# When coercion takes over: The limits of social capital in microfinance schemes

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# When Coercion Takes Over: The Limits of Social Capital in Microfinance Schemes[1]

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## Social capital in microfinance: why it matters

The United Nations has proclaimed the year 2005 the International Year of Microfinance. Microfinance has been accorded this special attention because it is believed to help people out of poverty. In addition to its clear financial goals, the UN declaration states that microfinance increases the empowerment of women and contributes to the social and human development process in general (UN 1998). Microfinance is expected to be more than a financial service used in the fight against poverty. It is also expected to contribute to empowerment and a social environment that is essential to people's well-being.

The concept of social capital has come to play a pivotal role in the debates, as well as policies, concerning microfinance schemes. There is a growing amount of literature that highlights that social capital is crucial to the functioning of microfinance schemes and that social capital should be strengthened and supported (e.g. Mayoux 2001a; 2001b; Molyneux 2002; Quinones and Seibel 2000; Bernasek and Stanfield 1997). Why has social capital become so pivotal to the microfinance debate and should we foster the attention paid to social capital or should the emphasis on social capital raise our concern?

The attention paid to social capital in the development literature has been accompanied by a change in economics, in which the correction of imperfections in economic and non-economic relations at a micro level dominates the main topic of discussion. It is thought that imperfect information may lead to inefficient projects and schemes, reflected in mismatches between demand and supply. Under such circumstances, individuals have to make decisions about whether to establish or partake in social structured activities in market and non-market organizations or in another organization falling between both types. Here, micro-economics are often used to explain phenomena at the macro level, a practice which has led to different types of new micro-economics: new growth theory; new trade economy; new institutional economics; new household economics; new political economy; etc. In these new endeavors the focus of economics is also directed towards areas that were previously the exclusive domain of the socio-cultural sciences (Fine 1999:2-4).

By using the label 'social capital' instead of the specific terms that are popular within sections of the social sciences, 'social capital' opened possibilities for interdisciplinary approaches have been opened up. Woolcock (1998:188) describes this as follows: 'In social capital, historians, political scientists, anthropologists, economists, and policy makers [...] may once again begin to find a common language [...] that disciplinary provincialisms have largely suppressed over the last one-hundred-and fifty years.' Indubitably, the concept 'social capital' has become so prominent because it offers possibilities for a multidisciplinary approach in which economic and social sciences can be combined (see also Fine 1999; Portes 1998:2-3).

The exact nature of social capital is somewhat nebulous. Likewise, there is a lack of clarity about what role it should play in the field of development. Molyneux (2002:176) even suggests that the conceptual opaqueness of social capital could serve certain interests: 'What social capital means to development agents, and how they think it should be strengthened, differs according to the political and institutional arrangements that prevail and the cultural context in which policies are applied'. It is quite a challenge to define what social capital is but some issues definitely offer a key to the term.[2]

Basically, social capital makes it possible to make a gain through social relations.[3] Particularly in the late 1990s, social capital became a popular concept in risk assessment in the microfinance industry. The microfinance industry deals mainly with the poor, who lack a sufficiently regular and sufficiently high salaried income or enough possessions to be used as collateral. Such conventional collateral has to a large extent, if not completely, been replaced by non-conventional or social collateral. The strength lies in the social constraint mechanism among participants; they exert pressure on each other or on specific participants to encourage payments to be made on time. Here, the security of repayment lies in the

[2] The interpretations of social capital differ enormously. Van Bastelaer (1999) distinguishes three types. The first interpretation restricts social capital to a set of horizontal networks between people and related norms that influence the productivity of the community (see Putnam 1993). Secondly, a broader concept of social capital is associated with Coleman (1990), who includes horizontal as well as vertical associations among people, but also other entities such as private enterprises. The third interpretation encompasses the political and social environment that forms the social structure and enables the development of norms and values. Apart from horizontal and vertical local networks, it also includes institutional structures, such as economic bodies, ... and civil and political privileges.



hands of the customers, possibly in collaboration with agents of the microfinance scheme. Conventional collateral is mainly institution biased.

Social collateral is used as an alternative where the principal emphasis is placed on financial intermediation between borrowers and lenders through groups. Groups include small solidarity groups such as used by ACCION and the Grameen Bank, but may also encompass large credit unions or *caises villageois* (Ledgerwood 1999:77). Microfinance institutions promote change, which 'serves to weaken some aspects of social capital: old networks get destroyed, and a past that contains rapid upheaval may reduce incentives to invest in reputation mechanism' (Stiglitz 2000:64), or in the words of Ledgerwood (1999:76): '[I]t is easier to establish sustainable financial intermediation systems with the poor in societies that encourage cooperative efforts through local clubs, temple associations, or work groups - in other words, societies with high levels of social capital.'

