Microfinance and rural financing

In 2005, the international year of microcredit, SOS Faim decided to work on access to financing in the rural world. Our analysis was conditioned by the fact that rural areas are the least favoured by microfinance whereas they show the highest concentration of population living below the poverty threshold (75% of the poor live in rural areas).

The issue of access has been analysed from the users' perspective – what are their needs? what are therefore the desirable innovations in the supply? And from the perspective of rural finance institutions – what mechanisms should be developed to guarantee the needed resources? Finally, we analysed the essential role of synergies and partnerships that need to be created among the different actors.

The analysis focused on three main issues:

— To let the Southern countries speak: they have clearly showed two priorities in the analysis: on the one hand, to talk about rural world instead of agricultural world and on the other hand to work on articulating the different actors.

— To reflect on the needs of financial services rather than focus on the supply.

— To gather a diversity of participants in order to debate the issues: farmers' organisations, microfinance institutions, credit and savings cooperatives, national and regional networks...

Theses ideas materialised in the organisation of a workshop on rural finance in the framework of the Luxembourg Round Table for Microfinance that lasted for 3 days in October, an initiative of the Ministry of Foreign Affairs. Afterwards, a one day meeting took place in Brussels to present the results of the workshop.
Financing needs

A consensus was reached to work on rural financing instead of agricultural financing. First of all, we could see that it was neither interesting nor relevant to oppose the rural to the urban and the rural to the agricultural scenarios. The reality is far more complex: there is a continuum between the rural and the urban worlds, since some members of rural families live in secondary towns, in the capital or abroad. Likewise, in the rural areas, there are very few families that live exclusively from agriculture.

The challenge in financing the rural world is therefore to adapt to a variety of situations shown by the “archipelago–families”, looking at demand not only from the economic perspective, but also from the social and family viewpoint. The family activities, the role of everyone in the main and secondary activities and their seasonal character must be taken into account. It has also been underlined that credits should not be granted at random. It is important to start with a realistic project developed by people with a vision of what they want to achieve.

Very often rural families have to diversify their production activities to survive. The providers of financial services follow this trend and offer diversified products and different approaches for different market segments. This segmentation is made according to the following criteria: localisation, the type of economic activity, the need of capital and its turnover. One of the best ways to achieve it is by associating users to the definition of this offer of services. In fact, an answer adapted to the clients’ needs is a factor that ensures the sustainability of a microfinance institution. Among the most appreciated elements by the clients are the flexibility (of guarantees and maturity dates) and the little formality.

Furthermore, if we listen to the users, they always make the same complaint to microfinance institutions (MFIs) regarding credits: they are granted for too short a time, they are too expensive and too weak.

However, we shouldn’t choose the wrong strategy. Opposition between farmers’ organisations and microfinance institutions reduces their political impact in

Market segmentation: the MIDE(1) example (Peru):

Following an in-depth study about its female clients, MIDE defined 3 segments:

- The rural economic micro unities managed by women who work with a weak capital showing a high turnover rate (about 4 to 8 times a month) for activities such as small livestock farming and the purchase and sale of agricultural products. The capital owned by women is generally less than 200 €. This amount allows to measure the debt capacity and to define the future financing needs.

- The economic micro unities in the administrative centres are generally managed by disorganised women. The activities are the preparation and commercialisation of food and the picking up and sale of industrial products. Women in this segment go from one activity to the other depending on different periods. The capital’s turnover occurs almost daily.

- Rural micro enterprises and administrative centres: we find here activities such as livestock farming at higher scale and micro enterprises (bakeries, restaurants, pharmacies...)

This segmentation allows MIDE to define « tailor made » products.

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1) MIDE was the object of Zoom microfinance n°8 dealing with Impact Studies
relation with public authorities while negotiating a common objective: the implementation of policies adapted to the rural world.

The participants at the workshop reached the conclusion that since the needs in rural financing largely exceeded the current offer, farmers’ organisations and MFIs had no choice but to leave aside their differences and work together sharing the same vision in order to overcome two main challenges: to develop innovation skills by drawing lessons from past failures (particularly the failures of agricultural banks) and to contribute to the transition of family economy from survival towards development.

