Oxford Policy Management

RWANDA SACCO SUSTAINABILITY STUDY
(Final Report)

Oxford Policy Management Ltd.

February 2012

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Executive summary

Access to Finance Rwanda (AFR) has contracted Oxford Policy Management (OPM) to undertake a critical study of the Savings and Credit Cooperatives (SACCOs) sector in Rwanda, which includes developing a practical set of measures and an action plan to ensure SACCOs become fully sustainable financial service providers, especially to the rural poor. The assignment is aimed at developing a strategy and concrete roadmap that will lead to the entire SACCO sector becoming not just sustainable, but able to grow and increase outreach in terms of numbers of people served, savings mobilised and loans provided, particularly in rural areas.

1. Diagnosis of the SACCO sector

Characterising SACCOs in Rwanda

SACCOs are distinguished from other financial service providers in that they are owned by members and financial services are commonly targeted towards this pool of members only. The members of a cooperative are united by a form of social bond, typically determined by their employment, income source or economic activity. The uniqueness of the SACCO also relates to an underlying tension between its economic and social foundations. Its strength is that it is membership-based and its members have a sense of ownership of the institution: it is in the interest of members that the institution is established and its operations sustained. As financial intermediaries, SACCOs finance their loan portfolios by mobilising member savings and shares rather than using outside capital. On the other hand, its members are at the same time the clients of the services it provides, which creates moral hazard and incentive problems.

In Rwanda, SACCOs can be broadly categorized as follows:

- **Umurenge SACCOs:** These SACCOs were initiated and formed with the support of the government, as a component of the National Savings Mobilisation Strategy. One SACCO was organised for each of the 416 sectors in Rwanda. Many of these institutions are still very young, having been formed in the years 2009-10. Of the 416 Umurenge SACCOs, 355 have been granted licenses to extend loans. Payments services are provided, especially in areas characterised by a lack of financial institutions, and the vast majority maintain only one branch or outlet. Membership is based on individuals residing in the same locality.
- **Non-Umurenge SACCOs:** These are the 89 SACCOs already operating prior to the introduction of the Umurenge SACCOs. They offer both savings and credit services to their members and outlets tend to be based in urban and peri-urban locations. Some SACCOs draw their membership from trades (e.g. teachers) or interest groups (e.g. youth, women).

Umurenge SACCOs tend to reach a larger number of individual members in absolute terms (roughly 27% more than non-Umurenge SACCOs), which is driven by the large number of institutions (416) under this category. However, Umurenge SACCOs tend to be smaller on average – with roughly 2,000 members, in comparison to the 7,500 members non-Umurenge SACCOs have on average. Umurenge SACCOs also appear to reach a poorer clientele, given their lower average savings balance per member. For non-Umurenge SACCOs, the average savings balance per member over the last three years is roughly US$ 90, which is almost three times the average savings balance held by members of Umurenge SACCOs. This is not surprising considering the differences between the two categories in terms of the location of the institutions and the tendency for non-Umurenge SACCOs to reach individuals with employment and who are relatively better off.

There are a number of important issues that need to be addressed in order to improve SACCOs' performance. Many suffer from **weaknesses in their governance**, which is rooted in a **poor sense of cooperative ownership among members**. Explaining this issue requires looking at the history of how these institutions have been formed: unlike more authentic cooperative institutions in countries with developed SACCO sectors, Umurenge SACCOs and indeed even some of the non-Umurenge SACCOs are institutions that were established and organized by parties other than the members themselves. The expectation is that once formed, these institutions would then be accepted and ran by the members as if it was theirs. But this has not yet been realized: members do not quite understand what these institutions are for, what the benefits of being a member of a SACCO are, and what their membership actually entails. Even more importantly, the parties and stakeholders involved in the promotion of SACCOs also seem to have limited understanding of what is needed in order to make SACCOs work.

Exacerbating these problems are the **severe capacity constraints** among SACCOs, especially among Umurenge SACCOs. These shortcomings comprise both institutional and human resource needs and include:

- the quality of leadership and management, i.e. the control and governance of institutions;
- the institutional systems/processes required for institutions to function and achieve their objectives as financial service providers; and
- the facilities they need to deliver services (e.g. building quality and location).

