ASSESSING THE IMPACT OF INNOVATION GRANTS
IN FINANCIAL SERVICES

Financial Landscape Baseline: Service Innovations of Pro Mujer Peru

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MICROFINANCE OPPORTUNITIES

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ABOUT THE PROJECT

The *Assessing the Impact of Innovation Grants in Financial Services* project is designed to examine the impact of financial services on the lives of poor people across the developing world. This project is funded by the Bill & Melinda Gates Foundation, which is committed to building a deep base of knowledge in the microfinance field. The IRIS Center at the University of Maryland, College Park, together with its partner Microfinance Opportunities, will assess a diverse range of innovations in financial services. The results of this project will shed light on the design and delivery of appropriate financial products and services for the poor, and the potential to scale up successful innovations to reach larger numbers of low-income households.

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REPORT SERIES

This report is part of a series that will be generated by the *Assessing the Impact of Innovation Grants in Financial Services* project. The reports are disseminated to a broad audience including microfinance institutions and practitioners, donors, commercial and private-sector partners, policymakers, and researchers.

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ABSTRACT

The purpose of the Financial Landscape research is to understand access to financial institutions and services in areas to be covered by Pro Mujer Peru's (PMP) service innovations. This study focused on two innovations funded by BMGF: 1) the Premium Product, a large group loan for relatively successful microentrepreneurs; and 2) the Feria Product, a small group loan targeting petty traders at traditional markets in more rural areas. Research at the pilot/launch sites for these products revealed intense competition for PMP, from formal to informal sources of credit. PMP is regarded as a leader in the provision of credit in these areas, but these innovations mostly do not improve on the offerings of its competition in terms of highly-valued credit features (e.g. interest rate). Instead, the value proposition for the Premium product is found in its potential to help PMP retain relatively successful clients, while rewarding those clients with a bigger loan. It also may become a niche product for successful microentrepreneurs interested in large group loans over individual loans. The Feria's value proposition pertains primarily to the service-delivery model. PMP's consistent presence in the rural launch areas brings the potential to educate clients about the product and credit in general, thereby activating a mostly dormant market. The delivery model also presents real advantages over nearly all competitors in terms of transaction costs, which will drive down the net expenditures for accessing credit.

OTHER NOTES

All photos included here were taken by the author.

An exchange rate of 3 soles/US$ was used in this report, except where otherwise indicated.

In instances when the report refers to individuals, names and identifying information have been altered.

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ACRONYMS

BMGF	The Bill & Melinda Gates Foundation
FSA	Overall project name (Financial Service Assessment, or *Assessing the Impact of Innovation Grants in Financial Services*)
FGD	Focus Group Discussion
FSP	Financial Service Provider
MFO	Microfinance Opportunities
PMP	Pro Mujer Peru
PRA	Participatory Rapid Appraisal

EXECUTIVE SUMMARY

The *Assessing the Impact of Innovation Grants in Financial Services* project, undertaken by the IRIS Center at the University of Maryland and its partner Microfinance Opportunities (MFO), is assessing the impact of grants provided by the Bill and Melinda Gates Foundation (BMGF) to microfinance organizations for the development of innovations in financial services. The present phase of study is known as the Financial Landscape. The purpose of the Financial Landscape research is to understand access to financial institutions and services in areas to be covered by the grantee's service innovations—in this case, those of Pro Mujer Peru (PMP). It draws on data from both clients and financial service providers, though the emphasis is squarely on client perspectives.

PMP was founded in 1999. Headquartered in Puno and mainly serving districts in southern Peru, PMP is a credit-led organization that offers a range of loan products to its traditional client base of resource-poor women. Historically PMP's loans have adhered to a conventional village-banking model. PMP was founded as and remains a microfinance NGO, as opposed to other types of regulated financial institutions in Peru, which can offer a wider range of financial services and enjoy tax advantages.

This study focused on two innovations in PMP's microfinance programs funded by BMGF: 1) The Premium Product is the largest credit product ever offered by PMP, with an average size of 2,600 soles ($867), and its delivery will involve new market segmentation for PMP. The major qualifying guideline is that Premium clients must have been a client of PMP for a minimum of three years or eight loan cycles. Clients will be relatively successful urban female microentrepreneurs. And 2) The Feria Product targets petty traders at traditional markets in rural hinterlands and provincial towns. This relatively low-income rural target population will be new for PMP, which historically has focused on urban areas. The product will begin small, in the range of $30-$100.

Research took place in the cities of Puno and Tacna (sites for the launch of the Premium product) and in the town and surrounding areas of Desaguadero, near the Bolivian border (site for the piloting of the Feria product). Research consisted of 24 Participatory Rapid Appraisals (a kind of focus group) and 26 individual interviews. The approach was qualitative and focused on the client's perspective, bringing both unique insights and subjectivity to the findings.

Supply-side research found exceptionally crowded microfinance markets in the cities of Puno and Tacna (Premium markets). Puno revealed six banks, three Cajas, one EDPYME, and five NGOs comprising PMP's competition. Tacna revealed seven banks, two Cajas, one EDPYME, three NGOs, and three other financial institutions as PMP's competition. Though seemingly a more pristine market, the Feria zones around Desaguadero had a presence of at least 12 competing institutions. In all three areas, the formal and semi-formal options are complemented by a wide range of informal credit options. All three areas showed a vast intensification in the number of competitors over the last five years. In side-by-side comparisons to directly competing products, the Premium and Feria products seem to offer no value over existing alternatives in obvious areas like size of loan or interest rate.

Demand-side research revealed a diverse and competitive credit environment. In the city of Puno, PMP was cited as a leader in providing credit to the city's lower and middle social classes, but with minimal penetration among the upper class. In Tacna, PMP was seen to serve all classes, but its position as preferred provider rose as one proceeded down the socio-economic scale. Lack of credit experience among respondents in Desaguadero made preferred providers difficult to tease out.

In terms of favored credit features, PMP clients in Puno showed more interest in the features of group loans (e.g. less required documentation), while non-clients tended to rank highly the features maximized by individual loans (e.g. lower interest rates). This pattern did not hold true in Tacna or Desaguadero, where bottom-line concerns like low interest rates were top-ranked across the board. The transaction cost analysis suggested tremendous variation in individual experiences. On the whole, there was a certain disconnect evident in these findings, as the lowest transactions costs and top-ranked features did not correlate consistently with the preferred credit providers, like PMP. The findings showed that individual, stated, highly-valued features may not be drivers of the market; instead, complex interactions of loan attributes and landscape conditions are what likely compel client toward one product or another.

Moving toward the value propositions of the innovations: with the Premium, the scaling up of loan size for a relatively successful segment of microentrepreneurs represents a limited innovation in the context of the markets of Puno and Tacna. The Premium has no apparent advantage over competing products vis-a-vis most highly-valued loan features. However, the core value of the Premium product is its relation to client retention. The Premium product presumably will keep some PMP clients from "graduating" from that institution and seeking larger loans with other institutions. As experienced clients cost less to serve, and larger loans generally offer greater profits, the product may bear positively on the organization's finances. At the same time, the product creates the opportunity for PMP to reward its more loyal clients with a product commensurate with their needs.

A second area of opportunity with the Premium loan is its potential to serve a particular segment of the market: those who favor group loans (group vs. individual loans being an oft-debated issue in these regions). But within that market, the product is even more specialized: it is nearly the only group loan of its size, targeting relatively successful microentrepreneurs. Virtually all other loans of this scale are individual products. Hence the Premium product offers a new path to large-scale credit for relatively successful clients.

With the Feria, these rural markets are new to PMP, but they are not new to credit. Moreover, as in the case of the Premium, the Feria product does not at present offer significantly better value than the competition vis-a-vis most highly-valued loan features, like size and interest rate. However, the manner in which PMP has chosen to deliver the product presents a relatively unique opportunity for market penetration and for serving this inexperienced client base.

The typical service model, followed by the majority of financial service provider (FSPs) with a presence in these areas, involves infrequent visits by a loan officer to a particular community. PMP's service model requires recurring visits to the weekly markets, meaning a high level of direct presence in the communities matched by almost no other institution. As such, there will be long-term opportunities to pitch PMP's products while demonstrating the advantages of using financial services.

A second area of opportunity is found in transaction costs. Among the service providers currently operating in the *feria* markets, we saw a variety of service models, all of which have different implications for transaction costs. In this area PMP's service model offers some fairly unique advantages to clients and a distinct edge over most competition, related to its ongoing presence in the communities on market days. Essentially, it will be cheaper to access PMP's loans than nearly all competing products.

Broader lessons gleaned for the industry from the Financial Landscape baseline include:

- The Whole as Greater than the Sum of the Parts - PMP enjoys a status among borrowers that is irreducible to constituent parts such as product attributes. It points to the need to consider the *intangibles* in market research—difficult-to-grasp holistic characteristics and collective opinions that may be mostly unstated.
- Is Credit Always the Answer? - The socioeconomic landscape of the Feria zones raises a real question of whether that population will respond in large numbers to any offering of credit. It is a quandary that demonstrates the potential pitfalls of a credit-led and credit-dependent approach to microfinance.
- Transaction Costs Can Be More Significant than Price - The Feria transaction cost analysis shows that PMP outperforms most of its competition. This can be a window of competitive opportunity for a provider that has difficulty matching the price features of competitors.

This study presents the results of the Financial Landscape baseline. Around September 2010, approximately three years after this research was conducted, researchers will return to these same sites to carry out a similar investigation that will constitute the endline. The intent is to document changes in access and in the makeup of the financial landscape—developments that may correlate with the introduction of the PMP innovations. In this way, the Financial Landscape study will help provide a direct window on the outcomes of service innovation.

I. INTRODUCTION: ASSESSMENT & MICROFINANCE

BACKGROUND

The *Assessing the Impact of Innovation Grants in Financial Services* project (also known as Financial Services Assessment; hereafter FSA), undertaken by the IRIS Center at the University of Maryland and its partner Microfinance Opportunities (MFO), is assessing the impact of grants provided by the Bill and Melinda Gates Foundation (BMGF) to microfinance organizations for the development of innovations in financial services. The impact of microfinance on clients and their households remains a perennial issue of inquiry within the microfinance industry, among service providers and donors alike. The project is situated within this investigative priority for BMGF.

This approach is mixed-methods, and the project endeavors to examine the impact of these innovations in terms of poverty alleviation, sustainability, and scalability. The aim is to identify the most promising products, services, and delivery systems in current microfinance. The approach taken by FSA emphasizes issues such as access to financial services and the role of the regulatory environment. IRIS is mostly handling the quantitative research, with MFO mostly responsible for the qualitative side.

The present study, known as the Financial Landscape, is qualitative in orientation. The purpose of the Financial Landscape research is to understand *access* to financial institutions and services in areas to be covered by the grantee's service innovations—in this case, those of Pro Mujer Peru.

The study aims to document the financial services available (both formal and informal) and how they are accessed, including client preferences and changes over time. It draws on data from both clients and financial service providers, though the emphasis is squarely on client perspectives. The study places the innovation in the context of local competition to examine how these interactions dampen or multiply the impact of the innovation. It draws this data together to move toward the *value proposition*, or unique value of the service innovations against the area's other service options from the client's perspective.

In the current baseline phase, the Financial Landscape study employed focus groups and interviews to document the range of financial service options in the area and provide insight into the value proposition of the innovations. The process will be repeated three years later to provide an endline—an indication of whether and how the landscape has changed in ways that correlate with the introduction and operation of the service innovations.

The Financial Landscape Baseline Study presented here is but one piece, specifically focused on access, in a complex assessment picture that will take shape through the overall FSA. Adding to this picture, proposed research in Peru includes a quantitative Poverty Outreach study, a qualitative Product Use survey, an Enabling Environment study, and the Financial Landscape endline. This configuration of studies in Peru reflects FSA's broad strategy of combining different methods and different moments in time to deliver a composite portrait of how conditions change, as well as why they change.

Access

Access resides at the heart of this study, reflective of recent scholarship suggesting a strong connection between access to financial services for low-income populations and national development (e.g. World Bank 2008). The term access has been employed in microfinance in a multitude of ways. Often it connotes use or uptake of financial services. In other contexts, access refers to the availability of financial services. For its part, FSA has reverted to the more traditional lexical meaning of access: *freedom or ability to obtain or make use of something*.[1] That is, we are interested in what financial services are available *and* whether potential clients, particularly those with low incomes, have the ability to obtain those services.

OPERATIVE DEFINITION & CONCEPT OF ACCESS:

Freedom or ability to obtain or make use of something.

Figure 1 below presents the causal model[2] underlying the FSA project:

In sum, the significance of access in impact assessment research is that

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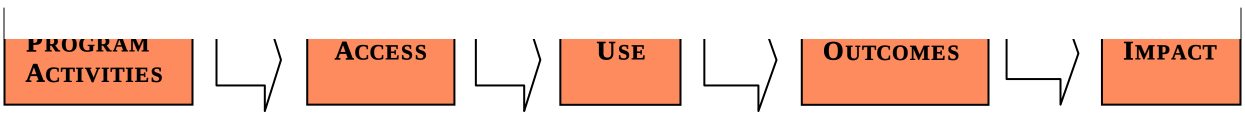
FIGURE 1 - PROJECT CAUSAL MODEL



utcomes will vary according to how different segments of clients of different income levels can and do avail themselves of the financial services in their area.

As noted earlier, issues surrounding access will be the primary focus of the Financial Landscape study. The use of the service innovations will be explored more thoroughly in other phases of research, particularly the Product Use study. The use-related issue of depth and breadth of outreach will be addressed both with information from PMP and with the Poverty Outreach study. Collectively these studies, along with the Enabling Environment, will allow us to understand the mediating effect of these inputs in the outcomes of financial service interventions.

ENGAGING WITH PRECEDENT

In this report on the financial landscape, specific problems and questions are addressed in particular context, drawing on empirical observations at several investigation sites. The mostly qualitative work here will be part of an ongoing investigation into the impact of service innovations funded by the Bill & Melinda Gates Foundation.

At the same time, the report has broader aims of engaging with and contributing to scholarly discourse on the current state of microfinance. As a case study, it brings that potential because it touches on so many of the hot-button issues under debate in the field.

[1] Merriam-Webster online dictionary.

[2] The reader should note that this is the causal model that applies to the FSA project as a whole. In the case of PMP, it was decided in collaboration with BMGF that research would focus proceed only as far as outcomes, the penultimate step in the model.

Like many areas of the world, the microfinance industry in southern Peru is not much older than 1o years but has seen explosive growth, especially in the last five years (cf. the Uganda case documented by Wright and Rippey 2003). Competition is fierce, coming both from non-profits and a multitude of commercial institutions. This trend in turn complicates the ideology on which the industry was founded. To borrow and transpose the words of Elisabeth Rhyne, what was revolutionary has become ordinary (see 2001, p. 157). In such a financial landscape, pragmatic concerns (e.g. beating the competition) can grow to trump ideology (e.g. a commitment to serving the poor). This can lead to the much-discussed and oft-dreaded phenomenon of mission drift.

Questions of competition interface strongly with another topical issue in microfinance: financial self-sufficiency. Experts across the field continue to call for a shift from subsidized to unsubsidized loans (cf. Rhyne and Otero 1994, pp. 17-21). PMP achieved operational self-sufficiency some years ago, but its case illustrates the challenges of sustaining that position in a changing financial landscape. In order to prosper in the face of mounting competition, where best to change? Newly-specialized products? Better product delivery? Technological innovations? And what new market niches to pursue? More rural outreach (cf. USAID 2007)? A move upmarket? Pro Mujer Peru's current product innovations bear directly upon such questions and the ideological issues underpinning them.

At the same time, the study aims to feed into a rich and provocative regional literature on Peruvian and Andean microfinance. One of the most closely-studied microfinance cases of all time is that of Peru's Andean neighbor, Bolivia (cf. Rhyne 2001). Some of the prevailing trends documented in Peru, including the hypercompetitive environment and rising commercialism, pose a striking parallel to the industry's trajectory in Bolivia. Interestingly, Peru seems to be about five years behind Bolivia's industry in terms of the progression of these trends, a disparity that might be explained by the civil war that disrupted Peru through the 1980s and early 1990s, as microfinance began to bloom in Bolivia. Rhyne (ibid.) and others have meticulously documented the trends and outcomes in Bolivia; it will be fascinating to note commonalties and divergences as time passes in Peru.

As well, Peru has been the site of a relative abundance of microfinance studies on a variety of topics by some of the industry's most-recognized scholars. In the area of impact assessment, Dunn and Arbuckle (2001), for example, investigated Mi Banco in Lima in a classic and well-regarded mixed-method panel study, while Karlan and Valdivia (2006) added a piece on the impact of business education in Lima and Ayacucho. Copestake, et al. (2005) recently drew on work from Peru to deliver a comparison of contemporary methods for monitoring the diversity of poverty outreach. Other scholars have published product case studies from the Peruvian microfinance industry (e.g. Brand 1999). Still another has drawn on investigation in Peru to deliver a stinging criticism of communal banking and its effect on the social fabric of Peruvian communities (Marr 2002).

This study aims to stake its own claim in this emerging regional canon. The deep holistic attention to the client's perspective complements like-minded work of scholars like Marr and Copestake, while standing in marked contrast to the quantitative rigidity of scholars like Karlan. At the same time, the particular focus on access is nearly unique in the regional literature and indeed has few parallels across the microfinance industry. In these ways, it is hoped that the study's specific findings will carry broader implications for the regional canon and beyond.

OUTLINE OF REPORT

The report is organized as follows: the next section (Chapter II) will present an overview of the research area and institution, a summary of research design, and a demographic overview of the respondents. Chapter III turns to the supply side of the financial landscape—what services are offered and by whom. Included will be findings on the trends in the service environment over the last five years, as well as an outline of other products that we expect will compete directly with the PMP service innovations. Chapter IV turns to demand, focusing on client preferences and habits. It includes rankings of preferred service-providers, rankings of preferred credit attributes, an initial presentation of transaction costs findings, and a summary of commentaries on PMP and its products. Chapter V closes with a discussion of the findings on the value proposition from the client's perspective of each PMP service innovation, including challenges in the financial landscape and opportunities presented by the innovations.

II. RESEARCH OVERVIEW & DESIGN

COUNTRY OVERVIEW: PERU

Peru is a county of just under 500,000 square miles, occupying the central west coast of South America. Geographically it consists of three major regions: the coastal desert; a mountainous spine through the center of the country, formed by the Andes; and the tropical Amazonian lowland zone on the eastern side of the Andes. Two of those three regions were featured in this project, with Tacna situated in the coastal desert and Puno perched high amid the Andes mountain range.

The country's population was estimated at just over 27 million in 2005 (INEI, 2005). Though the country's economic base remains in agriculture and livestock, the last half-century has been marked by high rates of urban migration and subsequent urban growth. The capital city of Lima alone now contains close to one-third of the county's total population.

In a global context, the country ranks toward the middle of the poverty scale—number 87 out of 177 countries on the Human Development Index (UNDP, 2007). Internal social indicators paint a somewhat direr picture. Peru's office of national statistics (el Instituto Nacional de Estadístico e Informático, or INEI) calculates domestic poverty rates based on varying levels of minimum income in the cities and rural areas of each of the three major regions described above (desert coast, sierra, and tropical lowlands). By their 2006 estimates, 45 percent of the country lived below the poverty line, and 16 percent lived in extreme poverty (INEI 2006). For a sense of what this means in international terms, Table 1 presents income figures derived from international poverty standards for the areas of the country covered by the research:

TABLE 1 - PERU'S POVERTY THRESHOLDS IN USD, 2007

	POVERTY LINE, DAILY INCOME PER PERSON	EXTREME POVERTY LINE, DAILY INCOME PER PERSON
Puno	$1.44	$0.72
Tacna	$1.44	$0.72
Desaguadero Region	$1.44	$0.72

Source: http://www.povertytools.org/Links/Calculating_PPP_Conversion.pdf

PRO MUJER PERU

PMP is part of a U.S.-based women's development and microfinance network with a stated mission "to provide Latin America's poorest women with the means to build livelihoods for themselves and futures for their families through microfinance, business training, and healthcare support" (Pro Mujer 2007). The organization operates in six Latin American nations: Mexico, Nicaragua, Bolivia, Argentina, and Peru.

The Peruvian institution was founded in 1999. Headquartered in Puno and mainly serving districts in southern Peru, PMP is a credit-led organization that offers a range of loan products to its traditional client base of resource-poor women. Historically PMP's loans have adhered to a conventional village-banking model consisting of communal associations (*asociaciones comunales)* of 20-30 clients, which are in turn composed of 4-6 loan groups (*grupos solidarios)*. PMP was founded as and remains a microfinance NGO, as opposed to the other categories of regulated financial institutions in Peru (see Chapter III for discussion of these institution types).