**Adapted products, but at what price?**

The presentation of two important experiences (DECSI[2] - Dedebit Credit and Savings Institution - in Ethiopia and LDF – Local Development Fund - in Nicaragua) has allowed to establish different factors of success to reach many people in a very vulnerable rural population:

- Financial services are clearly linked to food security
- The network shows a tightly woven rural mesh
- There are partnerships with other actors (NGOs, farmers’ organisations – FOs - local government...) for additional services: training, technical assistance, guarantees...
- Products are developed close to the users
- There is an attempt to give better rates to credits for agriculture
- The involvement of local staff with a good understanding of the economic, social and cultural framework is a priority
- Products are flexible, particularly in terms of reimbursement deadlines
- The analysis of reimbursement capacity is based on the family unit as a whole.

During the workshop in Luxembourg, a working group dealt with the issue of controlling costs. In fact, rural financing is more expensive because clients are more dispersed and there are higher risks related to certain agricultural activities. Therefore, we must find mechanisms that can still offer financial services at an acceptable price.

The importance of two tools has been underlined at this level: developing insurance systems to protect borrowers and mechanisms of guarantees that lower loaners’ risks. Regarding insurance, there are already some experiences to cover individual risks (invalidity, death) but the

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2) DECSI was the object of 2 previous issues of Zoom microfinance: Zoom microfinance n°3, showing a general presentation of the organisation and Zoom microfinance n°11, dealing with Impact Studies.

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**The case of BUUSAA GONOFAA (BG) in Ethiopia:**

BG primarily offers services to women in rural areas. Because clients were so scattered, BG took the following measures:

- The organisation diversifies the risk and increases the clients’ return by combining urban microcredit and rural financing.
- Certain costs are passed on to clients through groups that work as an intermediary: the selection process is simplified and the group constitutes the guarantee of credits.
- All decisions are decentralised at the level of network agencies
- Mobile units operate in small urban centres on market days
However, collecting savings implies additional costs other than remuneration of capital: managing and securing the capital, opening agencies regularly to allow withdrawing and placing deposits...

In fact, saving in a MFI represents an additional formula in relation with other saving mechanisms (in kind, traditional tontines...)

In order to strengthen the saving part collected by MFIs it is necessary to generate an environment of trust with savers (the importance of transparency) and to offer attractive remuneration conditions.

A debate also took place about the potential of MFIs to attract deposits made by immigrants with the possibility that such funds allow to create links with the financing mechanisms of local development.

For many poor countries the transfers of immigrants represent one of the main currency sources.

In 2004, 40,000 million dollars were sent to Latin America and transferences represented more than 20% of the gross domestic product of countries such as Haiti and Nicaragua. At the same time,

### Societies of Popular Investment in Ecuador (SPI):

SPIs are independent, enterprise-type organisations operating at local and popular level. They are managed and controlled by their members (between 5 and 100). SPIs work following the self-management principle. Each member contributes an initial capital and they have additional fixed monthly contributions commonly agreed. The capital is lent both to members and non-members (at a variable rate of 2 - 4% per month).

SPIs advantages are the almost inexistent transaction costs and an extremely quick reaction. The costs are limited to a few stationary expenses and occasionally the partial renting of an office.

In this way members obtain a high return on their capital: generally a big part of such return is added to the capital.

SPIs contribute to boost local economies by investing their gathered capital locally.

issue of climate risk has not yet been discussed.

### How to finance rural finances?

Among the different existing approaches to rural financing, the workshop analysed the ones linked to savings (local and international) and external refinancing.

The participants underlined the fundamental character of savings. Savings must be considered as a service to clients and members; they play an educational role (budget managing, learning to save before profiting from a credit...) and contribute significantly to the self-sufficiency and sustainability of microfinance institutions. The most important MFIs that attended the workshop had successfully developed the saving aspect. Consolidated MFIs can later offer the saving service to non members, the better-off and those likely to make more important deposits. This diversification is based on the offer of remuneration and more attractive conditions than banks.
the immigration phenomenon that gained importance at international level is also present inside the country as it is the case of Peru, Bolivia or Brazil.

