Doc 5.2 Potential sources of credit for micro-enterprises

Commercial banks

Regular commercial banks, where they exist in rural areas, normally require a security (collateral in form of physical assets) for the loans they provide. Most banks favour large loans over small ones, use lengthy administrative procedures and have misgivings about the rural poor, especially women and youth who are considered to be high risk clients. Since TREE graduates generally do not have collateral, commercial banks are not the most appropriate option except where they have started special programmes or windows to serve informal activities.

Government institutions

Many countries have government-sponsored credit schemes, often with good conditions for rural entrepreneurs. Where these exist they can be a suitable source of funds. Often they are limited to only one sector, such as agriculture.
Also, government funds might be highjacked for particular political interests and thus limited to specific target groups. Before considering government credit schemes for TREE graduates, government funds should be checked carefully. Caution is required regarding their credit policy, selection criteria (neutral?) and sustainability.

Microfinance institutions (MFI)

These are organizations that aim at providing financial services to the poor and those who are traditionally excluded. Due to the socially-oriented goals and poverty focus of most microfinance institutions, they are in principle favourable partners for the TREE programme. There are various types of microfinance.

NGOs

NGOs sometimes run a small credit programme for livelihood, either as a stand alone service or as part of a package which may include community organizing and the delivery of support services (e.g. agricultural extension). While some NGOs have their own sources of capital (sometimes from foreign donors), others serve as a channel for government institutions, specialized agencies, etc. They mostly provide short- term, small loans, which are sometimes too low for any investment beyond petty trade. They often charge a flat rate of interest which is higher than the bank rates because of their higher administrative costs, with smaller loans and intensive loan monitoring.

Generally they use a solidarity group/peer pressure and mutual guarantee system that exercises social sanctions for non-repayment. Loans are, therefore, given only if the potential clients form a group of three to five persons. Ideally, solidarity groups for mutual guarantee should not be artificial, opportunistic groupings, but comprise people who have previous ties as neighbours, kin, or fellow workers (see savings and credit associations). Experience shows that accessing credit through NGOs is not as easy as it looks. Commonly there are specific requirements with regard to target beneficiaries (certified poor, living in particular communities, operating in groups). Where this type of funding exists however, it can be amongst the most appropriate.

Savings and credit associations

E.g. credit unions, financial cooperatives, ROSCAs, ASCAs, village banks

In the case of savings and credit associations their capital is normally made up of the savings of their members. These associations require compulsory savings from individual members prior to extending a loan.

Informal credit sources

Informal sources of credit are usually the most important for small producers. These can be loans from friends and relatives, from money lenders, or credit from the supplier of equipment and materials.
The main problem here is that money lenders from these other sources may require interest at a rate which cannot reasonably be repaid and result in the collapse of the business. If this source of funding is used, the cost of borrowing should be carefully checked to see if it is worthwhile.

TREE credit rules

Credit should be used for profitable and sustainable economic activities. Interest will then not be a major problem inasmuch as it is not exorbitant. Small-scale production does not automatically mean that producers need cheap credit. Though artificially low interest rates may temporarily enable the survival of non-profitable economic activities, micro-enterprises may experience serious difficulties later, when they have to borrow at interest rates that microfinance institutions or commercial banks charge. Only in terms of loan security and repayment schedules do special arrangements need to be made when providing credit to informal producers.
To reduce the dependency on credit funds from outside, which invariably bring conditions and insecurity regarding timing of release of funds, beneficiaries should also be encouraged, as much as possible, to contribute to their own start-up capital.
To summarize:

— Start early in assessing the credit options.

— Be prepared to postpone the training if it is likely that essential credit will not be readily available.

— Minimize the credit/loan amount needed (for in- stance through smaller scale of production, less/ cheaper tools, selecting appropriate technologies and, if feasible, some contribution from the graduates themselves).

— Start with a small loan, and apply for a larger repeat loan.

— Group loans should not automatically be taken to mean collective responsibility.

— The business venture should in principle be able to afford regular commercial interest rates