Luxembourg Round Table on Microfinance

MICROFINANCE WEEK – LUXEMBURG

Capital markets – European dialogue – RURAL FINANCE

Guidelines

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I. Introduction

During this microfinance week it has been agreed to go beyond the results of the Ouagadougou " Dialogue on financing family farming in Burkina Faso, Mali, Niger and Senegal " organized by SOS Faim, as requested by the MAE.

Conditions of family farms in Africa and the Sahel area in particular had been analyzed, and ways to improve farmers' access to available finances had been suggested:

- how to bring financial services to villages?
- how to create links between farmers' organizations, MFI and rural banks?
- how to offer adequate financial products?
- How tofind solutions for :
  - farm equipment credits;
  - adequate securities;
  - interest rates adapted to farming activities?

In Luxemburg, representatives from Sahel countries will be joined by those from other African countries (Mali, Niger, Burkina Faso, and also Cameroon, Benin, DRC and Ethiopia) as well as those from South- and Central America (Peru, Bolivia, Ecuador, and Nicaragua) This will allow for a more comprehensive debate.

In Ouagadougou each participant had presented his own practical experience in family farming as well as with micro financing in that context, its constraints and his opportunities.

In Luxemburg, participants will try to describe those constraints and opportunities with greater precision, giving figures if possible, in order to suggest realistic guidelines (if not solutions) for the short or medium term.

4 main topics will be on the agenda:

- Farmers' requests which have to be described with greater precision (access to financial services)
- Financial products which would have to be adapted to such requests
- Existing financial aid structures for farmers (efficiency, management)
- Involvement of rural organizations

One more topic (5) not to be mixed up with the other 4 :

- Financing of the rural IMF, existing and future facilities

II. Concepts which need some refreshing and clarification:

1. <u>Rural financing or agricultural financing?</u>

- Rural financing is not limited to financing of <u>farming activities</u>
- There are activities outside farming which may be an alternative for people in rural areas:

    - trading farm products (small local shops, cereal banks, traders, collectors, wholesale dealers…)
    - manufacturing farm products
    - transportation of farm products (renting and maintenance of vehicles,…)
    - trade with farm inputs
    - interim credits (food for working members of a family during periods of intense work)
    - etc.

- Other agricultural activities, of course, (cattle breeding, fishery, forestry …)
- One could also say : financing of <u>global rural activity</u> in a wider sense,
- And any other non-farming activities in rural areas.

The problem to be debated is the following:

For which activities are people in rural areas really <u>willing to apply for credits?</u>

Such trends will have to be explored with the highest possible precision before suggesting any guidelines to improve access to credits.

The majority of small credits are fungible; rural MFI with precise statistics over the use of the funds allocated are very rare. Some, though, realised impact studies and/or have a fairly good knowledge of their agents' use of the funds.

Those institutions attending the week in Luxemburg, which have some experience in this field, are kindly invited to lead a debate on the following subject: what is the actual demand for financial services in rural populations (amounts if possible) and what are objective difficulties on the ground?

What kind of new solutions have they experienced? Financing global rural activities in a wider sense according to plans of certain MFI? Financing a more speculative line outside agricultural lines classical? Specific financial support for family farms?

Examples: For revenue crops in a stable production line, financial operators are ready to invest in a complete technical package (often up to 30 %) , provided, as for cotton in Mali, Benin or Senegal, the operator seals off the business line and has a total control in the sector, it can fund up 100 %of the necessary inputs.

For other food crops (family farms selling their surplus) it is a different story. Some farmers prefer to finance their farming activity with their own funds obtained with the help of non-agricultural activities, which in turn are financed through credits. Others again would accept credits only to pay for the manpower needed to extend production surfaces and/or to “save” a crop.

On the other hand, as soon as a production line becomes commercial (market gardening) producers and their associations (potato sector in Fouta Djalon in Guinea f.ex.) and MFI as well, may choose to fund the line more thoroughly.

In the breeding business, credits are asked to finance activities such as meat chickens or laying hen or fattening cattle (beef, sheep, goats). Some MFI consider such investments as secure and profitable, others hesitate, as they fear clogging of markets, should too many farmers use such credit facilities. Sometimes breeders are offered to buy cattle for short periods only before selling it again.

It will also be of interest to see how “rural” MFI are handling multi purpose credits (only one single credit use is declared, but the borrower uses it according to his priorities, ex.: trade for one part; breeding on his farm for another and, finally, for various social needs.)

Another interesting subject concerns collective credits: (1) collective or individual investments in mills, oil extractors, forges, woodwork...? (2) Motor pumps and irrigation systems? (3) Collective trading/ consumption (silos, cereal banks)?

Many MFI strongly mistrust the first and have reservations about this type of investments, except for individual cases. They would accept the second more willingly, provided the”group” has been able to prove its ability to ensure proper management. They readily accept the third kind, as the securities are easy to find.

The activities of villages or groups acting as acting financial intermediaries in these fields would be another worthwhile aspect of the same subject.It will be appropriate to examine the “gender“ aspects in the debate and to analyse the importance of products specifically designed for women (credit and training): When will these have accomplished their mission of integrating these categories who are often left at the margins of society? When will these beneficiaries be considered as full fledged customers?