The beneficiaries of these transferences are either single mothers with their children or poor rural families. The basic needs (primarily nourishment) represent the main usage of transferences.

With this increasing trend, microfinance institutions such as FOLADE face the challenge of creating mechanisms establishing a link between these financial flows and local development initiatives in the immigrant communities.

MFIs refinancing is obviously an important solution in quantitative terms. From the users’ perspective this option has several advantages:

- it allows to increase significantly the volume of activities carried out by MFIs: for a credit MFI (for example FDL in Nicaragua that “juggles” with more than 35 refinancing sources or CONFIANZA in Peru with 20 international partners and 8 national partners) refinancing is a growth factor. The diversification of sources is also a way to maintain their self-sufficiency. In the case of an institution that drains savings (such as Kafo Jiginew in Mali) refinancing is a way to satisfy a credit demand that is growing more rapidly than the members’ deposits;
- in certain cases, it also allows to obtain long-term resources that favour the granting of credits at a longer term. Furthermore, it is relevant to realise that the institutions with the biggest financial surface are the most successful in diversifying their credit supply towards longer term loans (3 to 5 years);
- Finally, for certain institutions refinancing is an excellent way to manage fluctuating funds. Kafo Jiginew in Mali is a good example of this: this MFI works a lot with members that are cotton producers and there are very strong seasonal variations in deposits (with a peak at the beginning of the year) and employment (it increases from the second quarter and the new agricultural season).

However, not everything is so rosy in the world of refinancing. In Luxembourg we listened to many questions and complaints regarding the interest rates imposed by social investors who might not have been loyal to their original mission. The high opportunity costs have also been highlighted: to bring forward a file on refinanciement is expensive and quite often a MFI must recruit specialised staff to this end in order to properly fill the different needed formats.

Finally, the issue of losing self-sufficiency has also been largely discussed: the risk of depending on some “refinancers” seems higher than the systems built with the savings of millions of members. The participants also wished that refinancing organisations do no earmark their loans to a precise end (in geographical or sectoral terms), in order to achieve a more flexible and easier administration of their credit portfolio.

A new type of “refinancer” has been alluded to as an interesting possible way to explore: the creation of second level national or regional financial structures: a similar project already exists in Bolivia within the rural MFI FINRURAL. In

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3) Kafo Jiginew was the object of Zoom microfinance n° 4 and 10.
West Africa, such experiences already exist with the Regional Bank of Solidarity (RBS) created at the request of the West African Economic and Monetary Union (WAEMU) and the Mali Bank of Solidarity (MBS). There is a concern about the coherence of these policies since the interest rates are slightly different: in fact, there is a range of 7-12% difference in interest rates.

**Long life to synergies!**

Synergies and essential links have been described as the “leitmotiv” of the debates that took place in the Luxembourg Round Table. They were discussed as a conclusion from different approaches.

**And what is the role of the State?**

In microfinance, the State’s role of promoter, regulator and controller through specific legislation is unanimously recognised as necessary. However, specific rules for the rural sector must be applied in order to have a democratic access to financing. A dominant commercial approach of microfinance does not match with the particularities of remote rural areas that need specific rules.

The absence of the State in the creation of a favourable framework for rural microfinance (lack of strong rural policies) has been described as a very negative aspect.

**When banks meddle in**

In Cameroon, an interesting experience of linkage between a formal bank (Afriland First Bank) and a rural network of micro banks (MC² – Community Growth Mutual Funds) supported by the NGO ADAF allows to create linkages at different levels: among these institutions, among the original rural and urban populations of rural areas and among tradition and modernisation.

This initiative allows to analyse the different advantages of each actor.

The Banks: relatively important resources, a range of services, access to the capital market, qualified staff and elaborated security rules.

Micro Banks: flexible procedures, guarantees adapted to the targeted population and a good knowledge of the local context.

The development of the MC² network has been proved: it has more than 50 entities representing more than 330,000 members (individuals or groups). It has gathered more than 13,000,000 € in deposits.