Social capital is regarded as a tool that enables poor, marginal people to organize themselves. In this light, it is treated as a source of power, particularly for women. Mayoux (2001b:438) argues that this lies at the core of microfinance schemes: 'The underlying assumption is that the material benefit which clients receive in terms of access to credit and savings is an acceptable exchange for material contribution in the form of interest rates and social capital'.

Social capital can also be seen as a kind of social glue. It holds society together, working in a similar way to cohesion and solidarity. The concept social capital stresses the positive aspect of dense social networks and community control.[4] It is expected that microfinance schemes will benefit women in particular as it should strengthen women's social networks and institutions and thus contribute to empowerment (see e.g. Hunt and Kasynathan 2001; Milgram 2001).

This summary gives a very positive view of social capital: social capital is expected to give people access to resources through their social networks, with the added bonus of a function as a social cohesive. Portes reveals that social scientists tend to associate social capital too easily with sociability and the positive dimensions of relations: '[I]t is our sociological bias to see good things emerging out of sociability, bad things are more commonly associated with the behavior of the homo economicus' (Portes 1998:15). To achieve a balanced picture, the less desirable aspects of social capital need to be examined in order to avoid a debate that is governed by moralizing statements about what community networks should be like and how control mechanism should work ideally. Undeniably, social capital can have severe negative consequences, such as the exclusion of outsiders, the unwelcome consequences of excessive claims on group members, the restriction on individual freedoms, as well as the highlighting of downward leveling norms (Fine 1999; Portes 1998:10-13). Research in Bangladesh revealed that the donor's attempts to strengthen civil society actually reinforce patronage relationships and inequality, making it even more difficult for people to escape poverty (Davis and McGregor 2000; McGregor 1989). Only if we seriously examine the downside of these dense social networks can we understand what the effects of strengthening these networks and increasing control mechanism are.

Against the prevailing single-sided positive account of social capital, there is a growing literature that contradicts the positive view of social capital. A wide variety of experiences of researchers and developers in the field of microfinance has revealed that social capital is not all it has promised to be. Mayoux (2001b:450) uses the term 'negative social capital' to capture the destructive side of social capital:

> The assumption underlying the paradigm is that social capital is inherently positive and beneficial and can be used by programmes without external intervention to build or increase it. This optimism is based on a very narrow understanding of the concept of social capital focusing on horizontal norms, networks and associations assumed to generate trust and information which can be used by micro-finance programmes (Mayoux 2001b:439).

The existence of the term 'negative social capital' implies that the damaging dimensions of social relations need to be examined. Some literature on microfinance has already exposed these negative consequences of social capital. There are three major deleterious effects

Firstly, emphasis on social capital in microfinance can lead to coercion of and violence towards borrowers. Rahman (1999:70) illustrates this for the Grameen Bank, where one of the female participants could not pay her installments for a couple of weeks. Peers brought her to the bank. 'The bank workers asked the woman to sit inside a room in the Bank and locked the door from outside. The woman felt so humiliated (...) that she hanged herself from the roof-fan by using her own *sari* (women's clothing in rural Bangladesh)'. Cogently, the impact of the use of a control mechanism declines during times of long-term economic problems and increased violence. Under such circumstances, reciprocal relationships between households diminish and consequently social capital deteriorates (Moser 1998:13-14).

Secondly, instead of increasing empowerment and strengthening social relations in such a way that they increase solidarity and social cohesion, the provision of microfinance can also strengthen unequal power relations. This



that social cohesion and solidarity can be particularly burdensome for less powerful members of households. For women in particular it is often difficult to cope with economic adversities: 'While households are an important asset providing security and redistributing income, they can also be sources of inequality for members on whom unequal burdens are imposed' (Moser 1998:12). Given this, increasing social capital and strengthening social relations can strengthen the inequalities that are embedded in these relations. Molyneux (2002) also found that increasing social capital does not necessarily challenge unequal power relations: 'Since power relations within societies are reflected in and reproduced by social networks, women can find themselves disadvantaged' (ibid.:181). Moser (1998) and Molyneux (2002) warn us against the negative consequences that increasing social capital can have on vulnerable groups. Microfinance through social capital might aim to generate equality and empowerment but is in danger of doing just the opposite.

Thirdly, the application of social capital in microfinance can undermine social cohesion and trust. Molyneux (2002:182) describes this situation as follows: '... as far as social capital is concerned, it has been observed that many micro-finance projects, far from creating and sustaining social capital may instead serve to undermined social solidarity in failing to foster co-operative relations among members and creating a socially corrosive competitive individualism.' This is exactly why Portes (1998) emphasizes that social collateral does not always have positive impacts on society. Therefore it is imperative to examine the negative consequences of strengthening social capital. To operationalize the concept of social capital as it will be used later in this chapter, we will focus on the concepts of the social network, trust, and control mechanism. We will take informal financial self-help organizations in India and South Africa as a starting point for gaining an understanding of social capital because this offers the possibility of looking at the relations of people behind the institutions in different contexts.

