101] *FunderPerú* stresses that UNICAs should be comprised of 10-30 families in order to operate. Once there is less than ten families capital growth is very slow and often less loans are issued.
[102] In three years and two months a grand total of 103 loans were documented for *La Tabita.*

to *La Tabita's* failure there is evidence that both, immigration and disproportional allocation of loans are possible explanations.

In the village of La Curva, the UNICA *La Semilla del Progreso* also faced adversities, however unlike *La Tabita* where challenges arose from within, *La Semilla del Progreso* suffered from a fraudulent outsider. In May of 2008 an individual from Cayaltí went to La Curva and received a microloan of S/.2,000.00, or about $714.29. This was more than double the amount of any other previous loan. After the loan was issued the individual was never seen again and no quotas have been paid. This was a devastating loss for *La Semilla del Progreso* as they instantly lost most of their funds. As a result of this incident, many members withdrew from the UNICA. However, there are some members who wish to continue with *La Semilla del Progreso* and see this experience as a harsh but valuable lesson. In August 2010 one meeting had already occurred in hope to restart the UNICA.

The data from Bar Chart 2 (Figure 3.2) shows that the first two years reflect some interesting changes in loan usage, particularly loans that target education. However, it must be noted that in "YEAR 2" there was a gap when loan distribution ceased starting in July 2007 until January 2008. Thus, instead of ending the twelve month period with 33 loans like in "YEAR 1" only 18 loans were issued during the eight active months of the twelve month period.

By the third year, during which the fraudulent S/. 2,000.00 loan was issued there was little capital left for other microloans. In fact, only 11 additional loans were distributed during the third year of operation

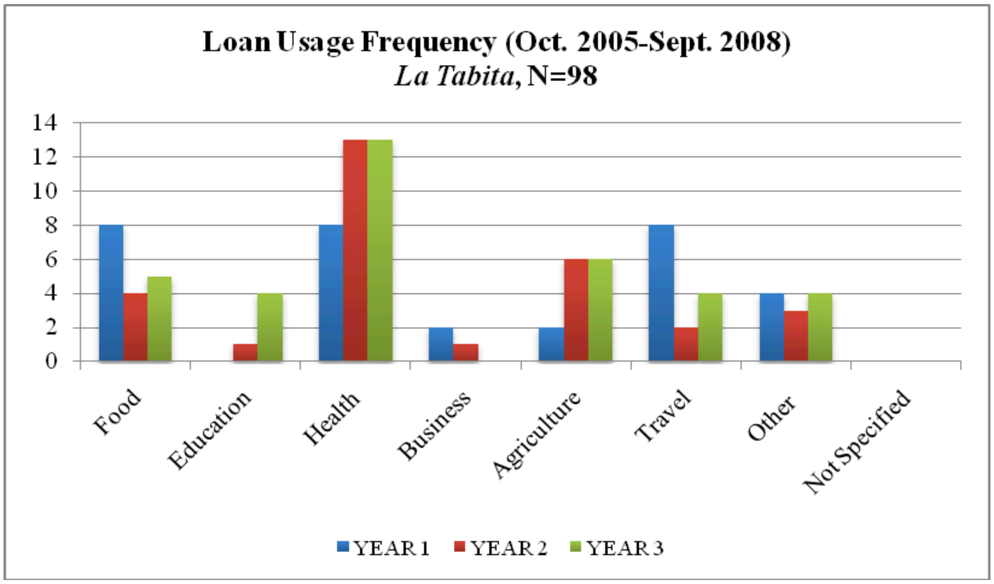

Figure 3.1: Total loans for YEAR 1 (N= 32), YEAR 2 (N=30) and YEAR (N= 36).

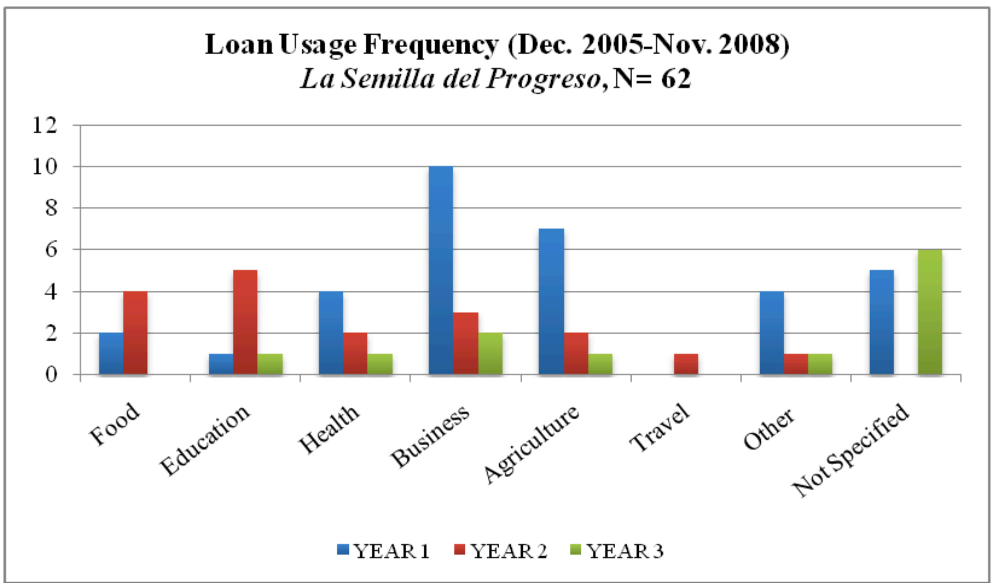

Figure 3.2: Total loans for YEAR 1 (N= 33), YEAR 2 (N=18) and YEAR 3 (N=11)

Stronger UNICAs: *Un Nuevo Porvenir*, *Sembrando el Futuro*, *Nuevo Amanecer* and *El Progreso*

The remaining four UNICAs *Un Nuevo Porvenir* and *El Progreso* in Cojal, *Sembrando el Futuro* in Cafetal, *Nuevo Amanecer* in Guayaquil reflect interesting patterns in their loan frequencies. For instance, in Bar Chart 3 (Figure 3.3) *Un Nuevo*

Porvenir's loan usage showed a steep increase in loans being used for agricultural purposes and more moderate increases in loans allocated for education. Also true is that food and health oriented based loans increased in the second year and remained at a constant level for the subsequent two years. This contradicts what was previously hypothesized, namely that emergency expenditures on food or health would decrease over time as loan frequency would shift to support expenditure on education, agricultural production, or microenterprises. Later in this chapter possible explanations for such results are discussed to a greater degree.

