WORLD SAVINGS BANKS INSTITUTE

REGIONAL MULTI-STAKEHOLDER CONSULTATION ON BUILDING INCLUSIVE FINANCIAL SECTORS FOR DEVELOPMENT: LATIN AMERICA AND THE CARIBBEAN
Santiago, Chile, 19 and 20 April 2005

Report of the Consultation[1]

The Financing for Development Office of the United Nations Department of Economic and Social Affairs (DESA) and the United Nations Capital Development Fund (UNCDF) have been undertaking a series of regional multi-stakeholder consultations on "Building Inclusive Financial Sectors for Development." These consultations are part of a yearlong project to produce a "Blue Book" for policy makers and other stakeholders on the questions that might be asked and experiences that might be considered in addressing why the overwhelming majority of the world's bankable poor are not using basic services from financial institutions (savings, credit, insurance and payments, including international remittances). The consultation for the Latin American and Caribbean region was organized with the World Savings Banks Institute (WSBI) and drew on the assistance of the Santiago office of the United Nations Development Programme (UNDP), the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) and the Microcredit Summit Campaign.

The consultation took the form of two working lunches in Santiago de Chile on 19 and 20 April 2005, arranged to take advantage of two important conferences scheduled for Santiago at the same time. The first was the Eleventh Assembly of the Latin American and Caribbean Regional Group of the World Savings Banks Institute, which met 17-18 April. The second meeting was the Latin America/Caribbean Region Microcredit Summit Meeting of Councils, which took place on 19-22 April. With the assistance of the organizers of both meetings and the Santiago office of UNDP, invitations were jointly extended by the United Nations and WSBI to senior-level participants in those meetings, and to a number of officials of the Chilean Government.

It is most heartening to report that there was a very positive response to the invitations and that the consultations were significantly oversubscribed. It was nevertheless possible to accommodate all who wished to attend (see list of participants posted with this report). Ms. Irene

[1]Based on notes prepared by Ms. Cecilia Vera, United Nations Economic Commission for Latin America and the Caribbean, Santiago.

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Philippi, the United Nations Resident Coordinator in Chile and an expert in her own right in microfinance, chaired both sessions of the consultation. While thus giving continuity to the discussion, she shared her responsibilities on 19 April with Mr. Javier Etcheberry, President, and Mr. José Manuel Mena, Chief Executive Officer, of BancoEstado of Chile, and on 20 April with Mr. Álvaro Ramirez, Chief of the Micro, Small and Medium Enterprise Division of Inter-American Development Bank.

As the following summary of the discussions brings out, the question of access to financial services by the poor is a highly salient issue both for national policy makers and individual financial institutions in Latin America and the Caribbean. Indeed, one proposal made at the second session was that further such consultations be organized in the region to continue to share experiences on a "South-South" basis.

First discussion, 19 April

The first working lunch meeting focused on successes and challenges experienced in the region in extending credit to micro entrepreneurs. A first key point made by senior officials of two large Latin American banks (one in the public sector and the other private) that carry out extensive micro credit activities was that it had proved possible for their banks to have positive rates of return while maintaining significant portfolios of micro-credit activities. They and others, however, emphasized that there had been a learning process in bringing microfinance into their banks and in effectively delivering microfinance services in general.

A representative of one of the large banks explained that it took some time for his bank to discover how to make a success story out of micro credit. He shared some of the features of the micro credit procedures that to his understanding the bank today carried out well. To start with, the bank looks for a person with not only the capacity to produce something well, but also with some months of experience in commercializing this something. It was not enough to have an idea. The bank expected that the idea would have already been tried out for at least some months before evaluating whether or not to extend a micro loan to the entrepreneur. Also, the entrepreneur had to show a commitment to repay the bank; if there was a record of previous non-payments this had to be taken into account at the moment the credit was considered and its causes had to be justified. A member of the bank's staff visits each applicant for micro credit and within 48 hours the bank gives a "yes" or "no" answer. In the latter case, the bank explains the reasons for rejection and the aspects of the micro enterprise that should be improved in order to be able to access credit. The bank has a big staff dedicated to the close follow-up of the micro credit clients. Each staff member gets to know his or her clients and their families well and it is in this close relationship that the bank believes lies its capacity to recover credits. Another feature of the process that was highlighted is the use of advanced technology to keep the transaction costs as low as possible. For example, a member of the staff makes one visit to the client with a portable computer connected to the bank's information system and gathers information which is instantly received by the latter. All these aspects are to his understanding what makes the bank's micro credit experience successful today.

