DEVELOPMENT OF COMMUNITY FINANCE: RECENT LESSONS LEARNED[1]

BACKGROUND

Towards the end of the 1990s, the popularity of microcredit again highlighted the importance of financial leverage in community development. Suddenly, much attention was directed towards the impact, methods and strategies put into place by microcredit operators promoting the fact that clients who are poor could use credit as leverage to improve their living conditions. There were two major contributors to the debate: the Microcredit Summit[2] which promoted the need to make credit available to the poorest clientele with the goal of reaching 500 million of the poor in order to significantly reduce poverty and CGAP (Consultative Group to Assist the Poorest)[3] which for its part emphasized the need to make microcredit operations profitable in a perspective of sustainability.

Today, the international community agrees that the two objectives must be jointly pursued and that this dual goal of reaching the poorest in both a profitable and permanently sustainable manner is a formidable challenge.

The last five years have been rich in learning opportunities for all those in the sector. Développement international Desjardins, which works with partners in community finance throughout the world, has drawn several lessons from this high level of activity, the most important of which are summarized in this document.

The importance of savings

DID recognizes savings deposits as a pillar for development of local financial institutions delivering true financial intermediation.

A slogan used by the Desjardins Group in the 1970s identified savings with freedom. In terms of development, DID firmly believes that savings deposits are the path to freedom and independence.

Towards the end of the 1990s, when microcredit achieved widespread popularity, DID confirmed its fundamental orientation of making financial services available by developing financial institutions whose main resources would come from the communities served, in contrast to simple credit outlets dispensing funds obtained externally.

This type of position usually draws two major criticisms. The first questions the potential of poor clients to save. Nonetheless, even in the poorest communities, DID partner networks are currently attracting sufficient savings deposits to meet the needs for credit. As of December 31, 2004 for example, in Africa, the average savings deposit of the seventeen networks of DID partner cooperatives was CAN $140 and varied among the networks from CAN $35 to CAN $660 for an average loan of CAN $710 (ranging from CAN $208 to $3400). With 69% of savings converted into credit in Africa, the data shows that depositors and borrowers are to a large extent distinct groups and that the institution is involved in a true process of intermediation, both financially and socially.

[1] Based on a range of experience and drawn up by Anne Gaboury, President and CEO of Développement international Desjardins.
[2] Lobby group made up of a number of non governmental organizations working in microcredit.
[3] Group of experts within the World Bank and financed by a consortium of donor agencies.

This institutional aspect results in a second criticism attacking the longer period necessary to set up or consolidate these institutions. Deployment stretched out over a long period is certainly a direct consequence of an institutional development approach. The result, however, is different from an outlet simply distributing credit products using funds obtained outside the community. Instead it produces a financial institution anchored in its community offering diversified services on a permanent and sustainable basis. On the other hand, impact assessments have widely attempted to evaluate the impact on credit. However, the security of deposits is highly important for members. As critical as credit, it helps stabilize cash flow for clients who are poor[4].

It should also be noted that savings deposits are advantageous for individuals, the community and for the financial institution. Fostering savings deposits within a community means helping build the future for both individuals and the community as a whole and encourages greater empowerment of the community while providing the financial institution with a less costly source of funds.

Today, microfinance is a more popular topic than microcredit, and many institutions specializing in credit are now striving to introduce savings into their practices. But this cannot be limited to simply adding one more product. By introducing savings, the institution is addressing a new and different clientele. Despite the fact that there are members who are both depositors and borrowers, most of the time depositors are not the same individuals as borrowers.

Moreover, in adopting a role of financial intermediation, the institution should be concerned with matching its funds, with the security of its member deposits and with the costs that are generated by mobilizing funds.

Savings deposits do have a cost and it is not just the cost of the funds or the remuneration of deposits. In fact, remuneration on deposits often appears marginal in relation to the costs incurred for transaction services (infrastructure, salaries, work organization, internal control and inspection services) which allows for good accumulation of savings in current accounts. This is especially true for current accounts popular with clients for their flexibility. Current accounts at some DID partners represent more than 80% of total mobilized savings deposits. Opening up to savings deposits often implies a large new number of current transactions (deposits and frequent withdrawals) which generates a strong need to optimize their processing.

Relying mainly on savings deposits does not necessarily mean rejecting external sources of funds. In most cases, funds converted into loans by savings and credit cooperatives or other community finance institutions are provided by the savings deposits of the members and clients. The trend is to make maximum use of savings before calling on external financing. If demand exceeds the offer, external sources could be called upon on the condition that certain ratios ensure deposit security. DID believes however that community finance institutions should always strive to use savings deposits as the primary source of funds.

Finally, accepting deposits raises the issue of the regulatory framework. All institutions mobilizing savings must be supervised.

Outreach of financial cooperatives

DID believes that financial cooperatives, under certain conditions, may become formidable networks delivering financial resources, with both vertical and horizontal outreach that allows for circulation of resources encouraging social intermediation.

[4] See *The Impact of Savings and Credit Cooperatives in Burkina Faso*, Développement international Desjardins Notebook 19. Available in French and English at www.did.qc.ca.