The next UNICA, *Sembrando el Futuro* in Cafetal is rather unique since the majority of the UNICA members are from the same family, which is usually discouraged by *FunderPerú* because in the past family based UNICAs have not been successful. However, it is difficult to analyze the graph because the governing body of the UNICA was not consistent in writing down what loans were being used for. For instance in "YEAR 3" there was no documentation on loan usage for 52 percent of the distributed loans. Information on loan usage data is primarily of interest to the monitors of *FunderPerú* and is not directly beneficial to the UNICA which might be one reason that *Sembrando el Futuro* was not consistent in documenting why loans were being used. Nonetheless, in Bar Chart 4 (Figure 3.4) comparisons can be made on "YEAR 1" where 20 percent of the loans were not specified with "YEAR 4" where 19 percent of the loan usage was unspecified. During these years the frequency of responses concerning loans used for education, business and agriculture purposes increased. In the same bar chart there is a decrease in loans needed for health reasons.

The results from Bar Chart 5 (Figure 3.5) for *El Nuevo Amanecer* in Guayaquil is unlike any of the other UNICAs mentioned thus far. The majority of the loans are used for health and educational reasons. Additionally, their average loan is S/.158.60 about $56.64 which is the second lowest loan average. From those who were interviewed from *El Nuevo Guayaquil* no one owned more than 1.75 hectors of land, which might indicate why agricultural production and business based loans are infrequent

The final UNICA, *El Progreso* is by far the most successful. This UNICA has dispensed more microloans than any other of the six UNICAs. By March 28, 2010 *El Progreso* was one loan shy of 550. The average loan size is S/.348.70 about $124.54. Bar Chart 6 (Figure 3.6) illustrates that there is an increase in the number of loans in all main areas excluding “travel” and “other”. However, loans used for health reasons have not decreased as suggested by my original research hypothesis. Does this mean members of *El Progreso* are more ill now or still cannot cover basic medical needs without loans? Perhaps this the case but another possibility is that there is an increased health awareness within the community resulting in greater use of health services, or an increase in illness in the community during this review period affecting expenditures on health. Perhaps members are more inclined to have routine check-ups, have children vaccinated or are seeking out specialists for illness rather than using local remedies. Since health is not well defined it is impossible without further research to know specifically what types of health reasons were present during the review process to fully understand why these loans are being allocated for these health services.

In conclusion what the data suggests is that UNICA trends have great variation, which likely correlates with member cooperation levels, return rates on loan recipients and other factors that are not yet clearly defined. Nevertheless, Figure 3.8 illustrates that UNICAs that do operate in accordance to *FunderPerú's* methodology typically see that average loan amounts increase with each year. Furthermore, In Bar Chart 7 (Figure 3.7) the annual percentages of loan usage form all six UNICAS suggests that in Cayaltí area, agricultural based are very popular but only become the most prevalent loan in year four. Also it is important to note that there continues to be a high percentage of loans being used for health reasons. In order to better interpret these results research focused on public health causes and health issues would be immensely useful. Lastly, in some cases over time UNICAs begin to neglect to fill out the loan recipient paperwork that *FunderPerú* has provided in the workbooks. This practice should not be condoned, as this information is very valuable not only to *FuderPerú,* but also, to future researchers who want to study UNICAs.

Additionally while information on loan frequency is useful from a researcher's perspective this study assumes that all declared loan motives are true but in fact that is not always the case. For example in one interview with a member from *La Semilla del Progreso* a special loan used for a medical emergency was incorrectly marked in the data set as used for food expenses. It may be the case that this type of data entry error is a result of dishonest practices by the loan recipient, but it is equally likely, that the UNICA's governing body incorrectly filled out the loan paper work. While it difficult to verify much of the information on loan usage after the fact, a method that may entangle individual motivation within the UNICA setting may be a more anthropological approach. This disciplinary will allow us to better understand whether UNICAs are functioning correctly and impacting the lives of its members as proposed in its model.

Through a more anthropological approach we will have a better understanding of the underlying influences of loan behavior and community impacts. Connecting directly with the members and receiving feedback about the program will strengthen the capacity of a researcher to interpret this data set. The next chapter attempts to bring in a different perspective, which includes observations from community members themselves and their personal opinions of the UNICAs. This observational approach will enhance and expand how the UNICA loan usage data can be interpreted in order to better test the proposed hypothesis and develop more accurate interpretations from these data.

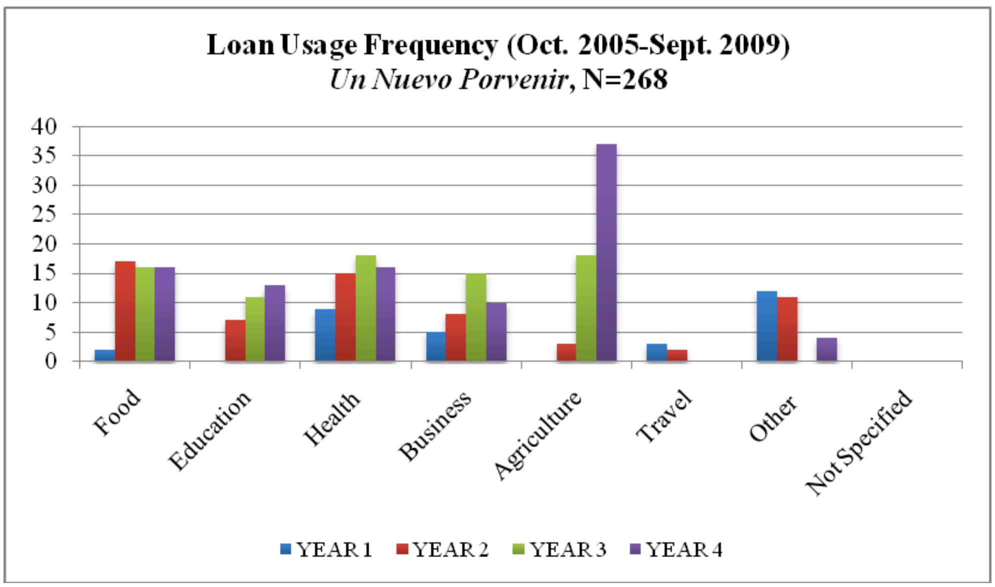

Figure 3.3: Total loans for YEAR 1 (N= 31), YEAR 2 (N= 63), YEAR 3 (N=78) and YEAR 4 (N=96)