Another point highlighted in the meeting was that institutions offering micro-credit should not look only at credit but at the potential for extending other financial services to small

or micro agents. As one example, a bank official described a life insurance programme extended by his bank to thousands of artisan fishermen, each of whom paid US$ 1 per month for coverage of about US$ 2,000.

Another speaker emphasized that the economic reality in different countries in the region was distinct and that the development of their financial systems was at very different stages. In some countries, banks serving lower-income populations did not have readily available funds and thus the development of saving instruments might warrant priority. Even more fundamentally, access to safe savings services is valuable in itself, as people's own resources are their first line of defence against adversity. Savings are also typically a first relationsuip that people develop with a financial institution. As one speaker observed, savings services thus served to help integrate people into the financial system as well as provide them with a safety net.

Participants also turned their attention to the difficulties that financial institutions encountered when intending to introduce or expand micro credit activities. The first barrier mentioned pertained to assessments of financial institutions by rating agencies and by official regulators. In countries in which financial markets are more developed and where banks can raise funds by issuing their own securities, independent rating agencies assign risk ratings to them. These agencies normally view micro credit activities as risky and hence banks with a bigger percentage of these types of credit in their portfolios are rated relatively poorly. There is no explicit rule that tells the agencies they should assign risk in this way, but it is a common practice and so what ends up happening is that this acts as a barrier for banks when they think of enlarging their micro credit portfolios. But in fact, having a large micro credit portfolio does not mean the financial institution would earn a negative rate of return in its banking business.

By the same token, bank regulators treated micro credit as a risky sector. This was mainly because they believed that micro credit borrowers normally did not have adequate business plans and because they lacked guarantees, etc. It is important, a speaker emphasized, to demonstrate that this "common wisdom" is not necessarily true. More information about the micro enterprise sector would help. In any case, a more sophisticated approach to regulation was required, in this view, taking account of institutional experience with lending to the poor, e.g., allowing flexible sub-segmentation of the portfolio rather than fixed quotas in assessing the risk being faced by a bank. This notwithstanding, as another speaker reminded the group, regulation is needed for financial stability and one must be careful of making trade offs of greater financial risk for improved outreach to underserved populations.

A second barrier mentioned was that banks have to operate with formal (registered) entrepreneurs as clients. For some of the micro entrepreneurs, it was very costly to establish a formal enterprise. Hence they might choose to operate informally and would have to remain outside of the credit circuit. It was also mentioned that micro entrepreneurs on a personal basis could tap consumer credit for some of their needs; however, this was unfortunate as the high cost of this form of credit (instalment buying) was not transparent.

A third barrier was called the "non-convergence" of the actions of the multiple agents involved in supporting the development of micro entrepreneurs, including government, non-governmental organizations (NGOs), banks, etc. It would be helpful if their actions were

coordinated in such a way that, for example, at the time when banks were issuing micro credits, the NGOs were giving orientation to the micro entrepreneurs. Unfortunately, this is normally not the case. In this regard, it was also asked who would pay for the assistance that new entrepreneurs required.

A fourth barrier to the development of micro credit activities was the cost to banks to reach out to micro entrepreneurs. It is costly to reach the potential micro credit clients because traditionally they do not themselves come to the bank to gain access to credit or other financial services. Indeed, frequent customers have an advantage in gaining new credits, as they know the bank and the bank knows them. Also, the median age of borrowers was middle age. They also needed to reach younger adults. In addition, in order to be able to communicate with the micro entrepreneurs, banks often have to have specialized staff that can let the entrepreneurs know that they qualify for micro credit in a language that is understandable by people who do not normally work with banks. On this issue, it was mentioned that many times micro credit is costly to banks because these factors raise transaction costs and not so much because of non-repayment of loans as is sometimes thought.

A last barrier mentioned was the content of some specific bank regulations. If regulations require that bank branches have special features such as alarms or reinforced glass windows that are very costly, then it is not economical for them to open a branch in a distant, poorly populated area.