These issues critically affect the current ability of these financial institutions to deliver inclusive financial services and effectively reach low-income groups. The process of consolidation recommended below is intended to address these problems.

The support institutions

There are already a number of SACCO unions operating in Rwanda. These unions are typically networks involving non-Umurenge SACCOs, although this is expected to change with the merging of a number of non-Umurenge and Umurenge SACCOs now starting to take place.

In discussing the role of unions/networks of SACCOs, it is vital to pay sufficient attention to the purpose and impact of external funding. Unions or networks are typically assumed to act as vehicles for channelling funds for on-lending by SACCOs, which can be detrimental to their development. There are significant problems arising from the incompatibility of external funding (assistance through loans or grants) with the concept of a member-owned and controlled self-sustaining financial institution. On the level of the SACCO as a provider, this may create the incentive for (new) members to join only on the basis of possibly obtaining loans financed by external funding. Currently, a number of the unions are also acting as channels of external finance for on-lending by their member SACCOs.

The biggest problem confronting the unions in Rwanda, however, is their limited institutional capacity, which mirrors the problem at individual SACCO level. According to the Association of Microfinance Institutions in Rwanda (AMIR), none of the existing unions are sustainable. Terrafina and AMIR are among the institutions currently supporting capacity building of SACCO unions.

The enabling environment

The quality and appropriateness of the policy, legal, and regulatory environment within which SACCOs operate also affect their ability to grow into strong, sustainable institutions with wide outreach. While the regulatory framework in Rwanda generally supports SACCO development, we identified several issues in Rwandan law that could affect the growth and sustainability of the SACCO sector.[1]

In terms of supervision of the SACCO sector, the key issues identified include (i) the need to clarify the roles of several actors involved (i.e. the Banque Nationale du Rwanda (BNR) supervision team, Rwanda Cooperative Agency, the District Cooperative Officers, etc.), which contribute to the fragmented approach to supervision; and (ii) the need for more appropriate reporting requirements for SACCOs.[2] Moreover, as the Banque Nationale du Rwanda (BNR) is only starting to build its capacity to supervise all SACCOs (with the recent introduction of Technical Control Units (TCUs) at the districts), there are limitations to how effectively it can supervise the large number of SACCOs currently operating in the country.

Significantly, there is a need to move beyond a ‘crisis management’ mode and into a more strategic policy approach to develop the SACCO sector in Rwanda. This is relevant not just in terms of the design of the supervisory framework, but also in terms of other policy measures that provide the incentives / disincentives for institutions to perform – such as, for example, policies with regard to the extension of wholesale loans to SACCOs and other financial institutions by government entities. This also includes addressing important strategic questions such as the distribution of Umurenge SACCOs across the sectors: (i) are SACCOs needed in all sectors and (ii) can enough business be generated in (all) sectors to allow the sustainability of individual SACCOs?

2. Analysis of approaches used to develop a sustainable SACCO sector

In developing the strategy and roadmap, it will be important to consider the current state of development of the SACCO sector in the country versus other approaches used to develop SACCO sectors in other countries. Three possible approaches have been considered:

- Establishing a cooperative bank;
- Promoting sector consolidation and establishing SACCO networks; and
- Establishing linkages with banks.

These approaches are not mutually exclusive and the roadmap for developing the SACCO sector may include combinations or a mixture of elements of these various models. The matrix below summarizes the characteristics and the issues that need to be considered when applying these approaches in the Rwandan context.

[1] Table 2.3 of the report lists these issues, along with our recommendations for addressing them.

[2] A simplified reporting template has been proposed and is provided in the report.

