

# Devfinance

Discussion list on development finance of the Ohio State University

## Quarterly Review

January to March 2004

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**News, publications and events**, like courses, workshops and seminars on financial sector development and microfinance can be obtained by:

- Regularly visiting the website of SDC's Backstopping Mandate Finance:

www.intercooperation.ch/finance

- Ordering the monthly news brief from CEREM available in French, Spanish and English by sending an e-mail to:

adainfo@microfinance.lu

- Ordering the CGAP e-bulletin on specific information concerning CGAP by e-mailing to:

cgap@worldbank.org

### Main discussion topics:<sup>1</sup>

- From interest rates to business models and efficiency:

The microfinance industry should pay more attention to the reduction of interest rates on loans through an increased efficiency of institutions, in order to broaden the outreach of financial services and ensure sustainability. Although, poor households have the capacity to pay back loans with high interest rates - often in emergency situations - they cannot afford to invest in productive assets and develop their business. If MFIs (microfinance institutions) really want to expand their services to rural areas where poverty concentrates, two things are basically needed:

1. From the side of the MFI: focus on efficiency and new business models (management structure and mechanism design), lean technology.
2. Increased public investment in infrastructure in areas with high concentration of poverty (Fernando,

30.01.04). An appropriate legal system, established norms, protection to borrowers and lenders, norm based supervision and good competitive environment are also very important (Srinivasan, 30.01.04).

In particular, the following recommendations may contribute to increase the efficiency and ensure the sustainability of microfinance institutions (Arunachalam, 30.01.04 and Staschen, 30.01.04):

- The MFI should seek access to low-cost funding (i.e. savings).
- The MFI should have a lean organization and an efficient methodology to offer its services.
- Appropriate and diversified product line.
- Donors should pay more attention to efficiency ratios, instead of only looking at sustainability and repayment performance.

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<sup>1</sup> If you are interested to read the whole discussion on each topic, you can download it from <http://postoffice.ag.ohio-state.edu:8100/Lists/devfinance/> (entering the topic in the search engine).

The Microbanking bulletin provides efficiency indicators ([www.mixmbb.org](http://www.mixmbb.org)).

➤ Donors could also support initiatives in customer education and information so that clients are able to make an informed choice.

➤ Cooperative policies and capacity building: example of FECECAM

The excess liquidity of a financial institution can be detrimental, as shown by the experience of FECECAM (*Fédération des Caisses d'Épargne et de Crédit Agricole Mutuel*) in Benin a few years ago. Actually, in the mid 90's this institution was in a situation, where it used only 25% of total savings to give loans to its member-clients. The remaining funds were deposited in a bank account (Galor, 25.02.04).

At the same time, FECECAM obtained a fund from a multilateral agency for on lending and capacity building, in order to increase the membership base and borrowers. The expansion was too fast and the network came into trouble, with rapidly increasing delinquency (Marx, 25.02.04).

Today West African Credit Unions are still reluctant to use their members' savings for lending and tend to have excess liquidity. Freedom from Hunger (FfH) has worked in partnership with various institutions in West Africa (FECECAM-Benin, FUCEC-Togo, Réseau des Caisses Populaires in Burkina, Nyesigiso and Kafo-Jiginew in Mali), combining credit with education products in order to diversify products and address the problems of excess liquidity (Loupeda, 25.02.04). The credit with education product helped to bring in dynamic new members who were very diligent in their repayment and contributed to put money to work instead of remaining in the bank. Nevertheless, after six or seven years the product got old and needed to be reconsidered, particularly with the older groups, what FfH actually did (Thys, 27.02.04).

Is it dangerous to fund credit unions through cold money (credit lines), in complement to hot money (client and

member savings)? Cold money is not more dangerous than hot money, as long as both types of funds are allocated in the same way by the institution (no directed credit). More important factors of success are staff quality, good management and an adequate volume of business.

FSA (Financial Service Association) International has received a grant for promoting, training and supervising a network of 31 FSAs in Uganda. The supervisory service provided by FSA International is now 40% self-sufficient. The 31 FSAs have 14'000 shareholders/clients, 4000 active loans and about 8000 active savings accounts. Most of the funds are from shareholders (hot money) but the FSAs have also received external loans. The real problem of external funds is related to the duration. What is needed is an extended loan term of 3 to 5 years or more, like a line of credit. FSA international has managed to rescue the idea that self-managed community based microfinance can work if properly trained and supervised (Jazayeri, 26.02.04).

**Recommendations in short:**

- promote prudent expansion patterns based on a careful analysis of the institution.
- balance risks and opportunities.
- promote sound management practices.
- right dose of capacity building and market oriented incentives.
- right lengths of loans from donors/investors.
- ensure an effective external supervision.
- constant adaptation/innovation of products to a rapidly changing environment.
- good client graduation and transition management.