In 1992, SOS FAIM, a Belgian development NGO took the initiative of creating a loan guarantee fund for Latin America.

Initially, this program aimed to facilitate locally sourced financing for SOS Faim’s southern partners, by providing first class guarantees, which would be acceptable to commercial banks. The times were characterised by the widespread withdrawal of the state: the dismantling of many development banks and the implementation of structural adjustment programmes that had been imposed by international institutions. The partners for whom the international guarantee fund was designed were both rural farmers’ associations in need of working capital (for collecting and/or marketing produce) and micro finance institutions that required additional funds in order to serve a larger number of farmer and micro entrepreneur clients.

A model based on the use of intermediaries

Originally, this innovative fund managed by SOS Faim was established with contributions from the Belgian public, the Belgian government’s development arm (Directorate-General for Development Cooperation) and the European Commission.

After a little over 10 years of direct management by SOS Faim, the challenge was taken up of incorporating the fund. In 2004, with the agreement of the fund’s original donors, a non-profit entity based in Lima (Peru) was established to take over control, called FOGAL. With its prior experience and with a view to ensuring continuity of mission and vision, SOS Faim got involved in this new association, which was created in partnership with a cooperative of rural farmers.
The model is designed to enable people excluded from the formal banking system to gain access to sustainable and timely financial services.

In this model, it is clear that the quality of the selected intermediary (FOGAL’s partner) is of fundamental importance.

The intermediary organisation, using an appropriate methodology, manages the selection of end customers, and is in charge of monitoring and recovering loans. The intermediary is also responsible for obtaining the loan from the financial entity that benefits from the guarantee issued, at the request of FOGAL, by the bank which holds the guarantee fund’s assets.

In all cases, the model is designed to enable people excluded from the formal banking system to gain access to sustainable and timely financial services.

In the intermediary selection process great importance is attributed to the institutional strength and dynamic of the candidates. In addition, where farmer organisations are concerned, representation and social issues are also subject to scrutiny.

Various partners

FOGAL establishes partnerships either with rural farmers’ associations or with microfinance institutions (MFIs).

From 2005 to 2008, during the first four years following the incorporation of the fund, the number of partners rose from 18 to 30. They are spread across 3 Andean countries: Bolivia, Ecuador and Peru.

When working with MFIs, the guarantee fund has set a maximum ceiling for its loan portfolio of 5 million dollars. FOGAL mainly aims at relatively young MFIs, which, however, are in the process of consolidating. How accessible the MFI is to the rural sector and its willingness to work with organised groups are also positive selection criteria of.

In 2008, FOGAL worked with 18 MFIs (7 savings & loans cooperatives and 11 foundations or NGOs) in the 3 Andean countries where it currently operates.

Furthermore, FOGAL has worked with 12 farmers’ organisations, mainly in export related sectors: coffee, cocoa and bananas. All of these organisations are engaged in the fair trade movement and organic production processes or transitioning to organic farming.

These organisations are involved in sustainable development as they exhibit both a desire to preserve the environment and create a sustainable approach to business (the search for niche markets that ensure their products sell at an attractive price) and social concerns (cooperative or associative approach).

Recent development: encouraging growth

Since its incorporation, guarantees issued by FOGAL have increased from US$ 1,422,500 to US$ 2,851,000. These are the figures from the year-end accounts on 31st December 2008. They show an increase of over 100%.

Meanwhile, credit lines opened with these guarantees rose from US$ 2,902,914 to US$ 7,566,000 (a multiple of 2.6).
The following graph illustrates this growth over the last 4 years of operation.

In 2008, the average leverage effect on the guarantees given was 2.65, a 31% increase over 2007.

This growth was achieved thanks to collaborations with European social investors such as ALTERFIN and ETIMOS (who «offer» leverage multiples of up to 3 or 4) and with the Micro Enterprise Support Programme (PAME) run by Banco de la Nación, in Peru (which offers a leverage multiple of 10).

On the other hand, it is still very difficult to obtain a real leverage effect from local commercial banks (credit amounts to 120% of the guarantee at best). In these situations, the advantage often is the availability of a more favourable rate of interest.

Loans enable farmers to diversify production.
Collaboration with local banks (about 52% of the portfolio) and solidarity funding entities from the North (48%) is relatively balanced. Choices are based on a number of criteria: the interest rate, the size of the required guarantee, the opportunity costs...

For FOGAL, there is nevertheless an advantage to working with solidarity financing entities: their involvement in the review and monitoring of applications is often much greater than that of local commercial banks and so there are economies of scale with regard to their monitoring obligations.

However, this arrangement distances FOGAL from their initial remit to raise capital available locally. In any event, the choice of partner as part of its strategy is of fundamental importance.