## Financial self-help organizations in India and South Africa

Before microfinance schemes became an important instrument of development organizations in the eradication of poverty, the poor, as well as the not-so poor, had organized a myriad of financial self-help organizations where the members could save money together, lend money to each other, or insure one another. In fact, these financial self-help organizations were a crucial source of inspiration for the development of microfinance schemes. They revealed that across the globe poverty-stricken people managed to save money collectively, even in the absence of conventional collateral, such as in a legal void, which means that they cannot go to the police or judicial institution in the case of a default.

In the absence of judicial institutions and conventional collateral, social relations become the most important organizational power in financial self-help organizations, leading to many different kind of organizations.[5] Examining urban financial self-help organizations in India and South Africa, provides a comprehensible picture of exactly what these social relations are, under which circumstances they enable someone to gain resources through them, how they can generate trust or distrust in society, and what the dynamics of control mechanism and coercion precisely are. The study of financial self-help organizations in India and South Africa permits the building up of an understanding of the dynamics of social capital, thereby revealing their potential for self-help, as well as their limitations.

A good look at financial self-help organizations in India and South Africa shows the way social capital works in practice. The advantage of looking at these two particular countries is that such an examination can highlight the different contexts in which social capital can be built and maintained, as well as in which instances social capital proves insufficient for the proper functioning of financial self-help organizations.

The Indian examples of financial self-help organizations are provided by Smets. During his research in Sangli in 1990 and Hyderabad in 1993-1994 (Smets 1992; 2000), he came across a myriad of financial self-help organizations. In Sangli, they were called *bishis* and *bishi mandals* and in Hyderabad chit funds and chitties. Finance derived from these self-help organizations was used for many different purposes such as income-earning activities, school fees, dowries, festivals, household utensils, furniture, and shelter. Some financial self-help organizations, like one among the semi-nomadic ethnic group Mandula were even used to finance the building of a community hall with mud walls and an asbestos roof. It is also possible to use participation in a financial self-help organization as collateral to obtain a loan. Some participants use the money from the financial self-help organization for business purposes. Depending on the type of organization, membership varies from fifteen up to a few hundred. The financial self-help organizations are organized among people from a wide variety of castes, religions, and classes. Contrary to popular belief, participation in financial self-help organizations is not restricted only to the poor. It is even popular among bank employees (e.g. Smets 1992) and high-class women (Smets 1998).

Bähre (1996; 2000; 2001; 2002) did research among Africans in Cape Town, South Africa, in 1995 and in 1997-1998. His research focused

[illegible] financial self-help organizations which are



mainly on African migrants who after the abolition of the pass laws in 1986 and with the first democratic elections in 1994 could finally leave the impoverished Bantustans. Most migrants were poor and tried to find employment as an unskilled worker. One of the first organizations that they established was a financial self-help organization. Consequently, financial self-help organizations were one of the first building blocks of social capital among neighboring migrants.

These financial self-help organizations were locally known as *umgalelo, umasiphekisane*, and *umasingcwabane*. The size varied from three up to a few hundred members, depending on the type of organization. Most members used the money to pay for school fees, funerals, furniture, food, and household utensils. Here, money was rarely used for building purposes. Pertinently, many relatives depended on the remittances of labor migrants in Cape Town and financial self-help organizations allowed the migrants to save money for people at home.

### *Social networks*

The kind of network of participants in financial self-help organizations is one of the key dimensions to understanding social capital. A distinction can be made between horizontal and vertical relations, each type generating its own social dynamics. Participants in organizations with horizontal relations often share the same value orientations and power status, but these relations can also be prone to envy, jealousy, ineffective leadership, pressure of different ethnic or religious identities, and the existence of political machine-like organizations (De Wit 1993:26). In a vertical social network, people with different value orientations and power status are linked. An example of a vertical social network is a patron-client relationship or patronage, which is based on expected advantages for both parties involved. A patron expects respect, support, services and/or votes in return for the goods and services he promises and/or delivers to the client(s). Because the patron is the one who can influence the allocation of goods and services, he has more advantages in the bargain and transaction, it is the patron who can fix the exchange price (Ellemers 1969:433-4). Patrons tend to solve conflicts only to such an extent to ensure that some tensions are maintained. In this way, these leaders make themselves indispensable. Similar characteristics can be ascribed to brokers, who are intermediaries in a chain of patron-client relationships. The broker is thus a patron to his clients lower down in the hierarchy and a client of those higher up in the chain (e.g. Burgwal 1993; De Wit 1989:25). These dynamics of different types of networks raises the question: who organizes financial self-help organizations and how are the organizers and participants related to one another?

In the financial self-help organizations surveyed in India and South works in his mother's shop. Together with some of the customers he organized a financial self-help organization, where Rs 2000[6] was collected per month and given to each member in turn. Later, in 1994, Rosal had also become the president of the neighborhood committee and organized a chit fund with twelve men and four women. Most of them were Muslims, except for three Hindu members. Rosal was responsible for collecting the contributions and in return Rosal received a commission. More important than gender and religion for membership in this self-help organization was that Rosal knew them, either as customers of his shop or as neighbors.