The cliché of specific microfinance for women is a topic which deserves to be taken up.

2. Interest rates: a never ending problem

Is it a real problem?

It probably is! When we are talking about financing an agricultural campaign. In other cases they can be adapted to the activity concerned by the credit.

And the MFI’s efficiency in all that?

Most of the time their relative inefficiency in rural areas is explained by great distances between customers, by the “ atomization” of customers.

What experiences have participants made so far? (Rates offered can differ widely, according to available documents)? What solutions can be imagined to squeeze rural rates between brackets still 'acceptable'[1] for sound management, down from REAL rates reaching from 12% to 17%, financial costs not included?

- Participation of beneficiaries to transfer some operating costs to these?
- Promotion of financial units (groups, villages…) acting as intermediaries?
- Streamlining costs and /or temporary subsidies from support units?

Example: a large scale "cotton" campaign is financed with a rate of 9% by a Mali bank consortium, while the autonomous self managed banks of the same beneficiaries are not able to offer that rate.

What if (massive) subsidies were a solution, as suggested in the minutes of Ouagadougou? How could such "mega funds" of subsidies be created or accessed?

Is this phase of rural financing (experienced already many times) not over?

3. <u>The question of real securities</u>

Is this a real challenge? The uncertainty about land and property rights certainly is a problem for the poor, but is it really a problem for MF?

Anyway, for small credits, securities are too expensive to be legally defined (if they exist at all – mortgages perhaps !), and foreclosure proceedings are very expensive (used at great cost sometimes to state an example!)

Microfinance, in rural as well as urban areas, has built its reputation on its capacity to mobilize other types of securities (group guaranty, social pressure…); is a real security not the easy solution to trigger a forced sale? And to ruin a borrower who had no proper "assistance" in assessing its proposal been given when he/she asked for his credit?

Some MFI, though, have come up with imaginative solutions (or, rather, adapted classical solutions to MF):

- hire-purchase schemes
- MFI contracts to purchase equipment from a borrower – receded to the borrower in a hire-purchase scheme – until maturity.
- warrants for cereal trade (problems of warehousing goods under supervision of a MFI or an intermediary (village).

Let us try to cope with this subject in a concrete way, without getting carried away by clichés laments about the absence of securities.

4. <u>Medium term credits, offer and demand</u>

Is it really the lack of long term funds to finance medium term credits which limit the MFI ? They do finance short term credits (4 to 12 months) with short term savings accounts, as long as they are able to control it statistically.

Obviously there is a problem of regulations(the PARMEC law in West Africa f.i.). But there are sometimes good solutions: projects are often ready to "store" funds with MFI which are then able to provide long term funding (loans); MFI can access long or medium term loans from other financial institutions .

Just keep digging and you will find many other reasons such as the ones that follow, often heard:

- draught oxen are very suspicious to MFI unless you can certify regular veterinary checks, or show a sound life insurance for .
- animal powered carts, yes, but then, there are so many, they are not worth very much, really.
- equipment for a new business? But how able is its promoter? And in rural areas, suspicions are even higher as no specialised support institutions are there to advice.

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[1] In the MF sector, as in any financial activity, one must talk about REAL rates, meaning annual on amounts due, all charges included, which unfortunately not always the case.

- equipment for a group ? No way! Too many bad experiences with “mills” or other jointly run businesses; except perhaps for joint storage capacities or joint irrigation schemes.
- borrowers “forget” to pay instalments when the equipment breaks down
- etc.

Are the real reasons linked to absence of sufficient funds, or to a temporary absence of know how by the MFI? Or do borrowers have doubts about the profitability of credits because of high rates? Are the risks too unpredictable and/or poorly dealt with?

Some operators present in Luxemburg have experienced new solutions in this field. They should be exposed and then examined with great care.

5. Picking up rural and immigrants’ savings

It has been known for a long time that rural savings do exist and that there are ways to pick them up. Most of the MFI invited to Luxemburg (those from Africa anyway) are entitled to collect these savings and have done so with some success. [2]

What is new besides classical deposits on demand (not very flexible) or longer term deposits ?

- Some MFI concentrated on modernized versions of traditional “ROSCAs” (Rotating Savings & Credit associations) schemes.
- Others modernized the traditional system of the “gardes monnaie” .
- Others again propose systems of accumulating savings, but complain about management problems;
- Others collect traditional insurance funds for funerals;
- And what about the savings for a pilgrimage?
- Or a pension;
- Or savings for any other kind of specific investment.

And what about those famous savings accumulated by West African migrants? Is it so wrong to assume that they reach enormous amounts which only wait for profitable investment opportunities? In MFI directly, or in more sophisticated bank products?

6. Insurances

This takes us to yet another innovative topic which is often discussed in the context of microfinance: insurances. The topic extends from simple insurance - which some MFI offer to borrowers to protect them (or their families) from reimbursing payments due in case of death or disability to other forms of life insurances (acting on behalf of insurance companies taking advantage of their proximity with the clients of these), or directly.

