



# **Bank of Africa and Mutual Guarantee Associations in Madagascar**

Analysis and Recommendations

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## TABLE OF CONTENTS

<b>Introduction.....</b>	<b>3</b>
<b>Executive Summary .....</b>	<b>4</b>
<b>Part I: Findings of the Project Team .....</b>	<b>Error! Bookmark not defined.</b>
<b>1.1 Historical Performance and Current Status of MGA Miarinarivo</b>	<b>Error! Bookmark not defined.</b>
<b>1.2 Best Practices for MGAs .....</b>	<b>Error! Bookmark not defined.</b>
<b>1.4 The Loan Process .....</b>	<b>Error! Bookmark not defined.</b>
<b>1.5 Approaches to Reducing Default Rates .....</b>	<b>Error! Bookmark not defined.</b>
<b>1.6 Involvement of the Malagasy Government.....</b>	<b>Error! Bookmark not defined.</b>
<b>1.7 Internal Governance and Management Capacity of the MGA.</b>	<b>Error! Bookmark not defined.</b>
Management Information Systems .....	<b>Error! Bookmark not defined.</b>
<b>Part II: Mutual Guarantee Associations- A Global Context.....</b>	<b>Error! Bookmark not defined.</b>
<b>2.1 Purpose and Structure of Mutual Guarantee Associations .....</b>	<b>Error! Bookmark not defined.</b>
<b>2.2 Genesis of the MGA and Experiences in Other Countries</b>	<b>Error! Bookmark not defined.</b>
<b>2.3 Operation of MGA Miarinarivo .....</b>	<b>Error! Bookmark not defined.</b>
<b>Annex: Country Context - Madagascar .....</b>	<b>Error! Bookmark not defined.</b>
<b>A-1 Economic Development Trends in Madagascar.....</b>	<b>Error! Bookmark not defined.</b>
<b>A-2 Poverty and the Rural Sector .....</b>	<b>Error! Bookmark not defined.</b>
<b>A-3 Legal and Regulatory Environment .....</b>	<b>Error! Bookmark not defined.</b>
<b>A-4 The Commercial Banking Sector.....</b>	<b>Error! Bookmark not defined.</b>
Structure and Scope of Services .....	<b>Error! Bookmark not defined.</b>
Privatization and Regulatory Reform in the 1990s.....	<b>Error! Bookmark not defined.</b>
Weaknesses .....	<b>Error! Bookmark not defined.</b>
<b>A-5 The Development of Microfinance in Madagascar ....</b>	<b>Error! Bookmark not defined.</b>
Market Penetration .....	<b>Error! Bookmark not defined.</b>
Strengths and Weaknesses.....	<b>Error! Bookmark not defined.</b>
<b>A-6 Bank of Africa-Madagascar .....</b>	<b>Error! Bookmark not defined.</b>
History of the Bank: BTM Becomes BOA .....	<b>Error! Bookmark not defined.</b>
BOA's Market Position among Commercial Banks in Microfinance	<b>Error! Bookmark not defined.</b>
BOA's Strategy in Microfinance .....	<b>Error! Bookmark not defined.</b>
Refinancing for MFIs .....	<b>Error! Bookmark not defined.</b>
Direct Lending and MGAs .....	<b>Error! Bookmark not defined.</b>
<b>References .....</b>	<b>Error! Bookmark not defined.</b>

## Introduction

This study was commissioned by the UN Public Private Alliance for Rural Development in order to assess the performance of Bank of Africa's innovative approach to rural financial services. The Alliance, launched in 2003, exists to identify, highlight and promote replication of successful business policies and practices, which are both profitable and promote social and economic advancement of poor people in rural areas. The Alliance chose Madagascar as its first pilot country and has been active with programming in the microfinance sector.

The overall objectives of this study are:

1. To investigate and analyze Bank of Africa's involvement with MGA Miarinarivo, understanding the bank's role, successes achieved and challenges encountered.
2. To distill this information into a set of recommendations for Bank of Africa, its partners and the microfinance community at-large.

