

A French Position

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In its support to the financial sector, French Aid is adopting a more broadly based approach than in the past, aiming to promote diversification, so that the complete range of an economy's needs can be met, and constructive interaction between the various components of the sector. Accordingly, not only the formal sector but new forms of financial intermediation are receiving support, to help them achieve long-term sustainability. In addition to this direct support to the sector, French Aid helps to create a favourable environment for the institutions operating in it, so that they can thrive and develop, by lending support at institutional, macroeconomic and social levels.

RECENT HISTORY

1. Development banks and the banking sector: primary instruments of development policy in the post-independence period

During the period following accession to independence, the state was the main driver of the development process. There was heavy regulation of banking activity and the distribution of credit, with the banking sector being used for the allocation of resources to productive or social projects, to deficit spending etc. This period also saw the establishment of state-owned development banks to finance activities in priority sectors and long-term investment. These banks were also the main channels for the deployment of international aid.

The flaws in this state-dominated vision of development policy were exposed by the severe financial crises which beset Africa between the late 1970s and early 1990s.

2. The 1990s: financial sector restructuring

In the wake of these crises major reforms, in which funding agencies from France in particular played an important role, were undertaken (liquidation of failed banks, restructuring and recapitalization of those considered viable, financial deregulation, reduced state intervention etc.).

Following the disappearance of the development banks and disengagement by states, the restructured banks that survived were reluctant to take on the risks of long-term lending. Long-term investment finance became unavailable or extremely scarce. The situation was exacerbated by the failure of credit components built into development projects set up by funding agencies, which had proved not to be a lasting basis on which an economy's needs for finance could suitably be met.

3. A drive to diversify the financial sector through the introduction of new forms of financial intermediation

In the light of these difficulties, French Aid responded to the need for adjustments in its approach to supporting the financial sector in developing countries. Since 1987 a proportion of its support effort has been channelled into new and sustainable forms of financial intermediation organized by microfinance institutions (MFIs). However, these institutions typically have only a limited impact on investment.

French Aid therefore continues to pay close attention to development of the conventional financial sector while seeking to promote greater complementarity and interaction, so as to increase the range of MFIs' capabilities, and diversification of instruments, so as to meet developing economies' varied funding needs.

TYPES OF SUPPORT GIVEN BY FRENCH AID IN FUNDING DEVELOPMENT

1. Institutional support

- *Establishment of a suitable legal and regulatory framework:*
 - French Aid organizes PAFIEs (programmes d'appui aux administrations économiques et financières) to assist in the formulation and application of economic and financial policy in countries in the franc area where structural adjustment programmes are in progress.
 - Specifically in connection with microfinance, French Aid lends support to monetary authorities in their efforts to evolve new institutional structures corresponding to the diverse range of institutions that have been set up, with the aims of integrating them more fully into the financial landscape, establishing their activities on a secure footing, giving them legal recognition and affording them access to refinance from banks and private sources.
 - In connection with the investment environment, the OHADA (Organisation de l'Harmonisation du Droit des Affaires en Afrique) treaty setting up harmonization of business law in Africa covers a very wide field (rehabilitation of businesses, liquidation, regulation of debt recovery, security etc.) and marks real progress in improving the legal environment.
- *Organization of regional support programmes:*
 - French Aid actively supports regional integration initiatives in the franc area which have seen the creation of supranational institutions responsible for setting up multilateral supervision and establishing a genuine regional common market: the West African Economic and Monetary Union (UEMOA), the Central African Economic and Monetary Community (CEMAC), OHADA, training institutions etc.
 - In the microfinance sector, programmes have been set up to promote capitalization on experience, consultations and the conduct of cross-cutting studies: from 1991 to 1998, the PRAOC regional programme supporting decentralized savings and credit schemes, since 1998 the PAFID programme supporting decentralized finance.
- *Organization of training programmes, through various channels:*
 - The Centre d'Etudes Financières, Economiques et Bancaires (CEFEB) in France provides basic and further training for executive staff of financial institutions, economic and financial administrations, and public and private enterprises in developing countries. A specific course on savings and credit schemes, SYDEC (Systèmes d'Epargne Crédit), is attended by about 30 staff members of microfinance institutions each year. In the field, French Aid has lent support to the establishment of two regional training centres for staff of ministries of economic affairs and finance (at Libreville for Central Africa and Ouagadougou for West Africa); it also supports established training centres.
 - A new regional programme providing training for trainers has been set up in partnership with the Consultative Group to Assist the Poorest (CGAP) with the aim of

building local private-sector capacity to deliver technical products and services appropriate to the microfinance sector on a sustainable basis.