Finally, there was some discussion of micro credit as an instrument to alleviate poverty. An intervention in this respect emphasized that micro credit should not be regarded as an instrument for all poor people, but only for those of the poor who have the capacity and willingness to repay their loans. For the rest of the poor, other instruments should be used to alleviate their situation, but not micro credit. In this same line of discussion, another intervention cited the example of Chile during the 1980s, when the Government made a public bank give micro credits to victims of earthquakes or floods. The speaker argued that this contaminated the bank's asset portfolio. Other instruments (in the extreme cases, even a government grant) would have been more appropriate for helping those people instead of micro credit.

Second discussion, 20 April

The second working lunch meeting focused its discussion on extending credit to populations that were under served or not served at all. Taking advantage of the presence of a number of experts and high-level interest at the table in rural development, the first such issue discussed was micro finance in the rural sector. While 70 per cent of Latin America's poor live in rural areas, rural micro entrepreneurs normally lack access to formal credit. It was said that this problem had been discussed on many previous occasions, but with no satisfactory solutions found.

One of the participants mentioned that, in his view, the regulatory frameworks for microfinance that were in use today had an urban bias and did not deal with rural issues. He reported on research studies being undertaken on regulatory frameworks for microfinance in five Central American countries and, within these, specifically on regulatory frameworks for rural micro credit. The intention of these studies is to develop the analytical elements to reverse this

urban bias and in this way promote the development of micro financial activities for the rural sector.

Another concern expressed about rural microfinance was that there were risks that were intrinsic to rural micro credit. A big problem was the lack of property rights in land, which linked with the general obstacle of informality and the borrower not being able to offer a guarantee against non-payment of a loan. Another problem also pertained to the rural activity per se. If a financial institution gives credit to rural micro entrepreneurs in a certain region of a country then most probably those borrowers will be concentrated in the products of that area. Hence, the lending institution will be vulnerable to a degree owing to the fact that there is relatively little risk diversification in the rural area. So, in the opinion of one speaker, financial institutions that extend micro credits to the rural sector should do this as a part of something wider, as a part of a more diversified micro credit portfolio, in order to achieve greater risk diversification.

Other suggestions were made to mitigate intrinsic rural risk to lending institutions, such as credit insurance or a system of guarantees (e.g., against a poor harvest). One participant, while acknowledging that subsidies are sometimes not well viewed as policy instruments, argued that the rural sector was special and warranted some type of government subsidy (interest rate subsidies for example). He also proposed some type of governmental guarantee against climatic events that affect this sector's production.

Turning to a broader topic, participants discussed inherent difficulties in being a micro entrepreneur. One participant saw micro entrepreneurs as sometimes in a situation of abandonment, of being the "orphans" of the business sector. They typically lacked professionalism and the network of contacts enjoyed by larger entrepreneurs, let alone knowledge of how to carry on their business activity. Many times they were unconscious of what taking a credit meant, what the obligations were (they appeared as well to be confused by consumer loans, as had been mentioned the day before). What they needed was some process of orientation; they needed to be prepared first before applying for a loan.

However, the speaker continued, the objective of policy should not be to "force" or overuse micro credit as an instrument to alleviate poverty and even less so extreme poverty. Not all people with a micro business activity are micro entrepreneurs in the full sense of the word. To try to help individuals who do not have the "entrepreneur genes" to get micro loans could be to put them on their way to failure. In any event, the mortality rate of new enterprises was very high. For individuals living in extreme poverty, not prepared to carry credit, other instruments of support would be much more appropriate.

A third topic discussed was the limited overall access of the people of Latin America and the Caribbean to financial instruments and how to increase access to financial services by the excluded population. One speaker mentioned that although access was hard to measure, studies spoke of a relation of "80/20"; i.e., in developed countries 80 per cent of the population had access to finance and the rest did not, while in developing countries the relationship was the other way around. When asked how to increase access, he explained that in his opinion what one needed were large networks of financial institutions and to authorize those networks to mobilize savings and give credit. He illustrated his point with the example of Africa, where he believed governments should authorize the postal financial networks that receive savings to also give credit. In this way, they could promote access to financial services by people in remote areas of

the continent where the postal system was virtually the only institution present with any financial mandate. Another participant mentioned that besides physical branch offices, access to financial services could be extended to distant rural areas through contemporary technology, as in mobile offices of banks or automated teller machines (ATMs). He cited the example of a large bank in India that combined both technologies to increase availability of financial services by putting ATMs on trucks. Another participant recommended looking at different institutional models. For example, although there had been lots of failures with rural financial cooperatives, there were also some successes, as in Albania and Armenia.

