Desjardins
Développement international

DEVELOPING COMMUNITY FINANCE: SOME LESSONS LEARNED[1]

DÉVELOPPEMENT INTERNATIONAL DESJARDINS

Created in 1970, Développement international Desjardins (DID) is a Canadian non-profit organization that specializes in providing technical support and investment for the community finance sector in emerging and developing countries. A subsidiary of the Desjardins Group, DID is currently working with partners in over twenty countries in Africa, the Americas, the Caribbean, Asia and Central and Eastern Europe. Over the years DID has developed expertise inspired by various longstanding strategies developed within the Desjardins Group, the sixth largest financial institution in Canada, reconciling cooperation and market competition, as well as by its numerous partnerships throughout the world where communities, cooperative networks, lawmakers and governments have sought to optimize community finance as leverage in fighting poverty and creating prosperity.

The mission Développement international Desjardins has set is to empower poor communities in emerging and developing countries by helping them control financial institutions that are community owned and which benefit the community. In light of the intense development that the community finance sector has experienced, this document describes some of the recent lessons learned by DID.[2]

BACKGROUND OF LESSONS LEARNED

Towards the end of the 1990s, the vogue for microcredit refocused attention on the importance of financial leverage for community development. Suddenly many eyes turned to the impact, methodologies and strategies set up by microcredit practitioners who insisted that poor clients could use financial leverage to improve their circumstances. Two main actors contributed significantly to the ongoing debate: the Microcredit Summit[3] which highlighted the need to make credit available to the poorest with a goal of reaching out to 500 million in order to significantly reduce poverty and the Consultative Group to Assist the Poorest (CGAP)[4] which, for its part, promoted the need to make microcredit operations profitable to ensure their ongoing existence.

Today, the consensus within the international community is that these twin goals are inseparable and that the two-pronged effort of maintaining both profitability and permanence while reaching out to the poorest is a major challenge.

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[1] Based on several experiments and written up by Anne Gaboury, President and CEO, Développement international Desjardins.

[2] While DID works with various donor agencies, its longstanding partnership with the Canadian International Development Agency should be noted. Over the last thirty years, this agency has supported many development projects aimed at increasing access by the disadvantaged to high quality financial services. Many SCC networks in the developing world have received support from CIDA during set up or consolidation. If lessons may be drawn today, this is to a great extent thanks to the partnerships that the Canadian International Development Agency was able to establish with several community finance institutions highly involved in their communities and with other stakeholders who had major impact on the sector.

[3] Lobby group composed a various non-governmental organizations working in the field of microcredit.

[4] Group of experts housed at the World Bank and financed by a consortium of donor agencies.

The last five years have been rich in providing lessons for all those involved in the sector. Développement international Desjardins, while working with community finance partners throughout the world has learned several lessons during these many developments, a few of which are summarized in this document.

LESSONS LEARNED

#1 THE IMPORTANCE OF SAVINGS AS THE PILLAR SUPPORTING DEVELOPMENT OF LOCAL COMMUNITY FINANCE INSTITUTIONS ABLE TO OFFER TRUE FINANCIAL INTERMEDIATION

"Savings is freedom" *(L'épargne, c'est la liberté)* **was a slogan used by the Desjardins Group in the 1970s. In terms of development, DID firmly believes that savings produce independence.**

Towards the end of the 1990s during the vogue for microcredit, DID confirmed its fundamental orientation of making financial services available through the development of financial institutions whose main resources were rooted in the communities being served instead of making external funds available to communities through simple loan distribution outlets.

Such a position usually draws two traditional objections. The first questions the savings potential of poor clientele. Yet, even in the poorest communities, DID partner networks are currently generating sufficient savings deposits to meet loan needs. In Africa for example, the average savings deposits within thirteen DID partner cooperative networks is CAN $100, ranging from $15 to $800. Loans average CAN $700 and range from $500 to $1200. With a percentage of savings converted to loans of 77%, this data demonstrates that depositors and borrowers are generally two distinct groups. Since this is the case, the institution provides a true intermediation process on both financial and social levels.