Similar membership criteria are applied in a financial self-help organization among neighbors in Sangli. This self-help organization was initiated by social workers who were active in that particular community and who felt that they could provide the participants with a bigger share in the profits compared with other financial self-help organizations in the same area, where participants pay regular contributions to a common loan disbursement fund.

In contrast to the variety of people being organized in financial self-help organizations surveyed in India, most self-help organizations surveyed in Cape Town are organized mainly among immediate neighbors. People who live more than a few streets away are rarely admitted to them. The bulk of the participants are women with children. Men do take part in financial self-help organizations, but they are generally in a minority.

Most important of all is physical proximity: members are selected from within the neighborhood only. One exception is, for example, the burial society; a financial self-help organization that insures its members against funeral costs. Burial societies can become quite large - up to a few hundred members - and these members do not necessarily live close to one another. The reason for this is that it is quite easy to exclude someone who fails to make contributions. If a member does not pay, the burial society will simply provide no money for a funeral. Some men and women also establish a financial self-help organization among colleagues, but this is not very common. One reason is that job insecurity is high and that a colleague might easily be fired, or quit, and literally be lost to sight.

The financial self-help organizations surveyed in India and South Africa are embedded in a fairly dense network of social relations. Notwithstanding the many differences in South Africa and India, face-to-face contact is pivotal. The only exceptions are large organizations, such as some Indian Savings Associations (SAVAs) and some burial societies in South Africa, where fairly low amounts of money are involved. Here, the people save regularly in a common fund for a predetermined purpose.

A close examination of the financial self-help organizations surveyed in contemporary India and South Africa, demonstrably shows that not all



relations are horizontal, and that some financial self-help organizations have horizontal relations only to a certain degree. Let us first look at the accumulating savings and credit associations (ASCRAs). The members of these self-help organizations pool money in a common fund and are able to take out loans (Bouman 1994). If the Indian ASCRAs surveyed are to work, the vertical relations between the organizers and the other participants have to be central to the prevention of default and be able to exert sufficient control. The centrality of a few leaders in the organization also make it possible for many members to join: after all, not all the members have to be trusted by all fellow members as long as the leadership does its job properly. Cogently, leaders often make use of linking a couple of participants in such a way that one is also responsible for the repayment of the loan of the other.

In the South African ASCRAs studied, relationships are much more horizontal. All participants know each other quite well and most live within view of one another. The participants within this dense network of neighborhood relations have to trust each other and in one instance clearly threatened and put social pressure on a neighbor to get back their money through seizing possession of household items. Although the relations are horizontal in Cape Town, in contrast to the preponderant tendency for vertical ones in India, in both the Indian and South African case studies the confiscation of household items is a final resort by which the members retrieve their money in case of default.

Let us now look at the SAVAs where members pool money and eventually divide it among each other (see Smets 1996). For example, members of a SAVA among the Mandula in India created a fund for a collective good: the construction of a temple. The participants paid relatively small contributions. Once the temple was built, the size of the contributions increased and the SAVA was transformed into an ASCRA. Central to this self-help organization were the community leaders who actually used the SAVA for the collection of fines, which emphasis the vertical relations within the organization. Control and power were therefore part of the institutions that dealt with deviant behavior and were borrowed from the rule of traditional norms and values among the Mandula. Unlike this Indian example, Bähre did not come across people in Cape Town who have organized a SAVA for a collective good. Membership of a SAVA is here much more exclusive because the members save for personal goals. In the South African SAVA and ASCRA, only a few people are responsible for organizing the fund at the bank. As mentioned, relations are more often horizontal than they were in India, although the web of relations is not very dense. The combination of horizontal relations with a dispersed social network has made these organizations vulnerable to fraud, or at least allegations of fraud. The few people who had to be controlled could therefore not be managed completely.

*Trust*

The success of financial self-help organizations depends largely on trust. As Putnam (1993:171) argues: '[t]rust lubricates cooperation. The greater the level of trust within a community, the greater the likelihood of cooperation' (see also Luhmann 1979:64). The interest in trust is not a new phenomenon, but regained attention in the 1990s (e.g. Fukuyama 1995; Misztal 1996; Seligman 1997; Smets et al. 1999). Trust can be gained through face-to-face contact, long-term acquaintanceship and mutually reliable credentials. But it can also be considered as reliability in an abstract system such as an institution, where faceless commitments are made (Giddens 1995:34, 80-3). For the latter type of trust, Luhmann (1988) suggests using the word confidence instead of trust.