In addition to the two credit innovations (described below), PMP currently offers the following loan types:

1) Regular Loan *(Crédito Regular)* – conventional group-loan product for microentrepreneurs.

2) Seasonal Loan *(Crédito Estacional)* - a parallel loan for meeting short-term capital needs during the regular loan cycle.

3) Education Loan *(Crédito Educativo)* – consumer credit for use in covering educational expense.

4) Health Loan *(Crédito Salud)* – consumer credit for use in a system of pre-paid preventive health services.

In addition to loans, PMP provides access to saving accounts (required with loans and offered via partnerships with institutions regulated to accept savings) and business and human development training. Through alliances with public and private healthcare providers, PMP also promotes integrated healthcare for women and children, and provides counseling and other care for women and families dealing with alcoholism and domestic violence. This healthcare component historically has served to set Pro Mujer apart from many other microfinance providers.

The institution achieved financial self-sustainability by the end of 2002. At the close of 2007, PMP reported 39,710 clients, with a gross loan portfolio of $8,478,000 and an average loan balance per client of $213. Total assets were reported as $9,379,000.

Client numbers at the two regional branches most relevant to this research, reported at the end of 2007, were as follows:

- Puno: 6,740
- Tacna: 14,070

PMP'S PRODUCT INNOVATIONS

This study will focus on two product innovations in PMP's microfinance programs funded by BMGF in 2005. Though the original proposal to BMGF concerned more than these two innovations, that plan has been altered substantially in the ensuing years; some aspects of the plan have been dropped, while others have new launch timelines.

"Premium Loan"

In a competitive microcredit environment, financial service providers (FSPs) face challenges in retaining their clients amid a multitude of credit choices. This is especially true as clients move up the socioeconomic scale and face a point of "graduation" (i.e. search for a larger loan) from the microcredit providers with which they began.

Market research conducted in 2006[3] with 375 current clients of PMP with a minimum of six loan cycles each found that 59 percent of those clients were taking up credit products with other institutions simultaneously. This represented a large lost market of experienced clients, who are traditionally less costly to serve (not an insignificant factor as one looks to generate funds internally). These clients were primarily interested in larger loans, between 2,000 and 6,000 soles ($667-$2,000), with a longer term than PMP's 16-week conventional loan. Though PMP initially envisioned an individual product, the market research found a preference for group structure even at this larger loan size.

The Premium product is the largest credit product ever offered by PMP, with a range of $667-$2,000 and an average size of $867. It is a group loan, targeted at groups of 6-7 people with a term ranging from four to 12 months. Interest is 4 percent per month (declining basis). Like all PMP loans, the Premium product has a mandatory savings requirement—in this case 15-20 percent of the loan as of early 2008, which is somewhat higher than other PMP products.

The major qualifying guideline is that Premium clients must have been a client of PMP for a minimum of three years or eight loan cycles. These clients will be relatively successful female microentrepreneurs residing in three urban areas: Puno, Juliaca, and Tacna. A test pilot phase was completed, and the product was launched in November 2007 in all three cities.

Given its link to relatively successful high-end clients, it is significant to note that in late 2007 PMP decided to limit the Premium Loan to 10 percent of its overall portfolio. This limit was explained as an effort to keep the organization focused on serving Peru's more impoverished women.

[3] The results of this market research were shared with the author in October 2007 via a PowerPoint presentation used internally at PMP in the product development process. Though it is conceivable to compare the results of this study with PMP's research (and to point out discrepancies), such parallels will be drawn only on a limited basis. This is because the studies differed greatly in scale, scope, and purpose. PMP's research helped provide a starting point for investigation of the two innovations; beyond that, the role was purposely limited.

“Feria Loan”

The Feria product was developed based on the results of market research conducted over 2006-2007.[4] The stated impetus for exploration into this new product domain was PMP’s strategic objective of expanding outreach into regional markets through the introduction of new products. However, development of the Feria loan also can be contextualized as part of a trend among financial service providers in this area of seeking new business in rural areas as urban markets have become more crowded.

PHOTO 1 - MARKET DAY

The product name refers to the area’s traditional weekly markets, an essential part of rural commerce in this area, where vendors sell everything from housewares to fresh produce. These markets rotate through different communities in the region, with the principal commerce day generally one day per week in each location. The product aims to serve these market vendors, where PMP’s market research found a demand for loans mostly in the range of 100 to 1,000 soles ($33-$330), for working capital to purchase inventory, or for small equipment purchases like tables or tents (a notable divergence from the findings of this study—see later discussion). The target client population includes both locals who reside in surrounding communities and sell exclusively at their local market, and non-locals who rotate through many area markets to sell their wares.

This relatively low-income rural target population will be new for PMP, which historically has focused on urban areas. The product will begin small, in the range of $30-$100, with terms of 2-4 months and biweekly payments. Savings requirements will be 20 percent. They will be groups

[4] See Footnote #2.

of 4-8 people, most with little or no experience in the formal financial sector. Interest rates will be 4.5 percent per month (declining basis).

Mobile loan officers will visit regional ferias on a rotating basis to promote the product. Clients must travel to a PMP agency office located in a nearby provincial town for the loan disbursement. Group meetings and repayments will then take place at the market sites, with mobile loan officers traveling there to lead them and collect payments.

The Feria product is currently in its pilot phase, with agency offices established in the provincial towns of Azángaro, to the north of Juliaca, and Desaguadero, south of Puno on the Bolivian border. The product is being promoted at a number of market locations surrounding these towns, as well as at the weekly markets within the towns themselves.

The features of the two innovations compare with PMP's other products as depicted in Table 2:

TABLE 2 - PRO MUJER PRODUCT FEATURES

LOAN	LOAN TYPE	SIZE	TERM (MOS.)	INTEREST RATE (PER MO., DECLINNG BALANCE)	SAVINGS REQUIRED (% OF LOAN)	PAYMENT FREQ.	COMMISSION
Regular Loan	Group	$33-667	2-12	4.5%	20	7, 15, 21 or 28 days	2.5%
Premium	**Group**	**$667-2,000**	**4-12**	**4%**	**15-20**	**Monthly**	**2.5%**
Feria	**Group**	**$30-100**	**2-4**	**4.5%**	**20**	**Biweekly**	**2.5%**
Seasonal Loan	Group/Parallel	$33-333	1-2	5.35%	Not required	Monthly	2.5%
Education Loan	Group/Parallel/Consumer	$33-83	1-2	3.5%	Not required	Monthly	2.5%
Health Loan	Group/Parallel/Consumer	$20-25	2-12	2%	n/a	7, 15, 21 or 28 days	2.5%

Source: Pro Mujer, February 2008

ORIENTATION: RESEARCH SITES

The research took place in two Departments (similar to U.S. states) that have served as sites for the pilot and/or launch of service innovations. The first is Puno, with roughly 1.2 million residents, and the second is Tacna, with roughly 275,000 residents (INEI 2007) (see map in Figure 2).

As noted earlier, the Premium product was launched in late 2007 in three southern Peruvian cities: Puno, Juliaca, and Tacna. For this study, the cities of Puno and Tacna were selected as research sites. Juliaca was eliminated based on the close social and economic parallels between Puno and Juliaca (the two cities, separated by around 30 miles, are seen by some as one contiguous economic zone).

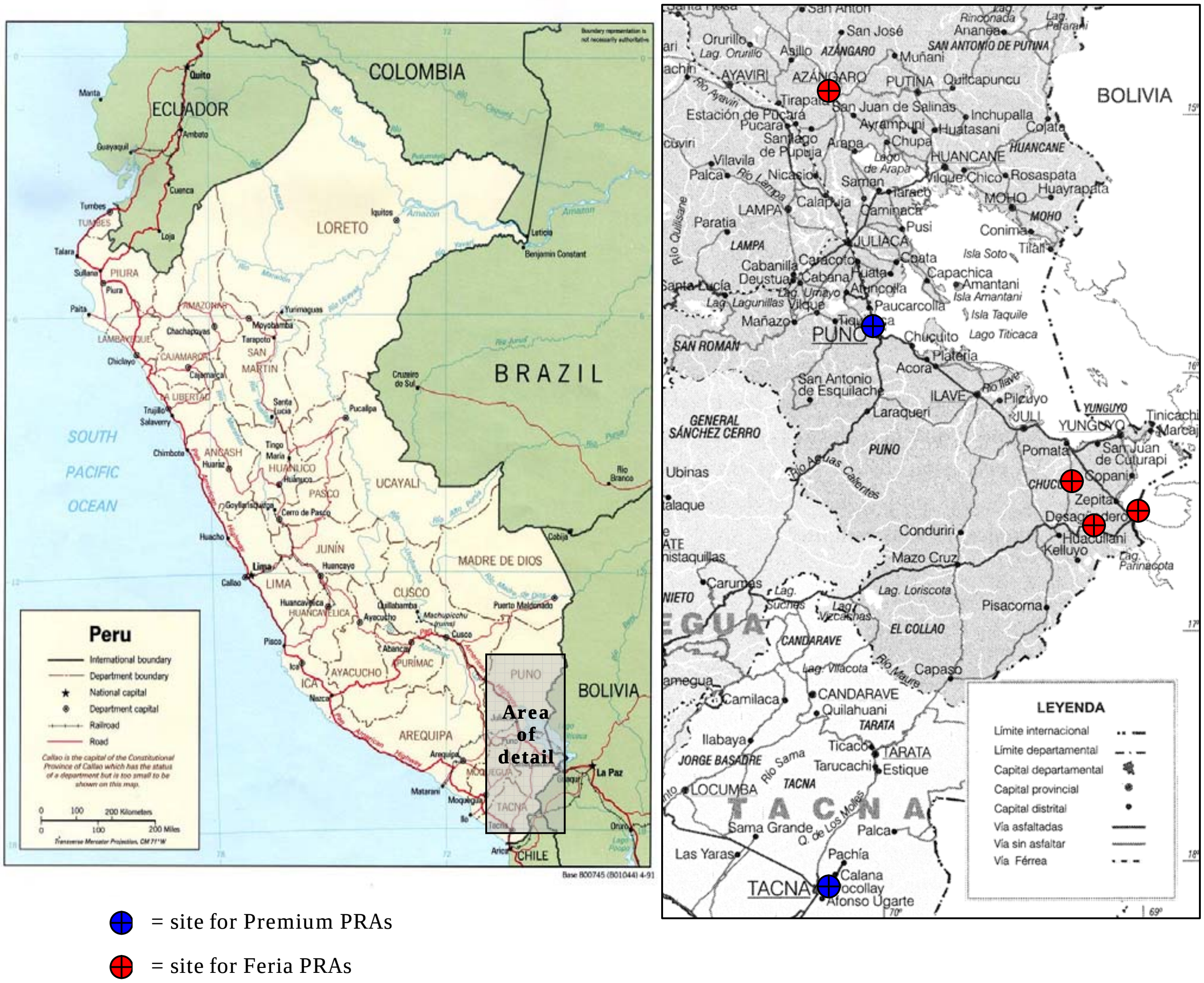
Home to PMP's headquarters, the city of Puno is the departmental capital with roughly 100,000 residents. It is located in the Andean high plain (*altiplano*) at over 12,500 feet above sea level (nearly the upper limit for all permanent human settlements worldwide). The majority of the city's population is indigenous, with familial ties to Quechua or Aymara-speaking communities in the surrounding region. Puno's economy is supported largely by commerce and tourism tied to Lake Titicaca and the nearby frontier with Bolivia. The surrounding countryside is extensively farmed. The stark though densely populated landscape supports a limited number of crops (e.g. potatoes and quinoa) and large-scale pastoralism, especially sheep, llamas, and alpaca.

The second Premium-related research site was the desert coastal city of Tacna, capital of its department and home to about 175,000 people. Though physically removed from the Andes, many of the city's residents migrated there from sierra communities, giving the city a distinctly Andean cultural feel. Much of the city's livelihood revolves around cross-border traffic and commerce to and from nearby northern Chile. Tacna's arid climate supports a less extensive though significant range of irrigated agriculture in the surrounding countryside.

On the whole, Puno is a much poorer region than Tacna. Its departmental poverty incidence of 76.3 percent is the third-highest among Peru's 24 departments. By contrast, Tacna's poverty figure of 19.1 percent is the country's second-lowest. Extreme poverty figures are comparably divergent: 41.6 percent for Puno, 3.3 percent for Tacna (INEI 2006).

The selection of research sites for the Feria product was based on PMP's piloting in and around two provincial towns—Desaguadero and Azángaro—in the Department of Puno. Desaguadero, on its southeast edge of the Department bordering Bolivia, was chosen arbitrarily as the primary investigation site, though research was supplemented by interviews in Azángaro to check for any major differences in that financial landscape. Primary data-gathering took place in Desaguadero itself (mostly a portal to frontier commerce) and at two rural market sites in the adjacent countryside—Wapaca and Chaca Chaca. The idea behind this distribution was that both in-town and wholly rural perspectives would be represented. The same general comments on landscape and livelihood above in the discussion of the city of Puno apply to these areas.

FIGURE 2 – MAP OF RESEARCH SITES



(MAP SOURCE: PERRY-CASTAÑEDA LIBRARY MAP COLLECTION, UNIV OF TEXAS)

KEY RESEARCH QUESTIONS

As noted in the introduction, the pivotal concern in the Financial Landscape is *access* to financial services and the *value proposition* of the PMP service innovations. Those issues are addressed by the following research questions:

- What financial service providers (both formal and informal) offer credit, savings, insurance, or remittance products to clients targeted by PMP?[5] What client segments do this target?

- How have these financial service options changed over the last 3-5 years?

[5] All financial services were explored in the research, though most attention was focused on credit, as PMP is primarily a credit provider and the innovations are credit products. That orientation is reflected in this report.

- What do clients know and understand about these financial service providers and the availability/accessibility of these products and services? Are they correct?

- What product attributes (e.g. proximity, security, service, fees) are most and least important to the target client base? How does this vary across different client market segments?

- What market segments are most and least served by existing services? Why?

- What factors govern norms of access (e.g. gender, ethnicity, class, education level, occupation, cooperative membership)?

- How do the perspectives of clients compare or contrast to the perspectives of financial service providers on key features of the financial landscape?

- What are the transaction costs (in terms of both time and money) involved in accessing financial services currently available?

DATA COLLECTION STRATEGY

The project utilized two major data collection strategies: 1) focus group discussions; and 2) individual interviews. Research for the baseline was carried out over a period of three weeks. A team comprised of an MFO lead researcher and local consultants carried out the research at sites noted above.

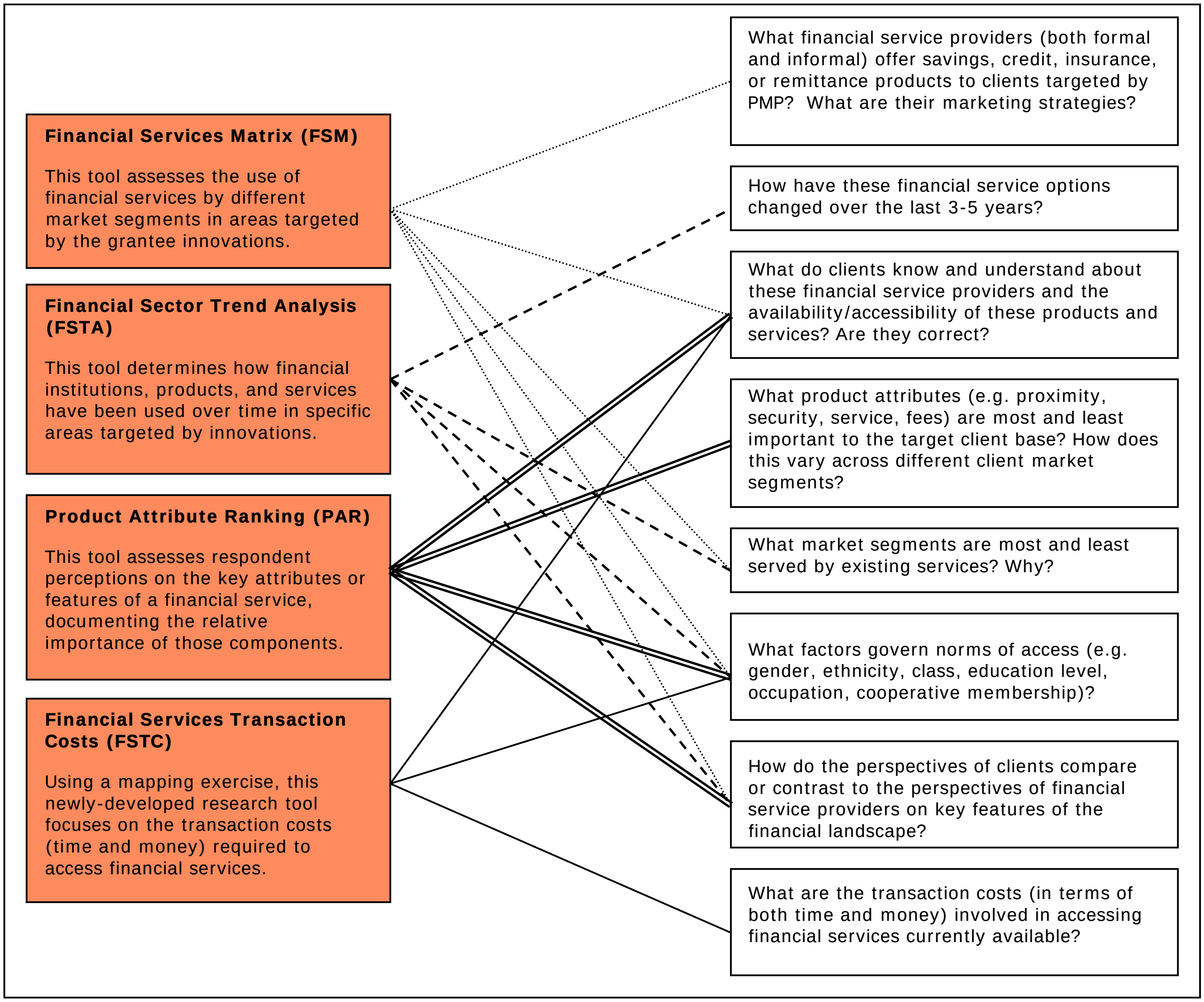
RESEARCH TOOLS: PARTICIPATORY RAPID APPRAISALS

Research featured Participatory Rapid Appraisals (PRAs), a form of focus group discussions, exploring clients' knowledge, use, experience, and perceptions of the financial landscape. The focus-group method was favored here because it allows for individual experiences to be related and debated, while at the same time moving toward whole or partial group consensus on key issues, all in a timely and efficient manner.

The groups employed four PRA tools adapted from MicroSave's Market Research for Microfinance Toolkit. All four have been employed by MFO in past research, though the Financial Services Transaction Cost tool is relatively new and still in a developmental stage. The tools were chosen for this project specifically for their potential to produce data relevant to the key research questions, with sufficient overlap to help validate results and/or reveal disconnects in the client testimony.

Figure 3 outlines the four tools and how each connects to the research questions. A more detailed narrative description of each PRA tool is included as Annex A.

FIGURE 3 – RESEARCH TOOLS & LINKS TO QUESTIONS



PRA SAMPLING/TOOL DISTRIBUTION

A total of 24 PRAs were carried out, 16 with clients and potential clients of the Premium Loan and eight with clients and potential clients of the Feria loan.

The PRAs centered on the Premium product in Puno and Tacna and included equal numbers of groups composed as follows: 1) PMP clients with sufficient credit experience to qualify for the Premium loan; and 2) non-clients with comparable levels of credit experience, to serve as comparison groups. The rationale for including non-PMP clients was that their perspective was needed for the fullest possible picture of the region's financial landscape.

The selection of PMP clients was random, based on client lists provided by the institution, and distributed across different "focal centers" (i.e. PMP branch offices) and neighborhoods in each city. The selection of non-clients was based on geography (the major neighborhoods and quadrants of each city were represented) and business type (including market-stand owners as well as other mobile and fixed-location microentrepreneurs). For the selection of non-client participants within those categories, the goal was randomization, but the availability of appropriate business-owners at the appointed time tended to determine the group rosters. A complete explanation of how these groups were composed appears as Annex B.

For the Feria product, the pilot phase had begun several weeks before the research took place, but selection of focus-group participants was random in the sense of not taking into account whether individuals were clients or non-clients of Pro Mujer. It was supposed (correctly) that it would be difficult to find sufficient numbers of existing PMP for client-centered PRAs; only a small minority of participants ended up being recently-enlisted PMP clients.

At the rural Wapaca and Chaca Chaca Feria sites, two types of groups were convened: market vendors who were local residents and vendors who were non-local. In the town of Desaguadero, three of the four groups were market vendors representing the various specializations within the market, and one group was composed of market authorities and officials. In all cases, participants fitting the criteria were randomly selected and invited to the fullest possible extent. See Annex B for additional details.

