BRIEF 5

Microleasing in Livelihood Restoration following a Natural Disaster

Microleasing, for its self-collateralising attribute and ability to help accumulate productive assets, is now considered a viable option to loans for quickly replacing productive assets lost by the poor in major disasters. In many ways, microleasing can provide a win–win proposition to collateral-poor clients and liquidity-strapped financial institutions, as well as to donors and policy makers concerned about market distortions and creation of grant mentality. Leasing is also permissible under Sharia Law, which may be practiced in some Islamic countries.

INTRODUCTION

In a simple leasing arrangement the lessor (leasing company or a MFI) rents the equipment/asset to the lessee (client) for a fee payable in instalments. The lessor retains the title of the asset so that the asset cannot be sold/mortgaged/pawned. As a result, no tangible collateral except a steady cash flow projection is required for approval of leasing contracts. The term of a lease may stretch up to 70% of the estimated useful life of the asset. In this way, should a leased asset need to be recovered due to delinquency, value of the lease is not depreciated beyond the resale value of the asset. A standard lease agreement consists of a promissory note and an acceptance receipt evidencing that the asset has been received. At the end of the lease, the client/lessee has an option of buying the asset from the lessor at a previously agreed-upon residual price.

MICROLEASING IN DISASTER RELIEF

Most microfinance clients are unable to provide collateral to financial institutions to access debt finance and purchase assets required to restart their livelihoods. In such situations, the self-collateralising nature of leased assets allows collateral-poor clients to obtain the assets while allowing the leasing institution to repossess the asset in case of default so that it can be sold and the investment in the leased asset recovered.

In addition, microfinance institutions may face liquidity shortfalls in the wake of a disaster, thus limiting their ability to make the many unsecured loans required to replace assets lost in the disaster. The loans made for asset purchases also require larger amounts, grace periods and medium-term duration that do not fit the standard loan products offered by many small and new MFIs. Also, MFI experiences in Bangladesh with new loans made for asset replacement after a disaster have shown that three consecutive new loans are required to replace lost assets in order for the client to

generate adequate income to service these loans.

Leasing usually incurs lower transaction costs compared to collateral-based term loans, due to lower costs in developing and enforcing contracts in areas where asset registries and judicial systems for contract enforcement are poorly developed. These features make leasing attractive to the lessor and especially to the impoverished lessee.

EMERGING LESSONS

Leasing facilitates client screening in times of distress

Leasing ensures that a price is paid for obtaining a productive asset that can be purchased over time and also should be maintained by the client for the period of the lease. Lease arrangements could have helped minimise the number of the client sales arising from excessive supply of free boats and assets in Tsunami-affected areas of Sri Lanka. One NGO in Batticaloa distributed free canoes that did not meet the fishermen's requirements to restore their livelihood. Since the boats were free, many affected households obtained them even if they could not be used, then sold them at 75% of the original price within a week of their distribution. The money received by beneficiaries through re-sale was not sufficient to restart livelihood activities. In consultation with the fishermen, a leasing arrangement in which the clients had to pay for the asset and hold it for the period of the lease could have been designed for boats. This could have helped identify the clients who were serious about their livelihood revival.

Down payments can help reduce the lessor's risks since the lessor assumes all of client's business risk

For example, CARE, India offers microleasing through 'The Rickshaw Bank Project' in Chennai, India. Rickshaws are small motorised/non-motorised tricycles used for transporting people. The owner of the Rickshaw Bank receives venture capital from CARE India to manufacture 200 rickshaws and issue them under a lease-to-own arrangement. The Rickshaw Bank partly leases the vehicle and partly issues it as an in-kind loan to be repaid in cash with interest. Each rickshaw costs about US$200. The client need to pay about 5% of the cost of the rickshaw as down payment and the rest in small sums of approximately Rs25 ($0.50) every day for 15 months. At the end of the daily payments in 15 months, the ownership of the asset is transferred to the client. Repayments have been high and no sale of rickshaws was reported (Source: CARE, India, 2006)[1]. CECAM, a cooperative in Madagascar that provides sewing machines, requires a down payment of 25% of asset value for a lease term of 4 months. The client pays the remaining 75% of the price in instalments tailored to client cash flows, with an annual interest of 30%. The asset title is transferred to the client upon full repayment (Boss and Henderson, 2000, page 10).