This institutional aspect results in the second objection which concerns the long lead time required to set up and consolidate these institutions. The long development horizon involved is certainly a direct consequence of taking an institutional development approach. However, the result is more than just the simple availability of loan products provided through outlets dispensing external resources. The result is a financial institution anchored in the community providing diversified services on a sustainable and permanent basis. Impact assessments have sought intensively to evaluate the effect of loans provided whereas savings deposits constitute a highly significant element of security for the members. Just as critical as credit, deposits serve to regulate monetary flow for poor clientele.[5]

Therefore, it should be noted that savings deposits are as much of an advantage for individuals as for the community and the financial institution. Encouraging savings within a community means encouraging the development of both individual and community wealth and empowerment while providing the financial institution with a less expensive source of funds.

Today, while microfinance rather than microcredit is the current topic of debate, many institutions that are specialized in lending are seeking to introduce deposit services into their practices. But this should not be limited to adding one more product to a list. It means targeting a different clientele. Despite the fact that there are members who both deposit and borrow, in general, depositors and borrowers are not the same individuals.

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[5] **Consult** *The impact of savings and credit cooperatives in Burkina Faso*, **Notebook 19 from Développement international Desjardins. Available in French and English at www.did.qc.ca.**

Moreover, by adopting a financial intermediation role, the institution should be concerned by matching the funds available, by the security provided to its members' deposits as well as the costs tied to mobilizing the funds.

Deposits do have a cost and it is not simply reduced to only the cost of the funds, namely the remuneration earned on deposits. In fact, the remuneration earned by deposits is often marginal in relation to the costs engendered by transaction services (infrastructure, salaries, work organization and internal controls) needed to allow deposits to build up in current accounts. This is especially the case for on-sight deposits, which are attractive to members seeking flexibility. For some DID partners sight savings represent more than 80% of the total deposits mobilized. Providing deposit services often implies a significant volume of current transactions (frequent deposits and withdrawals) which calls for optimizing the processing of transactions.

Using savings as the foundation for lending does not mean completely rejecting the use of external funds. In most cases, the funds converted to loans by savings and credit cooperatives do come from member deposits. The trend is to use savings deposits to the maximum before resorting to external financing. If demand exceeds supply, external sources could be a source, on the condition that specific ratios are respected to ensure the security of the savings deposits. However, DID does feel that community finance institutions should always strive to maintain savings deposits as the primary source for funds to lend.

In conclusion, accepting savings deposits raises the issue of the regulatory framework. According to our experience, all institutions converting deposits to loans should be regulated.

#2 UNDER CERTAIN CONDITIONS, FINANCIAL COOPERATIVES MAY BECOME FORMIDABLE DISTRIBUTION NETWORKS FOR DISPENSING FINANCIAL RESOURCES WITH VERTICAL AND HORIZONTAL OUTREACH THAT HELPS CIRCULATE RESOURCES FOR SOCIAL INTERMEDIATION

The concern which economic agents place on producing impact has caused community finance institutions to stress outreach in two ways: horizontal outreach - or how can the institution reach the greatest number of people and vertical outreach - how can it reach the poorest.

These concerns have made it possible to highlight the formidable potential that SCC networks offer for distribution. However there are certain conditions:

- **To develop vertical outreach (to reach the poorest), cooperatives must introduce methods into their practices (ex: group loans with solidarity guarantees) which will allow them to lower the entrance requirements now barring the poorest.**
- **To develop horizontal outreach (to reach the most individuals), cooperatives must strive for optimization of base unit outlets while avoiding the abuses of a multiplication of outlets, in order that each outlet serves a large membership. Horizontal outreach for a cooperative may be developed using service outlets linked to a single cooperative or through mobile decentralization of services.**
- **To encourage the circulation of resources, base SCCs should be united into a federated network where they share systems, standards, products and an image. Setting up shared services they provide each other with a certain measure of financial solidarity and can bring into play the mechanism of cross-subsidization in an atmosphere of confidence.**[6]

