
Breakout 5: Rural Finance Expansion: Experience in Commercialization

“Expanding Commercial Microfinance in Rural Areas: Constraints and Opportunities”

Authors

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Summary and Key Findings

This paper looks at past lessons in rural lending, elaborates the challenges of sustainably increasing rural finance, discusses practical approaches to successful expansion of MFIs to rural areas and comments on the role for governments and donors in expanding commercial microfinance to rural areas. General rural finance should include innovations with respect to branch size and design, location and staff allocation. To reach different segments of rural financial markets, financial services such as crop insurance, deposits, commodity-collateralized finance, hedging instruments and microleasing should be introduced and developed. And to provide greater access to rural clients, lenders should evaluate the risk “not of a single activity listed by the borrower on the loan application but rather of all the diverse cash flows of all household members” (p.11).

“Reverting the Tendency in Developing Finance: The Case of BANRURAL S.A. in Guatemala”

Author

Luis Noel Alfaro Gramajo (INCAE)

Summary and Key Findings

Scholars and practitioners often criticize restructuring/modernization of public banks because the capital structure of the financial institution does not change, and the state continues to be the sole owner. In the case of BANRURAL, private groups and civil society groups were allowed to participate in the transformation process of a traditional agricultural public development bank into a profitable rural bank. The success of BANRURAL depended on multiple factors, including viable leadership of the Administrative Board and General Management and participation of the private sector in the capital structure.

“Selected South African Micro Finance Case Studies in Rural Financing”

Author

Kachesa Ed Bbenkele (Microenterprise Alliance)

Summary and Key Findings

Lack of interest by commercial banks to provide financial services to the poor has been due to the risk and high transaction costs of servicing small rural accounts. This paper highlights problems faced by rural retail finance institutions and the difficulties of attaining profitability faced by micro finance institutions in South Africa. Retail rural financial institutions’ experiences with poor collection performance are attributed to ineffective management control systems and unacceptable levels of bad debt. Suggestions to counter these challenges to sustainability include: greater accountability, recruitment and training, post office banking, managing outreach, and market led micro finance with business development to reduce risk (and steer away from credit only services).

Questions and answers for session 5

Question by Richard Reynolds (World Vision) He believes there is a contradictory view on interest rates.

Answer: Luis Gramajo regarding Banrural: Banrural is covering its costs, charging a competitive interest rate and mobilizing deposits at lower interest rates. The government deposits money at Banrural to pay its civil servants. This gives Banrural additional financing since it pays low interest rates on its deposits.

Comment: Some banks are a fiscal agent of the government.

Answer: Luis Gramajo regarding Banrural: It does give a bank who provides government services a leg up, participation in the public sector gives Banrural access to move funds, for example teachers are paid through Banrural. The public sector pays the teachers' salaries and the bank holds the funds for a few days until it pays out the salaries. This acts as a subsidy to the bank. In addition each teacher has a saving account at the bank. Retired people receive their pension from the government in a similar fashion. Again this is an implicit subsidy; however Banrural is able to do this because it is often the only bank in an area.

Question: What is the optimal payment scheme?

Answer Luis Gramajo regarding Banrural: Monthly payments.

Question: How sustainable is it in the long run?

Answer Luis Gramajo regarding Banrural: Very optimistic. A few years ago Banrural was 29 out of 32 of the most profitable banks; now it is one of the most profitable banks in Guatemala. Luis does not know the portfolio at risk, but the loan recovery is at 98%.

Question: David Meroy from the Ford Foundation: Has the push to commercialization had a positive effect on poverty alleviation?

Answer Anita Campion and Stephanie Charitinenko from Chemonics: It is not clear. However, it is clear that more clients are being served now and better service is provided to the Microfinance clients. In addition increased commercialization has resulted in more areas served and more clients reached. There is a need for more empirical papers to show whether poverty alleviation has resulted from increased commercialization. In W. Africa and Mali there seems to be a positive effect, but it could also be due to other factors. Commercialization is defined in P.3 of the paper and it stresses a more business oriented approach.

Answer Luis Gramajo regarding Banrural: Banrural has a business vision, and it is consistent with the products that it offers.

Question: How do you design credit products? Savings products?

Answer Anita Campion and Stephanie Charitinenko from Chemonics: The point is to train loan officers to become agricultural specialists, overtime they gain knowledge to make decisions quickly, make decision on inflows and outflows. Regarding savings products—physical security is a big issues. In rural towns a (for ex, Madagascar) they looked at a few options. Postal savings was one option, also they linked credit with health centers, also are testing out the use of armored cars. Also they are working on a mobile option, in which rural areas are visited once a month for loans and payments.

Answer Luis Gramajo regarding Banrural: There has been an explosion of deposits. 52% of the deposits are from urban areas, and 89% of the loans go to rural areas. It has 30% of public sector ownership.

Question regarding commercialization: Instead of Profit maximization it is better to think about it sustainable microfinance. About a month ago group of practioners spoke about differential interest rates and that it is a standard practice. However it is often seen as a type of favoritism.

Answer Anita Campion and Stephanie Charitinenko from Chemonics: It is important to inform clients of the products that are available. In addition simplicity is also good as well as institutional transparency. Clients may be confused and feel like they are hidden

costs. Also MFI may raise fees or interest rates in order to achieve an appropriate average yield on its products.

Answer Luis Gramajo regarding Banrural: When Banrural began people felt that they didn't have to repay the bank. When they were later pushed to pay the borrowers threatened the lenders. When they didn't back down the borrower paid back their loans. It took about 32 years for this transition to take place. N There fore due to the persistence for managers by 1997 very few people were delinquent. In addition there was a reduction of people from labor unions. The mangers that did stay during the transition were offered better wages, in order to retain them for their expertise.

Question Claudio Gonzales Vega: Regarding Microfinance and poverty alleviation: he doesn't like how interest rates levels are often related to the ability to alleviate poverty. Higher interest rates are related to lower poverty alleviation. The focus on interest rates is a pro rich bias. The problem is that small loans do not alleviate poverty. Interest rates are only part of the cost of the loans. For example in village banks the interest rates have not changes in Bolivia. However in other sectors they have come down. Village banks provide other services such as emergency credit , ability not to have to sell the cow and internal accounts.

Answer Anita Campion and Stephanie Charitinenko from Chemonics: They are now in the process of doing a study on commercialization and competition. For example I Bangladesh there is a lot of competition, but not very commercial. BRI less then 30% of

The banks operate in a commercial environment but there isn't a lot of competition. Also it is not good to just look at interest rates. It is important to also look at other costs. For example Grameen has high transaction cost, for example the clients must attend weekly meeting, reducing the time they can spend on their micro enterprise.

Also saving mobilization does play an important role. Banks are not doing enough on mobilizing savings. It is an important tool for consumption smoothing. Also it allows MFI to have an additional source of funds and increases their chance for achieving sustainability. There is a 10:1 ratio between savers and borrower at BRI. There is an internal incentive to mobilize funds. There is also an internal incentive for rural banks to transfer funds to branches, because branches make larger loans. The first part of BRI was recently offered for privatization.

Answer Luis Gramajo regarding Banrural: The overall portfolio for MFIs is not that large Banrural charges lower interest rates in the rural sector, than in the urban sector.