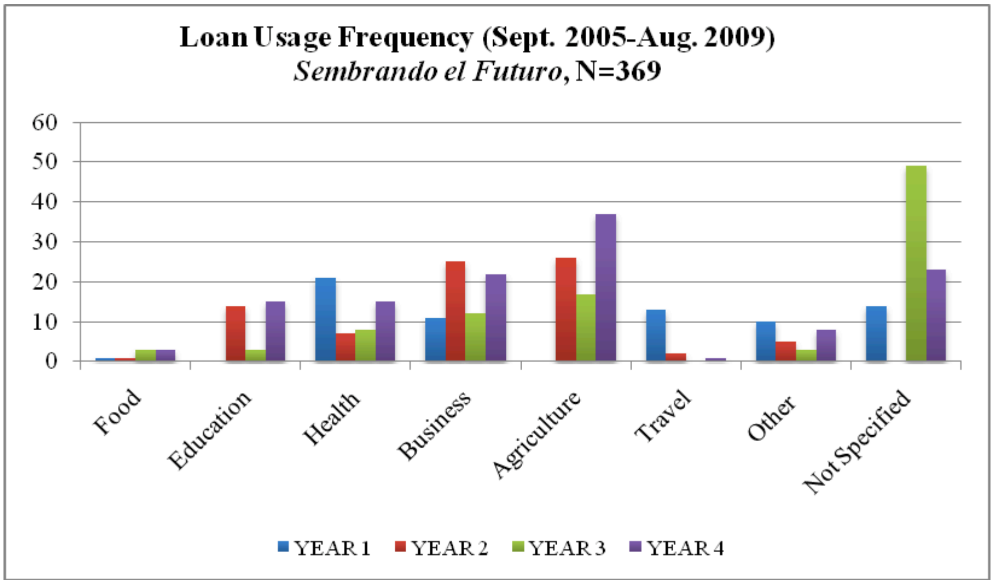

Figure 3.4: Total loans for YEAR 1 (N=70), YEAR 2 (N= 80), YEAR 3 (N=95) and YEAR 4 (N=124)

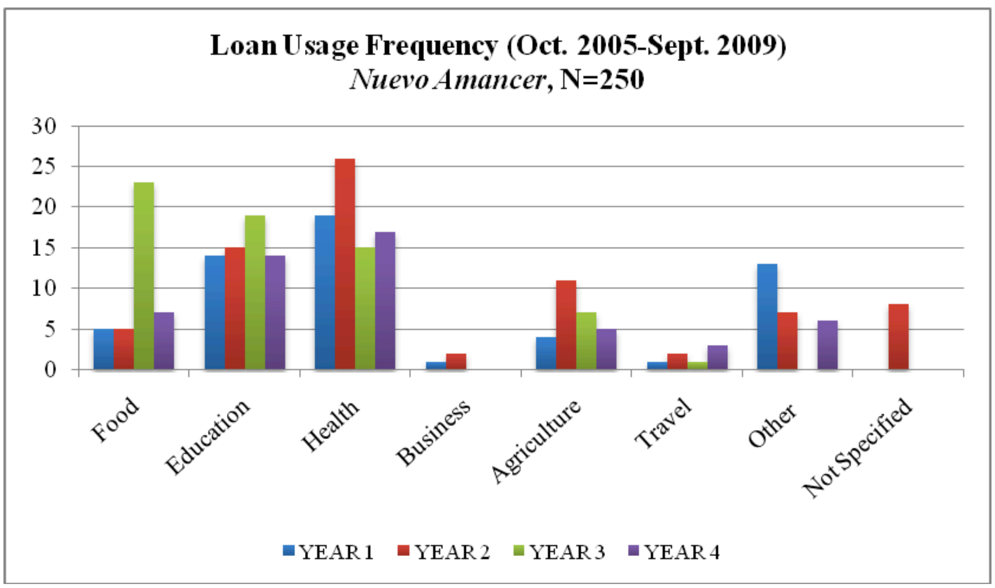

Figure 3.5: Total loans for YEAR 1 (N= 57), YEAR 2 (N= 76), YEAR 3 (N= 65) and YEAR 4 (N= 52)

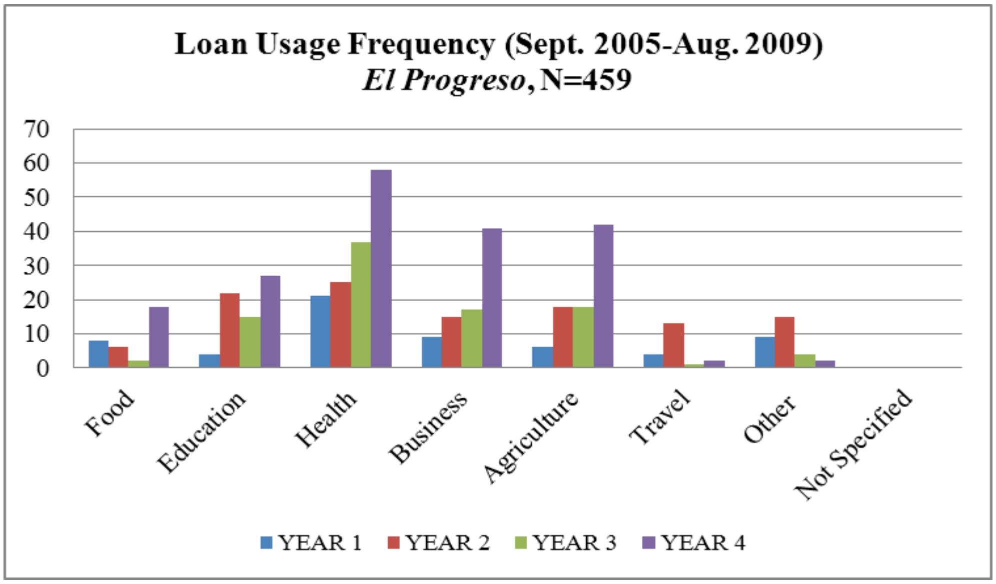

Figure 3.6: Total loans for YEAR 1 (N= 61), YEAR 2 (N= 114), YEAR 3 (N= 94) and YEAR 4 (N=190)