Distribution of the research tools was quite straightforward. Each tool was used once in each research site with each group type, with the exception of the rural ferias, where no more than two groups were possible at each site. The distribution is shown in Table3.

TABLE 3 - SAMPLE FRAME FOR PRAS

LOCATION	RELEVANT PRODUCT	PARTICIPANT TYPE	TOOL
Puno	Premium	Client	FSM
Puno	Premium	Client	FSTA
Puno	Premium	Client	PAR
Puno	Premium	Client	FSTC
Puno	Premium	Comparison	FSM
Puno	Premium	Comparison	FSTA
Puno	Premium	Comparison	PAR
Puno	Premium	Comparison	FSTC
Tacna	Premium	Client	FSM
Tacna	Premium	Client	FSTA
Tacna	Premium	Client	PAR
Tacna	Premium	Client	FSTC
Tacna	Premium	Comparison	FSM
Tacna	Premium	Comparison	FSTA
Tacna	Premium	Comparison	PAR
Tacna	Premium	Comparison	FSTC
Wapaca	Feria	Market Vendor	FSM
Wapaca	Feria	Market Vendor	FSTA

LOCATION	RELEVANT PRODUCT	PARTICIPANT TYPE	TOOL
Chaca Chaca	Feria	Market Vendor	PAR
Chaca Chaca	Feria	Market Vendor	FSTC
Desaguadero	Feria	Market Vendor	FSM
Desaguadero	Feria	Market Vendor	FSTA
Desaguadero	Feria	Market Vendor	PAR
Desaguadero	Feria	Market Vendor	FSTC

RESEARCH TOOLS: INDIVIDUAL INTERVIEWS

Critical details on the nature and diversity of the financial landscape were collected through individual interviews, also employing guidelines drawn from MicroSave's Market Research for Microfinance Toolkit. Generally, the individual interviews served three aims: 1) to follow up on important issues that emerged from the focus group discussions; 2) to explore topics that did not lend themselves to group discussion, including personal financial details; and 3) to obtain information from financial service providers not included among the PRAs.

INDIVIDUAL INTERVIEW SAMPLING

A total of 26 individual interviews were completed. The number of interviews on the demand side (eight) ended up limited by time and by the necessity to concentrate on the abundance of competitors on the supply side. Those that were completed offer a particular range of case study insights relevant to the two products. The interviews in Azángaro served as a point of comparison for that second Feria pilot site, to probe for any major difference from the Desaguadero landscape.

The distribution is shown in Table 4.

TABLE 4 - SAMPLE FRAME FOR INDIVIDUAL INTERVIEWS

LOCATION	INTERVIEW TYPE	CLIENT/INSTITUTION
Puno	Demand/Premium	Client
Tacna	Demand/Premium	Client
Wapaca	Demand/Feria	Client
Azángaro	Demand/Feria	Client
Azángaro	Demand/Feria	Client
Azángaro	Demand/Feria	Client
Azángaro	Demand/Feria	Client
Azángaro	Demand/Feria	Client
Puno	Supply	Pro Mujer
Puno	Supply	Pro Mujer
Puno	Supply	ROSCA Leader
Puno	Supply	Money Lender

LOCATION	INTERVIEW TYPE	CLIENT/INSTITUTION
Puno	Supply	Caritas
Puno	Supply	Edyficar
Puno	Supply	Banco de Crédito
Puno	Supply	Caja Rural Los Andes
Puno	Supply	Caja Municipal Arequipa
Puno	Supply	ECLOF
Puno	Supply	Mi Banco
Tacna	Supply	CrediFácil
Tacna	Supply	Caja Municipal Tacna
Tacna	Supply	Caritas Tacna
Tacna	Supply	ADRA
Lima	Supply	Prisma
Lima	Supply	Manuela Ramos
Lima	Misc.	Head of COPEME

COMMENTS ON METHODOLOGY

With some exceptions, like the socio-economic survey data described below, the focus of this study was respondent-reported data—i.e. what current and potential clients know and have known about financial service provision, and their opinions and preferences thereof. This reported data is considered the more significant data at this stage of investigation because of its qualitative representation of the client perspective, a critical piece of any well-rounded assessment. Other components of the FSA project will complement this data with quantitative inquiries and other methods.

Not all of the data in this report was collected in this manner. For example, much of the information on the supply side (i.e. the financial service providers) was drawn from interviews and secondary sources such as annual reports and websites of the providers themselves. Even in that section, however, client-reported data plays a key role. For example, the tables describing the formal financial service options and trends in each of the three research sites (Tables 6-8) are drawn from the PRAs. It is possible that these discussions omitted a handful of financial service providers operating in these areas, but such omissions are not problematic for this study. As stated above, the report focuses on what clients know. If an FSP operates in the area but is not widely known, it serves little purpose for this client group, and our study reflects that.

The subjective nature of the findings represents an intentional choice. Too often the clients' perspective is obscured in research related to microfinance and other poverty-alleviation interventions, with programmatic failure as a consequence. At the same time, this orientation conditions research results in a way that the reader must keep in mind at all times. The results are categorically different than, for example, the findings of a survey-based randomized control trial, which may maximize objectivity but lack richness of detail and a well-rounded insider's perspective.

Other methodological notes:

- This study is a baseline in what will be a two-part look at the financial landscape of these areas. It aims to shed early light on the value proposition of these innovations for current and potential clients. The findings offer insights into developments and trends that will be re-examined in the endline as well as other components of this research project. The present study serves as an opening to the discourse—not the final word.

- Researchers aimed for a random selection of participants (fitting certain criteria) in the make-up of the PRAs. As noted above, however, practical constraints prevented a fully random sample in some cases, particularly the Premium comparison groups. Though a random sample is always preferable, it is argued that the limitations here did not undermine the study's potential to represent consumer perspectives and identify trends in any fundamental way.

- PRAs (and FGDs in general) are a well-chosen means of gathering the perspectives of multiple individuals and moving toward consensus on issues quickly and efficiently. At the same time, the method brings potential pitfalls, such as the tendency of certain individuals to dominate the group over others. Many of these pitfalls can be avoided with an experienced moderator, which this project had in its Peruvian consultant, who received additional training from MFO on moderation techniques as part of this study. It is argued that, on the whole, the results reflect effective group management.

- The selection of individual interviews depended on time constraints and interviewee availability, as well as certain conditions of the study. For example, the abundance of competitors in all of these markets meant that the interviews ended up disproportionately focused on representatives of other financial institutions rather than clients.

SOCIOECONOMIC STATUS OF PARTICIPANTS

Each PRA included a survey that was administered at the close of discussion to gather basic demographic data. The intent was to gain an understanding of the socioeconomic profiles of our participants (beyond their general qualifications as Pro Mujer clients, business owners, etc.).

The results of those surveys are summarized in Table 4, with narrative commentary following.

TABLE 5 - SUMMARY OF KEY DEMOGRAPHIC CHARACTERISTICS OF PRA PARTICIPANTS

	OVERALL	PREMIUM – PUNO	PREMIUM - TACNA	FERIA
Number of Participants	205	63	71	71
Percent Female	79%	87%	76%	73%
Average Age	39	39	41	36

Average Education Level (see scale below)	3.75	4.03	4.41	2.81
Engaged in Farming in Last Year	45%	47%	8%	80%
Microentrepreneurs	95%	96%	94%	95%
Used Formal/Semi-Formal FS in Last Year	62%	93%	77%	16%
Loan Outstanding	65%	97%	84%	14%
Savings	61%	61%	63%	60%
Insurance	28%	26%	39%	18%
Access to Cell Phone	58%	71%	86%	18%

NOTE: As outlined in sampling plan, Premium figures include client and non-client FGDs; Feria figures refer to randomly-selected market vendors, regardless of client status.

Educational scale:

No schooling:	0
Some primary school:	1
Primary completed:	2
Some secondary school:	3
Secondary completed:	4
Some university:	5
Finished university :	6
Some professional school:	7
Finished professional school:	8

Discussion

The overall results in the first column indicate a sample that was nearly fourth-fifths women—not surprising, given Pro Mujer's mission and service characteristics noted earlier. Likewise, the sample is overwhelmingly microentrepreneurs. About two-thirds had used formal financial services (i.e. were "banked") in the last year, and about the same number had loans outstanding and savings. About one-quarter reported having insurance.

These composite results, however, can be somewhat misleading, in that the research dealt with several distinct populations, particularly in relation to grouping around the two product innovations. As a result of the eligibility criteria for the Premium loan, the participants in the Premium-related PRA (both clients and comparison groups) were relatively successful urban business owners with substantial levels of experience in the formal financial sector. By contrast, the participants in the Feria-related PRAs were petty traders who operated at the rural markets (i.e. market vendors), with fewer resources of all kinds at their disposal and less access to and use of formal financial services than their Premium counterparts.

These differences are borne out in key statistics in Table 5. The Feria participants were substantially less educated. Only 16 percent were banked (i.e. used formal or semi-formal financial services in the last year), compared with 85 percent in the Premium groups (Puno and Tacna combined), and only 14 percent had loans outstanding, compared with 91 percent in Premium-related PRAs. A similar disparity was seen in access to cell phones, a key indicator of relative socioeconomic status.

On the subject of savings, the three groups were remarkably consistent, all reporting around 60 percent as having savings. There were sharp disparities, however, in the nature of these savings. In the case of the Premium-related groups, the vast majority of savings was held at formal financial institutions. In the case of the Feria groups, the overwhelming majority of savings was in a decidedly informal form—livestock—with a smaller portion of cash saved at home. Almost none of the rural and just a few in-town Feria participants saved with formal institutions.

PHOTO 1 - PRA PARTICIPANTS IN PUNO

The Premium and Feria groups both reported substantial levels of having insurance (32 percent and 18 percent, respectively). The overwhelming majority of these cases, however, related to a social protection program provided by the Peruvian government. Through a program called Seguro Integral de Salud or SIS, the government provides free health insurance to individuals and families who are Peruvian citizens and fall below the nationally-defined poverty line (see Table 1). They also offer the program at a low cost to individuals above the poverty line. Only a handful of participants identified as 'insured' had coverage beyond SIS. A total of five participants (2-3 percent of the total sample) indicated that they have private life insurance policies.

For full details of socioeconomic status of participants, including statistics for every PRA, see Annex C.

GENERAL NOTES ON OCCUPATIONS

The sample reflects a common continuum of occupations in Peru, from farmer to microentrepreneur, with many combinations of agriculture and commerce therein.

On the agricultural extreme of the continuum, we find the rural PRAs in Wapaca and Chaca Chaca. Here 100 percent of participants undertook agricultural activity in the past year, and, in many cases, their small businesses were directly related to agricultural production—i.e. sales of farm products. This population might be fairly characterized as full-time farmers with part-time businesses. At the other extreme, the control PRAs of Tacna, the agricultural activity in the last year was minimal—just three percent. These were full-time business-owners who dabbled minimally in farming. In between, there were groups such as the Puno client PRAs and the Desaguadero PRAs, where about 2/3 of participants carried on both types of activities in the last year, operating their small businesses as well as farming.

In all cases such as these, the proportion of time devoted to farming vs. business operation varies seasonally with planting, harvesting, and pastoral calendars. Farming and microentrepreneurship do not represent the full range of occupations in Peru, but they are the predominant occupations for the sample population. This reflects the fact that these professions dominate the target client groups for PMP's service innovations.

III. THE SUPPLY SIDE: CREDIT PROVIDERS & THEIR PRODUCTS

Like most areas of the developing world, Peru offers a multitude of opportunities to access financial services including credit as well as savings accounts and other services. This chapter primarily concerns one type of financial service—credit at the micro level—because PMP's innovations are of that variation.

A basic distinction with which to sort these sources is between formal/semi-formal and informal credit providers.

FORMAL & SEMI-FORMAL CREDIT-PROVIDER TYPES

Commercial Banks

Peru has its share of traditional, commercial banks. These institutions are fully regulated by Peru's Superintendency of Banking and Insurance (*Superintendencia de Banca y Seguros [SBS]*), have the highest minimum capital requirements, and offer the fullest range of financial services permitted by law. Representatives of the commercial banks stated that historically they have geared most of their credit and savings products only toward Peru's small middle and upper class. Increasingly, however, commercial banks are turning downmarket with at least some of their products, reducing their scale and requirements in an attempt to increase their client bases. One commercial bank—Mi Banco—was transformed from an NGO to a bank in the 1990s with the expressed intent of serving the lower-end microfinance market, at the behest of President Alberto Fujimori. And even in cases when commercial banks have not changed their marketing strategies in terms of credit and savings products, Peru's poor have used and continue to use these institutions for other services such as remittances.

Savings and Loan Institutions (Cajas Rurales & Cajas Municipales)

Savings and loan institutions (hereafter "Cajas") are full-service microfinance institutions, regulated by the SBS. They commonly offer products ranging from loans of various sizes, to savings accounts, to remittance services, to insurance plans. Essentially these are full-fledged banks that specialize in smaller-scale products oriented toward a microfinance client case; they also have lower minimum capital requirements than traditional commercial banks.

Among the two Caja types, the difference is primarily one of ownership. In the case of Caja Municipales, these are considered semi-private institutions in which the primary owner is the municipality in which it is based (Arequipa, Tacna, Cuzco, etc.). Cajas Rurales are fully privatized organizations, with ownership in the hands of investors, general local entrepreneurs.

EDPYMEs

EDPYMEs are another form of SBS-regulated microfinance institutions in Peru; the name is a Spanish acronym that translates roughly as "Organization for the Development of Small and Micro Businesses." They are the least elaborate form of regulated financial service provider

PROFILE OF A YOUNG NGO: ECLOF

Overview: ECLOF's business plan is similar to PMP's in many ways, though it is a much younger institution (since 2002) at an earlier stage of development.

Client Overview: ECLOF has 2,500 clients in Puno. Like PMP, most are urban and the vast majority are women. Also like PMP, ECLOF specializes in serving resource-poor women; many of their clients are reportedly turned down by other micro-lenders.

in the sense that the range of permitted products is still quite narrow. Essentially, they must follow the same restrictions as NGOs—credit only, rather than a full range of services including savings. Their main advantage over NGOs has to do lower operating costs as a result of Peru's tax structure—see discussion below.

Credit Cooperatives

Cooperatives in Peru operate like credit unions—that is to say, they generally offer the same kinds of services as commercial banks, but they are owned and controlled by their members. The SBS is formally responsible for the regulation and supervision of credit cooperatives. In practice, however, most credit cooperatives are supervised by the National Federation of Peruvian Savings and Credit Cooperatives (*Federación Nacional de Cooperativas de Ahorro y Crédito del Perú [FENACREP]*). FENACREP is a federation that is responsible for the promotion, support, and supervision of credit cooperatives in Peru. As most credit cooperatives are only permitted to accept deposits from members (and not from the general public), regulation and supervision of such cooperatives is somewhat less taxing than the regulation and supervision of commercial banks and similar financial institutions.

They are a relatively minor component of the microfinance landscape in these areas and were only encountered in two instances in Tacna.

Consumer Lenders

In Peru, some commercial banks, both domestic and foreign, operate "consumer lending" divisions that specialize in flexible, fast, convenient credit products that generally come with higher interest rates than other microloans. Elsewhere in Latin America, such lenders have achieved considerable popularity, and, in some cases, infamy for lax lending standards.

In these particular areas, they are a small component of the financial landscape—just one example, CrediFácil, was encountered in Tacna. That institution is a division of the Mexico-based Banco Azteca. Banco Azteca applied for a banking license in Peru around 2006, but only received this license in January 2008. In the meantime, it had set up its consumer lending operations – which go by the trade name "CrediFácil" – as a leasing company (*empresa de arrendamiento financiero*). Leasing companies are directly regulated by the SBS. It is unclear whether CrediFácil will continue to be regulated as a leasing company or whether the current CrediFácil outlets will convert into Banco Azteca agencies.

NGOs

NGOs (non-governmental organizations) like PMP fall into the same category as all non-profit institutions carrying out charitable activities in Peru; these institutions simply focus on providing the service of microloans to the country's poor and/or underserved populace. NGOs represent the most basic phase of financial service provision in the sense that they are unregulated by the government and very restricted in the range of financial services they can provide under Peru's regulatory framework. In terms of direct service, NGOs are entitled by law to provide loans only—no savings products, no remittances, etc.—though in some cases those services are provided indirectly through partnerships with other types of financial institutions.

Implications of Peru's Tax Structure

Fully regulated institutions in Peru (e.g. commercial banks, savings and loan institutions, EDPYMES) are taxed differently than unregulated institutions (e.g. NGOs). One of the effects of this difference is a lower operating cost for the regulated institutions, such that loans can be offered sustainably with lower interest rates than those of unregulated institutions. The key points can be summed up as follows:

- NGOs pay a VAT, or transaction tax, of 19 percent of the interest on loans. Regulated financial institutions do not pay this tax.
- NGOs do not have to pay corporate income tax, while regulated financial institutions do pay 30 percent corporate income tax. NGOs must receive an exemption from the tax administration (SUNAT) in order to receive exemption, but this exemption is generally granted.
- In most cases, as a result of the way such taxes are calculated, the 19 percent VAT on interest will cost an NGO more than the 30 percent income tax costs of a regulated financial institution.
- An example helps illustrate this: consider a loan of $100 with 50 percent total interest. An NGO's VAT taxes will consist of 19 percent of $50, or $9.50. For its part, a regulated financial institution must pay 30 percent tax of the net income gained from that loan. Assuming a 10 percent interest paid for the $100, and a 30 percent cost for operational expenses, the net income from the loaned $100 might be $10 (50 percent interest earned minus 10 percent interest paid, minus 30 percent operational cost = 10 percent net income). Over the $10, a regulated financial institution would pay 30 percent or $3.33—close to one-third of what the NGO pays.[6]

Generally, this means that institutions like Pro Mujer have a great deal of difficulty matching or improving on the interest rates of regulated institutions like banks, Cajas, and EDPYMEs.

FORMAL & SEMI-FORMAL CREDIT PROVIDERS CITED BY REGION

Tables 6-8 list the formal financial institutions cited by respondents as available in each of the three primary research areas. Annex D provides further detail on each institution, including range of services, loan portfolio size, and total number of clients.

TABLE 6 - FORMAL & SEMI-FORMAL CREDIT PROVIDERS CITED IN PUNO (PREMIUM MARKET)

COMMERICAL BANKS	SAVINGS & LOAN INSTITUTIONS (CAJAS)	EDPYMES	NGOS
Mi Banco	Caja Rural Los Andes	Edyficar	Pro Mujer
Banco del Trabajo	Caja Municipal Arequipa		Manuela Ramos
Banco Wise/ Scotiabank	Caja Municipal Tacna		ADRA
Banco de la Nación			Caritas

[6] Source: Alfredo Ebentreich, personal communication, 2008.

Banco Continental	ECLOF (see box above)
Banco de Crédito	Red Rural

TABLE 7 - FORMAL & SEMI-FORMAL CREDIT PROVIDERS CITED IN TACNA (PREMIUM MARKET)

COMMERCIAL BANKS	SAVINGS & LOAN INSTITUTIONS (CAJAS)	EDPYMES	CREDIT COOPERATIVES	CONSUMER LENDERS	NGOS
Mi Banco	CajaSur	CREAR	Cooperativa el Tumi	CrediFácil	Pro Mujer
Banco del Trabajo	Caja Municipal Tacna		Cooperativa Santa Catalina		ADRA
Interbank					Caritas
Banco Wise/ Scotiabank					Habitad
Banco de la Nación					
Banco de Crédito					
Banco de Materiales (governmental)					

TABLE 8 - FORMAL & SEMI-FORMAL CREDIT PROVIDERS CITED IN DESAGUADERO AREA (FERIA MARKET)

COMMERICAL BANKS	SAVINGS & LOAN INSTITUTIONS (CAJAS)	EDPYMES	NGOS
Mi Banco	Caja Rural Los Andes	Edyficar	Pro Mujer
Banco de la Nación	Caja Municipal Arequipa		Manuela Ramos
Banco de Crédito			Colmena
Banco de Materiales (governmental)			Caja Comunal
			Fondos de la Apafa
			Caja Escolar

Note on Azángaro:

Interviews in Azángaro (the second Feria pilot site) revealed a narrower range of formal and semi-formal FSPs in operation than in the Desaguadero area (although the extent of the inquiries was much more limited in Azángaro). Three FSPs that also operate in Puno were cited: Pro Mujer, Caja Municipal Arequipa, and Banco de Crédito. Two additional FSPs were cited for the first time: 1) Prisma, a NGO that offers credit services; and 2) Interbank, a commercial bank that offers a range of financial services comparable to other banks in Puno.