**A farmer organisation participates in the decision-making of an agricultural bank.**

FONGS (Senegal), a federation of local and regional farmers’ organisations decided to participate in the Caisse Nationale de Crédit Agricole of Senegal in 1987. At first, the idea was to secure the only financing tool of agriculture available in Senegal and try to prevent its destruction in the framework of the policy of structural adjustments. Thanks to its participation in the CNCAS Executive Board and in partnership with other farmers organisations, the FONGS has obtained a progressive reduction of the interest rates imposed by the bank (from 18% to 7,5%).

These positive experiences, however, should not hide a certain number of difficulties and limitations that occur in financing the rural sector and in the implementation of synergies. This has led

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4) MC² was presented in Zoom microfinance n° 6.
to a more political reflection showing that microfinance can only be a wealth creating tool in a favourable environment.

The profitability of agriculture has also been questioned. How could an agricultural production activity, often not very profitable (less than 10%) support average interest rates of 25 to 30% per year?

How could an agricultural activity be profitable in the South taking into account the government subsidised agricultural production developed in the North?

A solution could be to protect national and regional agriculture following the EU practices and reducing dependency on imports.

Once again, we must state that a real partnership of civil society actors (farmers’ organisations, microfinance institutions, support organisations, professional organisations, civil society organisations...) can create the necessary balance of power that would lead to political changes.

**Systematise cooperation frameworks**

The implementation of cooperation frameworks specific to rural financing should be promoted. In fact, each actor has a role to play and specific skills to put in practise in order to solve the issue of financing the rural world. All actors (and not only farmers’ organisations and MFIs) must be able to contribute to the debate and the Northern partner states should deploy some efforts to ensure the creation of such exchange and cooperation places.

**Creating a fund to support rural initiatives (FAIR)**

There is a real need to promote pilot and innovative experiences in the rural world. The creation of a fund to support rural initiatives – FAIR– could be a useful tool to support microfinance that could be added to the existing tools in the North, and would give priority to emerging initiatives in vulnerable contexts.

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**Improvement Proposals**

Below are three specific proposals from the South to improve both the general context and the access to financing in the rural areas.

**Prioritise rural development**

The Northern countries should put rural development of the Southern partners at the top of their agendas, paying special attention to the drafting of national and regional agricultural policies, reinforcing the role of producers’ organisations in some branches, creating or developing real agricultural banks, infrastructures to open up isolated areas and improving food sovereignty through local transformation units.
This issue of Zoom microfinance has been written by Marc MEES, coordinator of Partners’ Support at SOS Faim. The minutes of the Luxembourg Round Table for microfinance are accessible at SOS Faim Luxembourg.

SOS Faim and microfinance
SOS Faim has been working for several years in the microfinance field and supports different partners involved in this sector in Africa and Latin America. As with all development tools, we have to analyse the aims, models and implementation conditions of microfinance. With this frame of mind, SOS Faim edits “Zoom microfinance”. You can find publication and download it in French, English and Spanish on the website of SOS Faim Belgium: www.sosfaim.be

Past issues of Zoom microfinance tackled:
- impact studies – Zoom microfinance nr. 8 and nr. 11
- interest rate policies – Zoom microfinance nr. 9
- investment credits – Zoom microfinance nr. 10
- microfinance experiences in conflict zones – Zoom microfinance nr. 12
- the efficiency of microfinance in reducing poverty – Zoom microfinance nr. 13
- the regulation of microfinance institutions: the Ethiopian experience – Zoom microfinance nr. 14
- venture capital in Bolivia: an alternative for rural financing – Zoom microfinance nr. 15
- the commercial model for microfinance and its effects on social inclusion – Zoom microfinance nr. 16
- the savings-credit cooperatives in Peru and Ecuador and the development of rural financial services – Zoom microfinance nr. 17

Apart from Zoom microfinance, SOS Faim publishes another newsletter, “Farming Dynamics”, which deals with the challenges faced by agricultural producers’ organisations and farmers’ organisations in their development. You can also find this publication and download it in French, English and Spanish on the website of SOS Faim Belgium: www.sosfaim.be