



**Paving the Way Forward for Rural Finance
An International Conference on Best Practices**

Discussant Reaction Paper

Comments on

**“Innovative Products and Adaptations for Rural Finance”
by Juan Buchenau**

**By Marguerite Robinson
(Institute Fellow Emeritus-HIID)**

This paper was made possible by support provided in part by the US Agency for International Development (USAID) Agreement No. LAG-A-00-96-90016-00 through Broadening Access and Strengthening Input Market Systems Collaborative Research Support Program (BASIS-CRSP) and the World Council of Credit Unions, Inc. (WOCCU).

All views, interpretations, recommendations, and conclusions expressed in this paper are those of the author (s) and not necessarily those of the supporting or collaborating institutions.

1. Overview

I enjoyed very much reading Juan Buchenau's thoughtful, wide-ranging, and well-written paper. His approach to innovation and adaptation in rural finance is, itself, refreshingly innovative. His paper is about innovations in products – and about innovations that improve product management. It explores innovations that reduce the transaction and risk costs of rural financial institutions (RFIs) and of their clients, and innovations that increase the investment capacity of clients. It's about changes that work, and those that fail – and why. And it addresses what such success or failure means for the institutions and for their clients. And the paper is about competition. As the author puts it, "Financial institutions are most likely to develop...innovations if they have to compete ... Competitive institutions are...always innovative...However...innovative institutions are not always competitive."

This paper analyzes changes that are new and those that are adaptations of practices used elsewhere. This is a terrific topic, and I think that the discussion period for this session will be of exceptional interest. Given the limits of time, I will be able to comment on only a few of the many valuable issues and ideas raised in this paper. Beth has asked us to comment on linking trade and agricultural finance, so I will add a brief observation to what Carlos has said. I will then turn to rural savings which, though a large and crucial component of rural finance, has been largely neglected in this paper. But to understand the dynamics of rural finance, analysis of both savings and loans is required. Therefore I will discuss some reasons for an increased attention to balance here. And I will conclude with an observation and some general comments on the paper.

2. Agriculture and Trade

Local commodity wholesalers and traders are a major source of informal credit just about everywhere. The paper makes the point that "Given the advantages arising from traders' knowledge of rural clients, some financial institutions have attempted to link their services with these traders" (p. 19). As the author points out, such linkages can occur when loans are disbursed to borrowers through local traders, or at the time of loan collection when loan payments owed the RFI are deducted from the traders' or processor's payments to the borrowers for their produce. But another important point is also made: "The willingness to supply credit often goes up with the monopolistic or monopsonistic positions of traders" (p. 19).

In my experience, this is correct. And it is not easily overcome. Collection through traders often results in below-market prices received by the producers. Typically I have found this problem more acute in the case of local traders than in larger processing factories or agro-industries where loan payments are deducted at the time of processing.

But the major problem with trader credit generally comes on the disbursement side. Local traders, who are usually more politically powerful than the borrowers receiving the institution's credit, are notorious for disbursing lower amounts to borrowers than they received from the financial institution. And sometimes these can be substantially lower amounts. Yet the client is expected to repay the full amount of the loan.

The paper points out that clients benefit from the convenience of receiving their loan disbursements from local traders rather than having to travel to the financial institution. This is undoubtedly true in cases where the borrower receives the full loan. But most clients I know who borrowed through traders decided to forego this convenience when they had an opportunity to receive the full amount of their loans directly from a financial institution. There is another point.

It is also sometimes difficult for financial institutions to collect from traders who are politically influential and well-connected in their localities. And many local traders are well known for their non-transparency in accounting. Even if as mentioned in the paper, banks take the portfolios of local traders as collateral for their loans to farmers through the traders, the banks will have to deal with the traders' multiple sets of (quite different) account books, their political intrigues and payoffs, and the variety of problems that are generated by non-transparent record keeping.