- *Organization of facilities for gathering and distributing information:* French Aid has given backing to a variety of initiatives: a website on investing in the franc area, “Investir en zone franc” (www.izf.net), technical and economic information centres, conferences and seminars, Afristat regional statistical institute etc.
- *Partnerships with other funding agencies:* French Aid plays an active part in various international consultative bodies, such as the Development Assistance Committee and, in the microfinance sector, the CGAP. Other partnerships are set up on a one-off basis (joint financing of projects, studies focusing on individual sectors etc.).

2. Support to the financial sector

- *The formal banking sector:* a range of conventional instruments is used in supporting this sector, including lines of credit earmarked for investment finance, funding to support rehabilitation of the sector, guarantee funds or schemes.
- *The microfinance sector:* encouraging results have led French Aid to make this one of its priority areas of activity, funding not only microfinance schemes as such but various operations linked to development of the sector.
- *Integration of the microfinance sector into its financial environment,* where two aspects are to be considered:
 - Access for MFIs to refinancing from banks (as their ability to grant credit on a sound and stable basis is greater than their ability to attract savings); since its first involvement in the sector, French Aid has addressed this aspect by setting up partnerships between banks and MFIs, which have been able as a result of this cooperation to extend their coverage to users they had formerly been unable to reach;
 - The possibility for MFIs to become specialized financial institutions taking the form of companies in which banks could become reference shareholders alongside other investors; this arrangement is widespread in Latin America and Asia but has not yet been developed to any great extent in French-speaking Africa.

Other avenues or approaches to integration of the microfinance sector are being explored by French Aid through such innovations as:

- a craftworkers’ mutual guarantee institution in Burkina Faso based on partnership between a soundly structured craftworkers’ organization, whose members accept liability for one another’s debts and are able to subscribe to a mutual guarantee fund, and an MFI with a network well established in the field;
- a combination of leasing and microfinance funded by a line of credit to a leasing company in Ghana (Leasafic) which plans to develop, alongside its mainstream 3-year contracts on industrial plant, a subsidiary (25%) microleasing business in partnership with local microfinance specialists;
- formation, networking and collective branding of well managed, efficient and financially viable MFIs specifically targeting a customer base of micro-enterprises; this is a replication of the ACEP/Sénégal scheme in other countries;
- cooperation in setting up the Africap Fund which will specialize in investing in MFIs in Africa, either by acquiring shares in them or, particularly in the case of those established in the form of mutual societies, by granting them loans.

3. Finance for the private sector

French Aid lends support to the private sector either through local banking and financial systems or in direct dealings with enterprise. It operates through a distinctive body specializing in corporate finance: PROPARCO (Société de Promotion et de Participation pour la Coopération Economique), a finance company founded in 1977 belonging to the Agence Française de Développement Group.

PROPARCO, an integral part of the French development assistance machinery, offers a wide range of facilities: investment in equity and quasi-equity; various types of loan; guarantee facilities; financial engineering; foundation and running of investment funds to provide entrepreneurs with investment capital; support to the establishment of banking institutions meeting stringent standards of management and financial soundness; promotion of leasing facilities.

FRENCH AID AND MICROFINANCE

1. Key indicators

Total commitments at 31/08/99	FF 877 m (\$138 m)
Number of institutions supported	33
Number of members or customers at 31/12/98	1 000 000
Balance of loans at 31/12/97	FF 314 m (\$52 m)
Balance of savings at 31/12/97	FF 450 m (\$75 m)
Interest rates	between 1.5% and 5% per month
Types of loan	Short-term (3 to 24 months), occasionally medium-term up to 4 years
Activities financed	mostly agriculture, commerce, processing and craft industry

2. Trends in support from 1987 to date

Phase 1, 1987-1991: experimentation

This phase, to which a total of FF 152 million was committed, was a period of experimentation with this type of project in Africa, seeking to fill the gap left by the closure of development banks and to develop an alternative to the credit components of development projects. Tests were conducted on new forms of financial intermediation targeting sections of the population that had no access to banking facilities, and efforts were made to define operating methodologies and check their feasibility (regional/national impact in terms of the supply of services meeting demand, numbers of members/customers, volumes of business and repayment rates).