OVERVIEW OF INFORMAL CREDIT PROVIDERS

Generally the informal providers of financial services break down into five types:

"THE CHRISTIAN MONEY-LENDER"

Not all money-lenders aim to exploit their fellow citizens, according to one interviewee in that profession.

Abimael was in his 60s and a lifelong resident of the Puno region. He was a lawyer by trade, operating a small law office near Puno's Pino Park.

Abimael has been loaning money for about 15 years, alongside his law practice. He began money-lending because he felt it would be a relatively easy way to supplement his income. His start-up funds came via loans from commercial banks. The interest on those loans was low enough that he could re-loan the money and turn a profit.

He described his client base as lower-middle class, such as artisans and teachers. The clients are all from his immediate neighborhood, and he always knows them at least in passing before they become clients.

Abimael described himself as a devout

Money-lenders

Unlike some areas of the world, money-lending is a lawful though unregulated profession in Peru, and such services are widely used. They were cited as in use by all social classes in all three research areas, though the particular patterns of use varied to some extent by context (see discussion below).

It is difficult to generalize about a diffuse industry like informal money-lending, but this research suggested that most loans are relatively small (under $100) and short-term (rarely more than a few months). The interest rates vary widely; one lender claimed he charges only 3 percent flat (see text box) on a six-week loan, while others were said to charge 30 percent monthly for similar loans. Collateral requirements are generally light, but vary; some lenders require the borrower to hand over possessions of value as collateral. Enforcement mechanisms and late payment policies also vary widely.

A substantial number of money-lenders in these areas double as money-changers. Money-changing is an important feature of the financial landscape of all three research areas, especially as a result of their proximity to international borders (Bolivia and Chile).

ROSCAs (panderos)

ROSCAs in southern Peru are known as *panderos*, Spanish for tambourine, which refers figuratively to the ring-like structure and circular exchange of funds.

The *panderos* in Peru work much like conventional ROSCAs in other areas of the world, as follows: a group of people join and agree to make set contributions to a pot of money on a regular schedule for a fixed period of time. The period of time corresponds with the number of participants. For example, 42 people agree to come together and contribute $20 per week for 42 weeks. Each time they meet, a lottery or *sorteo* is held, and the winner takes home the entire sum contributed that week. In the above example, this would be $840. The contributions and drawings continue week after week, except that the previous winners are no longer entered in the lottery. It continues until every member wins the pot once—in this case: 42 weeks, 42 drawings.

If a member of the group fails to show up and contribute to the pot on a given week, he/she must pay the winner his/her share within a few days, with interest (perhaps 5% of the normal contribution). No-shows are also ineligible to win the pot that week. Since the members generally know each other, there is strong social pressure to comply with the rules of participation and regular contribution.

Panderos were encountered in all research areas, often organized by profession (e.g. market vendors) and/or socioeconomic status (which bears on how high the payment can be set). Many participants viewed the *panderos* as a way of taking out a loan without interest. Uses of the funds ranged from business investments to family emergency coverage. Emergency use was enabled by the fact that winners sometimes make loans to other members with a particular need for money at that moment.

Pawn Shops (casas de préstamo/casas de empeño)

Pawn shops in Peru operate much the same way that they do in other countries. A client in need of a loan brings a relatively high-value item such as jewelry or electronic equipment to the store. The store determines its worth and gives the customer a loan that amounts to a portion of the item's resale value. In Peru, the fraction of the resale value tends to be higher than pawn shops in the United States—perhaps 2/3 of the value, as opposed to 1/3 in many U.S. shops. Loan disbursement takes places almost immediately, assuming the borrowers bring an appropriate item for the guarantee. The client then has a set period (typically one month, though sometimes longer) to repay the loan with interest (typically 10-20 percent monthly flat). Most often repayment occurs in a single sum at the end of period, though partial payments can sometimes be arranged. If a customer fails to repay the loan in a pre-established period, the store takes ownership of the item. The arrangement is enforced by way of a non-notarized contract.

Attempts to impose regulation on pawn shops have been rejected at the SBS, based on the contention that they do not pose any concern for the financial system.

Friends and Relatives

Friends and relatives were common sources of loans as well. The structure of these loans varied tremendously based on the nature of the relationships and the resources available to the creditor. Most often these loans are small and short-term, and used for emergency purposes, with some exceptions.

Wholesalers

Only one form of supplier credit emerged from the PRAs—that is, wholesaler credit provided to market vendors in the town of Desaguadero. Vendors described a process whereby wholesalers of farm produce would leave their products with vendors for a week, which the vendors would sell during that time. In exchange for the service, the vendors were allowed to keep some or all of the leftover produce at the end of week. It is unclear whether wholesalers provided this kind of service for non-food items as well.

NOTE ON DEFINING THE MICROCREDIT MARKET

In considering the institutions that serve the microcredit markets, it is important to note that PMP's current and potential clients are nearly all informal microentrepreneurs of modest means. Such clients might use the conventional commercial banks (i.e. all those listed in the tables as "commercial banks," excepting Mi Banco and Banco de Materiales) for non-credit services such as savings accounts and remittances. Rarely, however, do such clients qualify for the kinds of loans offered by conventional commercial banks. There are certain exceptions to that, including specific "downmarket" loan products developed and offered by such institutions as Banco del Trabajo and Scotiabank. In the vast majority of other cases, current and potential PMP clients are ruled out solely on the basis of operating informal businesses that do not pay taxes. Hence the supply-side of this microcredit market generally consists of formal, semi-formal, and informal sources of credit, excluding conventional commercial banks.

Reasonable indications of "realistic" options for pursuing loans, considered by social classes in each region, are found in the graphs of

"Preferred Sources of Credit" (Figures 7-13) at the beginning of the next chapter (Chapter IV).

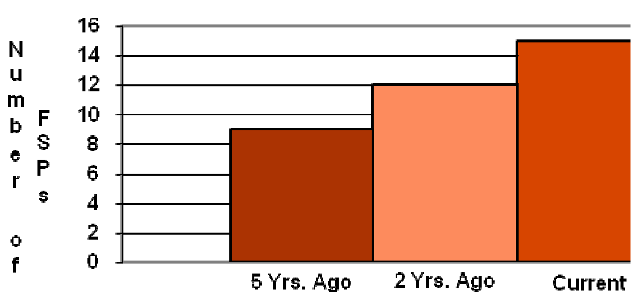
DYNAMICS OF CREDIT AVAILABILITY

Research inquiries focused on the last five years in exploring changes in the financial landscape. In this period, there was a very significant increase in the number of formal and semi-formal FSPs operating in all three primary research areas, with attendant changes noted across the financial landscape (e.g. decline in the level of use of some informal credit options). It was in this period that the current competitive environment among credit providers took shape.

Puno

In Puno, one PRA that focused on dynamics cited 15 formal and semi-formal credit providers operating in the city, a 40 percent increase from those that were known to operate five years ago. Figure 4 illustrates.

FIGURE 4 - REPORTED FIVE-YEAR TREND IN FORMAL/SEMI-FORMAL CREDIT, PUNO



Though PRA questioning did not extend back so far, interviews with FSPs and other research shows the vast majority of the microfinance market in Puno is only about 10 years old. Around 10 years ago, NGOs including Manuela Ramos, Prisma, and Pro Mujer began operating in the area, making some of the first forays into microcredit.[7]

These PRA exercises also focused on relative level of use of individual institutions across this five-year period. The findings revealed that despite a broad intensification of competition within the credit market,

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[7] Certain institutions, including Mi Banco, were offering microcredit services on a national basis well before the emergence of these NGOs in Puno. However, these older organizations had minimal presence in Puno during the period in question (10 years ago and earlier). Mi Banco, for example, did not open its Puno branch until 2006.

the relative popularity of most FSPs remained stable—e.g. Pro Mujer was widely used five years ago and remains so. Three exceptions in this market are noted:

1. ECLOF was described as declining in use over the last two years. Respondents agreed that a trend toward inattentive service and harsh credit evaluations was to blame.

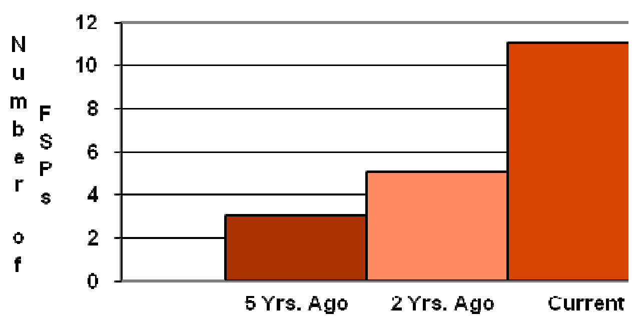
2. Mi Banco declined in popularity somewhat over the same period (though it still came out on top in a ranking of preferred institutions—see next section). Respondents suggested that it was more popular soon after it opened in 2006 because people were impressed by its well-appointed facility and wide range of products. More recently, they suggested, Mi Banco has not followed a trend among FSPs of lowering interest rates, losing some clients in the process.

3. Pawn shops were seen to be declining in use over the last five years. Respondents explained that pawn shops have always been relatively expensive to use, and that they were more popular when there were fewer competing FSPs operating in the area.

Tacna

In Tacna, a steeper progression to the current formal and semi-formal credit landscape was described, displaying a nearly three-fold increase from five years ago. Figure 5 illustrates.

FIGURE 5 - REPORTED FIVE-YEAR TREND IN FORMAL/SEMI-FORMAL CREDIT, TACNA



Additional interviews and research revealed a comparable dearth of microfinance services 10 years ago, with Caja Municipal Tacna and just a handful of others as exceptions dating back that far.

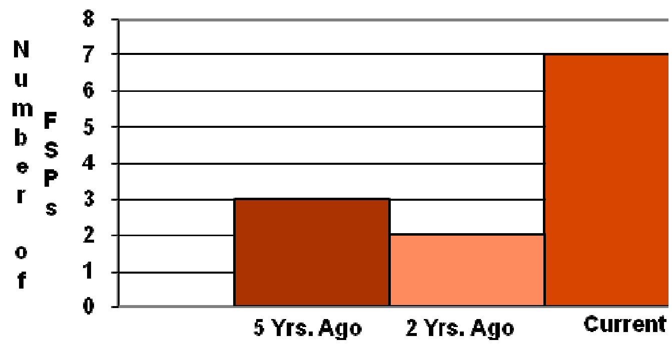
In terms of trends in popularity of individual institutions, many of the institutions currently operating in Tacna were not there five years ago. Among those that endured through this period, very little change in level of use or popularity was noted.

The one exceptional finding was that commercial banks, particularly Banco de Trabajo, rose in popularity over this period. The testimony suggests that commercial banks are increasingly aiming “downmarket” in Tacna in attempt to win clients from the NGOs and other institutions. Banco de Trabajo was described as having very low and competitive interest rates, which was not the case five or even two years ago.

Desaguadero Area

In Desaguadero, the number of current credit providers cited in the discussion of dynamics was smaller, but the progression from five years ago was just as marked. Figure 6 illustrates.

FIGURE 6 - REPORTED FIVE-YEAR TREND IN FORMAL/SEMI-FORMAL CREDIT, DESAGUADERO



Like the other sites, the microfinance market was scant to non-existent 10 years ago in Desaguadero. A handful of FSPs (Manuela Ramos, Banco de Materiales) had a presence extending back that far. At least one FSP, the Banco Agrario, reportedly operated in the area 10 years ago but folded about five years ago due to mismanagement—which explains the non-linear progression in Figure 6.

In terms of changes in levels of use among individual FSPs, again, almost none of the institutions have a long history in the area. The one institution that operated in the area consistently over the last 10 years—Manuela Ramos—was described as declining in popularity over the last five years. Respondents explained this trend as a matter of more competition for the same clients. Over that same period, informal sources of credit as a whole declined in use; again, the explanation has to do with the increasing number of formal and semi-formal FSP operating in the area as compared with five years ago.

DIRECT COMPETITION FOR PMP'S TWO INNOVATIONS

Opening this section is a central question: what is the effect of these markets on PMP as it tries to enter them?

Premium

The Premium product is the largest loan ever offered by PMP targeting a relatively successful segment of its client base, and it is thereby touted as an institutional innovation. Research found, however, that the product is not unique or even unusual in the Puno and Tacna markets.

PMP will face competition from comparable products offered by every level and type of financial institution, from NGOs to consumer lenders. Table 9 displays some examples from each city:

TABLE 9 - EXAMPLES OF COMPARABLE PRODUCTS TO PMP'S PREMIUM IN PUNO AND TACNA

INSTITUTION	TYPE OF INSTITUTION	PRODUCT NAME	LOAN TYPE	LOAN AMOUNT	MONTHLY INTEREST RATE*	INTEREST TYPE	TERM (MONTHS)
Pro Mujer	**NGO**	**Premium**	**Group**	**$667-$2,000**	**4%**	**Declining**	**4-13**
PUNO:							
Caritas Puno	NGO	Individual	Individual	$582 (average)	2-4%	Declining	12
Caja Rural Los Andes	Caja	PYME	Individual	$167-$11,667	2.5 – 3.5%	Declining	variable
Caja Municipal Arequipa	Caja	Crédito Microempresa	Individual	$167-$1,000 $1000-$2,000	3.5% 3.4%	Declining	18-60
Mi Banco	Commercial Bank	Capital de Trabajo	Individual	$100-$1,667	2.5% - 4.2%	Declining	6-60
TACNA:							
Caritas Tacna	NGO	Individual Agrícola	Individual	$800 (average)	2.5%	Flat	12
ADRA	NGO	Cuenta Complementaria	Individual	$267 – no set limit	variable	n/a	6-12
EDPYME Crear	EDPYME	Crédito Empresarial	Individual	$333 - $1,667	3.8% - 4.1%	Declining	n/a
Caja Municipal Tacna	Caja	PYME	Individual	$667-$1,667	2.5 - 3.7%	Declining	18-60
CrediFacil	Commercial Lender	Préstamo Personal	Individual	$1,083 (fixed first-time amount)	4 - 6%	Flat	18
Mi Banco	Commercial Bank	Capital de Trabajo	Individual	$100-$1,667	2.5% - 4.2%	Declining	6-60

*Payment frequency is monthly in all cases

Several points immediately emerge from this comparison, including: (1) that PMP's interest rate is equaled or bettered by most competitors; (2) that the product stands out among its competitions as group loan rather than an individual loan. Both points will figure prominently into later analysis

Feria

As providers of a simple, small-scale group loan in the Feria product, PMP faces competition from a number of other institutions in the Desaguadero area, though fewer than in the case of the Premium in this relatively untapped market. Table 10 outlines some examples.

TABLE 10 - EXAMPLES OF OTHER AVAILABLE PRODUCTS IN DESAGUADERO

INSTITUTION	TYPE OF INSTITUTION	PRODUCT NAME	LOAN TYPE	LOAN AMOUNT	MONTHLY INTEREST RATE	PAYMENT FREQUENCY	TERM (MONTHS)

Pro Mujer	**NGO**	**Feria**	**Group**	**$30-$100**	**4.5% (declining)**	**Biweekly**	**2-4**
Manuela Ramos	NGO	Banco Comunal	Group	$100-$1,000	3.5% (flat)	Biweekly	4-6
Caja Rural Los Andes	Caja	Solidario	Group	n/a	3.5% (declining)	n/a	n/a
Mi Banco	Commercial Bank	Grupo Solidario	Group	$100-$1,667	2.91% (declining)	Monthly	3-12

It should be noted that these products are proposed as comparable mostly by virtue of being available in the same communities. One notes that PMP's interest rate is on par with that of Manuela Ramos (taking into account the difference between flat and declining-balance rates) but higher than both Caja Rural Los Andes and Mi Banco. The PMP loan is on the low end of the scale in terms of size.

The size issue raises the interesting question of whether PMP is going more "downmarket" than its competitors here, offering smaller loans to those who might not qualify for the larger loans of the other institutions. It is possible that PMP will develop this niche in the market, though there was no indication in the research that those who wish to pursue loans in these communities are being excluded from institutions like Manuela Ramos and Mi Banco by virtue of their loan sizes.

PHOTO 2 - VENDORS AND CUSTOMERS AT A FERIA MARKET

SUMMARY ON SUPPLY-SIDE LANDSCAPE

In short, Puno and Tacna are very crowded credit markets. Loans can be acquired by PMP's target clientele everywhere from the street-corner haunts of money-lenders to the spanking offices of commercial banks.

The Desaguadero market is less crowded, but even there PMP faces more than a handful of competitors. All three markets have become vastly more diverse and competitive in the last five years. In side-by-side comparisons to directly competing products, the Premium and Feria products do not offer value over existing alternatives in obvious areas like size of loan or interest rate.

The value proposition of the PMP innovations will be examined against this backdrop in the report's conclusion (Chapter V). Before reaching that point, the report must turn its attention to the insider's view on these credit markets—the demand side.

IV. THE DEMAND SIDE: HABITS & PREFERENCES OF CONSUMERS

Having examined the supply side of the credit equation, the report now changes perspectives and focuses on the current and potential recipients of these services, i.e. the consumers. As in the previous chapter, the discussion focuses primarily on credit, as this is the two innovations are microcredit products. The following pages present a variety of perspectives on these markets, refracted through the lens of the consumer.

SELF-IDENTIFICATION OF SOCIOECONOMIC CATEGORIES

In investigating the demand side, the PRA tools employed in this study included an exercise whereby participants were asked to make very general distinctions among the kinds of people found in their home region. Through open-ended questioning, the exercise solicited an indigenous typology—how people conceive of themselves versus the people around them, and how they imagine their population to be divided up. The purpose is to employ this typology to determine differentiation of the market—whether certain segments of the population are served especially by certain products and services over others; e.g. the rich favor Bank A for their loans, or Bank A excludes small market vendors from taking out loans.

The answers tended to orient toward rather traditional distinctions of social class, e.g. rich and poor. There were generally three different groups that emerged, and most participants saw themselves as members of the middle, largest group.

In the Premium PRAs in the city of Puno, there were a multitude of slight variations on the scheme, but by and large the responses boiled down to three commonly cited economic classes:

- “rich,” (sometimes called “professional”)
- “poor” (sometimes called “middle class”)
- “very poor”

The middle group generally was viewed as the majority of the population; sometimes it was divided into two classes: “poor” and the slightly more affluent “middle class.” Most often this middle group was described as microentrepreneurs, such as owners/operators of stands in municipal markets. Nearly all PRA participants in Puno viewed themselves as members of this middle group.

The “rich” were seen as tiny and distant minority for average Puñenos; some groups omitted reference to the group or claimed it did not exist in any significant form in Puno. The “rich” category was described as professionals or owners of a small number of very large businesses. The “very poor” were seen as a sizeable group of the area’s most unfortunate

SELF-IDENTIFIED SOCIAL CATEGORIES AND ABSOLUTE POVERTY

A common question raised in recording and using these typologies is how they map onto distinctions of absolute poverty—i.e. how poor is “poor”? The question is not a simple one, or destitute citizens. Recent migrants, arriving at the city from the rural hinterlands, were seen to compose the bulk of this group. A typical occupation might be vending candy on the street with a portable display case. This group might have difficulty fulfilling basic needs like adequate food. They were seen to have less access to or use for formal financial services, though they were not viewed as entirely cut off from financial services, as later findings will demonstrate.

In the Feria PRAs, the distinctions were much the same, though the participants clearly viewed themselves as lower on the economic scale. They self-identified as a mix of the "poor" and the "very poor," with the latter referring especially to full-time rural farmers.

The Tacna Premium groups presented an interesting variation on this typology. Reflective of the city's strong commercial bent, some participants presented a three-class division of the population by the type of business they operated; hence:

- store/substantial business owners (highest social class)
- marketplace vendors (middle social class)
- street/mobile vendors (lowest social class)

The majority of participants considered themselves members of the middle group, though the upper and lower groups were represented by a minority of participants as well. The Tacna participants noted definitively that all three groups are served by Pro Mujer.