The success of a financial self-help organization depends largely on trust in the people who participate in them and is based on social relations, much less on trust in institutions. Trust is often not a priori present in India and South Africa. Nevertheless, many people do organize financial self-help organizations and in most instances financial self-help organizations function very well. Participants in financial self-help organizations are mostly aware that they are taking risks, as they do not know the exact financial situation of other participants or their willingness to pay. Pertinently, the poor often do not know if they themselves will always be able to contribute properly. The insecure circumstances in which they have to live, because of unemployment, irregular work in the informal sector, or dependence on others for financial support make it difficult for them to predict their own financial situation in the near future. To trust another person as participant in a financial self-help organization is problematic, because of the difficulty in obtaining insight into people's financial circumstances. This permits no more than an estimation of their trustworthiness. But, how is this trustworthiness established?

Trust has to be understood by analyzing the social relations of people co-operating with one another (see also Bähre and Smets 1999). Trust is intimately related to people's behavior and face-to-face interaction. Co-operation on the basis of blind trust is very rare. This does not mean that institutional trust, or confidence, is completely absent. For example, in the 1970s when a large ASCRA in Sangli collapsed because of default, financial self-help organizations had to cede some of their popularity became less popular in that neighborhood, because people no longer trusted each other. Only years later, when these feelings had abated, did people again start to organize ASCRAs.

Although trust cannot be achieved completely, people do have means to lessen the risks that they take. Such measures concern the relationships they have with ... and particularly the building of reputation. As Bailey



bankrupted; about gossip and insult and 'one-upmanship; in short, about the rules of how to play' the social game and how to win it.'

If trust is earned, apart from income, it is based on financial behavior, restricted or no use of alcohol, the reputation of a person's household, and behavior in observing religious rules. In other words, people have to earn trust on the basis of proved behavior, but in certain situations, such as inter-caste relationships, ascribed trust and distrust determine the trustworthiness of persons (see Knorringa 1999).

A person does not always find it easy to judge the trustworthiness of other people. A shopkeeper, for example, has a closely-knit network of clients of whom he knows a bit more about their family situation. He can also keep an eye on clients who have not paid their debts in time. Such a person could be trusted as an organizer of a financial self-help organization, even when the participants do not know each other sufficiently well to judge each other's trustworthiness.

In South Africa, for example, mothers are regarded as being more respectable and trustworthy because they have the responsibility for their children. Some women even pretend to have a child for this very reason. Because many children do not grow up with their parents but live with relatives in the Eastern Cape, it is quite feasible to be a mother even though there are no children in the household. Many women also complain about men who are not regarded as respectable because they are said to drink too much alcohol and are content to laze at home unemployed. In India, experiences were similar. Rosal, for example, explained that 'ladies are very prompt in making payments. The ladies think that they should not be blamed for delay in payments. It are the gents who postpone it.'

Reputation only matters in a fairly dense social network and if people interact with one another frequently. Under such circumstances, a person's reputation matters because people who a re said to misbehave or who were known to be dishonest are avoided. But ascribed reputation can also work against trust. It is difficult to refuse a person who enjoys a high status in the community membership of a large financial self-help organization, even though that person is known to be a troublemaker. In other words, people who are not really trusted can sometimes still join the financial self-help organization. One problem is that it is sometimes hard to keep the organization unknown to outsiders. Some people may find out about it through gossip and force their way into the financial self-help organization. In India, moreover, people who behave strictly according to moral and religious codes - and therefore ought to us have a good reputation - are also treated with some suspicion when it money matters come into play. If a person behaved so appropriately towards the outside world, surely he must have something to hide, reasoned some participants. Also in South Africa, distrust is an invaluable element in relationships which emerges me most jealousy and it is usually people whom a person knows very intimately who might become jealous and cause harm (Bähre 2000; 2002).

Generally, people are often reluctant to trust one another. The low-income participants in financial self-help organizations almost invariably live in economically and politically insecure environments. People tend to distrust rather than trust one another. Only after a relationship has been established, can distrust begin to be dissolved although it never disappears completely. In both research areas, the judiciary system and policing do not provide a source of trust as they often malfunction or perhaps because financial self-help organizations are not recognized by law. The neighborhoods are often violent and especially in the South African townships studied by Bähre (2001) mafia-type organizations have tried to gain control of all economic activities. Now, the increasing spread of AIDS in India and South Africa is damaging the trust in one another, because the chance that people will drop out because of ill health or death is great (see for Southern Africa: Athmer 2001).

### *Control*

Reputation not only allows people to trust one another, also functions as a form of social control. Control mechanisms can play an important role in enforcing behavior. Control can, like trust, be distinguished into institutional and social control. Institutional control or control of an organization, place, or system refers to the set-up and enforcement of regulations provided by those institutions to influence people's behavior and actions. Social control refers to 'social processes by which the behaviour of individuals or groups are regulated. Since all societies have norms and rules governing conduct [...] all equally have some mechanisms for ensuring conformity to those norms and dealing with deviance.' (Marshall 1994:485). Social control is often strongly presented among members of financial self-help organizations. People do not want to acquire a bad reputation and this compels them to comply with the rules and regulations of the organization. Because people often know one another in more than one context, default in a financial self-help organization also has consequences for other activities and relationships.

