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Financial Services and Poverty in Senegal

Microfinance is important in helping the poor.* Increasing accessibility of financial markets to the poor can be achieved through:

- **revising the legal and regulatory framework to increase the accessibility of financial services to the poor;**
- **improving the operation of financial systems; and**
- **promoting innovative financial products that are suitable for the poor.**

All sectors of society, including the poor, need financial services. Experience in several countries demonstrates the value of microfinance in helping the poor start small businesses and increase their earnings. To assess how Senegal's financial sector responds to the economic needs of the poor, USAID, through the EAGER project, supported a study of Senegal's financial institutions and the policies, regulations and financial products available to the Senegalese people. The study team examined research on poverty and finance, reviewed microfinance experiments in Senegal and worldwide, and consulted with poor Senegalese, operators in the finance sector, and regulatory authorities. The study identifies the poor, describes the existing financial system, and suggests ways to increase the poor's accessibility to financial markets. Following are some of the study's major findings and recommendations.

The potential market for microfinance among the poor is substantial. Many different variables can be used to determine poverty levels, such as diet, education, habitat, access to health care, access to potable water and income. Defining the poverty line as the expenditure needed to provide 2,400 calories per person per day, 30 percent of Senegalese households live in poverty. Among the 837,000 households living in rural areas, 58 percent are poor.

A survey of Senegal's poor identified four priorities in financial services. They are income generation, increases in debt capacity, secure, liquid and well-remunerated savings, and rapid, dependable and affordable transfers. Addressing these priorities would provide the poor with increased opportunities for microfinance and income growth.

The existing financial system separates formal banking from the organizations and informal practices that serve the poor. Banks are the foundation of the formal financial system, offering contracts suitable to large public or private enterprises and individuals with relatively high and stable incomes. Senegal's new 1990 banking law places cer-

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tain restrictions and reporting requirements on all banks and financial institutions. Only institutions approved by the Ministry of Finance and the Central Bank can call themselves banks or financial institutions. The new law strengthens protection of depositors, increases competition, and allows other financial organizations to exist parallel to banks without meeting all the requirements of formal banks.

The other organizations are mutual savings and credit organizations or cooperatives. They are regulated under a different law, adopted in 1995, and have the right to request bank status, once they meet the conditions required for authorization by the Ministry of Finance. For the poor, mutual savings and credit structures and non-mutual financial systems are the principle sources of microfinance and other financial services. Many financial organizations in rural areas were set up with financial assistance from donor agencies and continue to receive subsidies. These organizations provide financial services exclusively for their members and require the mobilization of savings before credit can be allocated. The security of the loan depends on the solidarity of the group.

Informal financial practices, operating outside the formal regulatory framework, also flourish. Included are private money keepers and credit suppliers and private arrangements with relatives, friends and shopkeepers who may or may not charge interest. Foreign exchange services are available in the principal market of Dakar. Savings may be in the form of jewelry, ruminants, village labor investments, cereal stocks, or investments in individual family members. Traditional savings are in harmony with the lifestyles of the poor, but they do not possess some of the characteristics of formal financial intermediation that can help engender faster economic growth.

The study team recommends the following actions.

1. Revise the legal and regulatory framework.

• Integrate all financial services into the formal institutional and regulatory framework. The three systems currently in operation—banking, mutuals, and informal—coexist with little or no articulation between them. The 61 banks and financial institutions are located in the main regional capitals with more than half in Dakar alone. The 363 mutual savings and credit organizations are distributed unevenly throughout the country, with some areas over served and others under served. In each of Senegal's 13,000 villages, individual operators offer informal financial services and, to some extent, intermediate between village and city. Integration will require that all organizations and individual operators have legal status to undertake contracts. Also required is a healthy institutional framework in which contracts are honored, legal procedures are normalized, and rules of law are applied. Integration would increase competition and encourage partnerships among financial organizations.

• Liberalize interest rates in mutual savings and credit organizations. The interest rate itself is not a limiting factor for the poor. In rural areas of Senegal interest rates for credit greatly exceed the authorized range. In some cases, interest rates reach 40-50 percent per day, but the activities financed are sufficiently profitable that borrowers can repay the loans and still earn substantial profits. The average loan rate in mutuals is 18 percent.

As loan sizes fall, both transaction costs per loan and risks increase. Remunerative interest margins can make the provision of credit to the poor attractive. Many mutuals are modest in size and financially fragile.

Liberalized interest rates would benefit the member-owners, provide incentives to save, and help guarantee the permanence of the institutions. For the most efficient and productive mutuals, liberalized interest rates would promote outreach, viability, and facilitate their operation without subsidies.