The paper comments that the systems of disbursing and collecting loans through traders "work better the less competition there is in the market." This a correct statement, but when we ask the question, "Work better for whom?" – it is pretty clear that it is not the clients who benefit. The situation in large processing plants may be different, but in my view financial institutions should be very wary of disbursing loans through local traders. This may work in some areas but I think there are easier and better ways to finance agricultural loans.

3. Savings

After reading the 17 pages of comprehensive and insightful material on lending, I came to the 2-page section on savings – and I thought of Bob Vogel. It was 19 years ago that Bob first made the now-famous statement that "Savings is the forgotten half of rural finance." Perceptions have changed considerably in the industry since then, but the crucial role of savings – both as a service and as a source of financing loans – is unfortunately not reflected in this paper.

Of course one can write an excellent paper about credit. But I think that a paper titled "Innovations in Rural Finance" has an obligation to remember the other half of rural finance. Partly the problem here arises from the author's choice of Latin America and Bangladesh as the main geographic areas from which material was drawn for this paper. Neither one is known for its leadership in the mobilization of large-scale voluntary savings.

But that leaves the rest of the developing world – where many rural financial institutions have massive rural savings. China leads with its \$167 billion in savings in three rural financial institutions in 2001, with the large majority of the funds in rural household savings. Developing countries as diverse as Benin, India, Indonesia, Ivory Coast, Kenya, Thailand, and Togo have substantial rural savings and credit union savings in relation to the size of their populations. In general, savings facilities are at least as much in demand as credit, and among the poor often more so. And institutions in these and other countries have developed innovations of many kinds – which would be well worth further examination.

The very limited treatment of savings in this paper – which I will come to in a few minutes – puts the topic of rural finance out of balance. Let me try here to look at the balance as it exists in reality.

The MicroBanking Bulletin and the Microcredit Summit maintain what are probably the best-known microfinance databases but neither includes savings information (although the MBB is about to start adding savings information in its next issue). However, other microfinance databases and the WOCCU database include savings data, and quite a lot of important information is available. Let's consider a few numbers (table 1).

1. *The World Bank's Sustainable Banking with the Poor 1995 Survey*. In this survey, the first major study of microfinance-providing institutions worldwide, the SBP group found that in aggregate 205 institutions had 15 million outstanding loans and 46 million savings accounts (3 times as many savings accounts as loans). And these institutions had in aggregate \$7 billion in outstanding loans and \$19 billion in savings (the savings was 2.7 times larger than the outstanding loan portfolios).

2.

2. *The MicroFinance Network (MFN)*. The MFN is a global network of leading microfinance institutions, with ACCION International as its international sponsor. The financial statistics for its member institutions are compiled and adjusted by the MBB. MFN's database for 2000 provides information on 25 MFIs in 21 countries. The total number of outstanding loans for the network was 7.4 million; for voluntary savings accounts it was 27.4 (thus there were 3.7 times the number of savings accounts as outstanding loans). And the aggregate loan portfolio was \$1.4 billion; the aggregate amount of voluntary savings was \$2.2 billion.

3. *The World Council of Credit Unions (WOCCU)*. WOCCU's data for credit unions and financial cooperatives in 2002 show that the more than 4,400 African institutions had in aggregate \$768 million in outstanding loans and \$752 million in savings. The nearly 16,600 Asian credit unions and cooperatives had about \$15 billion in loans and \$24 billion in savings. And in Latin America, the more than 1,900 institutions had an aggregate \$2.7 billion in loans and \$3.2 billion in savings.

4. *The Consultative Group to Assist the Poorest (CGAP)*. Ongoing work at CGAP on numbers of microfinance clients around the world was discussed by Elizabeth Littlefield at a meeting in Kazakhstan in early April of this year. Preliminary findings from many different kinds of institutions that supply savings and credit to the poor showed that that globally there are more than four times the number of savings accounts as outstanding loans.

The purpose of this exercise has been simply to show that savings is a fundamental part of rural finance, and that analysis of both rural finance and microfinance (which overlap considerably) must incorporate both savings and loans.