PREFERRED SOURCES OF FORMAL & SEMI-FORMAL CREDIT BY REGION AND SOCIOECONOMIC CATEGORY

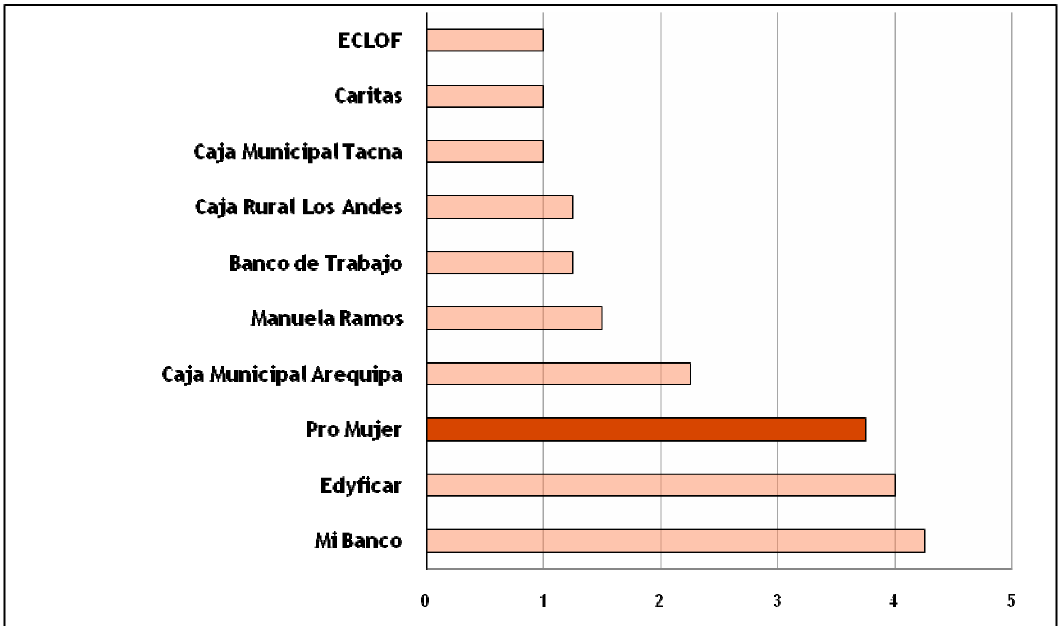
Research elicited a hierarchy of preferred credit providers in each region, and our analysis compares the preferences of different social groups (self defined) in each region. In other words, where do the poor go most often when they need money? Where do the rich and the very poor go? What do they like about the places they go?

The following sections outline the results for each region, beginning with formal and semi-formal creditors. In discussing specific credit providers, respondents were asked to rate them on a scale of usage, from one to five, with five being the most popular and frequently used.

Puno

First, Figure 7 shows the findings for the Premium target market, i.e. the middle socioeconomic group identified by respondents, in Puno:

FIGURE 7 - PREFERRED CREDIT SOURCES FOR MIDDLE SOCIAL CLASS, PUNO



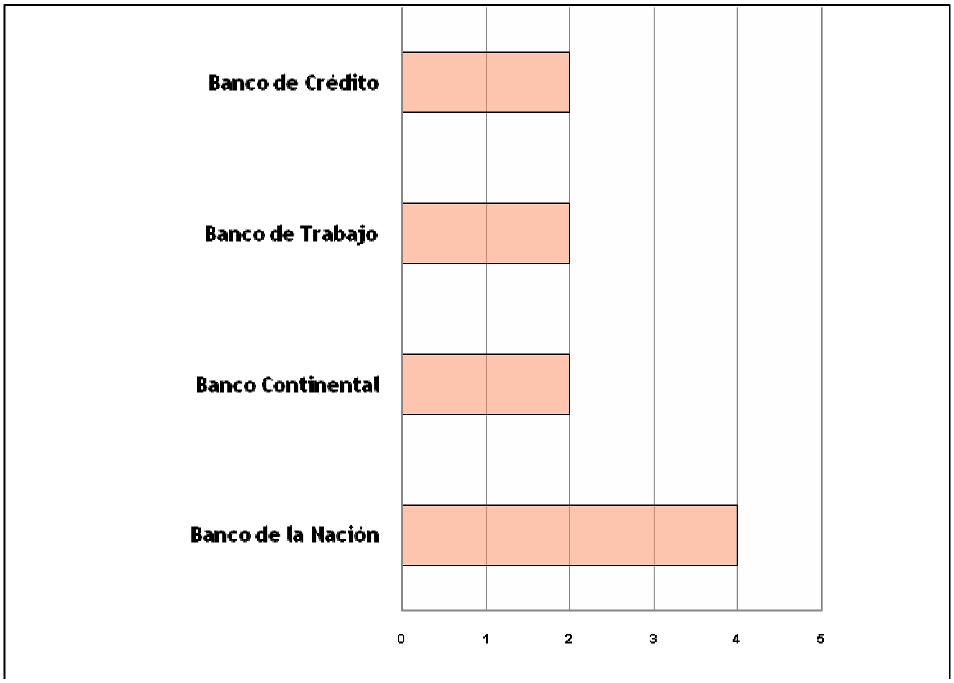
The reasons for preferred status among top-ranked institutions varied considerably. Table 11 lists some of the reasons cited for the top three institutions:

TABLE 11 - PREFERRED USE FOR PUNO MFIS

PUNO INSTITUTION	RANK	REASONS CITED FOR PREFERRED USE
Mi Banco	1	• Low-interest group loans. • Offers good education loans.
Edyficar	2	• Quick loans with few requirements. • Wide range of products for different uses. • Good access to parallel credit. • Good advertising on radio.
Pro Mujer	**3**	• **Quick, relatively easy group loans.** • **Training in credit management.** • **Commitment to serving women.**

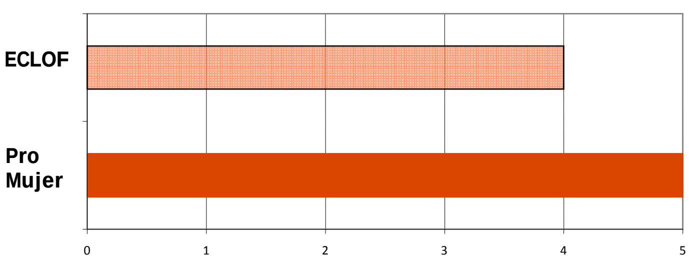
Next, Figure 8 displays comparable findings vis-a-vis the highest socioeconomic group in Puno:

FIGURE 8 - PREFERRED CREDIT SOURCES FOR HIGHEST SOCIAL CLASS, PUNO



Finally, Figure 9 shows the same for Puno's least affluent social class:

FIGURE 9 - PREFERRED CREDIT SOURCES FOR LOWEST SOCIAL CLASS, PUNO



In both cases, the reasons cited for preferred use had to do with perceived market strategies of these institutions—i.e. the commercial banks were seen to cater their products and services to a relatively affluent client base, while Pro Mujer and ECLOF were the only institutions cited as catering to the very poor.

Tacna

Findings for Tacna differed from Puno somewhat in that the highest social class was seen as less small and distant, and PMP was seen to serve that class as well as the other two. In Tacna, as shown in Figures 10-12, we see a distinct progression wherein PMP's position in the market rises as one moves from the city's most to its least well-to-do citizens:

FIGURE 10 - PREFERRED CREDIT SOURCES FOR HIGHEST SOCIAL CLASS, TACNA

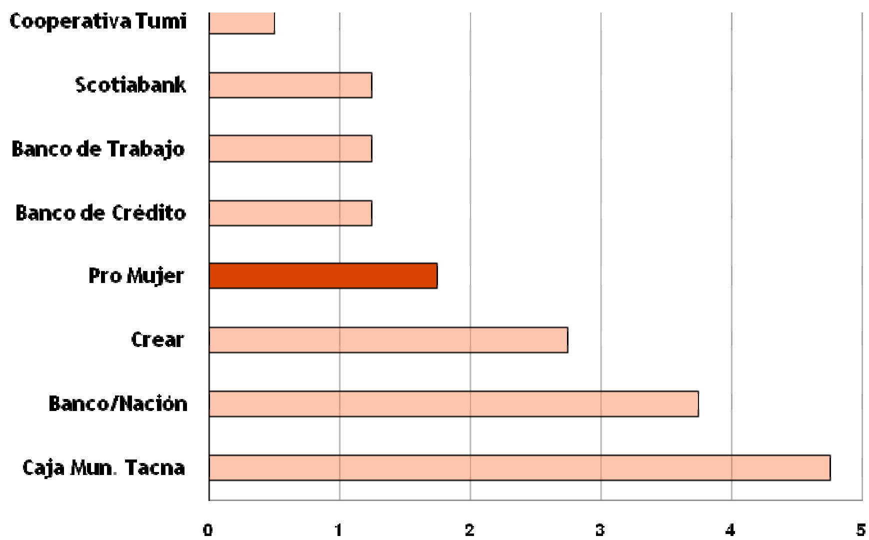


FIGURE 11 - PREFERRED CREDIT SOURCES FOR MIDDLE SOCIAL CLASS, TACNA

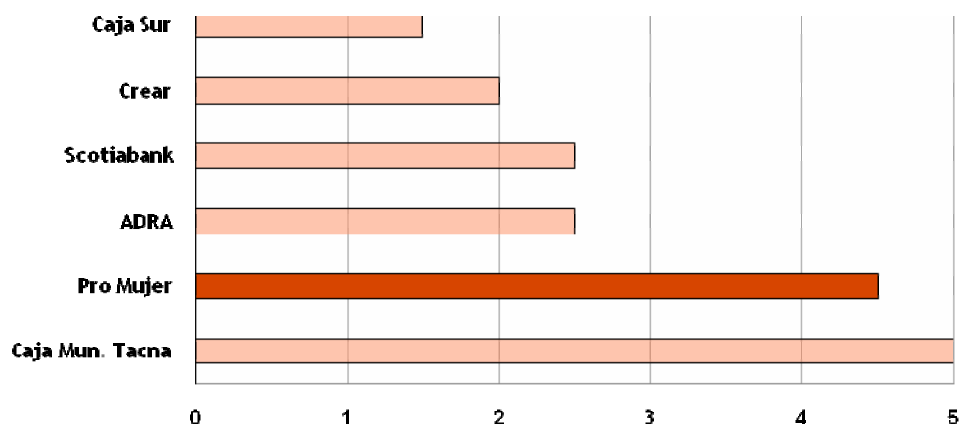
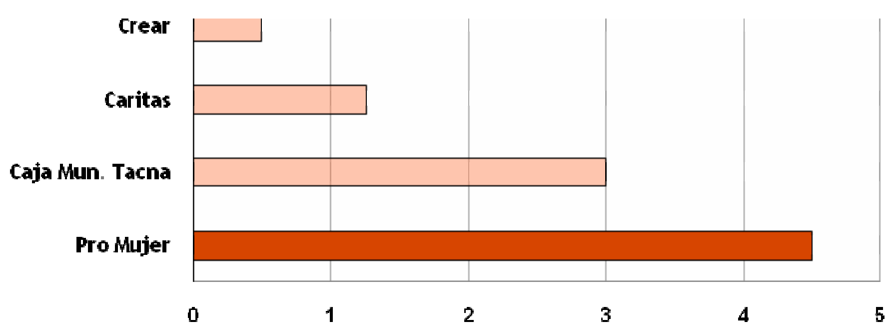


FIGURE 12 – PRFERRED CREDIT SOURCES FOR LOWEST SOCIAL CLASS, TACNA



In terms of reasons cited for preferred use, a closer look is warranted at the two institutions featured most prominently on these lists: Pro Mujer and Caja Municipal Tacna. As noted above, Pro Mujer's position rises as one moves from highest social class to lowest, while Caja Municipal Tacna's position drops slightly.

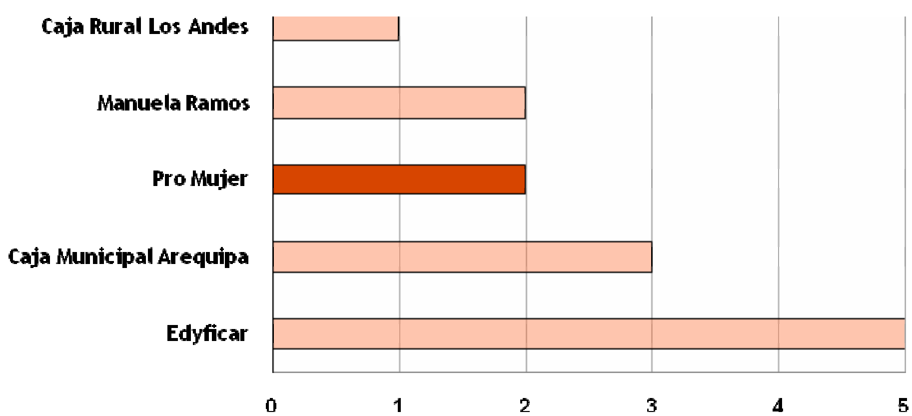
Pro Mujer was described as equitable service provider for all of Tacna's citizens; one respondent called it "designed for everyone, including the very poor." It was also cited for its commitment to serving women independently of their husbands or partners, and for the financial training it offers to women.

Caja Municipal Tacna was regarded as the ubiquitous presence with a long history in the Tacqueña financial landscape. Its products were described as easily understood and reasonable in terms of required guarantees. Service was described as cordial; several respondents indicated that they were given extra days to make payments when they needed them.

Desaguadero

In the rural sites near Desaguadero, the level of experience with formal and semi-formal credit was too low to generate this kind of ranking of preferred sources. In the town of Desaguadero, experience levels were somewhat higher, enough to generate some data, although the PRAs (and perhaps the town itself) are too homogeneous socioeconomically to produce the kind of disaggregation by social class seen in the Puno and Tacna. Figure 13 displays the results.

FIGURE 13 - PREFERRED CREDIT SOURCES, TOWN OF DESAGUADERO



In terms of reasons for preferred use, the products and services of the top institutions were seen as mostly interchangeable; levels of popularity had more to do with relative history in the area. Edyficar was the veteran presence with a considerable history of providing small business loans to people like the PRA participants. Pro Mujer was regarded as the upstart, which was now catching on and taking away some of the clients who previously used institutions like Caja Municipal Arequipa.

USE & AVAILABILITY OF INFORMAL CREDIT BY REGION

In Puno, respondents spoke of widespread use of informal credit providers. All social classes employ these sources of credit, from Puno's richest to poorest citizens. The middle group (i.e. "poor") was reported

"A FAMILY BENEFACTOR"

One interviewee has built his business around the use of family loans. Luis was in the business of distributing propane cylinders used as cooking fuel since 2000.

Luis's first financing was a formal loan from Caja Municipal Tacna. It was a one-year loan of several thousand soles. He paid it off successfully, but was to have the heaviest use of informal sources of credit like pawn shops; this was because the rich could borrow from family members and friends and the very poor could not provide the necessary collateral. Across the board, informal credit tended to be applied toward consumption smoothing—i.e. emergency needs such as a family member's illness or periodic needs such as a family celebration, rather than purposes like capital investment in business.

The findings in Tacna largely mirrored Puno, except that application of the funds was not so heavily skewed toward consumption smoothing. There were additional business-related uses of the loans, especially by the middle ("poor") class of microentrepreneurs—a type of use that might be called "revenue-smoothing." In Tacna, money-lenders position themselves in areas with a high concentration of microenterprise owners, such as municipal markets. The vendors in such markets routinely take short-term, small-scale loans from the money-lenders, to compensate for slow periods of commerce or periodic capital needs. Generally, the loans are quickly paid back as business resumes or picks up. These informal loans are seen as a normal component of microentrepreneurship in the area, in marked contrast to Puno.

In the rural PRA sites near Desaguadero, the use of credit was low across the board, and this included informal sources. Generally people sold animals when a need for consumption-smoothing arose. In town, use was higher, especially small loans from the money-changers, wholesaler credit, and family loans. But, sale of animals again was probably the most common means of meeting periodic capital needs.

PREFERRED FEATURES OF CREDIT BY REGION

PRA questioning also focused on the preferred features or characteristics of credit products—i.e. what was most and least important to respondents in pursuing a loan, including but not limited to formal attributes of the loan product.

Table 12 supplies the results by region, with features in ranked order:

TABLE 12 - MOST IMPORTANT CREDIT FEATURES, PUNO

PMP CLIENTS	NON-CLIENTS	COMBINED
1. Short waiting period before disbursement	1. Low interest rate	1. Short waiting period before disbursement
2. Higher amount	2. Less required documentation	2. Ease of guarantee/required documentation
3. Low guarantee requirements	3. Short waiting period before disbursement	3. Higher amount
4. Socialization (in case of groups loans)	4. Higher amount	4. Low interest rate
5. More variety of products	5. Confidence/trust in the lender	5. Socialization/personal treatment

In comparing PMP clients vs. non-clients, it is first interesting to note that the top feature for non-clients was interest rate, while interest rate did not figure into the top five among PMP clients. This difference likely corresponds with the fact that many non-clients are pursuing individual loans with organizations capable of lending money at lower interest rates (e.g. Cajas), as compared with NGOs like Pro Mujer. This divergence on

CLIENT PROFILE: MULTIPLE LOAN USE

One interview focused on the owner of a sizeable neighborhood bodega (larger than a typical neighborhood storefront operation) near the train station of Puno. Interviewee was in his 40s and a native of Puno, married with two teenage children.

Operation of Business/Use of Loans

Gregorio began the bodega as a very small operation 15 years ago with a loan from family members. He had early success with the business, with which he product type corresponds with other differences in the features as well; that is to say, several of the other top features among PMP clients (e.g. socialization, waiting period before disbursement) are better represented in group products of NGOs than in individual products at institutions like the Cajas, and vice versa for the non-client respondents.

An important question generated by these Puno findings as well as others is whether clients (passively) like what they get or go out (actively) to get what they like. It is difficult to answer based on the available data. Detailed examination of relevant testimony from the PRAs suggests some combination of the two.

The differences between group loans and individual loans do not apply so clearly in Tacna. Here, the client respondents highly valued features with which group loans with NGOs offer no real advantage or present disadvantage—e.g. interest rate. The findings across the board invite the generalization that in business-minded Tacna, all potential clients are concerned first and foremost with the bottom line in their borrowing. Table 13 displays the results.

TABLE 13 - MOST IMPORTANT CREDIT FEATURES, TACNA

PMP CLIENTS	NON-CLIENTS	COMBINED
1. Low interest rate	1. Fewer requirements for loan	1. Low interest rate
2. Shorter grace period	2. Low interest rate	2. Structure/ease of payments
3. Good security around facility	3. Ease of payment process	3. Fewer requirements for loan
4. Less frequency of payments	4. Policy re black marks on credit rating	4. Good security around facility
5. Freedom of use	5. Government regulation (i.e. preference for regulated institution)	5. Policy re credit rating

In Desaguadero, the top features both in-town and in the rural areas correspond mostly with basic bottom-line features of credit products. In both contexts, it is suggestive of a client base with a basic understanding of the credit concept, but little experience to create more nuanced preferences. Table 14 illustrates:

TABLE 14 - MOST IMPORTANT CREDIT FEATURES, DESAGUADERO

RURAL FERIA	IN-TOWN FERIA	COMBINED
1. Low interest rate	1. Freedom of use	1. Low interest rate
2. Good earning potential for loan	2. Low interest rate	2. Less frequent payments
3. Higher amount	3. Less frequent payments	3. Flexibility in use
4. Longer term	4. Fewer guarantee requirements	4. Higher amount
5. Less frequent payments	5. Less required documentation	

TRANSACTION COST DATA

Transaction costs, defined simply as "the cost of carrying out a transaction by means of an exchange on the open market" (Coase 1937, p. 386), are an area of increasing scholarly interest, particularly in the New Institutional Economics school. They are viewed as a ubiquitous consumer issue, fundamental to the functioning of any economy. They are a key mediating factor in mode of production, levels of production, and all manners of market exchange (Furubotn and Richter, 1997, p. 40)

The study was concerned only with transaction costs from the client's perspective. Such costs matter greatly for all microfinance clients in these areas and hence bear upon the value proposition of each PMP innovation. The following tables present some examples of individual experiences with or knowledge of transaction costs that emerged. The aim was to generate transaction costs at the client level in terms of time and money associated with two stages of the financial-service process: 1) the preparation for and travel to the point of service; and 2) the process of accessing service after arrival at the point of service.