This study is divided into three parts. Part One defines best practices of MGAs around the world and relates these to the findings and recommendations of the Project Team. Part Two provides a global context for mutual guarantee associations. Part Three describes the backdrop of Madagascar's economic and commercial development, with a focus on the country's microfinance efforts.

The methodology for the study included: (1) a review of existing literature on Madagascar's microfinance sector, MGAs in general, and Bank of Africa's microfinance operations; (2) interviews with practitioners, government officers, and program managers; and (3) a field visit to observe operations of a typical MGA (Miarinarivo).

## Executive Summary

Bank of Africa (BOA) is the leading commercial bank in Madagascar's microfinance sector, and has been active in rural development for more than two decades. Microfinance comprises one of many lines of business conducted by the bank. BOA provides refinancing to Madagascar's microfinance institutions, makes individual loans to the rural sector through 14 of its 49 branches, and has piloted an innovative Mutual Guarantee Association (MGA) program, in conjunction with the Ministry of Agriculture, Livestock and Fisheries (MOA).

This study concerns the performance of the Mutual Guarantee Association model, as observed through examination of MGA Miarinarivo. In a nutshell, the MGA performs credit analysis on individual loan applications, delivers a consolidated application to the lender, gathers the Internal Guarantee Fund (equal to 10% of loan amounts), disburses loans to individual borrowers, provides technical agricultural advice to the borrower (via personnel provided by the MOA), and collects repayment of debt upon maturity of loans. All loans through the MGA are targeted at meeting the credit needs of farmers who are implementing modern techniques of intensive rice cultivation.

The experience of MGA Miarinarivo points to the importance of pilot programs. On balance, the Project Team believes that the MGA model, as observed in Miarinarivo, holds substantial promise for increasing rural households' access to financial services, in a way that is attractive to both borrower and bank. However, the model does not appear ready for replication in other locations in Madagascar at this time. The MGA appears to lack adequate financial resources to meet basic operating expenses necessary for good management of the guarantee fund, the processing of loan dossiers, and the enforcement of repayment. Moreover, the recent track record of high defaults and un-recovered loans requires a vigorous response and dramatic improvement in future loan cycles to put the program back on firm footing. The Project Team concludes that it would be advisable to implement a number of strengthening measures in MGA Miarinarivo, in addition to adding another pilot site, and continuing to test the model until it is proven as a self-sustaining, effective institution.

### *Summary of Recommendations of the Project Team*

1. Improve corporate governance
  - a. Create checks and balances
  - b. Improve audits
  - c. Improve training for managers: management/technical/financial
  - d. Eject members of the governing body whose past loans are in default and who do not promptly rectify the matter.
2. Implement policy of zero tolerance for non-payment
  - a. Make an effort to collect on outstanding bad debt, to show borrowers that there are consequences to defaulting
3. Improve information management systems with regard to:
  - a. Loan applications – To improve flexibility/speed of application process

- b. Management of Internal Guarantee Fund – To ensure accurate pro rata apportioning of charges against the Fund
  - c. Loan collection process – To facilitate timeliness
- 4. Improve the remuneration of MGA management and examine prospects for making key staff full-time, salaried professionals
- 5. Make the MGA financially self-sufficient by implementing membership or application fees
- 6. Educate borrowers so they understand the terms of their contracts:
  - a. Why they might lose their guarantee funds if their fellow members do not pay
  - b. What the consequences will be if they themselves do not pay
  - c. To avoid subsequent misunderstandings and deterioration of customer relations
- 7. Incentivize field agents who originate loans with a bonus system tied to repayment rates
- 8. Incentivize repayment by offering borrowers an interest rate discount for timely repayment
- 9. Initiate a second pilot program in another area where there is not already a history of non-repayment, in order to test model on a clean slate
- 10. Future loans are a strong incentive for current repayment. The lending institution should continue to take every opportunity to publicly affirm its commitment to an ongoing rural lending program
- 11. Strengthen the image of the MGA as the source of funds. In hard times, borrowers are less likely to default on a community institution than they are to default on a distant-seeming and impersonal corporate bank
- 12. Work on improving the country's judicial system to provide lenders with recourse to pursue delinquent loans