	Establishing a cooperative bank	Promoting consolidation & establishing SACCO networks	Establishing linkages with banks
Description	• Membership may consist of individual SACCOs, and/or SACCO unions • Forming a cooperative bank will require a sizeable pool of strong SACCOs and/or SACCO unions (to raise the necessary capital and scale up operations to meet necessary regulatory requirements). • Participation of other (private) shareholders to meet capital requirements will be necessary.	• To facilitate formation of unions (and, eventually, a national federation), activities will likely include: - Capacity building for specialised private audit companies, that will analyse and grade the performance of SACCOs (especially Umurenge SACCOs) and identify options available to each category of SACCOs; - Capacity building for existing unions to enable greater membership coverage (where appropriate), and provision of services that can be offered to member-SACCOs; - Poorly-performing (Umurenge) SACCOs can be merged, or be transformed into branches or agents of other SACCOs or linked to other financial institutions.	• Will require investments in building the capacity of partner SACCOs; • Linkage-banking can be encouraged alongside other models –e.g. some SACCOs who participate in linkage-banking schemes may or may not belong to SACCO unions and networks; • Relationships between banks and SACCOs could evolve (in the long term) in such a way that some SACCOs may end up becoming a branch of the bank (i.e. if the SACCO members determine that it is in their/community's interest to undertake such a transformation); • Some SACCOs may also become 'agents' of the bank (although the regulations on the use of agents in Rwanda will still need to be developed/further clarified).
Supervisory structure	• Among all the approaches (presented in the report), this is the option with the least burden on the BNR: only need to supervise the cooperative bank. • However, if other larger SACCOs and/or unions are permitted to exist outside the cooperative bank model (likely), then BNR will also supervise those institutions that are not part of the cooperative bank.	• Supervision by BNR will be focused on the network-level entities (i.e. the unions and national federation), and a smaller number of larger SACCOs (that may opt not be members of unions); • Unions will be delegated authority to supervise individual member SACCOs.	• The burden of supervision by the BNR will not be affected if a linkage-banking scheme is implemented, i.e. supervision will still be focused on the networks/unions (should they exist) and other individual operators.

	Establishing a cooperative bank	Promoting consolidation & establishing SACCO networks	Establishing linkages with banks
Main cost drivers	• Capacity building – for members and boards of SACCOs that will form the cooperative bank. • Significant investments required in order to bring participating SACCOs up to speed (e.g. in terms of branch operations, Management Information Systems (MIS), accounting systems, human resources, etc.).	• Capacity building – for audit companies, for the unions/federation, for the SACCOs; • Rating of institutions (technical assistance); • Some start-up costs for the unions (e.g. management/accounting systems, etc.).	• Capacity building – for the participating SACCOs, as well as for the participating banks; • Technical assistance: in terms of developing products (including payments interface between the institutions), developing criteria for selecting partner institutions.
Drivers of revenue	• Once established, the cooperative will be able to develop and offer a variety of products and services that would enable it to generate revenue. If it continues to focus on the low-income market segment, revenue may be driven by the provision of transfer / payment services, micro-loan products, etc.	• Membership fees (annual) from member-SACCOs; • As the unions mature, they may offer other services to their members, which would allow them to generate additional revenues.	• Both banks and participating SACCOs can derive revenues from linkage banking arrangements: - For banks, revenue can be driven by fees and charges in providing of cash management services to SACCOs, and those associated with the other products / services that may be offered wholesale (to the SACCO) or on a retail basis (to members of partner-SACCOs) - For SACCOs, revenue can be driven by agent fees (charged to the partner-bank) and interest earned on deposits.