Tables 15 and 16 display the costs cited by individual respondents, speaking about average individual experiences, in preparing for and traveling to a point of service to initiate new credit services in two locations: Tacna and Chaca Chaca (near Desaguadero):

TABLE 15 - SELECTED CLIENT TRANSACTION COSTS, PREPARATION FOR & TRAVEL TO POINT OF SERVICE FOR NEW CREDIT, TACNA (PREMIUM)

FSP	DISTANCE CREDIT PROVIDER (KM)	TIME (MIN)	MODE OF TRANSPORT	RT COST	DESCRIPTION OF OTHER EXPENSES	COST - OTHER EXPENSES	TOTAL
Mi Banco	0.4	9	Bus	1 sol ($0.33)	Photocopies; one return trip to complete process	0.40 ($0.13) 1 ($0.33)	2.40 soles ($0.80)
Crear	2	15	Bus	1 sol ($0.33)	Verification fee; refreshment; two return trips to complete process	1.50 ($0.50) 0.50 ($0.17) 2 ($0.67)	5 soles ($1.67)
Caja Municipal Tacna	1.5	5	Bus	2 soles ($0.67)	Photocopies; one return trip to complete process	5 ($1.67) 1 ($0.33)	8 soles ($2.67)
PMP	1	8	Bus	2 soles ($0.67)	Verification fee; fee for mtg space; refreshments for mtg; additional drink; one return trip to complete process	2 ($0.67) 3 ($1) 5 ($1.67) 0.50 ($0.17) 2 (0.67)	14.50 soles ($4.83)

TABLE 16 - SELECTED CLIENT TRANSACTION COSTS, PREPARATION FOR & TRAVEL TO POINT OF SERVICE FOR NEW CREDIT, CHACA CHACA (FERIA)

FSP	DISTANCE TO CREDIT SERVICE	TIME (MIN)	MODE OF TRANSPORT	RT COST (SOLES)	DESCRIPTION OF OTHER EXPENSES	COST - OTHER EXPENSES	TOTAL (SOLES)

	PROVIDER (KM)					(SOLES)	
Caja Comunal	0.03 (in community)	10	Walk	0	none	0	0
Colmena	5 (Juli)	60	Bus	3 soles ($1)			3 soles ($1)
Caja Municipal Arequipa	3 (Yunguyo)	30 (bike) 15 (bus)	Bike and Bus	3 soles ($1)	Photocopies; snack; one return trip to complete process	0.50 ($0.17) 1 ($0.33) 3 ($1)	7.50 soles ($2.50)
Caja Rural Los Andes	Chaca Chaca to Puno (uncertain distance)	180	Bus	12 soles ($4)	Lunch; photocopies; legalization of documents	23 ($7.67)	35.00 soles ($11.67)

Both tables suggest major variation by individual in the resources expended to acquire loan from particular providers in those contexts.

In Tacna, nearly all providers have a local branch, so travel costs were not so much at issue. Instead the variable costs resulted from relative level of required paperwork, highest for some individual loans, or the various obligations associated with group loans, such as the cost of meeting space and contributions toward group refreshments.

In Chaca Chaca, a much more remote site, travel costs were the defining issue. There was tremendous variation between the costs associated with local small-scale credit providers and costs associated with the most distant provider, Caja Rural Los Andes in Puno, which a few members of the community used.

Tables 17 and 18 display transaction costs in the second phase of our inquiries—conducting business after arriving at the point of service in Tacna and Chaca Chaca, for new and existing credit accounts. Again, the results pertain to average individual experiences. Note that the cash outlays associated with these accounts tended to emerge in first phase of transactions inquires (e.g. Tables 24 and 25); as such, discussions regarding this second phase centered on time expenditures:

TABLE 17 - SELECTED CLIENT TRANSACTION COSTS, AFTER ARRIVAL AT POINT OF SERVICE, TACNA

FSP	TYPE OF SERVICE	INITIATING SERVICE OR EXISTING SERVICE?	TIME SPENT IN LINE/ WAITING FOR STAFF (MIN)	TIME SPENT INTERACTING WITH STAFF (MIN)	TOTAL TIME AFTER REACHING POINT OF SERVICE (MIN)	IF NEW, WAITING PERIOD AFTER INITIAL VISIT
Caja Municipal Tacna	Credit	New	60	60	120	3 days
PMP	Credit	New	60	60	120	1 day

Banco de Crédito	Credit	New	8	15	23	15 days
Mi Banco	Credit	New	120	120	240	1 day
Caja Municipal Tacna	Credit	Existing	2	3	5	n/a
Banco de Crédito	Credit	Existing	8	10	18	n/a

TABLE 18 - SELECTED CLIENT TRANSACTION COSTS, AFTER ARRIVAL AT POINT OF SERVICE, CHACA CHACA

FSP	TYPE OF SERVICE	INITIATING SERVICE OR EXISTING SERVICE?	TIME SPENT IN LINE/ WAITING FOR STAFF (MIN)	TIME SPENT INTERACTING WITH STAFF (MIN)	TOTAL TIME AFTER REACHING POINT OF SERVICE (MIN)	IF NEW, WAITING PERIOD AFTER INITIAL VISIT
Caja Rural Los Andes	Credit	New	240	15	255	1 day
Colmena	Credit	Existing	60	60	120	n/a
Caja Comunal	Credit	Existing	10	30	40	n/a

Again, variability by provider seems to typify the data these tables.

It is no surprise that service for existing accounts tends to take less time, though even there we see a range from five minutes to two hours to complete service. For initiation of new service, required time tended to be quite substantial, from two to four hours in most cases. The outlier that emerged was the Banco de Crédito in Tacna, where the process was described as requiring a modest 23 minutes in the bank. However, the waiting period after the Banco de Crédito visit—15 days—was by far the longest such period cited at any of the research sites.

DISCUSSION: TRANSACTION COSTS

It is difficult to draw extensive conclusions about the relevance of this data to the central concerns of this study, given the lack of patterns. To a considerable extent, this variation correlates with scholarly reflections on transaction costs, which have pointed out that such costs are always individualized and heavily mediated by social capital (cf. Benham and Benham 1989; Bourdieu, 1986).

Certainly we can conclude from these sample table as well as other data collected that PMP does not enjoy a consistent advantage over its competition via transaction costs in any of the research areas. At the same time, one must concede little correlation between the transaction costs cited here and relative popularity of the FSP—i.e. PMP and other FSPs remain preferred providers despite higher transaction costs.

Taking a broader view of the data, one can conclude that in some cases, the net transaction costs for some providers in some regions are so high that they negate the value of loans, particularly those on the smaller side. If a particular FSP is not prepared to address that fact, they might reconsider their plans to market products in some areas. If the FSP does wish to address transaction costs, it becomes an immensely complicated and multi-part issue beginning with the moment a client prepares to pursue a loan, to the hours spent in line, to the return visits for account maintenance.

If an FSP—PMP or otherwise—seeks an edge on its competition via lowered transaction costs, the institution must conceive a strategy that effectively addresses the greatest deterrents to uptake, be they paperwork, travel costs, or other concerns. PMP does not rise above its competition on lower transaction costs with the Premium product, nor does it attempt to do so. As the conclusion will discuss, the value of that innovation lies elsewhere. The Feria product, on the other hand, was indeed designed with transaction costs in mind. Here, PMP may have found a tangible means of distinguishing itself from competitors, as the conclusion will address.

NOTE: These transaction costs do not include any loan commission charges, which are generally deducted from the loan amount upon disbursement. Few clients understood these commissions or even knew they existed. PMP charges 2.5 percent commissions on all of its loans, including the innovations, though it offers one percent back if payments are made on time. Commission policies at the other institutions vary.

DISCUSSION: WHY IS UPTAKE OF FINANCIAL SERVICES SO LOW IN FERIA ZONES?

The chapter to this point provides much fodder for the reexamination of an issue that emerges early in the paper: the prevalence of an unbanked populace in the Feria zones studied. As Table 5 indicated, the sample in the Desaguadero area was shown to be 84 percent unbanked. This level of inexperience must be understood as a considerable challenge, as well as an opportunity, to any institution attempting to penetrate the market with new products.

Generally-speaking, the Feria-related PRAs did reveal some demand for loans. However, the stated purpose and amounts for these loans did not always match PMP's proposed plan for the Feria product. Most said they wanted loans to build assets, which in this region most commonly takes the form of livestock. Agricultural inputs and business capital were cited as secondary purposes.[8] The preferred amount for these loans ranged between 500 and 3,000 soles ($167-1,000).

From a supply perspective, the problem emerging from these responses is that livestock loans are complicated to offer and inherently risky, due to the unpredictable elements of animal husbandry. They are especially high-risk when coupled with inexperienced borrowers, like those in the Desaguadero area. Consequently, almost no MFIs operating in the Desagudero area offer livestock loans[9], and indeed relatively few MFIs throughout the world offer them. For its part, PMP has never offered agricultural loans and apparently saw no reason to pursue that direction in their initial formulation of the Feria product. The collective upshot for

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[8] This finding diverges from PMP's market research, which concluded that most wanted loans for business capital purposes.

[9] Caja Rural Los Andes has a livestock loan in its product portfolio, but the study revealed no evidence that such had been offered or taken up by the target client based in the Desaguadero area.

the region is that uptake is hindered because the most sought-after kind of loan is unavailable.

There are other barriers to the uptake of financial services in these areas as well. Across the board, the Feria PRAs, as well as the interviews in the Azángaro area, revealed a distinct “counter-credit” culture in these communities. Many simply preferred not to take loans, no matter what their size or purpose. “I’d rather lose my business than lose someone else’s money,” explained one respondent. Others described loans as a root of pernicious gossip in their communities.

A related issue is the depth of poverty of the scale of the microenterprises in these areas. These are very poor communities by Peruvian standards, and scale of many market vendor businesses is on the low end of the microentrepreneur continuum. There was considerable evidence to suggest that among those who expressed interest in loans, many declined to pursue them because they were deeply concerned about their ability to pay them back.

A final barrier is seen in the prevailing service-delivery model in the Desaguadero area. Most FSPs have no permanent presence in these communities send representatives very infrequently, as seldom as once a year, to promote their products and generate business. By necessity, the product orientation is fleeting. Moreover, those interested cannot pursue the loans within the community; rather, they must travel to a provincial town or city to apply for the loan and then return each time to maintain it. The limited product orientation, the lack of comfort with larger towns/cities, and the transaction costs in time and money all serve to discourage uptake of these products (see next chapter for a precise comparative analysis of transaction costs for pursuing loans in this area).

In sum, there are multiple, unmistakable reasons why this population may be 84 percent unbanked. As the Conclusion will point out, PMP’s Feria product makes considerable strides in addressing some of these barriers, though not all of them.

CLIENT PERSPECTIVES ON PMP

Though research was not introduced as explicitly connected to PMP and did not focus disproportionately on PMP products, we nevertheless recorded a multitude of comments on the organization by current and prospective clients.

In Puno, on the positive side, three major themes to the comments on PMP can be noted:

- There was considerable talk about PMP’s relatively long history and deep roots in the community. It was recognized as one of the first FSPs to serve Puno’s low-income micro-entrepreneurs; several participants suggested that PMP’s business model has been widely copied by newer organizations in recent years.

- PMP was regarded as a champion of Puno’s women. The fact that the organization does not require a husband’s signature for a loan was considered a major plus by female respondents. They also liked the solidarity of the groups composed entirely of women and the training geared to women.

- The group structure of PMP's loans also garnered its share of positive feedback. Numerous respondents spoke of strong social cohesion and interpersonal loyalty among group members. At the same time, respondents liked the fact that a property title was not required, paperwork was minimal, and the process was relatively fast. Others liked the fact that one's word was considered a valid guarantee. Still, others noted that the loans are available to informal business-owners, which is not the case with most commercial banks. Finally, several respondents pointed out that the groups allow for flexible allocation of funds—i.e. if one member needs extra cash at a given time, the other group members can make adjustments accordingly.

On the negative end, in Puno, three major themes also emerged:

- Loan amounts were considered small relative to other institutions.

- Several respondents noted a negative trend in PMP's service over recent years. They claimed the institution's staff offered much more hands-on assistance and support in past years. They also complained about the demeanor of some staff and described high turnover rates among staff at the organization as a whole.

- The group structure of PMP's loans elicited perhaps an equal number of detractors to supporters. The detractors generally delivered the classic complaint about group loans heard by FSPs all over the world: that some clients despise the idea of having to pay for the financial failures of others.

In Tacna, two major themes to the positive commentary are noted:

- FGD clients spoke favorably of PMP's support of Tacqueña women. The comments were comparable to those in Puno. "They open their doors to us," explained one female participant.

- Some clients also spoke positively about the group loan structure, much like Puno. As in Puno, clients spoke of strong social bonds and strong identity that has developed over time within their respective groups. They pointed out that a signature and an ID are sufficient to take loans in many cases. One participant noted that if one member of the group has a positive record in Infocorp (a Peruvian credit bureau), the whole group is eligible for another loan.

In general, PMP drew more negativity in Tacna than it did in Puno. Any number of broad explanations for this difference can be proposed. The most likely explanation seems to be PMP's longer history and deeper roots in Puno and the loyalty that such history generates.

Five major themes to the Tacna commentary can be noted:

- Several respondents pointed out that while PMP's group loans targeting poor women were once unique, many other institutions now offer comparable loans. They recalled a time when the vast majority of (formal) FSPs ignored clients like them, but said the atmosphere has completely changed and highly competitive now.

- Several complaints about loan attributes recurred: 1) small loan amounts; 2) high interest rates; and 3) frequent payments.

- Security at PMP was regarded as a problem. A number of respondents expressed concerns about being robbed outside of repayment points. They noted that commercial banks provide security both inside and outside their buildings.

- The savings requirement drew complaints from some. They felt it was unfair to keep this money "sleeping" and useless in order to maintain a PMP loan.

- Finally, the group loan structure once again drew negative comments. Many participants said they disliked paying for the mismanagement of others. They also pointed out that they waste a lot of time with the recurring group meetings and they cannot accelerate their payment schedule while part of a group (unlike some individual loans).

In terms of the Feria clientele, the level of experience with PMP was too low to discern any themes within the commentary about the organization.

PMP, PREFERRED PROVIDERS, & TOP FEATURES IN PERSPECTIVE

The above commentary on PMP, coupled with earlier data on top-ranked attributes and preferred service providers, combines to raise another important issue in the analysis: how do these findings fit together in characterizing the financial landscape and especially PMP's position within it?

The question is more complex than it may seem, because in all three research areas, there is minimal correlation between the most highly-valued credit features and the credit provided by the preferred FSPs. For example, in Tacna, where low interest rates emerged as the top-ranked attribute, the preferred credit providers were not necessarily those that would provide the lowest interest on their loans. Pro Mujer was cited as a top creditor, even though their loans tend to come with higher interest rates compared with EDPYMEs, Cajas, and commercial banks.

Moreover, when commenting on the individual pros and cons of PMP, as seen in the above commentaries, the negative often seemed to outweigh the positive, especially in Tacna. Respondents complained bitterly about issues like PMP's preponderance of group loans and lauded the better deals to be had at some competitors. Yet even in Tacna, PMP was the top-ranked provider of credit to the very poor and appeared near the top of nearly all preferred lists.

All of this suggests some disconnect between what people say they want and their actual credit-seeking behavior. It shows that individual, stated, highly-valued features may not be drivers of the market. Instead complex interactions of loan attributes and conditions are what likely compel clients toward one service provider or another.

So what are the complex interactions in the case of PMP? Why do clients profess to like the institution so much when specific complaints flow freely in the same discussion? To a considerable extent, we must look past individual complaints to the broader, less tangible issues, though mostly they must be inferred because respondents did not spell them out.

PMP clearly benefits from institutional loyalty, which brings potential to trump preferred product features and many of the individual gripes clients may have about the institution. That loyalty seems to derive from multiple factors, though two in particular: 1) its long history in southern Peru, especially Puno; and 2) its commitment to serving the poor, which likely corresponds with welcoming service to the segment of the population used to being ignored or mistreated by the formal financial sector.

It is difficult to translate PMP's experience into a lesson to follow for newer FSPs. What people seem to like about PMP is the whole package, which transcends the sum of its parts, and some of those parts cannot be recreated by other FSPs (e.g. being one of the very first institutions to offer loans to the poor in Puno). At the same time, the analysis points to complications for market research and product development, as the role of reputation and institutional loyalty is difficult to predict vis-à-vis new product launches. Among other things, it suggests the importance of trial-and-error of product piloting to refine product design, to see how the market reacts to individual features coupled with an institutional "package."

It should be noted that additional exploration of PMP's positionality as a preferred provider in these areas will be take place via the Product Use study, scheduled for late 2008.

SUMMARY ON DEMAND-SIDE LANDSCAPE

PMP is clearly regarded as a preferred credit-provider among the poor and very poor of Puno and Tacna. In both cases, there is less penetration with the highest social class. Beyond that, it is difficult to talk of patterns whereby specific institutions or types of institutions are favored in either region. In the Desaguadero region, low levels of credit use meant limited input on the subject of preferred providers.

In terms of favored credit features, PMP clients in Puno showed more interest in the features of group loans (e.g. less required documentation), while non-clients tended to rank highly the features maximized by individual loans (e.g. lower interest rates). This pattern did not hold true in Tacna or Desaguadero, where bottom-line concerns like low interest rates were top-ranked across the board. The transaction cost analysis suggested tremendous variation in individual experiences. In the cities, the major variables tended to be issues like preparation of paperwork, while in the rural areas, travel to conduct business was the major issue.

As alluded to earlier in the discussion of attributes, taken together these results suggest a certain disconnect in the decision-making about credit. This is to say, the lowest transactions costs and top-ranked attributes do not correlate consistently with the preferred credit providers. All of this suggests a very complicated situation from a marketing perspective—one where credit-seeking behavior is based on a vector of credit features, coupled with difficult-to-measure factors like regional history and institutional loyalty.

V. MOVING TOWARD A VALUE PROPOSITION FOR CLIENTS

This study focuses on service innovations underwritten by BMGF via a 2005 grant. PMP's original proposal to BMGF, part of the multinational innovation project coordinated by PMP's U.S.-based parent organization, laid out the project's primary goal as follows: "to demonstrate through a set of replicable innovations that integrated microfinance and health and human development services can viably and effectively reach poor clients and their families in large numbers, and that village banking can be creatively adapted to serve traditionally unmet markets" (Pro Mujer, 2005).

This study, a baseline in what will be a two-part look at the financial landscape of these areas, aims to shed early light on the value proposition of these innovations for current and potential clients. The findings offer insights into developments and trends that will be re-examined in the endline as well as other components of this research project. The present study serves as an opening to the discourse.

The discussion of the value proposition offered by PMP's two product innovations will begin with two questions that reflect both PMP's stated intent with the products and some of the realities of these credit markets:

1. Premium - In these saturated or near-saturated highly-competitive urban markets, how can PMP retain its clients who have reached a point at which they require a larger loan, and/or re-attract those clients who have left PMP in order to pursue much larger loans with other institutions?

2. Feria - How can PMP penetrate this new rural market in which there is some competition but little experience and considerable doubt about the about the value of credit?

VALUE PROPOSITION AND OPPORTUNITIES - PREMIUM

The Premium product is cited as an innovation for PMP in the sense that the organization has never offered this kind of product in the past, nor segmented its client base in this way. It stands out in terms of its average size—much larger than PMP's traditional loan—and its target client base—a relatively successful subset of PMP's traditional low-income client base.

This scaling up of loan size for a relatively successful segment of microentrepreneurs, however, represents a limited innovation in the context of the credit markets of Puno and Tacna. As Table 9 makes quite clear, there are a range of options in both cities for loans in this range. PMP faces competition at virtually every level of formal and semi-formal FSP in these markets, from NGOs to commercial banks.

On paper, it appears that from the client's perspective the Premium has no advantage over competing products vis-a-vis most highly-valued loan features. These include interest rates, where PMP always will struggle against the offerings of regulated competitors that enjoy a more favorable tax structure. In other commonly-cited attribute areas like loan term and payment frequency, the Premium similarly does not stand out against its competition. Transaction cost analysis revealed no consistent advantage on the part of PMP against its competitors (except possibly on the general simplicity of group loans vs. individual loans—see below).

Moreover, PMP's various training programs, offered alongside credit provision, did not emerge as a significant competitive advantage for PMP against institutions that do not provide training. Though some clients indicated that they appreciated PMP's training, it was rarely mentioned as a major factor in credit-related decision-making.

This is not to say, however, that the Premium offers nothing in terms of value proposition to clients in these markets. Research pointed to two areas of value and opportunity in particular.

Area of Opportunity #1 –Retaining Clients, Building Loyalty

The primary value of the Premium does not derive from product innovation per se. Comparable products are available, many with more desirable features. Moreover, the outreach of the product is entirely circumscribed by the stipulation that only experienced PMP clients are eligible; as such its impact on the populations of the areas will be constrained. Instead, the core value of the Premium product is its relation to client retention.

The Premium product presumably will keep some PMP clients from "graduating" from that institution and seeking larger loans with other FSPs. It has been well-documented in the microfinance industry that long-term existing clients cost less to serve. Moreover, the profit margin on larger loans tends to be considerably higher than on smaller loans.

While client retention as such may pertain primarily to the supply side of the microcredit equation, it links up with a key issue on the demand side: loyalty. PMP enjoys a relatively unique position in those markets. It is one of the oldest and most established microcredit providers in these markets (particularly Puno), and it is recognized as such. It has a reputation for serving the region's most humble credit clients, beginning at a time when those clients were overlooked by nearly all other institutions. Theirs is a stable and positive presence in the region, in the view of most respondents.

With this history comes a strain of loyalty that is difficult for other more recently-established institutions to emulate. The Premium product presents an opportunity for PMP to extend this loyalty to a new level. PMP's more experienced and successful clients no longer need to turn to another institution after reaching a point of prosperity where PMP's traditional loans will not suffice. The product, in a sense, creates the opportunity for PMP to "keep its family together" by rewarding its more successful clients with a product commensurate with their needs. In this way, the Premium product will both draw from and reinforce PMP's reputation as a *continuous* and *reliable* presence in the region (continuity and reliability being two of the highly-valued qualities of credit products cited in the seminal work of Morduch and Rutherford, 2003).