The financial situation

FOGAL had US$ 3,467,000 in assets at end-2008. Capital employed was therefore 82% of assets.

Despite its limited size, the FOGAL guarantee fund has been profitable since 2006, based on its two main sources of revenue:
- a commission paid up front of 2.5% on the net amount of the guarantee;
- income from the invested capital (term or fixed interest deposits): FOGAL does not invest in any risk-based assets given its origins and orientations.

In total, €133,000 has been accumulated over the last three years, allowing the institution to establish a reserve of 5% of its capital in case of a call on a guarantee.

Portfolio quality and guarantee calls

The job of managing a guarantee fund is ultimately to ensure a risk that a financial partner is not ready to take on by providing a guarantee to an organisation from the South.

In this context, the quality of the portfolio is a key factor for institutional sustainability. The risk assumed by FOGAL may be diverse in nature: it depends on the political and socio-economic stability of the countries concerned, how sectors evolve (especially where farmers’ organisations are closely linked to one sector), and finally the development and evolution of the institution itself.

From this perspective, performance has been satisfactory over the past 5 years, given that only one guarantee has been the subject of a call, to the tune of US$ 50,000, which represented 1.75% of outstanding guarantees as at December 31st 2008.

Social aspects of FOGAL’s success

If FOGAL’s financial results have been convincing in recent years, its «social audit» is no less important a consideration.

The scope of activities supported by FOGAL is significant: in 2008, FOGAL’s MFI partners represented more than 86,000 members and / or customers for a loan portfolio of US$ 69.35 million.

The current average loan size is about US$ 806 and is therefore much lower than the gross domestic product per capita of the countries concerned, which is respectively US$ 1,260 for Bolivia, US$ 3,080 for Ecuador and US$ 3,450 in Peru.

Farmer associations, meanwhile, had 8,025 active members and annual revenues exceeding US$ 25 million.

FOGAL targets support to vulnerable populations: in fact, it works specifically with farmer associations and with rural or semi-rural MFIs. A very large part of its activities is therefore in this area that is considered more difficult and riskier than others.

In addition, at FOGAL’s partner MFIs in Bolivia and Ecuador, women beneficiaries make up 51.87% and 72.48% of the respective totals.

Finally, all FOGAL’s farmer association partners are engaged in sustainable development practices, based on three pillars: economic, social and environmental. Indeed the practice of fair trade and organic production to ensure both a fairer price offered to farmers (of coffee, cocoa, bananas) and better social conditions of production, unlock margins that are spent on social investments (schools, sourcing water ...) and preserve the environment for future generations.

2: Besides ALTERFIN and ETIMOS, FOGAL works with CRESUD and OIKOCREDIT.

3: This was a guarantee provided to a Chilean MFI.
A measure of FOGAL’s impact

An impact study was conducted in 2005 among a sample of FOGAL’s partners. It was confined to a view of the impact on the partner institutions and not on the ultimate beneficiaries of the service. A number of effects of having access to a guarantee have been identified by this work:

**Direct effects:**

- an increase in funds available for partner entities has enabled a greater volume of transactions to be guaranteed, more customers to be taken on, services to be offered to a larger number of members, but also new types of customers be integrated (risk taking), or new products or services developed;

- in some cases, presenting international guarantees has meant access to a better interest rate or more flexible credit terms (particularly with regard to their duration).

**Indirect effects:**

- the guarantee has been the foundation of a lasting relationship with the financial system;

- the possibility of accessing new sources of financing (diversification);

- improving the profitability of the institution (better use of installed capacity);

- development of the institution itself.

These effects are illustrated by two examples:

**CEPESIU**, a non-governmental organisation in Ecuador, says that FOGAL’s guarantee was key to it being able to re-launch its activities after the country’s financial crisis (2000); it has helped grow the loan portfolio on average by 63% per year. Having access to guarantees has also made it easier to work with sectors that are considered higher risk. And finally, it has consolidated the relationship with a number of financial actors such as ALTERFIN, ETIMOS, CRESUD and BANCO SOLIDARIO.

**CONFIANZA**, a Peruvian regulated entity (with EDPYMES, or, Small Business and Microenterprise Development Agency status) gained access to FOGAL guarantees very

Loans often support expanded marketing strategies.
early in its history. The guarantee fund is associated with the early development of an institution that grew exponentially thereafter; CONFIANZA has diversified its sources of funding and established links with 18 funding partners. The guarantees have also given it access to a preferential rate (better by 1 or 2 points) and covered higher risk lending, specifically oriented towards the rural productive sector (agriculture).

