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Frontiers of Rural and Microfinance

By

Hans Dieter Seibel

Six tenets of RMF

(regardless of type, ownership, sphere of operation)

MFIs ultimately have to:

- ➤ Mobilize their own resources through savings, equity, retained earnings; domestic borrowings
- > Recover their loans
- ➤ Cover their costs from their operational income
- ➤ Acquire an appropriate legal status
- Submit to prudential regulation and effective supervision

The new paradigm in rural finance:

From agricultural credit to financial system development

Shifts in development policy:

- ➤ from targeting bigger farmers and SMEs to inclusive finance, incl. smallholders, microentre-preneurs, all segments of the rural population;
- From agricultural credit to rural financial services for a diversified economy;
- From development banks and credit NGOs to (rural) financial system development, with conducive policies and self-reliant institutions.

Frontier issues:

1. Local resource mobilization matters: donor vs. local initiatives

Source of funds: Internal vs. external

Risks: 1. Donor funds discourage local resource mob. (savings, equity, retained earnings) and growth

2. Inadequate equity curtails growth

Opportunities:

- 1. Dynamic growth through local resource mobilization
- 2. Donor equity leverages savings mob. & credit expansion

Proposals:

- 1. Comparative study of savings vs. grant-driven RMFIs
- 2. Study of leveraging effects of donor equity
- 3. Capacity building in savings-driven local FIs

2. Legal framework for local financial institutions matters

Legal form: Regulated deposit-taking FI (*local bank, coop*) **Risks:** 1. Non-formal FIs: lack of deposit mobilization, regulation and supervision

2. Formal Fls: Inappropriate regulation; gvt. interference

Opportunities: 1. Rapid endogenous growth of sector

2. Institutional sustainability and unlimited growth of inclusive saver and borrower outreach

Proposals: 1. Study of legal frameworks (eg, local banking law in Indonesia 1988, Philippines 1953, Nigeria 1990, Germany 1838/1889/1934; MFI law in Uganda 2003; coop. law in Vietnam 1996)

2. Preparation of model laws for private, coop and communal/public RMFIs; facilitation of pilot implementation

3.

Agricultural development banks matter

AgDBs are the largest providers of RMF services

Risks: Unreformed AgDBs waste public resources, lack growth and outreach, undermine rural finance

Opportunities: Reform may lead to sustainable outreach to all segments of the rural population through retail or wholesale services (*linkages*)

Proposals:

- 1. Regional reform policy seminars with fin. authorities
- 2. AgDB reform workshops through Regional Agricultural Credit Associations with FAO & other donors
- 3. Regular state-of-the-art reporting on AgDB reform

4. Institutions matter. Are there viable alternatives?

Eg, buyer/supplier credit:

Yes, if complementary to RMFIs

As an alternative: expensive and unsustainable

Other:

Warehouse receipts as collateral

Supplier credit vs. RMFIs: The case of the Netherlands, 1880-1900

From subsistence to commercial agriculture, in response to the agric. depression, 1882-1896: Traders and shopkeepers main source of credit: "exorbitant interest rates"; "forced sourcing" State Commission for Agriculture Report, 1886: Establish savings and credit (Raiffeisen) coops + agric. purchasing, processing, marketing coops Preconditions: agric. commercialization, savings 1896-...: Farmers coop banks" (>>>Rabobank) 1898: 2 central funds for refinancing, supervision

5. Linkages matter

Linkages: SHGs-MFIs-banks (start-up: by AgDBs)

Risks: Discouraging savings mobilization, growth

Functions and opportunities:

- ➤ Safe-keeping of deposits & excess liquidity
- ➤ Access to bank credit; channelling donor funds
- Liquidity balancing
- > Equity participation
- ➤ Money transfer, check clearing, payments
- ➤ Capacity building
- **≻**Monitoring
- **≻**Supervision

Recommended linkages

Support bank credit linkages for:

- Bridging initial liquidity shortages
- Liquidity balancing

Support equity investments for:

- Leveraging savings, other domestic resources
- Leveraging credit expansion
- Meeting minimum capital requirements
- > Demonstrating the viability of microbanking (eg, ProCredit)

Proposal: Support model projects of horizontal networking among non-formal MFIs, incl. SHGs in remote areas (incl. incentives-driven upgrading) and vertical linkages with banks (incl. downgrading)

6. Development matters

Complex relations: Does RMF lead to poverty alleviation and development, or does development lead to the growth of RMF and poverty alleviation?

Risks: An exclusive emphasis on the poor undermines development & outreach to the poor, sends wrong signals

Opportunities: 1. Establishing RMFIs for all segments of the population to respond to market forces in due course

2. Facilitating the establishment and upgrading of memberowned RMFIs/SHGs for the lower segments of the pop.

Proposals: 1. Study of interrelations between development, RMF and poverty alleviation: exclusive finance for women and the poor vs. inclusive finance

2. Study of SHGs in marginal areas, their upgrading in coop

General recommendations:

Objective of support:

Sustainable outreach of RMF to all segments of the rural population

RMFIs: formal, semiformal, informal – in private, cooperative, community or public ownership

Activities to be funded:

Studies, exploratory projects, dissemination of results

Studies to be supported:

Longitudinal studies, eg of impact, linkages, upgrading

Historical research on RMF in developed and developing countries

Packaging of results for practitioners

Facilitating collaboration of research funding and dev. agencies

Suggested key program areas

- ➤ Piloting appropriate legal frameworks, conducive regulation and effective (delegated) supervision for **self-reliant RMFIs** in private, cooperative, community and public ownership
- Innovative approaches to inclusive finance by integrating informal and semiformal FIs owned by people from the lower segments of the population into the financial sector
- ➤ Linkages of informal and semiformal RMFIs, including SHGs in remote and marginal areas, with the banking sector and their upgrading to recognized or regulated institutions
- > AgDB reform through policy seminars and RACA workshops
- Equity participation for bridging and leveraging purposes

Caveat: Don't sustain unsustainable institutions