Cooperative Financial Institutions in Rural Development: Promise and Challenges

Panel 1 - November 3, 2021

CFIs and Rural Financial Inclusion

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Panelists:

• Berhane Kidanu, Project Lead, Agricultural Transformation Agency (ATA), Ethiopia

• Zana Konini, Chairwoman, FED Invest, Albania

• Enrique Valderrama, Executive President, Fecolfin, Colombia

Executive Summary

This session explores how CFIs are uniquely poised to reduce the gap in financial inclusion faced by rural households and enterprises. The local/member-based nature of CFIs gives them proximity and community knowledge that reduce information and transactions costs. Panelists representative of three distinct models of CFI systems will discuss drivers of CFI performance in rural financial inclusion, challenges CFIs face in serving rural communities, and strategies and innovations in overcoming these challenges.

BACKGROUND

Rates of formal account holding in rural areas tend to be lower than overall rates in many low-income and middle-income countries (Global Findex, 2017). Beyond this rural-urban divide, rural women face even more limited access to formal financial tools when gender gaps are considered. Despite limited access to formal tools, research from CGAP on smallholder farmers illustrates a complex picture of the financial lives of rural households. While specific demands for financial tools varies by country, population segment, and levels of agricultural commercialization, some common themes emerge. Rural households need tools to:

- **Respond to shocks and manage risk**. These shocks include those that any family may experience, such as health and employment status, as well as shocks in agricultural production or markets (e.g. adverse weather, price fluctuations).
- **Smooth consumption and spending.** The agricultural cycle has a strong influence on the financial lives of smallholder families, who often experience income volatility throughout the year. Access to savings and credit options can smooth consumption during seasonal ups and downs.

Rural households often save through informal channels such as at home, with friends and family, and rotating savings groups. Credit may be similarly informal, consisting of borrowing from friends and family, a group, or getting credit from a store. While informal options can give smallholders flexibility, they also experience downsides, including high interest rates, risk, and repayment terms that may be inopportune.

Rather than "formalizing" the informal sector, increasing and improving the quality of financial inclusion in rural areas involves learning from the informal ways in which rural households handle their finances and offering tools that provide additional value. For example:

- Rural households primarily keep their savings in quasi-liquid forms (e.g. livestock, inventories) with associated high-risks. How do formal providers offer an alternative such as a savings account that compares in terms of return and maturity, but is safer?
- Rural households may resort to moneylenders or relatives to borrow for emergencies or smooth their revenue flows. These "informal contracts" are typically flexible meaning that the terms can be adjusted in the presence of contingencies, emergencies on either side of the loan. How do we develop formal loan types that convey a similar sense of flexibility and confidence?

The expected results are additional and improved financial services that complement rather than replace existing informal arrangements, while simultaneously serving as healthy competition. The aim of rural financial inclusion is therefore to meet unmet demand for financial tools or add new tools to households' financial portfolios to support risk management, consumption smoothing, and resilience. This panel will examine how CFIs can play a role in meeting demands for financial services and in expanding rural access to finance.

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Session Discussion

- What critical factors have enabled the institution/organization to successfully expand financial services provision in rural areas?
- What main drivers have led to the current state of the CFI system? What were the primary challenges faced in that process?
- Describe the vision going forward, including main drivers and innovations, such as digitization, agent banking, and others.

THE ROLE OF CFIs

CFIs have a critical advantage in meeting rural households' needs for financial services in that they are local, member-based, work in proximity to their clients, and are embedded in the community, conveying a perception of confidence and flexibility that is comparable with that of informal providers. The same features allow for reduced information costs and transactions costs of service provision relative to those of other providers. However, several factors must come together for CFIs to realize this potential. They include a conducive enabling environment (legal, regulatory, supervisory) and CFI capacity development and strengthening.

With appropriate regulatory and supervisory frameworks in place, CFIs can offer innovative financial services that allow them to expand rural access to finance. For example, correspondent agent models inclusive of CFIs (i.e., not limiting agency arrangements to banks) have allowed CFIs in countries such as Ecuador and Colombia to reach members in remote rural areas (especially women and youth, as Panel 4 of the symposium documents). Agents can also enable CFIs to keep connected with and offer services to cooperative members who may seasonally or permanently migrate. Adequate investments in digital tools and IT infrastructure are needed to complement the regulatory reforms for CFIs to take advantage of correspondent agent networks. Other key elements of proper regulatory and supervisory frameworks such as strict licensing processes, prudential standards, safety nets, and appropriate supervision are dealt with in detail in a separate panel in this symposium (Panel 3).