Do these conclusions point to strategic benefit for the institution or net value for the clients? It is a difficult question to answer. For their part, clients may desire to extend their loyalty to PMP even if they receive little in the way of conventional tangibles in return, compared to the loans they might pursue with other institutions. There is also the possibility that, in taking the Premium loan, clients will contribute to the financial well-being of PMP, enhancing its ability to serve more of the neediest microentrepreneurs. This analysis cannot speak to that issue directly; it is hoped that future investigation can shed some light.

Area of Opportunity #2 – The Scaled-up Group Loan Niche

Demand-side testimony very clearly points out that group loans are a controversial topic in these markets. While research did not include quantitative polling on the subject, anecdotal testimony suggested comparable levels of emotion on both sides of the debate—i.e. those who favor group loans and those who disfavor them. Even in PRAs composed solely of PMP clients, participants included both ardent supporters and detractors of group loans.

One strategy for success in a highly competitive context like this is market segmentation and product specialization. Viewed in this light, the Premium loan presents an opportunity to serve a particular segment of the market: those who favor group loans. But within that market, the product is even more specialized: it is nearly the only group loan of its size, targeting relatively successful microentrepreneurs. Virtually all other loans of this scale are individual products.[10] (It is significant to note once again that the Premium was originally conceived as an individual loan, but changed to a group loan after feedback from clients in PMP's market research.)

Even though the clients in this niche are relatively successful, research revealed a variety of reasons for preferring group loans that largely mirror the reasoning of lower-income participants in solidarity groups. In some cases, the reasoning is more personal—clients simply like the solidarity of the group and the socializing that comes with the group meetings, and they want and use the opportunity to carry on that group identity. Others prefer the relative simplicity of group loans. Though putting together a group takes time (up to perhaps a month), once it is complete, some participants suggested that group loans are quicker and easier to obtain than individual loans (though other respondents complained bitterly about the long-term commitment of group meetings). In other cases, despite relative commercial success, these clients cannot satisfy the collateral requirements for an individual loan, which may include the title to a house, a co-signer, and/or substantial business records.

Whatever their reasoning, the Premium product offers a new path to large-scale credit for these kinds of clients. In this way, PMP is injecting new value and a new *flexibility* into these crowded credit markets (flexibility being another one of most highly-valued qualities of credit products, noted by Morduch and Rutherford, 2003). Within this niche, the Premium loan brings the potential both to retain relatively successful clients and re-attract such clients who have left PMP, because neither group will find this particular product configuration elsewhere. There is also the possibility that it will it attract new low-income clients, with the incentive that they will be able to graduate to a larger loan in time.

10 The only major exception uncovered in this research was the "Cuenta Complementaria" loan offered by ADRA to its more successful clients.

Ultimately, however, the Premium's impact as a niche product and hence its innovation will be limited by the restriction on eligibility to experienced PMP clients. The extent of the market for this product and its potential for scalability is and will remain unknown. If PMP genuinely envisions the Premium as a niche product, then this restriction could prove self-defeating.

PHOTO 3 - A STREET SCENE NEAR PUNO

VALUE PROPOSITION AND OPPORTUNITIES - FERIA

The Feria product is an innovation for PMP in the sense that the organization has never offered this kind of product in the past. It targets a new rural client base in the countryside where the organization has had little to no presence to date.

These markets, however, are not pristine in the sense of being free of credit provision now. Table 10 demonstrates that more than a handful of credit options are available, both at the rural markets and at the markets in provincial towns. Moreover, the Feria product does not at present offer a significantly better deal than the competition vis-a-vis highly-valued attributes, including interest rate, loan term, and payment frequency.

Once again, however, this is not to say that the Feria loan offers nothing in terms of value proposition to clients in these markets. Research revealed two characteristics in particular that make the product stand out in these markets, and both represent areas of real opportunity for PMP in serving this clientele. Both have to do primarily with product delivery of the Feria.

Area of Opportunity #1 – Educating Clients, Activating the Markets

The lack of experience and anti-credit sensibilities seen in the Feria market constitute a substantial problem for PMP's entrance. However, the manner in which PMP has chosen to deliver the product presents a relatively unique opportunity to address this problem and serve this inexperienced client base.

As noted earlier, the typical service model, followed by the majority of FSPs with a presence in these areas, involves infrequent visits (as seldom as once a year) by a loan officer to a particular community. There he/she promotes the FSP's products and drums up business. Those who are interested in pursuing a loan must then travel to the nearest branch office, which may be anywhere from a few kilometers to several hours away. In between the infrequent visits, if anyone becomes interested in acquiring a loan, he/she must rely on outdated information from the last visit and/or word-of-mouth exchange about loan options within the community.

PMP's service model is somewhat different and will emphasize *convenience*. The promoters or loan officers will first visit weekly markets to promote the product. Those who become interested must travel to the nearest agency office in a provincial town (e.g. Desaguadero or Azángaro) for the disbursement. From that point, the process returns to the market communities—PMP staff will continue to visit each market on a biweekly basis, where they will promote their products, conduct meetings, and collect payments from existing loan groups.

This level of direct presence in the communities is matched by few other formal or semi-formal FSPs.[11] It presents the opportunity for aggressive product orientation as well as some ongoing financial education in these communities (if PMP chooses to include that in its curriculum). There will be long-term opportunities to demonstrate to potential clients the advantages of using formal financial services, thereby countering the anti-credit attitudes that prevail. And once again, the product delivery will bear directly upon the advancement of overarching credit attributes of *continuity* and *reliability*.

On the whole, PMP's staff of *promotoras* who will be carrying out this work have a positive reputation in the community and seem capable of making this kind of connection, even with a skeptical initial reception. PMP would do well, however, to pay attention to the reports of clients that service and attention have declined in recent years. Those qualities will be the key to capitalizing on this opportunity to create, build, and retain a new client base.

All of this must take place in light of the finding that many vendors of these areas favor loans for asset-building (e.g. the purchase of livestock) rather than for business capital. PMP will have to demonstrate the value of a kind of loan that may not be the preferred option. It is an added, though seemingly surmountable challenge, given the opportunities presented by a recurring presence in these communities.

A final point to note is that the delivery model provides ample opportunity for PMP to promote its other products (e.g. its Regular Loan) in these new markets. The gains need not be limited to the Feria product. Early 2008 results from the Feria pilots suggest that this widening of product promotion and take-up is already occurring.

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11 Manuela Ramos would be the most notable exception, though its loan portfolio and client base is considerably smaller than PMP—see Table A4 in the Annex.

PHOTO 4 - RURAL LANDSCAPE NEAR AZÁNGARO

Area of Opportunity #2 – Transaction Costs

For low-income residents of rural communities in Peru, or peasants anywhere in the world for that matter, transaction costs are an important consideration in accessing formal financial services. The costs in time and money can quickly outweigh the benefits of utilizing a service like formal credit.

Among the service providers currently operating in the *feria* markets, we saw a variety of service models, all of which have different implications for transaction costs. It should be noted that the investigation into transaction costs operated under the assumption that the best models from the perspective of clients are those that offer the maximal level of service within clients' own communities. Such in-community service obviously is the most economical in terms of transaction costs, since they minimize travel costs and waiting.[12]

In terms of transaction costs, PMP's service model offers clients some fairly unique advantages to clients and a distinct edge over most competition. The advantage here pertains to transaction costs associated with travel to the point of service, rather than costs incurred after arrival at the point of service. The key is PMP's commitment to service provision in rural communities where the *ferias* take place, on their respective market days.

Essentially, the process will unfold as follows: 1) PMP's *promotoras* visit the *feria* site and recruit a group of vendors; 2) that group travels to Desaguadero or other provincial town for the disbursements; 3) all subsequent meetings and repayments take place at the *feria* site on market days. The process differs considerably from the more common model, in which MFI staff visit a site, but require ALL subsequent service, including disbursements and all repayments, to take place at the nearest branch office. Moreover, by synching their visits and meeting schedules with market days, PMP in effect eliminates the transaction costs associated with traveling from surrounding villages (where most

[12] The argument here is purely economic—we recognize that other cultural factors (e.g. gossip generated by acquiring a loan in front of one's neighbors) might complicate in-community service provision.

prospective clients live) to the *feria* sites. Because all clients will be market vendors, presumably they already will be at the *ferias* on those days to conduct business.

Table 19 helps illustrate this point. It represents a hypothetical annualized comparison of loans from five different providers, for a client who operates a stand at the Chaca Chaca feria and resides in the nearby village of Batalla. The annualization is based on three group loans (four-month terms) from each of Manuela Ramos and Pro Mujer, and a one year-long individual loan from each of Edyficar and the two Cajas. The comparison is structured in this way to be more equitable, as opposed to one-to-one comparisons between loans, when loans from the NGOs tend to be shorter-term and smaller than those from the other institutions.

TABLE 19 - TRANSACTION-COST COMPARISONS, HYPOTHETICAL LOANS FOR VENDOR AT CHACA CHACA

FSP	FROM BATALLA TO CHACA CHACA, RT (HRS ON BIKE)	NUMBER OF TRIPS TO CHACA CHACA	OFFICE CLOSEST TO CHACA CHACA	PURPOSE OF TRIPS TO OFFICE	NUMBER OF TRIPS BY MINIBUS TO NEAREST OFFICE	COSTS OF TRIP IN MINIBUS, RT	TRAVEL TIME IN MINI-BUS, RT (HRS)	OTHER COSTS (E.G. FOOD)	TOTAL COST	TOTAL TIME (HRS)
Manuela Ramos	0.5	27	Puno	n/a (all service in Chaca Chaca)	0	0	0	0	0	13.5
Pro Mujer	0	0	Desguadero	Disburs.	3	4 soles ($1.33)	1	3 soles ($1)	21 soles ($7)	3
Edyficar	0.5	13	Yunguyo	Disburs. Repaymts.	13	3 soles ($1.67)	0.67	3 soles ($1)	78 soles ($26)	15.21
Caja Municipal Arequipa	0.5	13	Yunguyo	Disburs. Repaymts.	13	3 soles ($1.67)	0.67	3 soles $1)	78 soles ($26)	15.21
Caja Rural Los Andes	0.5	13	Puno	Disburs. Repaymts.	13	9 soles ($3)	6	3 soles ($1)	156 soles ($52)	84.5

This analysis is taken one step further in Table 20, by converting time into money, based on a calculation of the typical daily wage one might find an area like this.[13]

TABLE 20 - CONVERSION OF TIME INTO TOTAL MONETARY COST, HYPOTHETICAL LOANS FOR VENDOR AT CHACA CHACA

FSP	TOTAL CASH OUTLAY	TOTAL TIME (HOURS)	DAILY WAGE	OPPORTUNITY COST IN LOST WAGES*	TOTAL COST
Manuela Ramos	0	13.5	5.33 soles ($1.78)	7.20 soles ($2.40)	7.20 soles ($2.40)
Pro Mujer	21 soles ($7)	3	5.33 soles ($1.78)	1.60 soles ($0.53)	22.60 soles ($7.53)
Edyficar	78 soles ($26)	15.21	5.33 soles ($1.78)	8.11 soles ($2.70)	86.11 soles ($28.70)
Caja Municipal Arequipa	78 soles ($26)	15.21	5.33 soles ($1.78)	8.11 soles ($2.70)	86.11 soles ($28.70)
Caja Rural Los Andes	156 soles ($52)	84.5	5.33 soles ($1.78)	45.04 soles ($15.01)	201.04 soles ($67.01)

* Based on a 10-hour workday, a conservative estimate for peasants in this area

As the tables indicate, Pro Mujer enjoys a wide advantage over Edyficar and the two Cajas in terms of time and money expended, even when counting three separate Feria loans over a year.

Its only competition in this realm is Manuela Ramos, which conducts all of its business in-community, but does not synch its visits with market days (nor does Manuela Ramos specifically target market vendors as clients). As compared with Pro Mujer, Manuela Ramos' particular service model applied to this hypothetical case brings an advantage in terms of money (essentially zero costs) but a disadvantage in terms of time (the client would have to bike to Chaca Chaca for each meeting/transaction, as opposed to being there already for vending). It should be added that Manuela Ramos' credit operations are considerably smaller-scale than PMP's (see figures in Table A4 of the Annex) and represent less competition in that respect.

Pro Mujer would do well to point out this transaction-cost advantage over its competitors in marketing its products to rural customers.[14] Even compared with Manuela Ramos, their model appears quite favorable, especially for market vendors, who would almost never have to travel outside their normal course of business in order to use loans. With the product, PMP may indeed trump its competition in terms of *convenience*, yet another key quality of contemporary credit provision noted by Morduch and Rutherford (2003).

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13 The daily wage figure was calculated as follows: it began with the INEI's latest monthly income figures associated with poverty and extreme poverty in the "sierra rural" regions, locating a mid-point between them (133.2 soles) as an estimation of the monthly income of Feria clients. That figure was then divided by 25, as a reasonable number of days a Peruvian peasant might be available for wage-labor in a given month; hence 5.33 soles/day. The reader should note that no official agricultural wage rates were available.

14 With its focus on client perspectives and experiences, this analysis did not consider the implications of this service-delivery model in terms of the transaction costs for the institution. The in-community service presumably involves higher costs for PMP than most of its competitors—a point that bears upon the net value of the innovations. It is hoped that these issues can be explored thoroughly in future research.

VI. CONCLUSION: LESSONS FOR THE INDUSTRY

With the caveat that this paper represents only the baseline of the study, the analysis of PMP's clients and the financial landscape in which they live carries lessons for the microfinance industry. The points below reflect the challenges as well as potential rewards of implementing what Wright (2004) has called a "market-led, client responsive approach to microfinance":

POINT #1: CONFRONTING THE COMPETITIVE ENVIRONMENT

Industry experts have articulated the value of market research in product development (cf. Frankewicz, 2006), but not all market research is created equal. Here, both new products confirm the need to take a broad look at the competitive environment when investing in such research. This prescription comes in marked contrast to the tendency in market research to focus on individual attributes at the expense of big-picture context (see related Point #2). In the case of the Premium loan, product development seemed to orient around a rather narrow consideration of why clients leave PMP (e.g. to seek bigger loans) rather than why some stay in the context of many loan options. A broad examination of context helps reveal how the different elements of the financial landscape fit together, including the role of complex intangibles (e.g. institutional loyalty). In the case of the Feria, the environment is one in which multiple competitors are offering products of varying appropriateness, and none have really taken hold. Collectively, the landscape suggests that the best route to unlocking the market may be effective product delivery combined with financial education.

POINT #2: THE WHOLE AS GREATER THAN THE SUM OF THE PARTS IN COMPETITIVE ANALYSIS

Market research and subsequent product development tends to get at answers by framing complex socio-economic choices as the net result of multiple, constituent preferences. The case of PMP in the markets of Puno and Tacna demonstrates the limitations of such an approach. In those markets, PMP enjoys a status among borrowers that can only be understood in holistic terms, irreducible to constituent parts such as individual product attributes. It points to the need to consider the *intangibles* in market research—difficult-to-grasp characteristics and collective opinions that may be mostly unstated in testimony.

POINT #3: IS CREDIT ALWAYS THE ANSWER?

The socioeconomic landscape of the Feria zones raises a real question of whether that population will respond in large numbers to any offering of credit. There is evidence to suggest that other financial services (e.g. savings) might resonate more clearly with the attitudes and economic realities of the populace. However, such shifts in product provision are not practicable for an organization like PMP, which is prohibited by law from offering a full range of financial services. It is a quandary that demonstrates the potential pitfalls of a credit-led and credit-dependent approach to microfinance.

POINT #4: ACCESS AS A COMPLEX MATRIX OF PRACTICAL & SOCIAL CONSIDERATIONS

As noted at the onset, this project primarily concerns the issue of access. The Feria product in particular demonstrates how the access can be an especially complex composite issue, far beyond the question of what providers and products are technically available in a given community. *Effective* use of the available options was hindered by at least four factors: 1) inappropriate product design/intent; 2) transaction costs; 3) anti-credit attitudes; and 4) overall poverty and scale of businesses. The case strongly suggests that the product development must include a thorough assessment of the different dimensions of access, including practical as well as cultural considerations, followed by a design that takes as many of them as possible into account.

POINT #5: TRANSACTION COSTS CAN BE MORE SIGNIFICANT THAN PRICE

The Feria transaction cost analysis showed that while PMP may not beat its competitors on conventional price attributes, it certainly outperforms most of them in transaction costs. The difference can mean a net advantage for a provider like PMP. As long as consumers are informed and remain aware of the transaction-cost advantage, it can be a window of competitive opportunity for a provider that has difficulty matching the price features of competitors.

THE FIRST PIECE OF A BROAD IMPACT PICTURE

As noted earlier, this study presents the results of the Financial Landscape Baseline. Approximately three years after this research was conducted (around September 2010), researchers will return to these same sites to carry out a similar investigation that will constitute the endline. The intent will be to document changes in access and in the makeup of the financial landscape—developments that may or may not correlate with the introduction of the PMP innovations. In this way, the Financial Landscape study will provide a more direct window on questions of impact.

In addition, the endline will provide an opportunity for follow-up on a number of questions raised by the baseline results, including:

- Will the preferred providers in each area retain their status, and if so, why?
- Will PMP's status as an FSP rise in any of the service areas, related or unrelated to the innovations?
- How will the trend toward saturated markets in Puno and Tacna play out over the next two years?
- Will the level and purpose of use (e.g. consumption smoothing) for informal credit sources remain stable?
- How will competitors adapt their services (if at all) in the face of PMP's new products, and how will PMP adapt to the evolving landscape?

- Does the Premium product provide enough incentive for clients to stay with PMP over its competitors?

- How important to clients is the Premium's group loan structure over time?

- How quickly will Feria clients adapt to the use of credit, and for what purposes?

- Are transaction costs recognized by clients as an advantage to the Feria product?

- What levels of client retention do both products achieve over time, and what are the key factors affecting those rates?

The results will be paired with a quantitative Poverty Outreach study which began in late 2007. That study employs a customized survey to examine the depth (level of absolute poverty) of outreach to clients who receive the innovations. It is conducted at two points in time—when the innovation is first launched and again three years later. In addition, the project will include a qualitative Product Use survey, to be conducted in the fall of 2009. That study uses interviews to examine how financial service clients use the innovations in the management of households and/or businesses. Finally, an Enabling Environment study on Peru's regulatory system will provide additional context.

These components of FSA will combine different methods and different moments in time to deliver a composite portrait of how conditions change, as well as why they change. The expectation is that the results will contribute significantly to the learning agenda of BMGF and the field of microfinance in general.

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ANNEXES

A. DESCRIPTION OF PRA TOOLS

B. DETAILS ON PRA SAMPLING

C. FULL DEMOGRAPHIC STATISTICS FOR ALL PRAS

D. DETAILED TABLES OF FSPS CITED BY REGION

ANNEX A – DESCRIPTION OF PRA TOOLS

Financial Services Matrix (FSM)

This tool assesses the use of financial services by different market segments in areas targeted by the grantee innovations. It first identifies the groups that use specific types of formal and informal financial products and institutions; these market segments may include, for example, men and women, households at different socioeconomic levels, people in different occupations or businesses, or people living in different geographic areas. It then explores where the different groups fall in terms of preferences; what they like and do not like about the products and services; and their views on how they could be improved. The tool encourages discussion around factors related to convenience, accessibility, and use. Focus group discussions using this tool before and after introduction of the innovation seek to identify changes in access patterns across market segments and institutions.

Financial Sector Trend Analysis (FSTA)

This tool determines how financial institutions, products, and services have been used over time in specific areas targeted by the grantee innovation. The aim is to understand changes in the access and use of various financial institutions over time, and why respondents may or may not have used them. Focus group participants generate a list of financial institutions available this year and at two points of time in the past. They are asked to indicate their level of use to indicate the relative importance of various services over time. Focus group discussions probe how and why each of the services was used more or less over time. The findings provide an understanding of the dynamic (historical context) in which the innovation was introduced, and short-term changes in the market before and after introduction of the innovation.

Product Attribute Ranking (PRA)

This tool assesses respondent perceptions on the key attributes or features of a financial service, documenting the relative importance of those components. It also can be used to understand clients' relative satisfaction or dissatisfaction with certain attributes of a financial service. It generates data on the qualities that matter most to respondents (e.g., an extended repayment period for enterprise loans), the reasons for those preferences, and how those preferences change over time. It can also document relative value of an innovative attribute related to a grantee product (e.g., the ability to access savings through an ATM).