[1] Information was provided by Dev Prakash, CARE, India during the interview by Geetha Nagarajan, March 12, 2006.

Choice of long-term credit-worthy microfinance clients helps reduce risks if down payments are not possible

Grameen Bank has offered microleases in Bangladesh since 1992. In 2002–03 the average lease amount was equivalent to US$364 and total outstanding lease portfolio was US$22 million. Lessees are selected among existing microfinance clients with additional sources of income. No down payment is required from the lessee and a 20% flat interest rate is charged. Flexible repayments include allowing lessees to repay the entire amount if they wish.

Microleasing provides an option for the poor to diversify livelihoods

CARE India designed a lease-to-own product to help diversify income-generating activities of fishermen affected by the Tsunami. Diversification of income-generating activities is an effective risk-/vulnerability-reduction strategy. The product was introduced one year after the Tsunami in order to support sustainable livelihood activities and reduce the dependence on subsidies and grants of those affected by the Tsunami. As a result, many fishermen who till then had been unsuccessful in accessing funds for diversification reportedly moved to the transport business.

Microleasing can help provide grants without creating market distortions and help create productive assets

In Banda Aceh, Indonesia, the World Vision (WV) Livelihood Team developed a leasing product to assist motorised becak drivers who lost their livelihood as a result of the Tsunami. The program involves the drivers, the motorcycle dealer and World Vision. World Vision provides 50% of the purchase price of the becak to the dealer on the condition that the dealer finances the second 50% of the purchase price with the driver under a lease agreement. The monthly payments at prevailing market rates (18%/yr) are structured over 18 months to make the payments manageable for the driver. In this scheme, the drivers need to set aside Rp17,000 (USD1.80) a day from their daily income to repay the loan and own the becak. WV community facilitators undertake a background check at the becak registry in Banda Aceh to ensure the beneficiaries were becak operators prior to the Tsunami. As part of the qualification process the beneficiary drivers must agree to the conditions of the program. Once this has been completed the dealer is contacted and they determine whether they are eligible for dealer financing. After that the driver beneficiaries are able to receive the new becak. From September to December 2005 World Vision assisted 21 becak drivers in Aceh and Meulaboh to regain their livelihoods under this program. Through this scheme—namely equal portions of grant and loan under a lease arrangement along with active participation from the community—WV hopes to provide an economic boost to Tsunami-affected communities.

Not all MFIs can and should provide microleasing, especially after disasters

Human capital requirements are higher for leasing operations than for standardised loan operations, and specialised staff is

difficult to hire in a short time frame after a huge disaster. Leasing contracts are also more suitable for individual (versus group) transactions that are common among MFIs. Also, not all assets required by typical microfinance clients can be leased by the MFI and this may limit reaching scale to minimise costs.

Liquidity-constrained MFIs may not be suitable for microleasing

Many MFIs that are liquidity-constrained will be unable to purchase assets to lease to their clients. They may prefer to make small loans compared to leasing, even if benefits of leasing may be higher than from loans. In such cases, trade financing from manufacturers and dealers to MFIs, and partnerships with them, can help offer microleases.

Microleasing is appropriately provided through partnerships between MFIs with leasing companies, dealers and manufacturers

It is feasible for MFIs inexperienced in providing microleases to provide venture capital type financing to specialised leasing companies with a requirement to provide necessary services to its clients. The case of CARE India that provided a venture-capital loan to the Rickshaw Bank to provide microleases is one good example, while another is the case of microleasing through becak dealers in Banda Aceh.

Microleasing is less suitable for remote areas

Existence of secondary markets for resale of re-possessed assets and repair/maintenance services highly facilitate leasing operations, but these are scarce in remote areas

SUGGESTED READING

- Bass, Jacqueline and Katrena Henderson, 2000. Leasing: A New Option for MFIs. Paper presented at Bamako, Mali: Advancing Microfinance in Rural West Africa Conference, page 10. http://www.itcltd.com/microleasing/docs/bamaco%202000.pdf
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