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

These three conditions may considerably increase the strength and distribution potential of a network of SCCs. In terms of community finance development, these strategies present a major advantage mainly linked to the diversity of the clientele and circulation of resources. In fact, if a network of SCCs is highly integrated, it allows it to push financial resources into marginalized zones at lower cost. It is recognized that financial operations in rural areas are more difficult to make profitable than those in urban areas. A highly integrated network could cover distribution costs in rural areas through the profits made in urban areas. It is not unusual for the savings deposits collected in urban areas to make it possible to meet the growing need for loans in rural areas which generate fewer savings deposits. Circulation of resources through cross-subsidization will also bring better management of seasonal fluctuations and encourage transfers among women and men (in some networks, savings deposited mainly by men provide access to loans made mainly to women).

At the same time, a study undertaken over a period of two years among borrowers within an SCC network in Burkina Faso (Réseau des caisses populaires) revealed that up to a certain loan level (500,000 CFA francs), the availability of financial resources helps families meet their basic needs, which is a major impact, especially when income may be raised above the poverty level. Therefore, only above this level do borrowers start to reinvest in their business (7% of the surplus). To generate some economic reinvestment in business and consequently in the community, community finance institutions must also target larger borrowers (over 500,000 CFA francs), namely the micro and small business segment. Micro-enterprises help create jobs to lift even more out of poverty conditions. Credit to the poor does not have the same impact on the community as credit to micro-enterprise. They are two critical types of leverage in a development strategy based on improving access to financial resources.

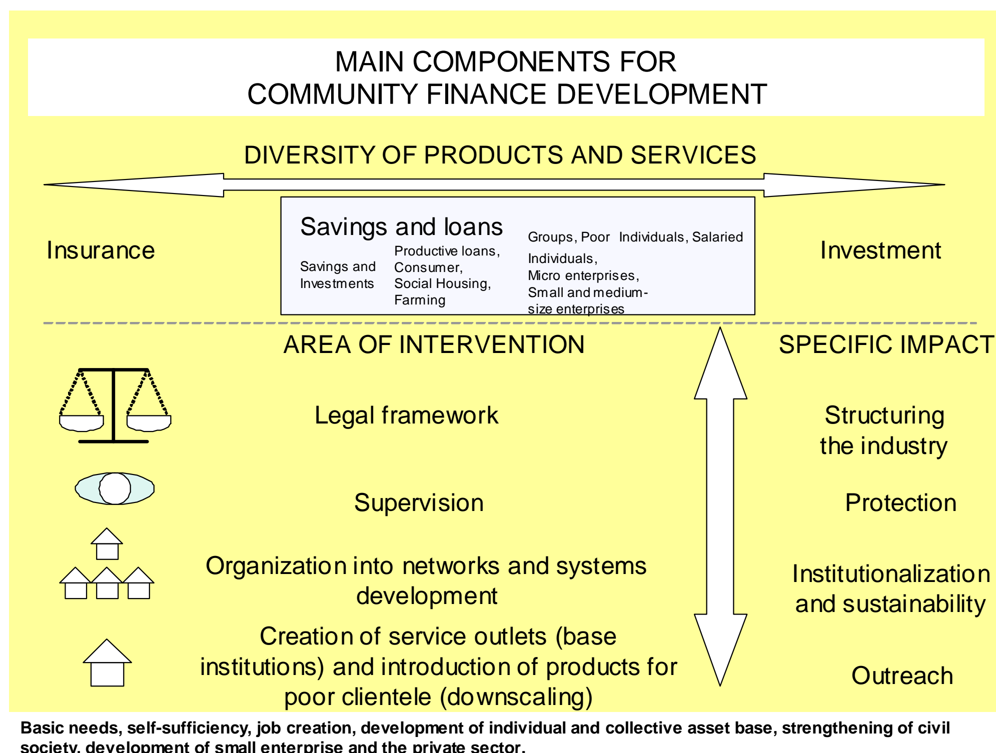
With this in mind, DID has always promoted openness by financial cooperatives to the overall community - serving not just the poor but also the less poor. When this diversity of clientele is added to an oiled mechanism for circulating resources within a federated network, cross-subsidization of clienteles and social intermediation result, two phenomena accelerating the impact of community finance on its surroundings.