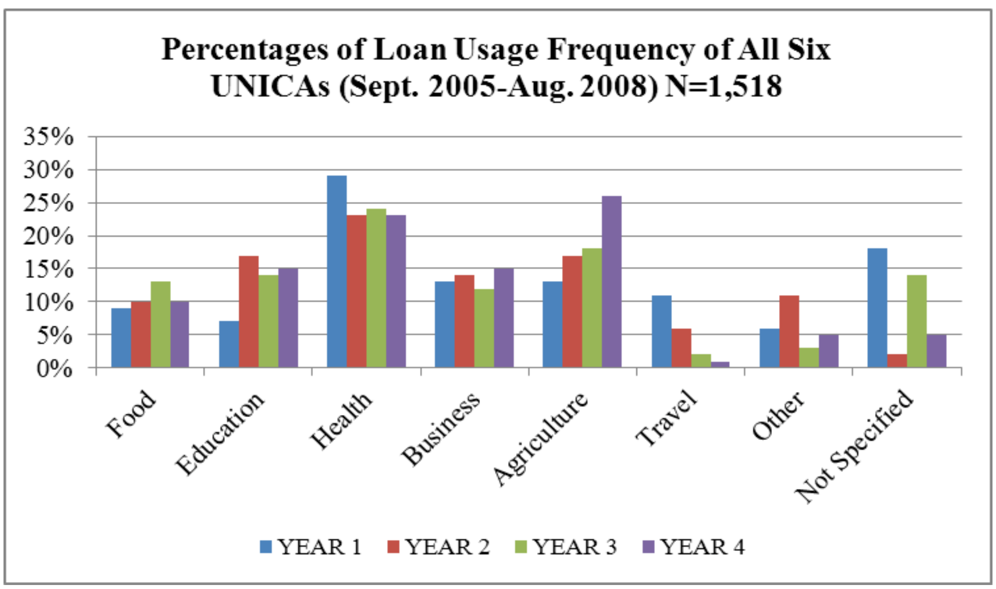

Figure 3.7 Total loans for YEAR 1 (N= 284), YEAR 2 (N=381), YEAR 3 (N= 380) and YEAR 4 (N= 473)

Average Loan Size for Each Year and Average Age of Borrower						
UNICA	YEAR 1	YEAR 2	YEAR 3	YEAR 4	Combined Years	Average Age
Semilla del Progreso	S/.110.08	S/.175.00	S/.391.67	S/.333.33	S/.195.40	44
La Tabita	S/.91.84	S/.209.9	S/.141.86	n/a	S/.146.36	38.7
El Progreso	S/.116.89	S/.209.87	S/.335.96	S/.589.68	S/. 348.70	42.2
Nuevo Amanecer	S/.128.86	S/.131.80	S/.179.80	S/.204.90	S/.158.69	43.1
Un Nuevo Porvenir	S/.144.19	S/.206.90	S/. 241.79	S/. 252.50	S/.226.14	41.9
Sembrando el Futuro	S/.144.69	S/.190.52	S/. 206.36	S/. 178.30	S/. 182.02	42.2

Table 3. 1

Chapter 4: GENERAL FINDINGS FROM THE INTERVIEW SURVEYS

One month of fieldwork was needed to complete the forty follow-up surveys, which are comprised from members of the same six UNICAs that were used for the loan tracking in chapter three. These surveys complement the data analysis. Although the loan frequency data provides insightful information regarding client loan usage and repayment rates it does not provide information about the socioeconomic or cultural dynamics of any of the communities members. Comparing the 2006 surveys to the 2010 surveys provides insight into the personal lives of these community members and illustrates the numerous changes these individuals and their families have experienced over the last four years due in part to the presence of the UNICAs. Additionally when confronted with inconsistent data entries the surveys and face-to-face interviews with community members proved to help clarify these inconsistencies in the data. For instance, why were some loans exempted from interest charges or never repaid? Answers to these types of questions will be presented later on in this chapter. UNICAs.

The original surveys were conducted throughout 2006, or roughly one calendar year after the UNICAs were created. The surveys although never published, provided *FunderPerú* with extensive information about household services, diet, loan usages, education levels and property ownership of their clients (see appendix). Two formats of the surveys were used, but the objectives and questions overlapped so that it was reasonable to use both surveys for this analysis. For research purposes only the questions that were consistent between both surveys were used for this chapter.

Family Data From 2010 Surveys

UNICA	*Village*	*Total Surveys Completed*	*Average Land Area per Family (Hectors)*	*Crops Harvested in 2010*	*Families with Potable Water*	*Families with Cell Phones*	*Families with Electricity*
Un Nuevo Porvenir	Cojal	7	2.46	Corn, Sugarcane,	7	4	7
El Progreso	Cojal	9	1.65	Corn, Sugarcane, Legumes	9	3	9
La Tabita	Cojal	4	0.25	Corn, Legumes	4	4	4
Sembrando Futuro	Cafetal	5	0.93	Corn Legumes	0	4	5
Nuevo Amanecer	Guayaquil	10	0.72	Corn, Rice, Sugarcane	0	8	10
La Semilla del Progreso	La Curva	6	1.42	Corn, Legumes	3	5	5
TOTAL		41*	1.24 **				

Table 4. 1 Highlights from the general findings of the 2010 surveys.

*In the original surveys, two surveys were conducted for one couple as each spouse was a member to a different UNICA, thus their loan history was different but their household information is the same and thus are considered to be one family dropping surveys to actually represent 40 families rather than 41.

** Averages exclude one family, an outlier who owns 20 hectares of land. Despite owning a large land mass only a small parcel of the land is farmed.

Basic Household Conditions

Household conditions varied within each survey but there was one question, asking of the construction material of home walls, which received the unanimous reply of “Adobe”. Also from the forty surveys only two homes were rented the rest were occupied by homeowners. In general, changes that were seen from 2006 to 2010, included an increase in electricity for public and private use, the introduction of cell phones, more available clean water and a small attempt to use gas energy for cooking rather than wood.[103] The following sections provide descriptive summaries of the surveys conducted in each UNICA.

***La Semilla del Progreso*, La Curva**

Based on the original surveys from 2006, individuals from this UNICA exclusively relied on well water. However, today half of the families have access to a potable water source. Also, in 2006 no one reported owning a cell phone where as currently all but one family owns a cell phone. The last major development for this community was indoor and public lighting neither, of which was available in 2006. Wood continues to be the primary fuel source used for cooking, but two families now alternate between gas and wood energy. An area that has seen little improvement is that of toilet facilities. Only three of the families report having some permanent toilet facility such as a latrine or outhouse the other responded with *"no hay"* or there isn't any. This implies that human waste is discarded in open fields.

