Community-based financial organizations

IFAD
Investing in rural people

Inclusive rural financial services

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Niger - Project for the Promotion of Local Initiatives for Development in Aguie

Introduction

Formal banks are not interested in servicing remote rural areas due to a lack in economies of scale, high transaction costs and a perception that the rural poor are not a viable target market. Community-based financial organizations (CBFOs) are often the only institutions available to provide basic financial services to the rural poor, especially in areas where basic infrastructure is lacking.

Background and context

The term ‘community-based financial organization‘ (CBFO) covers a wide variety of entities that provide a range of financial products and services. CBFOs typically operate in remote areas that lack access to the formal financial services, and often without government regulation and oversight. Most CBFOs are self-governing, often relying on volunteers. These basic features allow CBFOs to play a powerful role in achieving other aspects of IFAD’s social mission, such as empowering women and helping isolated communities to access public services.

CBFOs range from informal (decentralized, unsophisticated) to formal (sophisticated) community-owned financial institutions with an array of products and services, paid staff, and often centralized management and governance structures. They are typically defined by their primary mode of operation.

Types of CBFO are as follows:

- **Small community-based, time-bound savings groups**: In these less formal institutions, savings are required for being part of the group. Being time-bound, these CBFOs disburse all funds after each cycle. Groups are dissolved once everyone has had their turn to receive a loan. After groups are dissolved, many are re-established, often in different formations. Generally, they are grassroots organizations and often form and operate without any external intervention or support.
- **Small community-based accumulating savings groups**: Although savings are required to be part of the group, size and timing of contributions and withdrawals of savings are more flexible. Also, these types of CBFOs have an unlimited life. Accumulating savings groups have more complex operations than time-bound groups. While they are responsible for safeguarding member savings, they can also accumulate more capital for lending, allowing them to vary their loan products.
- **Large community-based cooperative groups**: Generally, larger savings groups are characterized by more formal structures of management and governance. Whilst savings can be either voluntary or compulsory, these groups remain largely savings-driven. Ownership of cooperatives is usually arranged by members buying shares or by paying membership fees. Institutions are democratically controlled by members who appoint the Board and annually review the cooperative's performance.

Rationale

CBFO success is highly dependent on a range of factors. It is essential to understand what types of CBFOs and support structures might best serve remote rural communities, and poor rural households in particular. Past experiences has made it possible to identify basic success factors required and the potential challenges to be overcome to improve the effectiveness of interventions to support CBFOs.

CBFOs can be a positive force in bringing about increased agricultural productivity in Africa and the developing world at large. There are many examples of how CBFOs bring financial services to rural areas, empower the poor and women in particular, enable rural households to better manage seasonal income and expenditure fluctuations, provide a safety net for life events, and allow households to invest and build assets. Interventions to set up, strengthen, or upgrade CBFOs should be designed with these types of social goals in mind.

Summary of past experiences

CBFOs have many strengths, which include:

- They have better outreach in remote areas..
- Local ownership leads to greater trust and empowerment.
- They have a greater possibility to link up with the formal financial sector whereas individuals cannot on their own).
- They can encourage a savings culture through compulsory savings.
- They encourage replication in neighbourring areas.

Conversely, they also have weaknesses, which include:

- They have a limited ability to generate a big pool of savings.
- Sustainability is not guaranteed for externally funded groups.
- They require thorough technical assistance (TA) and monitoring.
- They have a restricted range of products and services.
- They have higher interest rates compared to formal financial institutions.
- They lack management skills and have weak governance.
- They are vulnerable to elite capture.

For these and other reasons, there are best practices for supporting a CBFO. For more information on lessons learned, see *CBFOs: Lessons Learned*. http://www.ifad.org/knotes.

Summary of key issues

Preconditions for IFAD to support community-based financial organizations

IFAD is not ideally equipped to support the creation of new CBFOs. Rather, its resources are better deployed in identifying existing CBFOs with a potential to be successful, building up their capacities and outreach, and helping them overcome their weaknesses. The *CBFO: How To Do note* (http://www.ifad.org/knotes) details ten conditions that a project must meet to in order to receive IFAD support.

Recommendations for project design and implementation

Governments are often reluctant to finance these activities with debt, instead preferring to use such funds for investments in infrastructure and agricultural inputs. IFAD needs to demonstrate to them how access to financial services lifts rural people out of poverty. If host governments remain reluctant, the project design team could recommend preparing a joint IFAD/Government request to other donors for funding. The *CBFO: How To Do note* shares the do's and don´ts for CBFO project design and implementation.

Second-tier organizations

In situations where IFAD wants to support small CBFOs, working in conjunction with a second-tier organization is a viable option. These organizations can provide economies of scale and are advantageous to both the CBFOs and IFAD in ensuring the long-term sustainability of CBFOs. Past interventions have shown that most CBFOs continue to require support after interventions are finalized, and second-tier organizations can ensure continued service delivery. The *CBFO: How To Do note* provides insights on the types of second-tier organizations, their strengths and weaknesses, and the design and implementation of second-tier organizations.

Challenges, opportunities and benefits

Every intervention is different in terms of goals, scope, needs and capacities. Cultural and contextual factors must be considered before making decisions on what intervention best suits the needs of the target populations and project partners.

Selecting and designing the right intervention starts with considering the beneficiaries of financial services. The needs of the poor should be at the forefront when considering financial interventions and policies in support of rural outreach. Our considerations are supported by an increasing wealth of information on programmes that give us a closer look at users of financial services and bottlenecks in the supply and the demand of the market.

CBFO interventions face some basic challenges, such as:

- **Financial literacy:** The target audience lacks basic financial knowledge. Practitioners need to build awareness on available financial products and client needs. Focusing on financial literacy also provides CBFOs with valuable information to design better products.
- **Trust:** In order to overcome potential rural clients' mistrust of financial service providers, transparency is vital.
- **Reaching the unbanked:** Practitioners must develop products and delivery methods for non-users. This includes most of the rural poor and possibly, farmers producing crops that are difficult to finance by other financial service providers, such as those with high price volatility or without well-established markets.

- **Proper supervision and regulation:** Practitioners must ensure that regulation and supervision extend to non-bank segments of the financial system, taking into account client protection. However, regulation should be proportional to the size of the financial service provider.

The following recommendations should be considered before engaging in a CBFO intervention:

- **Abandon up-front external funding:** Providing initial external capital to CBFOs distorts incentives for members and almost always leads to default and collapse. Agencies that want to support CBFOs should use a savings-based approach.
- **Consider bank-linkages:** To provide groups with more capital than their savings can provide, explore promoting linkages with banks. Eligible CBFOs should have a solid track record in collecting and lending out members' savings, and should be receiving the support they need to manage larger amounts of capital.
- **Provide strong technical support:** Groups need competent external support and training for a range of functions, including governance, bookkeeping and delinquency management. Donors can finance this support in the early stages, but should plan for structures that can provide it on a long-term basis, for example, through federations.
- **Insist on meaningful performance reporting:** CBFOs cannot be burdened with elaborate record-keeping, but it is critical that projects report at least some key performance indicators (KPIs), such as outreach (numbers of clients and groups), loan repayment (using industry-standard measures) and group survival.
- **Track CBFO projects:** Implement mechanisms to monitor CBFO components internally, to ensure adequate technical review and monitoring systems.

The Community-based Financial Organizations toolkit

⇨**Teaser:** Sets out the scope (you are here).

How-To-Do Note: Conceptualizes key issues and provides guidance for design and implementation.

Lessons Learned: Analysis of past experiences with recommendations for the future.

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