A financial self-help organization can also be an instrument by which community leaders enforce social control. For example, a financial self-help organization among the Mandula was used for the collection of fees. Whenever someone behaved defiantly within the Mandula community, that person had to make a financial contribution to the fund. Moreover, whenever someone got married, Rs 1000 had to be contributed. This money was used for a festive communal meal at the wedding in order to relieve some of the financial burden entailed by the marriage. In practice, however,



a communal meal organized with the SAVA money, they needed to serve a meal for wedding guests.

In South Africa, mutual exchange systems, which also take place in financial self-help organizations, can also function as a form of social control. For example, commuters charge a pack of Mcintosh sweets if a fellow commuter had missed the train. This helped them to get up early and catch the right train into the city to be at work in time. From what began as a 'game' the commuters developed a financial self-help organization (Bähre and Smets 1999:57).

Whenever a member fails to contribute, or is expected to fall short, social control functions as a way which ensures that the member still pays. This can vary from malicious gossip or spreading rumors, to personal visits to the member. Who makes such a visit depends on the kind of relations. If the relations among members are vertical, the organizer of the financial self-help organization is expected to take on the duty. If, however, financial self-help organizations are more horizontally organized, it is more likely that a group of members will pay such a visit. For social control to work properly, it is important that members live close to one another, or else have other places where they cannot avoid each another. Some rules of the ASCRA also function as a form of social control. All members are expected to attend at all the meetings. Some feel this is inconvenient and prefer to put the money in an envelope and ask a fellow member to take it along. They have to pay a small fine as a penalty for not attending the meeting. More importantly, members who are not present at the meeting are then not allowed to borrow money from the ASCRA. Only those who turn up can borrow money. Cogently, the loan hardly ever exceeds the financial contribution that the member has made in the past. Because of the horizontal relations, many members feel responsible if a fellow member does not pay in time and are therefore willing to put pressure on the member.

In India and South Africa, financial self-help organizations with horizontal relations appear to be more sensitive to social control than the financial self-help organizations that are organized by one or a few leaders. It therefore does seem that, as Putnam found in Italy, horizontal relations are more likely to be found with social capital than are hierarchical relations.

Social control is not the last resort that people turn to, as it is not always sufficient to prevent default. For example, Smets (1992) came across a financial self-help organization where the secretary was accused of fraud. The secretary had pocketed money that, according to the books, had been disbursed as loans. In another instance, the leader of a SAVA used the money for personal gain and was accused of having used it for building a house. Because many poor South Africans are almost illiterate, it is quite easy for the organizers of an ASCRA or burial society to cheat. The calculations are often complex while interest rates and transaction costs economic sector, it does not lead to a permanent and complete collapse of financial self-help organizations.

In addition to social control, members apply physical threats and threats of confiscation of property. The pressures that are put on members can be quite severe and incidentally they have led to suicide, or possibly murder. For example, in Sangli the third cycle of an ASCRA was coming to its end, but the money had not been recovered in time. Just before the money had to be paid back to all members, the person responsible committed suicide. Some people told Smets that the account books had been burned in order to hide that the total collected fund of Rs 500,000 was gone. For South Africa, Lukhele (1990) has described how a man who was robbed of the money of a burial society was found dead hanging from a rafter at a railway station three days later.

The visits that people pay to members are mostly far from pleasant and are often hostile. Smets (1992), for example, describes how the organizer of a financial self-help organization kept on trying to get in touch with a member who had failed to contribute. The member, however, was in permanent hiding and the organizer could not get hold of him. Shrewdly, the organizer found a way to make sure that the member could not avoid him. In this neighborhood in Sangli residents had no toilets in their homes and had to relieve themselves on a special designated public field. The organizer stood guard and finally caught the man. He publicly humiliated him and scolded him. In the meantime, the defaulter had felt very uncomfortable because he had to relieve himself but could not do so. This way it was made sure that he paid the contribution.

Bähre also found that women were pressurized at meetings and visited in their homes. Members of one ASCRA visited a woman who failed to return a loan and they took virtually all her humble belongings, such as a black and white television, pots and pans, and the curtains. They sold these belongings among the members for very cheap prices and used that money to repay the loan. Although the woman was very poor, and although the participants felt very uncomfortable about what they were doing, they nevertheless resorted to confiscation and public humiliation (Bähre 2002). In another instance, tensions within a self-help organization led to rumors about witchcraft (Bähre 2001).

Reputation, social capital, and trust were not always sufficient guarantees to ensure financial self-help organizations functioned. Although social capital was built up to some extent, even among African migrants in Cape Town who hardly knew one another, it only solved the problems of collective action to some extent. At some stage there was always the, often implicit, threat of coercion, confiscation, destruction of one's livelihood, and physical violence. This raises serious doubts about whether financial self-help organizations would be able to function on social capital alone and



about their organization positively by stressing solidarity, trust, and mutual support, it is essential to look beyond this image and be sensitive to other mechanisms behind it, such as the threat of violence and the confiscation of property.