***El Nuevo Amanecer* in Guayaquil**

Ten surveys were collected from *El Nuevo Amanecer* members. From those surveys not a single household reported having access to potable water. Most depended on the irrigation cannel running through the village or traveled to the river a few kilometers away from the village. Public lighting has increased and electricity inside the home was present and used in all households. Three of the individuals responded as having a basic bathroom facility where-as the other seven of the respondents reported using open land for their human waste disposal. Three families alternated between gas and wood energy, the remainder strictly used wood fuel for cooking.

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[103] Gabriela de la Torre. "*Encuestas Familiares de FunderPerú*." Survey. July 2010.

El Progreso, Un Nuevo Porvenir and *La Tabita* in Cojal

Twenty surveys were collected between these UNICAs and everyone responded to having access to clean water. In fact, in the village of Cojal potable water is available two days a week for thirty-minute intervals from water valves that were placed in front of most of the houses. Furthermore, all participants responded to having indoor and outdoor electricity, whereas in 2006 only a few select individuals had access to electricity in their homes. Also, ten individuals responded to having a gas energy source to cook their food. Two of those ten or twenty percent depended on solely gas for their cooking energy source. Cell phone use also increased within these UNICAs during this period and fifteen of those interviewed stated that they have at least one cell phone. Similar to Guayaquil and La Curva, toilet facilities in the village of Cojal were limited.

Sembrando el Futuro in Cafetal

Only four interviews were conducted in Cafetal. There was no potable water and all four households depended on an untreated irrigation canal for their water consumption. One family had a basic toilet facility, but the rest of the respondents used open land. These respondents indicated that everyone had electricity indoors, but within the village there was no public lighting at night. Three households depended on wood for cooking and one household alternated between gas and wood.

Social Capital

Today there continues to be a pressing need to address general public health issues in all of these villages. Toilet and sewage facilities have not improved since 2006. In addition, wood continues to be the primary energy source used for cooking and some communities still depend on contaminated water for human consumption. Nevertheless there have been positive strides made by these communities. For instance, in all these communities the introduction of cell phones indicates that important communication technology is providing these community members with greater contact to the broader Peruvian regions and outside countries. In addition, with the introduction of electricity in these homes there is greater possibility of other technological advances as well as improved safety at night for these communities. Finally, for many communities this is the first time they have had access to potable water, which is an important public health achievement for these communities.

Although there is no direct evidence that illustrates that these community enhancements emerged as result of the UNICAs it is possible that social capital stimulated by the UNICAs helped to propel these observed changes. Social capital, does not have one explicit definition, however, social capital is derived from studying the economic productive entity called human capital. Social capital addresses the relationships and the networks that people create to stimulate jointly advantageous results or outcomes through these relationships.[104] These networks typically increase the human capital of each individual and enable them to receive more employment opportunities or other necessary resources.[105]

Social capital traditionally has been expressed as one necessary structure for the poor as social capital networks provide an outlet that allows the poor to "survive despite social exclusion."[106] Nevertheless, social capital is not always positive, and in fact,

[104] Jo Anne Schneider, Social capital and Welfare Reform: Organizations, Congregations, and Communities (New York: Columbia University Press, 2006) 9.
[105] Ibid. 28.
[106] Ibid (Stack 1974; Susser 1982) 12.

scholars also warn that certain types of social capital can act as “barriers” and reinforce the unbalanced power structures that keep the poor from rising out of poverty.[107] One example is the devaluation in public education in impoverished regions. For instance in the United States there is a growing awareness that public schools situated in low resource urban areas are not able to show acceptable success in educating students.[108] Too many of these schools use outdated textbooks, have overcrowded classrooms, and are operating without libraries, computer and science labs. These inadequate educational resources hamper student educational success, and the poor environmental conditions do not inspire students to reach for higher goals.[109]

This same type of example is seen in Peru. In the village of Guayaquil, one UNICA member, a mother, expressed her concern for the local elementary school. She was dissatisfied that two grade levels were eliminated for the academic school year due to a teacher shortage. She also, mentioned that the teachers are not from the community but rather they commute from Cayaltí or even as far is Chiclayo, both are significant travel time distances. As a result class time often ends hours earlier or begins hours later to accommodate the long commute of the teachers. Her concern is that her children are not receiving an adequate education and they will not qualify for jobs that will allow them to prosper in the community.

One proposed way to prevent such negative social capital is to prompt networks that naturally adjust current power levels and social boundaries so that the redistribution process of power is active rather than stagnant.

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[107] Ibid.
[108] Loic J. D. Wacquant, “Negative Social Capital: State Breakdown and Social Destitution in America’s Urban Core,” Journal of Housing and the Built Environment, 1998, 13,1, 33.
[109] Ibid. 32.

These power structures can be altered using various different techniques. In the case of the UNICAs there is one clear example of power structures being adjusted. That is, by increasing credit opportunities for members in their community, UNICAs are taking away power from the traditional financial structures that previously controlled who received access to credit.

UNICAs are also reliant on the assumption that there is an agreed shared trust among the members. Trust in social networks is one of the defining aspects that are needed in order to build social capital.[110] Not everyone in the community is a member of the UNICA because this network will only perform well if all the members trust that each of those involved will purchase shares, repay loans, and be reliable and supportive of the UNICA. From this trust new relationships are created among members. Relationships are based and reinforced within communities on this perceived financial competency. Members learn to identify which individuals are consistent in paying back their loans on time and who are reliable with regards to attending monthly meetings. The UNICAs stimulate an environment where neighbors interact with one another in a professional setting rather than just in a social manner. That noted, with social capital being stimulated as a result of these UNICAs there is reason to believe that these mass communitywide changes may have partially occurred in the last four years because of greater social capital, which fosters community activism that leads to change in perceptions and behavior.

While scholars debate about whether social capital contributes to "social exclusion," in general there did not appear to be noticeable tension among the ex-

[110] Baum 321.

members surveyed.[111] The process for new member selection requires that UNICA members unanimously agree to induct the applicant. This could create some tension for those rejected by the group, however since UNICAs frequently lend to individuals outside the community and they will accept saving deposits from non- members, there are options for participation by non-members. At the same time the UNICAs benefit when non-members participate. Finally, because UNICAs can easily be replicated, it is possible for those who are rejected membership to decide to form their own UNICA, often receiving support and advice from the existing UNICA.