	Establishing a cooperative bank	Promoting consolidation & establishing SACCO networks	Establishing linkages with banks
Key risks	• Significant challenges foreseen in terms of balancing the interests of SACCO member owners and other (private) owners, especially given that the vast majority of SACCOs currently operating in the country are still at a very nascent stage of development; • A shift in the mission and target-market orientation may occur over time, given the commercial interests of other owners; • Consider: is this the approach best placed to serve the rural / low-income market?	• Pressures / temptation to undertake external lending (e.g. through Unions), which can be detrimental to SACCOs' development especially if SACCOs still need to build capacity; • Some SACCOs may fail even before governance is consolidated; • Resistance by leaders of some SACCOs to participate in networks; • Balancing building networks versus the need to build strong SACCOs who will own and manage the networks.	• Banks might be tempted to offer external lending to SACCOs, which would undermine the nature of SACCOs as savings-driven institutions; • Monopoly risks: if there are banks that decide to make the necessary investment to build a network of SACCO partners, this could lead to exclusive agreements between some SACCOs and some banks; • Public's perception of risk in SACCOs participating in the linkage scheme should be safeguarded: a SACCO's participation in a linkage scheme does not mean that its deposits are guaranteed by the partner bank.
Main benefits (versus other options)	• Reduces burden on supervision; • Could facilitate professionalisation and formalising of the operations of SACCOs – but will require considerable resources / investments (including private equity) and time to develop.	• If successful, this option has the potential to: - achieve deepest financial inclusion, in both scale and scope; - effectively develop emerging leadership capacity in the Umurenge SACCOs; - reduce governance risks especially among Umurenge SACCOs; and - reduce supervision requirements to a small number of network level entities.	• If successful, a linkage-banking option has the potential to: - provide the platform for a more integrated financial market; - enable learning between the banks and SACCOs; - provide a platform for developing leadership/managerial capacity (especially in Umurenge SACCOs).

3. Key recommendations

Description of the proposed roadmap to develop the SACCO sector

The proposed roadmap to develop the SACCO sector in Rwanda follows an approach that will help to facilitate greater financial inclusion in the long term. The roadmap encompasses two stages, namely, (a) a market preparation phase; and (b) SACCO sector consolidation (i.e. facilitating mergers and building networks between SACCOs).

Stage 1: Market preparation phase

This stage consists of the following four components:

- **Component 1:** Engage all relevant stakeholders in dialogue to present and discuss the roadmap.
- **Component 2:** Carry out a massive information campaign targeting all relevant stakeholders/actors involved in developing SACCOs.
- **Component 3:** Implement financial education for users of financial services/members of SACCOs.
- **Component 4:** Continue and strengthen the delivery of capacity building support to SACCO and SACCO union leaders.

Stage 2: SACCO sector consolidation

While the introduction of Umurenge SACCOs in all 416 sectors of Rwanda has addressed the need for a more widespread supply of financial services (especially savings and payment facilities), many of these institutions are too weak to continue operating, especially if government funding/support were to be withdrawn. Developing a framework that will encourage consolidation can help to facilitate the achievement of economies of scale in the provision of services.

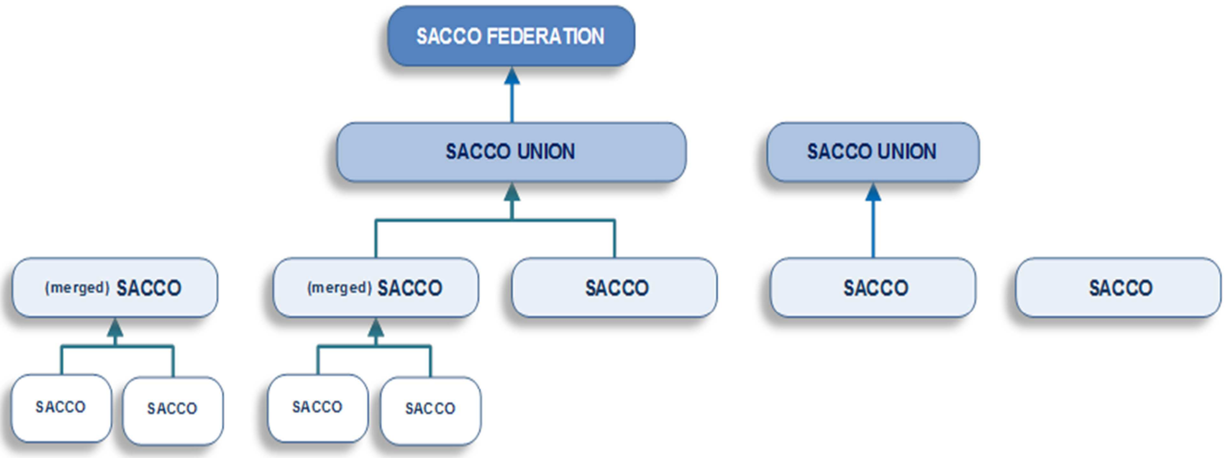
Given the differences in terms of the characteristics of the local markets served by SACCOs (i.e. between sectors), as well as the differences between the individual SACCOs currently operating in Rwanda, it is important to emphasise that the process of consolidation should not be seen as prescriptive. Not all SACCOs should be required to merge or become union members. Rather, there are a number of options that individual SACCOs may consider, depending on their particular situations and their assessment of the opportunities presented to them among the options available.