Financial Services Transaction Costs (FSTC)

This newly-developed research tool focuses on the transaction costs (time and money) required to access financial services. Questioning centers on where community members go for such services, illustrated in a map created by the respondents themselves. The map is used as a base to pinpoint the time and money expended after leaving one's home and traveling to the service point. The tool then explores all costs associated with accessing the services at the service point (e.g. standing in line at the bank) and activating the service (e.g. processing time for an application). The results provide insights into the relative convenience of different services, as well as which institutions the clients value and trust and how far they are willing to travel to use these services.

ANNEX B – DETAILS ON PRA SAMPLING

PRA Sampling: Premium Loans, Client Groups

Puno and Tacna served as research sites for the study. Juliaca was eliminated based on the close social and economic parallels between Puno and Juliaca (the two cities, separated by around 30 miles, are seen by some as one contiguous economic zone) as well as the need to keep the PRAs to a manageable number.

In both cities, the PMP branch office produced lists of clients with sufficient experience to qualify for the Premium loan. The original intent was to select participants on a random basis, drawn from a cross-section of neighborhoods and occupational categories in each city. Limited availability of certain client information prevented that precise plan from taking shape. Selection remained random, and the geographic distribution in each city was upheld, but occupation could not be figured into the process.

In Puno, the first two focus groups were assembled by inviting four PMP clients from each of four “Focal Centers” (essentially intra-city branches) representing different areas of the city (Bellavista, Laykakota, Central y Sur). A third PRA was assembled specifically to include the neighborhoods in the southern part of Puno (e.g. Aziruni, Villa del Lago, Laykakota, Leoncio Prado, Huajsapata), the fourth PRA did the same for the northern neighborhoods portion of the city (e.g. Bellavista, Vallecito, Circunvalación Norte, Las Cruces).

Total Puno Client PRAs: 4

In Tacna, the first group was organized geographically around a southern zone including the Alfonso Ugarte neighborhood and surrounding areas. This method proved to be highly inefficient in terms of travel time to make contact with those selected from the list and delivering their invitations. The remaining three groups were organized around single PMP focal centers, each situated in a different quadrant of the city, thereby achieving a reasonable geographic diversity.

Total Tacna Client PRAs: 4

In all cases, the general procedure for individual selection of PMP client-based PRA participants was as follows: the client list from the PMP branch office was narrowed down based on specific geographic criteria. Project consultants chose every 20th name on the resulting list and contacted them to participate. If any individual declined and was unavailable, the name immediately following that individual on the list was chosen. Based on contact information provided by PMP, individual invitations were delivered to the home or business of those selected. As Pro Mujer historically has served only women, all participants in these groups were female.

PRA Sampling: Premium Loans, Comparison Groups

The project also included comparison groups of non-clients, intended to match the client groups in terms of major socioeconomic characteristics. The rationale for including non-clients was that their perspective was needed for the fullest possible picture of the region’s financial landscape. The Pro Mujer client base might be skewed toward a certain type of borrower, for any number of reasons. Moreover, their knowledge of the financial landscape might be biased by their experience with PMP. In the years after its founding, PMP had a policy of exclusive lending—i.e. their clients could borrow from them and no other formal or semi-formal institution. That policy has since been abolished, due to heightened levels of competition, but it certainly limited exposure to other service providers for many years among the longer-term Pro Mujer clients.

In Puno, like the client groups, all participants were business-owners, and they selected from two categories. Fifty percent of the invitations went to market-stand owners at one of Puno's permanent marketplaces—e.g. Laykakota, Bellavista, Mercado Central, Galerías centrales. The other 50 percent of invitations went to microentrepreneurs, both fixed location and mobile, in a distribution of neighborhoods around the city (e.g. Barrio Leoncio Prado, Barrio Mañazo, Villa el Lago, Bellavista, Vallecito, Las Torres) to ensure geographic diversity.

<u>Total Puno Comparison PRAs</u>: 4

Tacna control groups were assembled in much the same way, though with heavier reliance on the principal markets of the city (e.g. Mercado Barreto, Mercadillo 28 de julio, Morro, Tupac Amaru, Gregorio Albarracín, and Santa Rosa). A smaller percentage of participants came from businesses established around the city, in a random selection of neighborhoods.

<u>Total Tacna Comparison PRAs</u>: 4

The selection procedure for individual participants was less systematic in the case of the control groups, in that there were no lists from which to begin. Invitations were handed out on a more or less random basis to vendors and business-owners encountered in the neighborhood contexts noted above. Before the full invitations were extended, project consultants confirmed that potential participants had a minimum of one year of experience with formal or semi-formal financial service provision, and a maximum of 10 years. In many cases, the project's principal consultant, Dony Benique Mamani, exercised personal judgment in terms of offering invitations to individuals whose businesses and socioeconomic status were on par with the Pro Mujer client participants.

Women tend to dominate these economic sectors in Peru, so the comparison-group participants were predominantly female. Some men were selected as they were encountered in these business contexts.

PRA Sampling: Feria Loans

One of two pilot sites for the product, the Desaguadero area was chosen as the focus of research for this study, though the second pilot site—Azángaro—was investigated via individual interviews (see below). The research plan featured two types of *feria*-related PRAs: 1) groups composed of vendors at markets in outlying rural areas; and 2) groups composed of vendors at the market in the town of Desaguadero. The premise was that the two types might present significantly different levels of access to financial services.

In all cases, the sampling was done without consideration of whether participants were clients of PMP or not—i.e. there was no distribution of separate client and comparison groups. Since the Feria was still in its early pilot phase at all locations, it was supposed (correctly) that it would be difficult to find sufficient numbers of PMP clients for separate client-centered focus groups. A very small number of existing PMP clients ended up captured within this sample.

The rural market PRAs took place in two locations, Wapaca and Chaca Chaca, with two groups at each site. Since we could do no more than two groups in a day, and the markets occur only once a week, it was necessary to spread this sample over two locations.

In Wapaca, invitations to the first group went to vendors who resided only in the local community. The second group was composed of vendors who had traveled to the market from elsewhere (the majority of vendors at the market were non-local). In both cases, selection was random, spread among the different types of businesspeople seen at the market, ranging from food vendors to livestock vendors.

Total Wapaca PRAs: 2

In Chaca Chaca, the first group was assembled of non-local vendors, after it became apparent that many of the non-locals left the markets to travel home by midday. A second, later group consisted of local Chaca Chaca-based vendors. A similar random selection was made across the spectrum of specializations observed among the vendors.

Total Chaca Chaca PRAs: 2

In the town of Desaguadero, three of the four groups consisted of randomly-selected vendors who operated stands in the town's market. All of the major specializations within the market were represented. A fourth group consisted of market officials (*dirigentes*) in different areas of specialization, including meat, produce, housewares, prepared foods, and dairy products. The decision to convene the group of market officials was based on the pervasive lack of experience with financial services encountered in the other groups; project consultants wished to put the same questions to these authorities to gain their perspective on why experience levels were so low.

Total Desaguadero PRAs: 4

ANNEX C – FULL DEMOGRAPHIC STATISTICS FOR ALL PRAS

Individual PRAs are categoried in the tables below as follows:

PCLT = Puno client groups (Premium)

PCMP = Puno comparison groups (Premium)

TCLT = Tacna client groups (Premium)

TCMP = Tacna comparison groups (Premium)

FRUR = Rural Feria groups

FTWN = In-town Feria groups

TABLE A 1 - DEMOGRAPHIC CHARACTERISTICS OF PUNO CLIENT & COMPARISON GROUPS

	PCLT1	PCLT2	PCLT3	PCLT4	PCMP1	PCMP2	PCMP3	PCMP4
Female Participants	10	11	6	10	6	2	3	7
Male Participants	0	0	0	0	2	3	2	1
Age	34.9	36.8	46.7	43.7	38.5	40.6	36	36.6
Education [codes][15]	4.1	2.9	2.5	2.8	4.8	5	5.2	5
Total # persons in HH	3.8	4.7	3	5.4	4.4	5.2	5.8	3.5
Total # persons in HH earning money in the past year	1.7	2.7	1.8	2.5	1.8	2.6	2.2	1.8
Engaged in any type of farming activity in the past year? (Y/N)	30%	36%	100%	70%	63%	60%	20%	0%
Engaged in any type of wage employment in past year? (Y/N)	20%	18%	17%	0%	25%	80%	60%	0%
Engaged in self employment or business activity (other than farming) in past year? (Y/N)	100%	64%	100%	100%	100%	100%	100%	100%
Did you use any formal financial institution in the past year? (Y/N)	90%	100%	100%	100%	75%	100%	80%	100%

[15] Educational scale:
No schooling: 0
Some primary school: 1
Primary completed: 2
Some secondary school: 3
Secondary completed: 4
Some university: 5
Finished university : 6
Some professional school: 7
Finished professional school: 8

	PCLT1	PCLT2	PCLT3	PCLT4	PCMP1	PCMP2	PCMP3	PCMP4
Do you have any outstanding loans? (Y/N)	100%	100%	100%	100%	88%	100%	100%	88%
Do you have savings? (Y/N)	90%	82%	100%	80%	38%	20%	40%	38%
Are you a member of a ROSCA? (Y/N)	11%	0%	33%	0%	0%	20%	0%	0%
Are you part of a community welfare society to which you make regular contribs.? (Y/N)	0%	0%	0%	0%	0%	0%	20%	0%
Do you have any insurance? (Y/N)	10%	36%	17%	0%	38%	60%	20%	25%
Do you have access to or own a cell phone? (Y/N)	70%	73%	33%	60%	63%	80%	100%	88%

TABLE A 2 - DEMOGRAPHIC CHARACTERISTICS OF TACNA CLIENTS & COMPARISON GROUPS

	TCLT1	TCLT2	TCLT3	TCLT4	TCMP1	TCMP2	TCMP3	TCMP4
Female Participants	10	9	8	14	0	5	5	3
Male Participants	0	0	2	0	8	2	2	3
Age	35.2	47.7	42	41.7	51	37.6	28.9	43.8
Education [codes]	5.5	4	3.2	4.2	5.4	4.7	4	4.3
Total # persons in HH	5.4	4.2	5.5	4.1	3.9	3.4	3.3	5.3
Total # persons in HH earning money in the past year	2.9	3	3.1	2.2	1.9	2	1.3	1.8
Engaged in any type of farming activity in the past year? (Y/N)	20%	11%	20%	0%	13%	0%	0%	0%
Engaged in any type of wage employment in past year? (Y/N)	20%	11%	20%	14%	63%	43%	57%	67%
Engaged in self employment or business activity (other than farming) in past year? (Y/N)	100%	100%	100%	100%	100%	100%	86%	67%
Did you use any formal financial institution in the past year? (Y/N)	100%	100%	90%	71%	75%	57%	57%	67%
Do you have any outstanding loans? (Y/N)	100%	100%	100%	100%	50%	86%	71%	67%
Do you have savings? (Y/N)	100%	89%	100%	100%	13%	29%	57%	17%
Are you a member of a ROSCA (Y/N)	20%	11%	0%	29%	13%	29%	0%	17%
Are you part of a community welfare society to which you make regular contributions? (Y/N)	0%	0%	0%	0%	0%	14%	86%	67%
Do you have any insurance? (Y/N)	40%	44%	40%	14%	50%	0%	57%	67%
Do you have access to or own a cell phone? (Y/N)	100%	78%	70%	79%	100%	71%	86%	100%

TABLE A 3 - DEMOGRAPHIC CHARACTERISTICS OF RURAL AND IN-TOWN FERIA GROUPS

	FRUR1	FRUR2	FRUR3	FRUR4	FTWN1	FTWN2	FTWN3	FTWN4
Female Participants	6	8	8	5	6	8	6	5
Male Participants	1	5	1	5	0	3	1	3
Age	35	34.5	40	42.3	48	29.9	29.4	25.8
Education [codes]	2.6	3.1	2.9	2.7	1	2.8	3.6	3.9
Total # persons in HH	4.6	5.5	4.4	4.6	4.7	4.5	4.3	5.3
Total # persons in HH earning money in the past year	2	2.4	2.6	2.1	2	2.2	1.7	3.3
Engaged in any type of farming activity in the past year? (Y/N)	100%	100%	100%	100%	67%	45%	86%	43%
Engaged in any type of wage employment in past year? (Y/N)	0%	9%	0%	0%	0%	18%	14%	14%
Engaged in self employment or business activity (other than farming) in past year? (Y/N)	100%	100%	67%	90%	100%	100%	100%	100%
Did you use any formal financial institution in the past year? (Y/N)	0%	0%	33%	30%	17%	9%	43%	0%
Do you have any outstanding loans? (Y/N)	0%	0%	22%	10%	17%	9%	29%	29%
Do you have savings? (Y/N)	86%	45%	100%	90%	17%	0%	57%	86%
Are you a member of a ROSCA? (Y/N)	0%	0%	0%	0%	0%	0%	0%	14%
Are you part of a community welfare society to which you make regular contributions? (Y/N)	0%	0%	0%	10%	0%	0%	0%	0%
Do you have any insurance? (Y/N)	29%	27%	11%	10%	0%	9%	14%	43%
Do you have access to or own a cell phone? (Y/N)	0%	9%	11%	30%	33%	18%	0%	43%

ANNEX D – DETAILED TABLES OF FSPS CITED BY REGION

TABLE A 4 - FORMAL AND SEMI-FORMAL FSPS IN PUNO[16]

	INSTITUTION TYPE	MAJOR SERVICES PROVIDED (TO INDIVIDUALS)	GROSS LOAN PORTFOLIO (NATIONAL)	NUMBER OF ACTIVE BORROWERS CLIENTS (NATIONAL)	AVERAGE LOAN SIZE (NATIONAL)
Pro Mujer	NGO	Credit	$5,604,637	33,650	$167
Manuela Ramos	NGO	Credit	$1,959,345	10,692	$183
ADRA	NGO	Credit	$2,117,182	10,631	$199
Caritas	NGO	Credit	$10,495,351	23,031	$456
ECLOF	NGO	Credit	n/a	n/a	n/a
Red Rural	NGO	Credit	n/a	n/a	n/a
Edyficar	EDPYME	Credit	$79,312,126	84,372	$940
Caja Rural Los Andes	Caja	Credit Savings Currency Exchange Remittances Insurance (planned)	$5,233,183	5,877	$890
Caja Municipal Arequipa	Caja	Credit Savings	$182,650,255	114,020	$1,602
Caja Municipal Tacna	Caja	Credit Savings Bill Pay Currency Exchange	$55,993,697	24,715	$2,266
Mi Banco	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards	$320,419,273	221,802	$1,445

[16] All financial data for NGOs, EDPYMEs, Cajas, and Mi Banco was drawn from the MixMarket profile of each institution (2007). All other commercial bank data was drawn from 2006 annual report of each institution. Annual report data was originally expressed in soles, and an exchange rate of 3.3 soles/dollar was used. The higher exchange rate reflects that these figures draw on business over the last several years, when the exchange held fairly steady around 3.3 soles/dollar.

	INSTITUTION TYPE	MAJOR SERVICES PROVIDED (TO INDIVIDUALS)	GROSS LOAN PORTFOLIO (NATIONAL)	NUMBER OF ACTIVE BORROWERS CLIENTS (NATIONAL)	AVERAGE LOAN SIZE (NATIONAL)
Banco del Trabajo	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards	$334,905,152	n/a	n/a
Banco Wise/ Scotiabank	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards Investments	$2,423,328,485	598,072	$4,052
Banco de la Nación	Commercial Bank	Credit Savings Bill Pay Remittances Currency Exchange Credit Cards	$3,830,837,000	n/a	n/a
Banco Continental	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards Investments	$3,925,206,061	n/a	n/a
Banco de Crédito	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards Investments	$5,723,808,485	n/a	n/a

TABLE A 5 - FORMAL AND SEMI-FORMAL FSPS IN TACNA[17]

	INSTITUTION TYPE	MAJOR SERVICES PROVIDED (TO INDIVIDUALS)	GROSS LOAN PORTFOLIO (NATIONAL)	NUMBER OF ACTIVE BORROWERS CLIENTS (NATIONAL)	AVERAGE LOAN SIZE (NATIONAL)
Pro Mujer	NGO	Credit	$5,604,637	33,650	$167
ADRA	NGO	Credit	$2,117,182	10,631	$199
Caritas	NGO	Credit	$10,495,351	23,031	$456
Habitad	NGO	Credit	n/a	n/a	n/a
CREAR	EDPYME	Credit	$13,016,110	9,426	$1,381
CajaSur	Caja	Credit Savings Remittances	$23,523,333 (net)	n/a	n/a
Caja Municipal Tacna	Caja	Credit Savings Bill Pay Currency Exchange	$55,993,697	24,715	$2,266
Mi Banco	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards	$320,419,273	221,802	$1,445
Banco del Trabajo	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards	$334,905,152	n/a	n/a
Interbank	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards Investments	$1,339,187,273	493,946	$2,711
Banco Wise/ Scotiabank	Commercial Bank	Credit	$2,423,328,485	598,072	$4,052

[17] All financial data for NGOs, EDPYMEs, Caja Municipal Tacna, and Mi Banco was drawn from the MixMarket profile of each institution (2007). All other data was drawn from 2006 annual report of each institution. For CajaSur, only 2005 annual report and net loan portfolio figures were available. Annual report data was originally expressed in soles; and an exchange rate of 3.3 soles/dollar was used (see Footnote 2).

	INSTITUTION TYPE	MAJOR SERVICES PROVIDED (TO INDIVIDUALS)	GROSS LOAN PORTFOLIO (NATIONAL)	NUMBER OF ACTIVE BORROWERS CLIENTS (NATIONAL)	AVERAGE LOAN SIZE (NATIONAL)
		Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards Investments			
Banco de la Nación	Commercial Bank	Credit Savings Bill Pay Remittances Currency Exchange Credit Cards	$3,830,837,000	n/a	n/a
Banco de Crédito	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards Investments	$5,723,808,485	n/a	n/a
Banco de Materiales	Commercial Bank (governmental)	Credit Technical Assistance Emergency Aid	n/a	n/a	n/a
Cooperativa el Tumi	Cooperative	Credit	n/a	n/a	n/a
Cooperativa Santa Catalina	Cooperative	Credit Savings	n/a	n/a	n/a
CrediFácil	Consumer Lender	Credit (other services to be launched in coming year)	n/a	n/a	n/a

TABLE A 6 - FORMAL AND SEMI-FORMAL FSPS IN DESAGUADERO AREA

	INSTITUTION TYPE	MAJOR SERVICES PROVIDED (TO INDIVIDUALS)	GROSS LOAN PORTFOLIO (NATIONAL)	NUMBER OF ACTIVE BORROWERS CLIENTS (NATIONAL)	AVERAGE LOAN SIZE (NATIONAL)
Pro Mujer	NGO	Credit	$5,604,637	33,650	$167
Manuela Ramos	NGO	Credit	$1,959,345	10,692	$183
Colmena	NGO	Credit	n/a	n/a	n/a
Caja Comuna[l18]	NGO (?)	Credit	n/a	n/a	n/a
Fondos de la Apafa[19]	NGO (?)	Credit	n/a	n/a	n/a
Caja Escolar[20]	NGO (?)	Credit	n/a	n/a	n/a
Edyficar	EDPYME	Credit	$79,312,126	84,372	$940
Caja Rural Los Andes	Caja	Credit Savings Currency Exchange Remittances Insurance (planned)	$5,233,183	5,877	$890
Caja Municipal Arequipa	Caja	Credit Savings	$182,650,255	114,020	$1,602
Mi Banco	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards	$320,419,273	221,802	$1,445
Banco de la Nación	Commercial Bank	Credit Savings Bill Pay Remittances Currency Exchange Credit Cards	$3,830,837,000	n/a	n/a

18 A small, highly localized loan fund, limited to the community of Tikaraya near Deaguadero. It is thought to operate as an NGO, though time limitations did not allow for a full investigation.

19 A small, highly localized loan fund, limited to the area of Chaca Chaca near Deagauadero and used only to assist families with school tuition. See footnote #6 re status as an NGO.

20 A second small, highly localized loan fund, limited to the area of Chaca Chaca near Deagauadero and used only to assist families with school tuition. See footnote #6 re status as an NGO.

	INSTITUTION TYPE	MAJOR SERVICES PROVIDED (TO INDIVIDUALS)	GROSS LOAN PORTFOLIO (NATIONAL)	NUMBER OF ACTIVE BORROWERS CLIENTS (NATIONAL)	AVERAGE LOAN SIZE (NATIONAL)
Banco de Crédito	Commercial Bank	Credit Savings Insurance Bill Pay Remittances Currency Exchange Credit Cards Investments	$5,723,808,485	n/a	n/a
Banco de Materiales	Commercial Bank (governmental)	Credit Technical Assistance Emergency Aid	n/a	n/a	n/a