For banks, the loan interest cap should be retained. Banks have a number of alternatives for raising capital that are not open to mutuals, including equity investments. Currently, the law prohibits the complete liberalization of bank charges to protect consumers against overcharging due to collusion among banks. However, banks could partner with mutuals to finance micro-activities if interest rates were commensurate with levels of risk.

• Make investments to encourage the development of viable rural markets. The development of a rational agricultural product marketing system would provide agricultural producers with opportunities to increase their incomes. Investments to increase competition and production include the development of irrigated areas, the liberalization of commercial markets, and land tenure reform. Currently, the government owns all land. Transferring ownership to farming households would provide producers with collateral for bank loans.

2. Improve the operation of financial systems.

• Increase bank efficiencies through partnerships with financial intermediaries. Experience in India suggests that banks can lower transaction costs for serving the poor by using financial intermediaries such as cooperatives or non-governmental organizations. Where subsidies are involved, they should not be used as a substitute for loan repayment because establishing a culture of loans as gifts is damaging to the financial market.

• Increase bank efficiencies by training staff and using appropriate credit products. Staff abilities play an important role in financial systems because of the high level of direct contact with clients. Strengthening staff abilities can improve efficiency and contribute to client loyalty and repeat demand for service. In the case of mutuals, the training of officers can help improve oversight of financial operations. Using simple and flexible credit products that respond to the needs of client groups is beneficial, especially in reaching the poor. Credit products should fit local realities and avoid targeting that biases production decisions.

• Develop savings-based approaches. Most of the solid and sustainable rural financial systems mobilize savings. Deposits allow potential borrowers to establish their solvency systematically and provide lenders with low-cost and useful information in the selection of potential borrowers. Deposits provide funds for loans, increase self-sufficiency, and reduce the need for assistance from donors or the government. Even the poor have significant amounts of savings. One study found that the overall volume of savings in mutuals from 1991 to 1996 was 9.5 billion CFA (about $14 million). Attractive investment opportunities for these funds could provide the poor with the secure, liquid, and well-remunerated savings they desire.

3. Promote innovative financial products that are suitable for the poor.

Detailed market studies are needed to assess the profitability of innovative products. Reform of institutions and financial infrastructure will be needed to guarantee their feasibility and compatibility with Senegalese law.

• Develop financial transfer services. Especially in the period between harvests, many poor people depend on financial support from relatives and friends. Currently, financial transfer services are available through the post office and through informal services provided by transporters, travelers and relatives. Even in an organization that has 76 offices, no transfer possibility exists for members in different geographical areas. The provision of financial transfer services would require the integration of systems in diverse locations, advanced managerial capabilities, greater professionalism, and legal reform to enable mutuals to issue checks to facilitate transfers and reduce their cost.

• **Develop insurance products for the poor.** The provision of insurance products, such as health or accident insurance, could benefit the poor by ensuring access to public health services. The development of insurance products requires an appropriate regulatory framework and macro financial stability to ensure their profitability.

• **Improve incomes for retirees.** People who have worked in cities often return to their villages at retirement age. To receive their pension checks, they must travel back to the city. Transport costs may be nearly equal to the pension payment. An alternative could be depositing pension checks into village mutuals. In addition, mutuals could offer capitalized supplementary savings that would pay out to beneficiaries at the age of retirement.

• **Offer risk capital.** Risk capital is financing that is linked to profits and usually includes technology and knowledge transfers. Lenders have a role in the management of funds and do not require guarantees from the entrepreneur because expected yields are greater than normal. To provide risk capital, mutuals need an environment favorable to private enterprise, an attractive fiscal network, an appropriate mechanism for absorbing losses, and a more substantial level of investment in percentage of total capital than the five percent currently allowed by law.

• **Offer capital leasing.** For small entrepreneurs, capital leasing reduces the debt service burden and may include a provision for group insurance so that if a borrower defaults, equipment can be transferred to another member of the group. Capital leasing improves the level of fixed capital utilization and offers possibilities for breaking the credit-repayment-credit circle.

Conclusion

Senegal's poor offer a large potential market for microfinance, but the country's financial systems fail to adequately address their needs. Formal banking is separate from the organizations and informal practices that serve the poor. Revisions in the legal and regulatory framework are needed, specifically the integration of all financial services within the framework and the liberalizing of interest rates in mutual savings and credit organizations. The operation of financial systems must be improved to increase efficiencies, enhance services and allow for innovative financial products. Partnerships within the financial system and staff training are especially important for increasing efficiency.

***This policy brief is based on EAGER Research, *Financial Intermediation and Poverty in Senegal*, 1998, by Hamet Ndour [remix@enda.sn], Cabinet REMIX Etudes-Informations, Dakar, Senegal; and Aziz Wané [remix@enda.sn], Cabinet REMIX Etudes-Informations, Dakar, Senegal.**

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