Personal Perceptions on the UNICAs' Impacts

Despite living relatively close to one another these founding members from the six UNICAs have faced an array of challenges, set different goals and have various outlooks on how the UNICAs presence have impacted their lives. Six surveys are used to illustrate four different views on how UNICAs are now perceived by the original members.

The Content ex-UNICA Member

El Progreso is the UNICA with the highest social capital and arguably the most successful of the six UNICAs. However, it has not impressed everyone. One of the original-founding members, Marisol, decided to leave the UNICA within the first year.[112] She felt that there was not enough capital generated and she was unable to receive the loans she wanted.

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[111] Ibid. 320-323.
[112] All individuals in this chapter will be referred to with pseudonyms in order to protect their identity.

In September 2007, after she already dropped out she received a modest loan form *El Progreso* for S/.100.00. Marisol was required to pay the non-member interest rate of six percent per month on this loan. That was the first and last loan documented under her name in *El Progreso's* records.

In 2008 Marisol was able to build her first home with a S/. 3,000.00 loan from the *Banco Sullana.* She repaid the loan in October 2009. Her newly constructed home is modest, with dirt floors and still lacks water service. She goes to her father's house for potable water. However at the age 49 she has finally moved out of her father's house into her own space and home.

Although *El Progreso* has changed greatly since she was a member, Marisol does not have any interest in rejoining *El Progreso*. However, her two grown sons are now active members of the UNICA. She explains if she needs a loan they will request the money. This way she will be able to pay the lower member interest rate rather than the nonmember rate.

Is Marisol taking advantage of the system? Surely some members would say she is, but *FunderPerú* claims that UNICAs are comprised of families, and depending on how one defines the family unit she could qualify for the member interest rate. Perhaps more importantly is that she, an ex-member acknowledges *El Progreso* as a support system that she can easily utilize if it is necessary. A similar message is echoed in the surveys from members of *La Tabita.*

The Failed UNICA

La Tabita, or the failed UNICA, is fascinating because those who completed the surveys gave very different explanations regarding the collapse of *La Tabita.* Yet evidence suggests that there is some truth connected with each account of this failure of the UNICA. In 2006 when the first surveys were conducted, nine founding members were interviewed. Today only four of those members still remain in Cojal. Coincidently, of the four families two are part of the Rosales family, who received the majority of the loans and the other two are members of the Jaramillo family who indicated that unethical loan distributions were occurring by the Rosales family. Yvette Rosales and her sister-in-law Eugenia agreed that *La Tabita* started strong with 15 members and then eventually dropped to ten and then six until finally there were only four members. The apparent collapse of this UNICA occurred after six members moved away in search of better employment opportunities. Those who stayed behind were unable to buy shares every month because they did not have steady incomes, so capital growth diminished and the UNICA collapsed.

Marco Jaramillo rejects the Rosales' account and claims that people moved away after the UNICA collapsed and not during its existence. Marco also claims that not only was the Rosales family unevenly distributing funds, but also, that the religious differences between these families caused tension. The Jaramillo family is Catholic where as the Rosales family is Evangelical. The data provides evidence that there may be some truth in both accounts. For instance, many members did move away from Cojal and the loan distribution concentration was centered on the Rosales family members.

However, today without the presence of *La Tabita* these families seek out capital from different establishments. For instance, Marco's father received a loan from the *Banco Sullana* in Cayaltí and Yvette's husband, a farm worker for the *La Empresa Agroindustrial* (EAI), was granted a small loan directly by his employer. In Marco's case his options were more limited. He is a divorced single father who lives with his parents. He works as a mototaxi driver in Cayaltí. He claimed he purchased his mototaxi used, however, the registration documents for the vehicle are not in his name and he does not have the time or the money to resolve this issue concerning the ambiguity of the registration of the mototaxi. As result, his vehicle will not be accepted by any banks as collateral as there is no proof to identify him as the owner. With *La Tabita* no longer an option he relies on *El Progreso* for microloans, which enabled him to buy new parts for the upkeep of his vehicle. Marco's difficulties provide some evidence that UNICAs can serve as important creditors to even the non-members within the community. Since the UNICA members know and trust neighbors, they will not have the same requirements that traditional financial institutions do, such as documentation of proof of ownership of vehicles or direct collateral to approve their loans.

Slightly Competitive Competition

Teresa and her husband Reymundo are members of the UNICA *el Nuevo Amanecer*. They own a modest parcel of land, 0.75 of a hectare where they grow corn and occasionally legumes. Farming has many upfront costs and often Reymundo and his wife need loans to cover these costs. Before the UNICA was organized they went to a loan shark to help cover their costs for their farm. They paid an eight percent monthly interest rate for a S/. 500.00 loan, which they used to purchase seeds and other basic necessities to prepare the land. In 2006, after the *El Nuevo Amanecer* was developed, they received loans at a much lower five percent monthly interest rate. In 2010, Teresa reported that they received S/. 800.00 worth of fertilizer from a loan shark who now offered short term loans by actually providing the needed agricultural inputs. However, the interest rate for receiving his products was set to that of the UNICA's, five percent monthly rate. This allowed Reymundo and Teresa to directly purchase their agricultural inputs at an overall lower price as compared to that offered by the local loan shark in 2006. This is an ideal situation. Now community members in *Guayaquil* not only have the local UNICA as a potential creditor, but other competitors are now forced to provide their credit at a rate that is lower than in prior years due to the increased competition. Lastly, for the consumer living in *El Nuevo Amanecer,* this healthy competition within the small market expands the credit market in this community and enables them to have more credit options so that they can begin to identify the best financial options for their families and their business activities.

The Outliers

From the forty surveys, there are two clear UNICA outliers. One is from *La Semilla del Progreso,* Marco and his wife Adriana and second from *El Nuevo Porvenir,* Humberto and his wife Herminia.

The last few years for Adriana have been very stressful. She has gone from having three people living in her house to now cooking and cleaning for eight. Then in 2009, Marco became very ill and Adriana had to take out a S/. 900.00 loan from *La Semilla del Progreso* to help cover transportation costs to Chiclayo and help pay for medical treatment. The physicians amputated Marco's leg and he became permanently disabled. With limited physical mobility, Marco lost his capacity to work as a local teacher in Cayaltí.