This can also take the form of management of specific traditional insurance savings of groups. It may concern “health” insurances: there is an intensive debate on the question of whether to separate the insurance business from financial services.

Let us deal with this question to try and find out, in the light of experience or observation, whether MFI are offering insurances (directly or indirectly), for the benefit of their customers/members and/or for the benefit of their own financial health.

7. Microfinance and farmers’ organisations (FO).

This subject has been mentioned in Ouagadougou, but has not been thoroughly discussed. On the other hand we know a number of FO allocating rural credits with the help of funds provided by NGO donors. Some became professionals in this field, with good results (MFI of FO)
However, many FO fail to care enough about the long term viability of the activity. (They accept outstanding payments, offer low rates that do not allow to cover operating expenses and systematically charge management costs to other budgetary items unrelated to the financial services concerned.)

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[2] Beyond compulsory or « suggested » savings

The subject may be extended to the linkage of MFI with FO (which represent, recommend, sometimes provide securities for MFI customers/clients).

This subject is hardly ever discussed at length, and it could be interesting to know why this is so, at least in the minds of those rural MFI and FO present in Luxemburg.

III. General view of subjects to be discussed

Subjects	Countries/Institutions
Rural credits and/or agricultural credits	- analysis of actual realistic needs; - what do rural populations want, how do they assume risks? - sectors for agricultural credits (new lines, breeding, fishery).
Interest rates	- reasons for high levels (too high?) of rates; - systems are inefficient, the excuse being that customers are far away and allocated amounts to small; - are they really too high for certain activities ? - what if they should be subsidized, as has been suggested?. How can this be done massively? Through what pressures can “big money” be convinced to invest in subsidies?
Securities	- Real ones and their limits? - Classical ones of MF (group pressure) - Innovations and difficulties with real securities (warrants, hire-purchase contracts, reverse hire-purchase schemes…)
Medium term credit	- What are the actual constraints other than “ short term funds/ long term use” - Technical difficulties - Opportunities – conditions for implementation- profitability- risks
Individual or collective credits	- collective investments or individual ones for mills, forges, oil extraction, wood shops ? - Or motor pumps and irrigation systems? - or joint trade and user facilities (silos, cereal banks)? - financial intermediaries ; specific professional groups in this field?
Savings and new products	- adapting “traditional saving schemes” such as ROSCAs; adapting up traditional life insurance or “ health” schemes; money transfers from migrants
Insurance	- MFI as brokers for insurance companies interested in rural markets? - MFI acting as insurers? For which products
Cooperation with rural organisations(FO) among others	Few experiences have been made, but it would be interesting to identify the existing ones, their problems, their merits and successes. The same is true for any existing linkages between MFI and FO, as insignificant as it may look.

IV. The financing of microfinance

Up to this point, except for a few words about savings in rural areas, nothing has been said about possibilities of financing rural MFI, to enable them to offer financial services to rural populations .

But apart from savings, or when savings are not wanted or not sufficient or not allowed because of local regulations to be used as coverage for credits, what are the trends and achievements of MF operators?

- Access to funds offered as free of charge loans by NGOs and which could be converted into donations after a period of observation. These funds still remain limited in scope.

- Access to alternative sources which are not necessarily cheaper than refinancing through regular banks, but easier to access. Some MFI have highly diversified portfolios with most of these “alternative” sources (Alterfin in Belgium, Etimos in Italy, Sidi in France, Oiko Credit in Holland…) Several of these MFI will be attending the Luxemburg meeting and will present their experiences in this field.

- Access to refinancing by specialized banks, by banks which recycle the lenders funds (BNDA in Mali to refinance village savings banks with KFW funds from Germany) or which are associated with other MFI (CCEI Bank and the Autonomous Credit & Saving Banks MC2 network in Cameroon).

- Access to special MF investment funds (on a loan basis) through important specialised banks such as the European Investment Bank, the African Development Bank, the Inter American Development Bank) and private banks, either associated in a consortium or not. Some MFI attending the Roundtable have access to these sources. What are the conditions? Are they accessible for all? What are the conditions?

- Access to Guarantee Funds. Here we are discovering interesting varieties which reach beyond a traditional free of charge and generous “guarantee fund” (sometimes with a coverage up to 100%, interests included) which will end up completely eroded after a period of time (a pillow of laziness, as one well known MF specialist would say). One finds guarantee funds which ask a price for their services (not below operating costs) as well as new formulas like of Guarantee Funds combining investments from a donor, one or more banks and borrowers’ organizations: Together they will all win when the fund is adequately managed, and have a lot to lose (the two latter categories any way), should that not be the case.

- And, finally a new facility is on its way: access to funds in form of specialised investment funds created by “social investors” who expect some minimal returns on their investments, or by investors who are inclined to speculation and expect solid profits.

- Discussion will also have to be extended to clearing systems between Urban and Rural units managed by the same MFI, as the first partly subsidise the second. Is that a possibility or just a dangerous illusion? (The FECECAM in Benin failed, but the RCPB in Burkina Faso made it!). Some participants, Kafo Jiginew from Mali among them, may tell us more on the subject.