## Cautions for the microfinance industry

As shown above, social capital as wielded in financial self-help organizations is a powerful tool because of the implicit threat of physical violence and the confiscation of household utensils. These threats seem to work very efficiently and limit the incidence of default in financial self-help organizations. For microfinance institutions, it is assumed that relying on social capital, including peer pressure, will cover the risks of default, especially when conventional collateral is lacking. Here, just as in other kinds of economic development, social capital is seen as a powerful instrument.

A well-known case of the use of social capital in group-based microfinance institutions is the Grameen Bank, which gives small loans to more than 2 million poor borrowers. Although the repayment rate is as high as 97 percent (see e.g. Woolcock 1998:182-7), Jain (1996) revealed that group guarantee is actually not practiced and is not the reason for the bank's success. According to Rahman (2001:2):

> many of the borrowers of the project become victims of institutional use of social ideology; they encounter intense pressure from joint-liability model of the Bank for timely repayment; they maintained their regular repayment schedules, but do so through a process of loan recycling (i.e., pay off previous loans with new ones) thus, build considerable debt liabilities for the household, and face with unintended consequences of the erosion of social safety-net and group solidarity, as well as encounter aggression and violence.

Any effective use of social capital by microfinance institutions appears to be restricted. In such institutions physical violence cannot be tolerated because of the legal status of these institutions. When fieldworkers of microfinance institutions use violence or confiscate goods in the case of a default, they are operating outside the legal system. We cannot imagine a system of law that allows people to be their own judge and jury in the case of default. Admittedly, at present the legal system in many developing countries is not functioning properly, but once it has been improved, these self-help punishment practices will be out of the question. Clients of microfinance

The microfinance business is being encouraged to reach 100 million of the world's poorest households, especially the women of these households, with credit for self-employment and other financial and business services by the year 2005 (Micro Credit Summit 1997). This target encourages microfinance institutions to serve the poor, although these institutions are often unaware of the fact that their intervention can destroy or harm the operation of 'informal' financial self-help organizations and the function in which they serve their beneficiaries. In other words, '[t]he new policies erode the traditional forms of safety net.' (Rahman 2001:7). The situation is even worse when the intervening agency makes use of a top-down approach, without seriously consulting the beneficiaries (for urban Indonesia see Lont, in this volume).

For example, employees working for the Indian Grameen Bank replica SHARE said that they never bothered to look at existing financial self-help organizations in a specific village where they wanted to set up savings and credit groups. Indeed, they were not aware of the fact that people already had self-financing arrangements or that their intervention could destroy or harm existing savings and credit associations. They even condemned the traditional systems as backward and claimed their scheme would be better.

Also in Gambia (Africa), intervention did not seem to be beneficial to all. The poor in particular benefited less from the scheme:

> [T]he traditional kafos [self-help organisations] had an explicit village welfare objective, the NGOs and the VISACAs [village banks, established by an NGO] are trying to develop local institutions with more of a business approach to savings and credit. Villagers with more assets may find they are better served by NGOs and VISACAs than they were by traditional kafos. But the marginal population may be rationed out of these NGO activities. (Nagarajan et al. 1994:219)

Smets' research in India has also shown that the involvement of the development sector can do more harm than good to social capital:

In one of the slum areas in Hyderabad a woman entered the neighborhood and told the dwellers there to leave their chit fund (ROSCA) and join a savings and credit scheme introduced by the church. The dwellers gave up participation in their chit fund and started to participate in the new scheme after being motivated by the organizer to do so. However, when she stopped organizing the scheme, everything collapsed. Moreover, the trust between the dwellers was harmed and they did not trust each other any more. As a consequence they did not dare to start their own chit fund.

Bähre found that in Cape Town NGO schemes for housing found themselves in competition with existing financial self-help organizations,



When existing social capital is destroyed and replaced by new capital, introduced by an intervening agency, trust relations among the community members can be impaired. It will take a long time before new initiatives will flourish. Wilson (1997:756) shows that social capital is obtained and rebuilt step by step by individuals in concert action with others. One of the consequences of the promotion of top-down initiated self-help is that social capital is taken for granted as the key to the building of microfinance institutions. This is all the more alarming when the 'new' self-help scheme harms established means of social capital, self-financing arrangements at a community level are seriously harmed.

Social capital should not be glorified as the solution in microfinance. The financial self-help organizations have shown the importance of social capital combined with severe threats and actions against members. Some doubts could be raised whether the microfinance institutions should and can reproduce such mechanisms, as illustrated below.