During the prolonged illness and recovery, Marco was unable to make payments on his loan. These late payments and additional late fees increased his personal debt substantially, resulting in his new monthly loan payment quota increasing to S/.320.00. Marco realized that if he were to pay back these monthly quotas he and his family would be unable to survive. As result, Marco decided to run away from this debt obligation and remain in his isolated village of La Curva. He understood that he will likely never be approved for another bank loan, but he felt there was no other alternative given his circumstances at the time.

A similar scenario occurred with Humberto and his wife Herminia. Humberto, like Marco, was a college graduate who now teaches in Cayaltí. At one time Humberto was a member of *EL Progreso* until 2008 when he decided to leave the UNICA because he did not have enough time to attend all the monthly meetings. His wife Herminia was a member of a different local UNICA, *Un Nuevo Porvenir.*[113] As a result, once Humberto left the UNICA he no longer was active in any of the UNICAs. Instead he took out loans from the Cooperative Cosemselam, which is a cooperative formed by professional educators in the Lambayeque region. Humberto continued to take out more loans and as of July of 2010 he had four loans he was struggling to pay off. One was from the *Banco Interamericano de Finanzas*(BIF) for S/. 9,000.00, the second from the *Caja Muncipal de Trujillo* for S/. 6,000.00, the third from *CajaNuestra Gente* for S/. 7,800.00 and Humberto estimates he has received S/.5,000.00 from Cosemselam through various small loans.[114] While he has not defaulted on any of these loans, Humberto realized this financial situation was not sustainable and he expressed interest in either renting or selling hectares of his land. If he is able to sell his unused land debt relief would be possible and the stress from these loans could be quickly reduced.

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[113] *FunderPerú* does not support the idea of households belonging to multiple UNICAs.
[114] Humberto's loans add up to be nearly $10,000.00.

These two households are considered to be outliers because they are the only two incidents reported where massive debt was accumulated within the household. Ironically, these two cases share some defining characteristics about them that make them different from the rest of the households. The first is that both husbands are college educated and secondly their wives are not college educated. Adriana completed only elementary school and Herminia completed third grade. Also the wives have continued to be active participants in these UNICAs, while the husbands have not. While any sweeping generalization based on two cases is not feasible there are some interesting dimensions of these two interviews that should be discussed. For instance, does their employment as teachers rather than as farm workers make them more attractive clients to financial institutions hence; this is why they can qualify for larger loans? Thus, is it that their own human capital skills through education, which allow them to be, viewed as safer investments by a credit agency? Another possibility is that perhaps the wives, who have some basic understanding of finance, do not find it appropriate to provide suggestions to their husbands about their husbands' financial endeavors as the men generate the family income. This could be a result of the more traditional gender roles that exist in these villages where men have greater control or voice in making large financial decisions.

More importantly what these interview outliers clearly illustrate, which is also seen in other surveys, is that while *FunderPerú* stresses that membership needs to incorporate the whole family unit many UNICAs in practice struggle with this concept and only see one person as the UNICA member. Humberto and Herminia should have never both belonged to separate UNICAs as a husband and wife.

Additionally, there are other important lessons learned from these interviews resulting from the unique practices of the UNICAS in several of these communities. Adriana's loan of S/.900.00 was documented in the data set as being repaid, but without any interest added to this loan. Looking at data alone there is not enough information to determine why an UNICA would not charge interest rates for such a large loan. By conducting the surveys, it was discovered that due of the perceived distress of Adriana's situation the UNICA decided to forgo interest charges. This loan modification example reinforces the idea that while UNICAs strive to increase monetary capital that is not their sole reason for existence. Social capital is also being generated, as UNICA members are aware that they must look out for one another in a fashion that sometimes results in a sacrifice of capital gains.

Summary

Extrapolated from the surveys are two important ideas. The first is the notion that basic household and public health services have developed and improved on some level over the last four years in these communities. Highlighted improvements include increased access to running water, superior communication through cell phone use and the expansion of electricity indoors and outdoors.

The second notion is that UNICAs are creating social networks that are beneficial to both its member and those not affiliated to the UNICA. The highlighted surveys, illustrate that UNICAs are credit facilitators who are easily accessible and will provide to neighbors who would otherwise not be able to receive loans from a traditional financial institution. Additionally, UNICA interest rates in some areas have pressured loan sharks to lower their own interest rates. Finally, UNICAs do not operate under the same conditions as banks, but are autonomously controlled by community members and therefore have invested interest in the well being of the actual community. This translates into the fact that UNICAs will sometimes waive interest rates, provide donations or simply fund events that they deem beneficial to their community.

Chapter 5: POLICY IMPLICATIONS AND CONCLUSIONS

Expanding Financial Literacy

The microfinance phenomenon has captivated audiences in a fashion that very few other development aid schemes have achieved to date. Microfinance rides on the premise that the poor have the ingenuity to escape the cycles of poverty but simply lack the capital means to jumpstart the process. Of course this assumes that entrepreneurism is a commonly shared attribute that is found among all impoverished individuals. Nonetheless, microfinance is depicted by organizations as an effective form of alleviating poverty as microfinance redistributes power to the impoverished people who can use allocated funds in a manner that is most beneficial to them rather than have an organization dictate what changes are needed to improve their social economic conditions.

However, the wave of microfinance intervention strategies has lost some of its momentum. Impact assessment studies report there is little evidence to indicate that microfinance members are better off then nonmembers. Other case studies illustrate how clients can mismanage their microloans and become over indebted. Despite these disappointing results, the microfinance market continues to attract the participation of large banks interested in developing these markets. As banks increase their control over this market, should investors and clients be suspicious? The agenda of large financial institutions is profit maximization not poverty reduction.[115] Therefore, while interest rates for microfinance loans tend to be higher than traditional loans there is confusion in

[115] Neil MacFarquhar, "Banks Making Big Profits From Tiny Loans," The New York Times April 13, 2010: A1. Nov.14, 2010, <http://www.nytimes.com/2010/04/14/world/14microfinance.html?scp=1&sq=Banks%20Making%20Big%20Profits%20From%20Tiny%20Loans&st=cse>

deciphering between high exploitive interest rates or cost covering high interest rates. How much profit should banks or MFIs be allowed to generate from the poor? In 2009 CARE, the humanitarian international organization sold their shares of their Peruvian MFI, EDYFICAR, to one of the nation's largest banks, *Banco de Crédito del Peru.*[116] This transfer of ownership left CARE with a $74 million net gain.[117] In countries such as Peru where there is no interest rate cap on microloans will the growing presence of banks in the microfinance industry create a legalized financial environment that emulates the exploitative loans sharks?