A concern about impact by development agents has led community finance institutions to examine their outreach in two ways: to what extent is the institution able to reach the largest number of persons (horizontal reach) and to what extent is it able to reach the poorest (vertical reach).

These concerns have highlighted the formidable distribution potential that networks of savings and credit cooperatives offer. This potential is based however on certain conditions:

- To develop vertical outreach (reaching the poorest), cooperatives must introduce into their practices methodologies to help lower entry barriers for clients who are poor (ex: group loans with a solidarity guarantee).
- To develop horizontal outreach (reaching more and more individuals), cooperatives must seek to optimize the creation of base units avoiding abusive proliferation, so that each cooperative has sufficient membership. For this purpose, the horizontal reach of the cooperative may be developed by opening up service outlets linked to the same cooperative and by mobile decentralization of services.
- To foster circulation of resources, it is important that base financial cooperatives be brought together into a federated network where, by sharing similar systems, standards, products and image, they can set up joint services and enjoy a degree of financial solidarity. Through these mechanisms they can safely benefit from the advantages of pooling their resources.[5]

These three conditions can considerably raise the soundness and the range of the distribution potential for a network of savings and credit cooperatives. In a perspective of community finance development, these strategies provide major advantages linked mainly to the diversity of the clientele and the circulation of resources. In fact, if a network of cooperatives is highly integrated, this helps financial resources penetrate into marginalized zones at a lower cost. It is recognized that it is more difficult to make financial operations profitable in rural areas than in urban areas. A network that is highly integrated could cover the cost of distribution in rural areas with profits made in urban areas. It is not unusual for example, that savings collected in urban areas help meet the increased need for credit in rural areas which generate fewer savings. The circulation of resources made possible by the mechanism of shared resources also helps manage seasonal cash flows better and often fosters financial transfer between genders (in some institutions, savings deposited mostly by men foster access to credit by women).

A two-year study of borrowers of the Réseau des caisses populaires du Burkina Faso[6] shows that up to a certain loan level (500,000 CFA francs or CAN $1250), access to financial resources helps families fulfill their basic needs, a highly important impact, especially if the income lifts them above the threshold of poverty. As a result, it is only above this level of loan that borrowers start to reinvest in their businesses (7% of the profit). To generate economic reinvestment in a business and as a result in the community, it is important therefore for community finance institutions to also target larger loan operators (above 500,000 CFA francs or CAN $1250), namely the niche of micro and small businesses.

Micro-enterprises help create jobs that offer others the chance to rise out of poverty. In this manner, credit to poor clienteles and credit to micro-entrepreneurs will not have the same effects on the community. They are two critical types of leverage in a development strategy based on improving access to financial resources.

In this spirit, DID has always insisted that financial cooperatives must remain open to the community as a whole and strive to serve not only the poorest, but also the less poor. This diversity of the clientele when joined to a well-oiled machine that circulates resources within a federated network, fosters cross subsidies among clienteles and social intermediation, two phenomena that accelerate the local impact ofcommunity finance institutions.

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[5] See *The Characteristics of a Federated Network of Financial Cooperatives*, published by Développement international Desjardins and available in French and English at www.did.qc.ca.

[6] For complete information, see *The Impact of Savings and Credit Cooperatives in Burkina Faso*, Développement international Desjardins Notebook 19. Available in French and English at www.did.qc.ca.

Sectoral approach to development

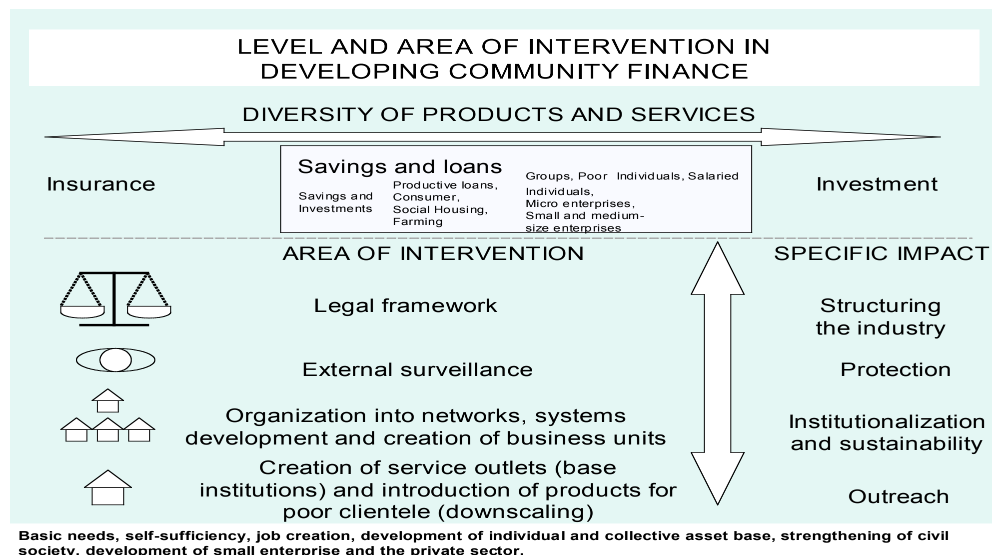
Since community finance is an integral part of a country's financial system, DID believes it is necessary to strengthen both the institutions and their legal environment with its supervisory framework by encouraging a sectoral type approach.