In terms of mergers, **consolidation based on geographical spread and coverage of institutions** could facilitate the creation of SACCOs that will then determine their own branch network (i.e. the number of branches/outlets and in which sectors it should and can maintain branches), based on an assessment of the business volume that can be generated by respective sectors. In some cases, therefore, organising SACCOs (and especially Umurenge SACCOs) into district-based SACCOs might be the appropriate approach.

Another important step to take in the process of consolidation is **strengthening existing unions and establishing new ones** (where needed). As there are already a number of SACCO unions operating in Rwanda, this approach could, by and large, build on this existing institutional capacity. In some cases, membership of existing unions may be expanded to include other SACCOs not yet part of unions. In other cases, however, new unions may need to be established to specifically address the need for SACCO networks in certain geographic locations. It should be recognised that there may be some geographic locations where the existing unions are already catering to the needs of member-SACCOs that are defined by a shared bond and where expansion of membership (e.g. to include Umurenge SACCOs) may present problems both to the union and the non-member SACCOs. Therefore, care needs to be taken in establishing the parameters of the SACCO unions.

SACCO unions are crucial to the sustainability of the SACCO sector, as they will fulfil support functions for and act as representatives of member SACCOs. Ideally, **unions can play an important role in the provision of capacity building** (and technical advice) to member SACCOs. Currently, most, if not all, of the existing unions suffer from institutional weaknesses and severe capacity constraints that would make them incapable of fulfilling the envisaged role effectively. The capacity building support for SACCOs and unions therefore relates not only to ensuring that there are adequate skills in the leadership and management of these organisations, but also to helping set up adequate systems within these organisations.[3] The approach to development must allow the gradual addition of services and responsibilities over time.

The proposed activities under each stage (in the roadmap) are designed to address the key issues confronting the sector (and especially the Umurenge SACCOs), which broadly encompass problems relating to the governance and ownership of SACCOs and how well these SACCOs are managed (both in terms of the quality of institutional leadership and management in place, as well as their supervision). The goal is to organize the sector following a tiered structure that would allow us to rationalize the number of institutions operating, and thereby facilitate the development of stronger institutions and enable a form of delegated supervision – however avoiding, as much as possible, any negative consequences on access to financial services. The resulting structure for the SACCO sector in Rwanda is proposed to follow what is illustrated in the figure below:



Within such a structure, existing individual SACCOs may either: (a) merge with other SACCOs that may or may not become members of SACCO unions, (b) become a member of a SACCO union; or (c) continue to operate as individual SACCOs.

[3] For example, a union may consider offering liquidity management services or assist members in developing important organisational policies (e.g. in terms of credit administration, product development and marketing, recruitment, etc.). SACCO unions may also link with commercial banks, to which the transactional banking business of SACCO members can be outsourced. As the sector evolves and matures over time, some unions may also be best placed to provide central IT service solutions and allow member SACCOs to share in a common IT platform.

Under this proposed restructuring of the SACCO sector, **BNR will supervise the activities of a much smaller number of institutions**, consisting of a few large SACCOs that operate independently (i.e. those that are not members of unions) and the SACCO unions. SACCO unions will be tasked with supervising their member SACCOs and will work closely with the BNR in fulfilling this role, especially in the early stages. As the sector evolves and matures, there may be cases where unions have SACCO members that grow in scale and expand to such an extent that they need greater supervision; as such, these SACCOs will then have to be subjected to BNR supervision (even if they continue to be members of a SACCO union).