As the market for microfinance expands to more regions, microfinance branches where loan officers who work on commission and facilitate a quick and easy loan application will lead to more financial opportunities for the poor. However, shortening the application process does not imply that clients understand the contracts they sign. Fully understanding a financial loan contract and the implications of this loan to the borrower is a problem commonly experienced across all economic classes, but the poor are more vulnerable and experience greater risk of not having adequate financial literacy. Also, when the poor are requested to pay added charges or late fees these extra expenses will cause a greater household strain for these borrowers than for those borrowers in higher economic classes.

FunderPerú's approach to microfinance, which requires at least two members to attend microfinance training courses, is a positive approach to increase financial literacy among the poor. When the UNICAs first collectively form in a community the governing body of the members must quickly put into practice the new skills they obtain from

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[116] "Banco de Credito del Peru to Acquire Financiera EDYFICAR." Nov. 14, 2010. http://www.care.org/newsroom/articles/2009/09/edyficar-2009-09-07.asp>.
[117] MacFarquhar.

FunderPerú training classes such as keeping financial records updated, calculating interest rates, managing monthly repayments, and teaching the rest of the UNICA members about basic finances. This approach means that members are learning about microcredit from both the recipient and lender's perspective. Furthermore, in comparison to other MFIs, the loans distributed from UNICAs begin with much smaller and manageable amounts, which only increase if the UNICA members repay their initial loans and save their money to buy new shares in the UNICA. Another, advantage of the UNICA is that members are not allowed to borrow more than the total number of their shares purchased without first providing a source of collateral, which can be livestock, appliances, furniture, land or other items of value. They can also have another member co-sign their loan. This reiterates a notion that microloans should be of a manageable size for each member so that even when an extreme financial circumstance occurs for the borrower they will be able repay the loan.

With more institutions adding microfinance to their loan portfolio, images of humanitarian efforts, poverty reduction and genuine concern for the poor are often perceived by outsiders as their ultimate goal. While most MFIs do operate with the best of intentions, borrowers considering a microloan from any MFI should fully develop their skills so they have a basic working knowledge of financial literacy before they sign contracts.

Throughout Latin America, MFIs have been the victims of clients abusing the system, which has resulted in a great effort to increase transparency between MFIs and new managing practices that discourage moral hazard and minimize adverse selection. Thus it is important that both actors, microcredit providers and clients, learn how to protect themselves from being exploited. MFIs with larger budgets and more resources are at less risk than the poor for this type of exploitation. Thus, based on my study, one can include that at a minimum the UNICA model provides an important model to enhance financial literacy within these high-risk communities. In addition, the UNICAs not only work to increase financial literacy, but also, provide loan and saving options to borrowers. An important lesson learned from these UNICA case studies is that this model prepares the poor with valuable knowledge and experience that prepare them for the option to apply for loans in the traditional finance sector.

Recommendations

The interviews conducted in this research provided an opportunity to compare the 2006 microloan data to the 2010 microloan data. It is apparent that while the UNICAs provide individuals with microloans more families have also decided to take out larger microloans from banks, Municipal *Cajas*, Edpymes and cooperatives. In general, these families are managing their loan payments, but in two cases mentioned in chapter four there was evidence of loan delinquency and over indebtedness. Many women participate in UNICAs in the region of Cayaltí, nevertheless, in regards to loans, traditional gender role still play a prominent roles in how information is distributed within some households. Thus, it is not enough to simply educate one spouse on the model, each spouse must be educated. While *FunderPerú* does advocate for family participation within in the UNICA, in practice this is not always the case. One suggestion to broaden household and community awareness on basic finance is for monitors to assist first year UNICAs by conducting public presentations within the community about their experience as UNICA members and teach basic financial concepts that they learned since joining the UNICA to both the men and women in the community.

Another area of concern for all NGOs is funding and sustainability. Currently FunderPerú relies on financial support from the Peruvian development bank, COFIDE and development organizations such as *Los Andes de Cajamarca.* Complete financial sustainability would require that *FunderPerú* charge fees for its services. Once MFIs no longer depend on outside support and subsidies they become self-sustainable but this change is problematic. Subsidies enable MFIs to operate in a fashion that lets them focus more on social conditions and less on trying to obtain a break-even budget. Subsidies are also the main way low interest rates area maintained.[118] While cost-benefit analysis studies could give insight into whether subsidies used for microfinance stimulate benefits that justify subsidy costs, there are very few well-developed studies that have undertaken this effort.[119]

Until more research is done examining a wide range of microfinance studies, subsidies will continues to play an important role in maintaining operations of MFIs, particularly in the case of NGO's such as *FunderPerú.* If *FunderPerú* tried to immediately stop depending on subsidies they would have to require that UNICAs and those interested in the program begin paying for monitor visits and training sessions, which could be detrimental to the growth of the UNICAs. Many individuals who learn about the UNICAs lose immediate interest once they learn that the organization does not actually distribute loans from their own funds, the free training is one way that *FunderPerú* is able to convince people to participate in their unorthodox model.

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[118] Armendariz and Morduch. 321
[119] Ibid. 319.

The *FunderPerú* model has made impressive progress since 2005 with hundreds of UNICAs in the Lamabayque and Cajamarca region forming. Nonetheless, they are still virtually unknown in Peru, which has one of the most competitive microfinance markets in Latin America. In the 2010 publication of *A Mustard Tree: A History of Microfinance,* there is no acknowledgement of the UNICAs or any comparable model. This illustrates that *FunderPerú* has yet to make its presence known in the microfinance arena. Hence, while the organization should consider new schemes to minimize subsidy dependency, there is also reason to suggest that they need to make their presence and their work shared on a larger stage within the Peruvian and world finance arena. Their financial strategy could benefit through more aggressive public relation efforts so that more opportunities for developing and testing this model could occur in different regions in Peru and in other Latin American countries.

Finally, further research should focus on whether there is a difference in loan repayment rates between active UNICA members as compared to nonmembers from the same community. If there is evidence that suggests a difference in repayment rates, banks and other MFI's may consider incorporating a system where inexperienced loan users first complete a training session similar to what is practiced in the UNICAs. Once members have completed training and after participating in an UNICA they may be much better prepared to begin receiving capital in the traditional financial sector. This type of structure would be used for the very poor in order to close the gap between those who have access to the financial sector in Latin America and those who because of a lack of financial resources and educational skills continue to not qualify for these important microfinance loan.

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