Now we return to the paper, which discusses two aspects of savings. One is the innovations made by SafeSave in Bangladesh, an institution that has initiated many innovations which are especially important because they based on a solid understanding of clients' needs. But SafeSave is still a small institution, with little rural experience. Begun in 1996, it had about 7,200 clients in April 2003. And it had \$127,000 in savings and \$184,000 in loans. SafeSave is not yet financially self-sufficient. Thus the results are not yet in as to whether its many innovations can lead to large-scale sustainable outreach.

The other approach to savings discussed in this paper concerns financial institutions that outsource their savings activities to local groups – often to voluntary groups run by relatively low-skilled personnel. The advantages for clients are said to be reducing transaction costs and convenience. But in addition to convenience, other requirements that generally top savers' lists of requirements are security (virtually always ranked first), liquidity, confidentiality, service provided by well-trained and helpful staff, and returns. These are rarely available in such outsourcing arrangements – and especially not as a package. Outsourcing savings can be appropriate in some extremely remote areas, but in general this approach can be risky for clients

– and also for the financial institutions. And outsourced savings is a tiny part of the current state of global rural savings mobilization.

As this paper is currently written, the reader gets a broad and dynamic sense of the credit side of rural finance. But there is so little about savings that the two examples provided, while interesting in themselves, become misleading because they do not show the role of savings in the larger context of rural finance.

A brief comment on remittances. The paper provides a short but interesting commentary on overseas remittances, almost entirely in the Latin American context. But the issue of domestic remittances is omitted. While unlikely to be as large in aggregate amount as international remittances, domestic remittances are often of great importance to the millions of poor people who receive them, and they are part of the core of rural finance.

4. Conclusions

I will conclude with an observation on a particular point and some general comments. The first is a point about pilot projects. I was struck by a sentence that says (p. 34), “Sometimes it may be advisable to develop the pilot as an activity carried out with complete independence from the existing institution in order to prevent reluctance or hostility against change.”

There may be cases where this could work. But pilot projects are carried out for well-defined reasons. Thus they are used to assess client demand for particular products and services and to test pricing. However another crucial role of pilot projects is to identify, among management and staff, potential leadership for introduction of the innovation on the one hand, and potential resistance and opposition on the other hand.

The latter can be considerable, especially for middle managers who may see innovations as a threat to the status quo – from which they currently derive their benefits. Thus a crucial purpose of pilot projects is to find ways of strengthening the leadership for the innovation and to overcome or deflect resistance to the change.

If the pilot project is conducted outside the institution, and then brought back to be implemented, the results can be negative, even disastrous.

Overall, what I especially liked about this paper is its emphasis on innovations at all stages and junctures of rural finance. It is an exciting paper. It has omissions, as noted, but that is to be expected when the paper itself is so much of an innovation. The nature of innovations in rural finance and their complex interactions are well analyzed. In addition, one of the most important achievements of this paper is the thought processes it sets spinning in the reader’s head. For example, one might want to analyze innovations according to their scale. Or one could explore the life cycles of rural finance innovations. Other questions pop up. I can think of examples of well-implemented innovations whose great success then caused impediments or obstructions to later innovations in the same financial institution. When is an innovation an improvement? And for how long?

Thus this paper leaves us with important evidence about innovations, their dynamics and their interactions. And – a characteristic of the best papers – we are left thinking about this paper’s many contributions and formulating new questions.

Table 1**Savings and Lending in RFIs, MFIs, and Credit Unions/Cooperatives:
Information from Three Databases**

| Database and date of information | No. of financial institutions covered | No. of outstanding loans (millions) | No. of savings accounts (millions) | Amount of loans (in US\$ billions) | Amount of savings (in US\$ billions) |
|---|--|--|---|---|---|
| WB-SBP 1995 | 206 | 15 | 46 | 7 | 19 |
| MFN 2000 | 25 | 7 | 27 | 1.4 | 2.2 |
| WOCCU 2002 (for Africa, Asia, and Latin America) | 22,929 | --- | --- | 18.8 | 27.8 |