In Mozambique, a microfinance project had promoted solidarity groups of three to five people. Within each group, all members were held responsible for the repayment of credit obtained for income-earning activities. Moreover, each member had to indicate certain productive or household assets as security, which could be confiscated in the case of a default. Both security measures are formalized in a contract between the peer group and the lender. Should a default occur, the project was not permitted by law to confiscate these goods but could make use of the peer factor. However, the group members refrained from doing so and asked the project management to step in. A new solution was found by employing the police as debt collectors, against a fixed percentage of the installments collected. After a local human rights commission protested against these illegal practices, it was immediately stopped. In this project, the peer factor did not work because the group members considered the project to be rich; they did not want to confiscate goods from their peers, who defaulted. In addition, the legal system was very weak, which minimized the possibilities open to the microfinance project to take legal steps (personal communication from Gabriëlle Athmer).

At a meeting in South Africa the functioning of a microfinance programme came up for discussion. One of the organizers proudly said that the microfinance scheme had worked out very well and that the members were very 'committed'. She gave the example of a woman who had used the loan to start raising chickens. She was so 'committed', the organizer explained: the member had not eaten all day and went to bed hungry in order to repay her loan installment to the microfinance institution. The fact that she did not even eat in order to repay was regarded as a sign of the success of the microfinance institution. The fact that it is unhealthy to stop eating and that the woman was probably afraid of the consequences of such instances the microfinance institution receives more attention than the people who participate in it. As Rahman (2001:7) eloquently put it:

> The current practice of microfinance reveals that the term 'microfinance' refers only to a vehicle without saying that (sic) is in it or where they are going. Sadly, there is a growing fascination among us with the mechanics of microfinance, with the vehicle. There is less and less concern about the passengers and their destination. Unless, we turn our attention back to the passengers and the destination of that vehicle, we will lose our way.

These experiences are only some examples of the havoc that microfinance institutions can cause when they attempt to rely on social capital. When they embark on such an undertaking, microfinance institutions are in danger of creating more financial problems for the poor, increasing inequalities and violence, damaging existing organizations that have important social security functions, as well as diminishing trust in society. If intervening agencies aim to establish microfinance schemes, they should first consider whether any intervention is required at all. If intervention is required, they have to look beyond simplistic models of society and culture and instead consider what the consequences are when social capital is relied upon.

## Conclusion

In order to cope with risks of default among the poorer sections of society, social capital (network, trust and control) is a powerful dynamic instrument in financial self-help organizations. Social capital works well when one of its main weapons is losing face, but also it can also involve threats of violence and other drastic sanctions such as the confiscation of goods. In the microfinance industry, social capital is considered a useful instrument in the absence of conventional collateral. However, the effectiveness of the use of social capital is dependent on the possibility of the imposition of severe sanctions and violent behavior. In microfinance institutions, the threat of violence and confiscation of goods is limited because of their legal backing. In other words, the process of institutionalization creates an inherent friction with social capital. An increased process of institutionalization goes hand in hand with a process of decreasing effectiveness of the use of social capital. This can be attributed to the incommensurability of powerful threats and actions with the institutional framework of microfinance organizations. We hope that this hypothetical statement will encourage researchers, policy makers, and fieldworkers to obtain more insight into the



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# Secrets of Institutional Transformation: The Low Politics of Financial Self-help Organizations in Post-Colonial Africa[1]

Otto Hospes and Mark Prosé

## Introduction

One of the most difficult tasks of those studying member-based financial self-help organizations in developing countries is to describe, analyze and compare their institutional complexity - taking a perspective of change and assuming that the development of such organizations is an expression of and contribution to many other processes (Bouman 1994). The first problem to be tackled is their diversity in terms of 'being', of functions, embeddedness, scale and meanings. The organization is possibly part (of the activities) of a labor group, care arrangement, religious society, migrant population, government programme or foreign development project (Hospes 1996:145-70; Kappers 1986; Mrak 1989). Rahmato's case on rural institutions in post-revolution Ethiopia is exemplary:

> The institution that is of interest to us is the *edir* which is universal here and to which virtually every household belongs. On the surface the *edir* is a burial society, the kind commonly found elsewhere in rural Ethiopia or Africa. However, a closer look reveals that the organization is a multi-purpose body, with wider and more socially-oriented responsibilities. [...] In many communities the larger *edir*, which may have a membership of 300 or more households, is often sub-divided into smaller *edir*, sometimes called *amba*, consisting of 50 or more households. The following are the most important cooperative and support activities carried out through the *amba*. First is the mutual exchange of labour to help families [...] Connected with this is the practice of supporting families unable to farm their land due to old age, widowhood or serious physical disabilities. [...] Secondly, *amba* provides credit services to its members: needy peasants have access to

[1] This article draws heavily on conceptual and fieldwork undertaken as part of the comparative WUR-FAO research (1998-2001) called 'The Forgotten Dimension of Rural Development: Savings of the Rural Poor - A Cross-Cultural Review of PPP and other Savings Arrangements in Zambia, Tanzania, Al