The development of community finance is not just limited to opening up service outlets. Development efforts must affect the sector as a whole. The figure on the following page provides a good overall illustration of the various levels of intervention required for development of the sector.

To make financial services available, efforts should concentrate on development of base financial institutions by striving to reach the most people possible. Proliferation of service outlets and introducing target products for clients who are poor will help increase impact in terms of the number of persons affected and their poverty level. On this point, DID believes that it is important to develop strong base institutions that have strong membership and offer a range of services.

To ensure the long-term sustainability of these financial institutions and thereby guarantee that financial services remain available over the long term and not only over the short term, the internal systems of the base units must be formalized and they must be organized into a network.

The goal is to develop true community finance institutions that are strong, locally owned, profitable and sustainable. With this in mind, DID believes that encouraging base institutions to organize themselves as a federated network is a strategy that helps strengthen them.



Basic needs, self-sufficiency, job creation, development of individual and collective asset base, strengthening of civil society, development of small enterprise and the private sector.

Because they accept deposits, these financial institutions must be strictly supervised in order to ensure the security of clients' assets. Intervention at this level will support the development of strategies, methods and surveillance tools to confirm that networks meet the main financial ratios in the industry. On this point, DID recommends strong independent external surveillance. If unable to obtain this type of service, networks should implement rigourous internal surveillance.

This overall support could not truly get off the ground without an adequate legal framework for regulating the operations of these institutions. Supporting development of the regulatory framework governing community finance institutions produces leverage for development that is just as important, although less direct. It is convincing to observe the strong growth of community finance institutions in countries where such regulations have been promulgated. On this point, DID believes that savings and credit cooperatives should be governed by legislation that is dedicated specifically to the sector.

Finally, the community finance sector should not be limited to savings and credit for the poorest but should also develop services for small and medium-size enterprises, farmers, consumer credit (which is often used to finance education), support the financing of social housing and improve development of insurance services and potential investment.

Therefore, in a global manner within the community finance sector, intervention will gain from operating on several levels in order to formalize this sub-sector of the financial sector. The gradual formalization of the community finance sector will ensure access over the long term to quality financial services that are secure and which will have an impact on clients who are poor.

Performance factors

DID believes that the performance of a community finance institution must be monitored and analyzed using three complementary dimensions: business performance, organizational performance and institutional performance.

All prior lessons learned have led us to believe that the performance of community finance institutions is not limited to a series of ratios. The experience acquired with our partners suggests to us that performance should be assessed and monitored, with the aim of optimizing the following three dimensions:[7]

- business performance that assesses the degree of relevance of the institution in its market as well as financial performance
- organizational performance that assesses the degree of formalization of the various systems at the operational base of the organization and the level of mastery by various actors
- institutional performance that assesses the level of development of institutional maturity from the perspective of base unit integration and interdependency.

From the viewpoint of sustainability, attention should be directed to each of these dimensions which will call for short, medium and long-term strategies. This approach echoes recent trends in the sector which increasingly call for greater professionalism by the operators. Greater professionalism, in our opinion, will be achieved not only through better business results, but also through increased organization of internal systems and optimization of institutional structures.

Trends in partnerships

DID believes it is necessary and beneficial, for community finance institutions to expand their partnerships.

[7] These elements make up the DID *TOP SYSTEM*, a performance assessment and monitoring system that will be the subject of a future publication.

This finding reveals itself as partners and aid for development grow. By developing their operations, market and staff, community finance institutions identify their needs more accurately and seek out increasingly specialized support.

Growth in the sector has clearly highlighted the need for operators to be more professional in the face of competition that will soon come from a well-organized commercial sector.

Faced with this trend, community finance institutions in the process of consolidation must establish strategic partnerships and not just coach local organizations. They are seeking experts in technology, organizational development, finance and marketing. They are seeking added value from one or two benchmark partners who can demonstrate concrete results to inspire what they wish to develop in their own way in their sphere of influence. They are seeking partnerships based on long-term institutional agreements. They are also mentioning investment and proposing business alliances.

It is difficult to envisage where these alliances will lead us since they are only now being set up. They are inevitable and beneficial. Their appearance will lead to new experience and help us redefine our development strategies and their impact.

CONCLUSION

Recent years have been highly stimulating in terms of the lessons learned in the development of community finance throughout the developing world. Efforts to optimize operations must be maintained. Too many individuals are still excluded from formal financial systems and deprived of important financial leverage for developing their community, their family and their individual circumstances.

Organizing and democratizing the access to financial resources is certainly not a panacea in the search for poverty alleviation strategies but nonetheless provides a strong leverage. Community finance needs to be seen and treated as a sector requiring a global approach to take advantage of all the potential available for assisting populations and communities. With help from partners in the developing world who are stakeholders already providing strong leadership in the sector, community finance in coming years will perhaps receive that treatment.