Phase 2, 1991-1994: spread of experimentation, focus on cost-effectiveness and sustainability

With these projects having recorded successful results in terms of repayment rates, market penetration and volumes of business (savings deposited and loans granted), this phase saw a rise in project funding, which amounted to FF 332 m, and a consequent increase in the number of projects funded. In parallel, a start was made on a process of reflection, capitalization on experience and consultation on the future of these projects. The PRAOC regional programme supporting decentralized savings and credit schemes was set up and

focused on ways and means of securing the sustainability of MFIs and evaluation of their socioeconomic impact.

Phase 3, since 1995: focus on consolidation and professionalization of MFIs and their integration into national financial sectors

This phase has seen a number of new departures:

- The main concern of French Aid has become consolidation and professionalization of MFIs so that each type of scheme is able to operate according to business logic. Thus the emphasis is on institutionalization, financial viability, organization and autonomy of management, the aim being to establish them as durable financial enterprises integrated into their national financial sectors.
- New projects are being set up on a smaller – local or regional – scale (solidarity group credit, village funds), and more recently there has been diversification aimed at tackling the specific problem of finance for very small and micro-enterprises in urban areas.
- The geographical coverage of support to the microfinance sector has been extended beyond sub-Saharan Africa to North Africa, Asia (Cambodia, Vietnam, Laos) and the Caribbean.

3. Characteristics and schemes supported by French Aid

Origins

The methodologies adopted have been founded on a combined development/banking approach and based either on models derived from developing countries (mutual societies) or replications (adapted to local contexts) of successful experience in other parts of the world (notably the Grameen Bank). Other schemes have been rooted in their local contexts (self-managed village funds).

Features in common

All the schemes supported by French Aid:

- serve sections of society with no access to conventional banking (90% of the population);
- offer short-term financial facilities involving very small amounts and high management costs; other forms of intermediation need to be found for investment financing (agriculture, medium/long-term investment in plant and equipment);
- operate on the basis of direct contact with members/customers, which is their basic principle;
- have to cope with the same problems of mitigating the potential consequences of lending to borrowers unable to provide security and keeping down the costs of managing small loans.

Differences of approach

French Aid has made a deliberate choice to support a variety of approaches according to a pragmatic method applied in three phases: a test phase, a confirmation phase and a consolidation and stabilization phase. It has selected four main types of scheme:

- *mutual schemes,*
- *solidarity group credit schemes,*
- *self-managed village savings and credit schemes,*
- *schemes lending to very small and micro-enterprises.*

A recent development has been a blending of approaches by some schemes, seeking to increase their capacity for innovation and diversify their customer bases, as in the case of mutual schemes offering credit to solidarity groups in a particular target population.

A diverse range of partners

- Operators: the organization of schemes has been entrusted to about a dozen technical operators or NGOs, most of them French but some foreign, bringing methodological input from other sources.
- Banks: French Aid sought to cooperate with banks as soon as it became involved in the microfinance sector, particularly in countries where there had been development banks (Mali, Burkina Faso). This cooperation is on two levels: institutional partnership, in which banks are assigned an operational role in the running of microfinance schemes, and financial partnership, in which they refinance MFIs.

4. Impact

The various impact studies available confirm the recognized role of microfinance as an instrument of both economic and social development:

- microcredit has a positive influence on the profitability of activities financed and is conducive to the development of small-scale economic activities, job creation and stability of employment in the informal sector and micro-enterprises, higher incomes and improved standards of living in disadvantaged populations;
- collection and safekeeping of savings give these populations opportunities to control the use of their resources more effectively and extend their budgeting horizons;
- when made available to women, microcredit and savings facilities have collateral effects seen in improved health and education of children;
- microfinance schemes also play a part in lending structure to society, through the adoption of democratic practices and the sense of responsibility and belonging fostered by membership;
- market penetration rates are reaching significant levels: the schemes supported by French Aid have reached between 8% and 20% of families in some countries, but often in excess of 50% in their catchment areas;
- MFIs still lag behind the conventional banking system in terms of volume of business, but they have between 5 and 10 times as many customers/members;
- microfinance schemes provide an auxiliary means of alleviating poverty, so that the poorest of the poor will need other forms of subsidized aid.