Participants also discussed helping the poor to receive remittances from abroad, especially in the context of small countries that did not have the options of large countries like Mexico where the volume of transactions was vast. The remittance question was a salient issue, for example, in Bolivia, where small institutions (Bolivian mutuals) faced high costs when trying to access a technological platform to receive the transfers, such as the SWIFT system. Other sources of the high cost of transfers were also at the recipient country end, such as the exchange rate used to make the conversion into local currency. To cope, Bolivia was exploring establishment of a special arrangement with Spain, although such a bilateral arrangement could only be a partial solution. On the other hand, it had to be noted that most aliens in developed countries who were there illegally could not use the formal financial system to transfer funds home.

Besides the problem of getting the bank to the people, another participant noted that sometimes the people serve as a barrier to their own access to services. For example, in some developing countries where illiteracy rates are high, people seemed to be less conscious of how to save and use credit. They often did not have a culture of saving. Also sometimes they lacked the basic knowledge of how to interact with financial institutions. So here, information and orientation could play a key role in expanding access to financial services. One example mentioned where this orientation and support existed was Guatemala, where a promising practice was to hire bank staff who spoke local Mayan dialects and thus were specialized in understanding the needs of clients who did not speak or write other languages. Another example in Guatemala was the use of machines that operated with fingerprints in places where a signature would normally be needed. This has helped overcome the barrier of illiteracy to the expansion of access.

Another barrier to the expansion of access cited by a participant was the lack of interest of many financial institutions to engage in micro financial activities. There were sometimes problems of high transaction costs and “asymmetric information” (not knowing the borrower’s intentions) that made these institutions unwilling to work with micro entrepreneurs. Along this same line, one participant mentioned that generally in forums on micro finance some of the audience expresses the view that financial institutions do not want to get involved with micro credit because of the inherent risk of non-repayment of this type of credit. But he said, systemic risks (such as climatic risks for the rural sector) are the same for all. They are not worse for micro entrepreneurs than for bigger entrepreneurs. Indeed, he emphasized that recovery rates of micro credit are high and that when banks have gone bankrupt it was not because of micro credit defaults but because of defaults of big clients whose debt represented a large portion of the banks’ net worth.

Among the challenges for the future, more than one participant mentioned the importance in reaching the very large number of informal micro entrepreneurs. In Chile, for example, around

40 per cent of micro entrepreneurs were informal (unregistered) and had very little access to financial services. Another challenge was how to extend more medium-term micro credits (as for equipment acquisition) as opposed to the predominantly short-term loans (as for working capital) that are currently the standard practice.

Lastly, many participants agreed on the importance of a stronger process of South–South discussion of such topics as had been brought to the table at the present meeting. One speaker proposed identifying Latin American institutions and countries that had successful experiences with micro financial activities and asking the people involved to share their views and exchange ideas in discussion forums, in particular at the sub-regional level (e.g., Southern Cone, Andes, Central America). Those countries that had successful experiences should explain the lessons learned to other countries in similar situations to them so they might learn from the experiences and then implement them in their own countries. Such exchanges were viewed as a key opportunity for strengthening the possibilities for developing inclusive financial sectors.

It was noted, by way of conclusion, that UNDP was now facilitating just such a new strategic mechanism on small and medium-sized enterprises in seven Latin American countries. The network is called TECHNONET LATAM and aims to share experiences, findings, data and information intra-regionally, as well as inter-regionally, as it would cooperate with TECHNONET ASIA, which has 30 years experience in the field. In addition, UNDP has selected Chile to host a South-South Cooperation Centre, which will seek to strengthen regional markets in Latin America, as through agreements on rules and regulations, standards and quality, payment arrangements and dispute settlement mechanisms. The goal is to help the countries benefit better from global markets through multiple levels of coordination and cooperation on the basis of shared interests and economic and social needs.