#3 AS AN INTEGRAL PART OF A COUNTRY'S FINANCIAL SYSTEM, COMMUNITY FINANCE INSTITUTIONS AND THEIR LEGAL AND REGULATORY ENVIRONMENT MUST BE STRENGTHENED .

The development of community finance is not limited to simply adding on new service outlets. Development efforts must affect the sector as a whole. The following table gives an overview of the various levels of intervention needed to develop the sector.

To make financial services available, efforts should deal with the development of base financial institutions while seeking to reach the largest number of individuals. Multiplying the number of service outlets and introducing targeted products for poor clienteles are aimed at increasing impact in terms of the outreach to individuals affected as well as their level of poverty. In this respect, DID feels that it is important to develop strong base institutions that have a large membership and offer a wide range of services.

To ensure the permanence of these financial institutions so that financial services are available over the long term and not just on a short-term basis, the internal systems of these base units need to be formalized and a network must be set up.
The goal is to develop strong and true community finance institutions that are locally owned, profitable and permanent. For that purpose, DID believes that a strategy to consolidate base units is to encourage organization in a federated network.



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 savings deposits, these financial institutions must be strictly supervised in order to ensure the security of client assets. Intervention at this level will support the development of strategies, methods and supervision tools to help networks attain the financial ratios current in the industry. In this aspect, DID promotes strong and independent external surveillance. If unable to benefit from such a service, the network should set up strict internal surveillance. In any cases, important financial institutions should develop their own control strategies in a spirit of self-discipline.

This type of support could not produce an impact without an adequate legal framework regulating the operations of these institutions. Support for developing a regulatory framework for community finance institutions is a development tool that is just as important, if not quite as direct. The proof is the strong growth observed for community finance institutions in countries where a regulatory framework is in place. Concerning this aspect, DID believes that SCCs should be regulated under dedicated legislation.

In conclusion, the community finance sector should not be limited only to providing savings and credit to the poorest, but should also develop services to small and medium sized business, farmers, consumer credit (often used to finance education) support social housing and develop insurance services and possibilities for investment.
In general, even when dealing strictly within the community finance sector, intervention should be implemented at several levels in order to formalize this sub-sector of the financial sector. Gradual formalization of the community finance sector will ensure permanence for the availability of secure, high-quality financial services and their impact on the poor.

#4 THE PERFORMANCE OF A COMMUNITY FINANCE INSTITUTION SHOULD BE MONITORED AND ANALYZED USING THREE COMPLEMENTARY DIMENSIONS

All previous lessons have led us to believe that the performance of community finance institutions should not be measured using only a series of financial ratios. The experience acquired with our partners suggests to us that performance should be assessed and monitored in order to improve performance using the following three dimensions:[7]

- **Business performance assessing the degree of relevance of the institution within its market as well as its financial performance**
- **Organizational performance assessing the degree to which the various systems on which it is based are formalized and the level of mastery by various actors**
- **Institutional performance assessing the level of institutional maturity from a viewpoint of integration and solidarity between the base unit SCCs.**

From the viewpoint of permanence, each dimension deserves attention for short, medium and long-term strategies. This type of approach is echoed by the recent growth in the sector, which is increasingly calling on its operators to make services more professional. Greater professionalism will be attained through better business results as well as through improved internal systems organization and the optimizing of institutional structures.

#5 THE INTEREST IN AND NEED TO EXPAND PARTNERSHIPS

In conclusion, we could not avoid mentioning one of the major lessons learned in recent years: the interest in and need to expand partnerships.

This observation is obvious with the growth in partnerships and aid for development. In developing their operations, their markets and staff, community finance institutions redefine their needs and require increasingly specialized support services.

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 accompany 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.

[7] **These elements make up the** *TOP SYSTEM* **at DID, a system to assess and monitor performance which will soon be featured in a publication.**

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 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.