The results of these impact studies need to be refined, on the basis in particular of organized monitoring and evaluation to provide institutions with regular information enabling them to assess where adjustments are needed.

5. Challenges ahead

Experience to date shows that many of these schemes are still vulnerable today. It is going to take a great deal of effort to consolidate them and secure their future on a sustainable footing. The main challenges can be summarized as follows:

- Financial viability: although some MFIs have reached financial break-even and others have clear prospects of achieving viability in the near future, there is another group for which this remains a distant objective.
- Institutional viability, to which there are two aspects:
 - legal recognition, where there is still room for improvement in making legislation applicable to all microfinance institutions or filling legal vacuums in this area;
 - a key factor in viability is the quality of staff, where capacity-building through training is required, plans need to be made for the takeover of responsibility from technical assistance personnel (new forms of partnership have to be devised), and the emergence of local expertise has to be fostered.
- Social viability, to which there are also two aspects:
 - within an institution: acceptance of rules, allocation of resources, balancing of powers;
 - integration of an institution into its social environment.
- The need to fit in with the financial sector, developing further interaction between MFIs and the formal banking sector through new mechanisms: risk management, refinancing facilities, partnership.
- The need to fit in with the economy as a whole, which entails being more responsive to increasingly pressing customer demand to meet needs for investment in basic infrastructures (electrification, health and sanitation etc.), housing and so on. This pressure on MFIs to diversify will require a great deal of financial engineering and innovation in developing new products, which in turn will complicate risk management. MFIs will have to find ways to contain their risks through new mechanisms for making the services and products they offer more secure.

6. The current strategy of French Aid

- Underpin the environment and overall performance of the microfinance sector through training, action supporting improvement of the legal and regulatory framework, the development of management tools, and the application of new approaches and innovations (new products etc.).
- Support governments' efforts to put national sector strategies in place, notably in countries where MFIs are widely established.
- Foster the development of operations aimed at improved coverage of rural and urban populations' needs for access to basic financial services (savings and credit).
- Develop synergy and cooperation with operators and funding agencies on the basis of working themes linking up with those pursued by French Aid.

These strategic aims are being furthered by action that can be summarized under six headings as follows:

6.1 Continued funding of projects

6.2 Training of MFI staff and support to their associations

The aims here are twofold:

- to consolidate the internal viability of MFI networks by increasing the productivity and efficiency of operations by developing human resources and raising standards of skills;
- to structure and foster the development of centres of expertise in the South able to exchange experience and eventually become a viable alternative to technical support from organizations in the North (support to the foundation of professional associations of MFIs to define professional standards, brand institutions nationally and promote their concerted development; support to the development of private-sector sources of expertise offering services to MFIs).

6.3 Support to improvement of legal and regulatory frameworks

- Support to improvement of the legal and regulatory environment where legislation on MFIs has already been enacted.
- Support to the Bank of the Central African States and the Commission Bancaire de l'Afrique Centrale, the regional regulatory authority for the sector, in terms of capabilities for monitoring and supervising MFIs in the Central African Economic and Monetary Community.

6.4 Information systems: monitoring – evaluation – audit

The aims are to improve the quality of both internal and external information on networks (impact, financial results etc.), to promote better use of information generated for operational purposes, and to establish methods based on lessons of experience on a formal basis and spread their use (development of indicators, management reports, forecasting instruments, external auditing methods etc.).

6.5 Innovation in products offered and operating methods

With a view to increasing the impact of MFIs and improving their profitability, campaigns and discussions are organized on diversification of the financial products and services they offer, development of new areas of financial business (such as insurance), arrangements for security etc. Cooperation with banking and financial partners, including the formulation of refinancing arrangements, should be pursued as a long-term alternative to support from funding agencies.

6.6 Communication and capitalization

- Continue the process of capitalizing on experience and consultation on such aspects as the impact made by microfinance and the relationship between microfinance and promotion of the role of women.
- Intensify coordination with bilateral funding agencies, given the benefits to be derived from pooling resources to finance new MFIs and develop management tools. Coordination is also needed in working towards the setting of standards and definition of best practice in cooperation activities.