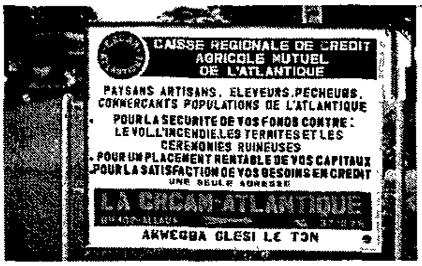
Bruno Stöckli

Sustainable Microfinance for the Poor: Downscaling National Development Banks

One principal lesson has been learned from successful examples of microfinance in the 1990s: financial intermediation must be combined with social intermediation (see SCN No. 17). Social intermediation means capacity-building for grassroots organisations, which then either become eligible for partnership with formal intermediaries («linking») or will be able to develop their own financial systems («developing»). There are three sets of approaches that combine financial with social intermediation: (i) seeking to integrate grassroots organisations into the formal sector (see SCN No. 18), (ii) upgrading more or less structured informal organisations to *(semi-)formal organisations* (see SCN No. 19), or (iii) downscaling national development banks or microbanks to the grassroots level. The present paper focuses on the third set of approaches and discusses efforts to rehabilitate development banks according to the principals of sustainable microfinance.



The end of the statal development banks ...

Until the end of the 1980s, agricultural policy in the South differed from agricultural policy in the North in one significant way. The industrialised countries subsidised their agricultural sectors to a considerable degree, while production for export accounted for a significant portion of governmental revenue in the countries of the South. The concept of interest-subsidised credit was developed to encourage production by farmers in developing regions. In order to legitimise producer-fixed prices that were far below prices on the world market, farmers were provided with cheap credit. In almost all developing countries agricultural banks were created with the purpose of channelling credit in kind at subsidised interest rates.

This policy had sobering results. Traditional agricultural banks went bankrupt in rapid succession, as they could no longer finance their activities with the low interest margins set by the state. At the same time, this policy made it impossible for sustainable financial infrastructures to develop. In most rural developing regions, for example, investment of savings was no longer possible.

... including those in the West African nation of Benin

Like state-controlled agricultural banks in many other countries, the one in Benin went bankrupt in 1987. The willingness of the bank's clientele to repay was lamentable, target groups were rarely reached, and the fixed interest margin was so small that it fell far short of financing the bank's activities. The bank was constituted according to a strictly top-down pattern; all decisions, including those on granting credit, were made in the capital city; and the bank operated more in accordance with political than economic criteria.

Ten years later, after extensive restructuring, the bank is no longer recognisable. The membership of FECECAM (Fédération des caisses d'épargne et de crédit), as the bank is now called, has multiplied almost fourfold. A one-time agricultural credit bank has now grown into a credit union network that offers a wide range of services for farmers, traders, and artisans – target groups who rarely have access to commercial banks.

FECECAM is not the only example of a successfully restructured bank that has succeeded in combining financial and social intermediation. But because it serves as a model in Africa, the main elements of its success will be mentioned here, along with the accompanying risks.

FECECAM: from top-down to bottom-up ...

At first glance, no great differences are apparent between the new and the old networks. FECECAM – a pyramid-like, three-tier organisation – is still structured like most credit unions. At the bottom are the local credit unions (caisses locales), supported by seven regional unions

(unions régionales) and a federation at national level. Nevertheless, duties and responsibilities have changed considerably. While the old headquarters in the capital defined all policy and operational matters and had responsibility for controlling, the new local unions and regional unions enjoying far-reaching autonomy. A board of directors at local union level, elected by the members, is now fully responsible for selection of those receiving credit, for timely repayment, and for the design of the financial services offered. The regional unions no longer grant loans but offer important support services to the local unions, including inspection and monitoring. The federation's main tasks are to develop accounting and financial procedures and carry out national policies for the network.

... from supply-driven to demand-driven ...

The local unions in the previous structure served as mere executing agencies for headquarters, established in order to channel subsidised development funds in one way only. The services offered were limited to standardised «credits in kind». The credit unions now offer three types of deposit products and four types of loans with flexible interest rates and duration. Collateral accepted for loans varies among the local unions and can be of several types: a group guarantee, tangible property, or real estate. The relatively strict collateral requirements have led to high rates of repayment (over 90%).

... and from a farmer's bank to «the peoples' bank»

In general, membership in the federation is open to all self-employed individuals, but each local union is free to set its own membership requirements. In order to serve the most disadvantaged groups in society, public employees and NGOs are excluded from membership. The network has been continually expanded to urban areas, but farmers are still in the majority. The introduction of a program known as «very small loans» in 1996 resulted in a substantial increase in female membership. Nevertheless, women's participation in the executing bodies is still weak. In 1996, women held only 12 percent of the positions in the local unions.

Empirical evidence shows that FECECAM does not lend to the poorest segments of the population, nor to those who have access to commercial banks. But there is a question about whether this is really its function, as interest rates are currently between 15 and 18%. Moreover, those responsible for the network do not claim that their services are an effective means of alleviating poverty.

Success can be dangerous

The growth in federation membership and in deposits (currently more than $30 million) is remarkable. This is all the more astounding as the great majority of the more than 60 local unions now involved are financially self-sustaining and hence have considerable technical and financial autonomy. Thanks to heavily grassroots-oriented decision-making, the risk of defaults has been kept to a minimum. This has been reflected in high rates of repayment.

These visible successes may harbour potential danger, however. The bank has long resisted credit lines from third parties, arguing that network capacity is limited, and heavy infusions of outside capital could reduce the readiness to mobilise indigenous savings. An overly heavy infusion of outside capital could also weaken political autonomy at different levels of decision-making. Potential donors are asked to make a close examination of the absorption capacity of intermediaries as potential partners, and to largely reject conditionality in the allocation of resources.

References

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For further information contact Bruno Stöckli at Swiss Coalition's Debt for Development Unit (phone: +41 31 381 17 14; phone: +41 31 381 17 18; e-mail: bstoeckli @swisscoalition.ch).