**Conclusion and outlook**

The first job of a guarantee fund is to take risks that other financial institutions do not wish to assume, either in part or in whole. This risk needs to be measured and reasonable if one wishes to maintain the tool over time and ensure sustainability.

FOGAL’s experience shows that it is both possible to ensure a balanced finances despite a small amount of available capital, and service relatively high risk partner institutions:

- **start-up** or early growth MFIs with a portfolio below US$ 5 million, which prioritise rural areas;
- **farmers’ organisations** which have difficulty securing working capital financing from local banks or international social investors.

Despite current satisfactory results, FOGAL faces three main challenges in the coming years of its development:

- **attracting new financial backers** in order to increase the fund’s scale of operations; this increased activity should go hand in hand with diversification of geographical risk;
- **adapting to a changing «market»**, in which it clearly strengthens its work in favour of farmer and producer organisations, while more and more microfinance investors refinance institutions based on the quality of their portfolios as evidenced by ratings;
- **improving negotiating outcomes** with local banks on behalf of the fund’s partners, both in terms of the multiplier effect (better and more equitable sharing of risk) as well as preferential interest rates (better leveraging the existence of a guarantee, given that risk is a component in setting an interest rate).

Having access to guarantees has also made it easier to work with sectors that are considered higher risk.
Two case studies: FOGAL works closely with its partners

A Microfinance Institution: FONDESURCO

FONDESURCO works in southern Peru, in the Arequipa region. It was set up by 4 national development NGOs.

FONDESURCO received a guarantee from FOGAL of US$ 75,000. This guarantee enabled it to take a loan from ALTERFIN cooperative (a Belgian social investor). Initially, the amount was US$ 150,000, rising to US$ 355,000 in 2009.

The table below shows the positive evolution of a partner FOGAL works with.

FONDESURCO’s specific distinction is that it targets a mainly rural audience (95%) but also largely productive activities (78%), with agriculture and livestock accounting for 61% and 17%, respectively, of its loan portfolio.

An offshoot of farmer organisations: CAFE PERU

CAFE PERU was founded in 2001 by 5 of the country’s major coffee farmer cooperatives. Currently, 7 cooperatives are shareholders in the company’s stock. The main activity of the company is to process and commercialise its partners’ crops, its partners being the associated cooperatives, but it also services other small cooperatives. The goal is to get as attractive a price as possible for its 5,783 affiliated farmers and their families, while maintaining a high level of quality and seeking high value added niche markets.

CAFE PERU’s members generally have farms of 3 to 4 hectares in size. 46% of their produce is sold through fair trade channels and 35% is certified organic.

In recent years, CAFE PERU has been able to both pay farmers a fairer price, «erasing» or moderating the fluctuations in the global coffee market by targeting niche markets (fair trade, organic, gourmet, ...) and turn a profit that has enabled the company to capitalize and invest in facilities more suited to its size and ambitions.

The table below shows the guarantees granted to CAFE PERU and its members have evolved in size in tandem with annual turnover, sales volume and average coffee prices.

Location of CAFE PERU’s partners.
This issue of Zoom Microfinance was written by Marc Mees (who manages SOS Faim’s Partner Support Service).

SOS Faim and microfinance
For several years, SOS Faim supports different microfinance institutions in Africa and Latin America. As with all development tools, we have to analyse the aims, models and implementation conditions of supports to farmers organisations. With this frame of mind, SOS Faim edits “Zoom Microfinance”. This publication is available for download in French, English and Spanish on SOS Faim’s website: www.sosfaim.org.

Apart from “Zoom Microfinance”, SOS Faim publishes another newsletter, “Farming Dynamics”, which deals with the challenges faced by agricultural producers’ and farmers’ organisations in their development. This publication is also available for download in French, English and Spanish SOS Faim’s website: www.sosfaim.org.

The last issues of “Zoom Microfinance” have dealt with the following topics:

- n° 27 Serve remote rural zones: The experience of Buusaa Gonofaa MFI in Ethiopia
- n° 26 Legal status and good governance - is there a clear link?
- n° 25 Alliances with financial institutions: the best solution for financing needs of farmer organisations and their members?
- n° 24 Popular investment associations in Ecuador: A case of “solidarity-based micro-investment”
- n° 23 Equipment loans provided by Kafo Jiginew (Mali): investing in family farms
- n° 22 Moving towards a structured microfinance sector in Senegal: the experience of FONGS
- n° 21 Buusaa Gonofa in Ethiopia: marketing vision and fighting against poverty

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Coordinator: Marine Lefebvre
Graphism: Marmelade Studio
Zoom Microfinance is printed on recycled paper

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“Zoom Microfinance” is produced with support from the Belgian Directorate-General for Development Cooperation and the Ministry of Foreign Affairs in Luxembourg.