When it comes to digital tools, there is an opportunity for CFIs to partner, rather than compete with, FinTech companies. CFIs' embeddedness in and trust with communities make them well positioned to bridge the gap between rural communities and a non-local FinTech provider. From the CFI's side, partnerships and use of digital tools can help them overcome barriers to serving rural populations, such as dispersed populations, infrastructure challenges, transportation costs. Panel 2 in the Symposium addresses these issues. The significance of these innovations for CFIs' ability to finance agriculture are discussed in Panel 5 of the symposium.

A RANGE OF MODELS IN CFI DEVELOPMENT / PANELISTS INTRODUCTIONS

Globally, CFIs share a number of common features that are consistent with or a result of their member-based structure. As mentioned in the opening session, their growth is rather slow but steady, gaining significance as their membership increases as a proportion of the population at a sustained pace).

The structure and performance of CFI networks however, varies substantially across diverse country realities. Highly functionally integrated systems, while maintaining their democratic governance, such as FED Invest in Albania, Sicredi in Brazil, and others, have reached a state in which they are solid and significant components of the country's financial system. We are fortunate to have **Zana Konini**, Chairwoman of **FED Invest Albania** with us in this Panel to share their evolution over the recent half decade, and the lessons their experience conveys to our knowledge of CFI development. We at the WBG deem FED Invest as the result of strong cooperation among government, international development organizations, and technical assistance by highly qualified providers, in a country where 40 percent of the population is rural.

FED Invest Albania key facts

Growth in membership 2016–2020: 91 percent; accounts for 60 percent of all CFI membership in the country. Penetration rate up from 1.7 to 6.4 percent (membership as percent of active population). Deposit portfolio growth 2016–2020: 55 percent; loan portfolio growth same period: 53 percent. Nearly 70 percent of FED Invest branches operate in rural areas.

At the other end of the spectrum, a sector structure that is common in many East African countries and also in some countries in Asia (e.g., Indonesia), is one of large numbers of small savings and credit cooperatives (typically known as SACCOs in English-speaking Africa), rather loosely integrated if at all, to some extent serving government programs aimed at financing small farmers. The challenges these CFI networks face are certainly different from those of the integrated systems referred to above. Our colleague **Berhane Kidanu** from **Ethiopia's Agricultural Transformation Agency** with extensive experience in the SACCO sector has kindly agreed to contribute his knowledge of the recent evolution of the sector and the current state of its challenges, in a country where 78 percent of the population is rural.

Ethiopia key facts
Growth 2016-2020: number of SACCOs, 15 percent; membership, 76 percent. Penetration rate up from 6.1 to 9.8 percent. Savings portfolio growth, 201 percent; loan disbursements 5.7 times (2020/2017). SACCOs in rural areas, 70 percent of total.

In between those two ends of the spectrum, in many countries the CFI sector is comprised by a blend of small,-medium- and large-scale individual CFIs, often including second-tier and even third-tier apex organizations that may or may not be under the same regulatory and supervisory authorities. We are pleased to have in this panel **Enrique Valderrama**, the President of **Fecolfin, Colombia**, a country with a long tradition of cooperative finance, with its share of ups and downs and quasi-crises but fairly stable and resilient in recent years, under a dual regulatory and supervisory system. The rural share of the population in Colombia has come down to about 20 percent but is still important especially when rural poverty is considered.

Colombia key facts
Growth 2016-2020: number of CFIs, 6 percent; membership, 8 percent (2018-2020) after a crisis in 2017. Penetration rate a steady 9.5 percent 2018-2020. Annual portfolio growth 2017-2020: deposits, 7.4 percent; loans, 4.7 percent.

SELECTED REFERENCES

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Panelist Organizations:

- https://www.fedinvest.al
- https://www.ata.gov.et
- https://www.fecolfin.coop/sitio/

ANNEX - STATISTICS

CFI Country Statistics	Year	CUs	Members	Penetration rate % of active pop.	Population, % rural	CFIs, % rural
Albania	2016	13	48410	1.66		
	2017	13	85287	4.27		
	2018	13	100459	5.03		
	2019	14	114480	5.86		
	2020	14	124345	6.44	38	70[1]
Colombia	2016	178	3584725	11.4		
	2017	244	7205159	21.53		
	2018	189	3149650	9.41		
	2019	188	3294760	9.54		
	2020	188	3407292	9.74	19	
Ethiopia	2016	18959	3430655	6.05		
	2017	19788	4177541	7.36		70[2]
	2018	20591	4763275	7.83		
	2019	21028	5384559	8.56		
	2020	21863	6385984	9.82	78	

Sources: WOCCU Statistical Reports 2016 – 2020; ATA/FCA data for Ethiopia.

[1] *Percent of FED Invest branches in rural areas.*
[2] *Estimate for 2016/17. No rural breakdown in FCA data after 2016.*