Moving towards this proposed structure will, however, not only be a matter of merging institutions and requiring the formation of Unions among SACCOs. In order to successfully arrive at such a structure (that functions well in the long term), strong institutions (both SACCOs and Unions) that are capable of effectively providing services to their target markets and of operating sustainably will be required. In other words, the micro foundations of the SACCO financial services market need to established and strengthened first and foremost.

Implementing the recommendations will therefore need to be taken as a process and the activities will need to be paced, with some requiring a more gradual approach. Moreover, some interventions must follow a certain sequence. Policymakers and stakeholders who will be involved in helping to develop the SACCO sector in Rwanda will need to take serious consideration of the trade-off between the speed of institutional building and the quality of/impact on financial inclusion. This is a complex and long-term process, which requires effective coordination of roles and interventions.

A detailed five-year plan covering the implementation of the proposed roadmap is provided in the report.

Implementing the recommendations presented in the report will have implications on the resources that will be required to support the development of the SACCO sector. The cost implications centre around (a) the investments that are required to support the preparation and development of the market, and (b) the subsidy that will likely be required to support individual institutions (over a certain period of time). A financial model has been developed, which builds on the key recommendations provided in this report, and elaborates on the likely costs and economic implications of developing the SACCO sector in Rwanda, given a number of assumptions.

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Abbreviations

AFF	Access to Finance Forums
AFR	Access to Finance Rwanda
AMIR	Association of Microfinance Institutions in Rwanda
ARFSS	Agricultural and Rural Financial Services Strategy
ATM	Automated Teller Machine
BDS	Business Development Services
BNR	Banque Nationale du Rwanda
BPR	Banque Populaire du Rwanda
DCO	District Cooperative Officer
EDPRS	Economic Development Poverty Reduction Strategy
FSDP	Financial Sector Development Plan
GoR	Government of Rwanda
KCB	Kenya Commercial Bank
MINAGRI	Ministry of Agriculture and Animal Resources
MINECOFIN	Ministry of Finance and Economic Planning
NISR	National Institute of Statistics Rwanda
NPLs	Non-performing loans
MIS	Management Information System
MFI	Microfinance Institution
OPM	Oxford Policy Management
PAR>30	Portfolio at risk, greater than 30 days
RAFSS	Rural and Agricultural Financial Services Strategy
RCA	Rwanda Cooperative Agency
SACCOs	Savings and credit cooperatives
SMEs	Small and medium-sized enterprises
SSS	SACCO Sustainability Study

TCU	Technical Control Units
ToR	Terms of Reference
UBPR	Union des Banques Populaires du Rwanda
VUP	Vision Umurenge Programme
WOCCU	World Council of Credit Unions

1 Introduction

Access to Finance Rwanda (AFR) has contracted Oxford Policy Management (OPM) to undertake a critical study of the Savings and Credit Cooperatives (SACCOs) sector in Rwanda and develop a practical set of measures and an action plan to ensure SACCOs become fully sustainable and thriving financial service providers, especially to the rural poor.[4] The assignment is aimed at developing a strategy and concrete roadmap that will lead to the entire SACCO sector becoming not just sustainable, but able to grow and increase outreach in terms of numbers of people served, savings mobilised and loans provided, particularly in rural areas. While the study will focus on the Umurenge SACCOs, given their number and importance as one of the components of the National Savings Mobilisation Strategy, the study and the resulting strategy and action plan also cover other non-Umurenge SACCOs. The Terms of Reference for the assignment are set out in Annex A.

The assignment began in May 2011 with a review of relevant literature and data sources, followed by a field visit on 10-21 May,[5] on the basis of which an Inception Report was submitted on 25 June. During the field visit, meetings with relevant stakeholders were carried out, and the preliminary findings were discussed with the SACCO Sustainability Study (SSS) Working Group on 21 May.

This report begins with a diagnosis of the SACCO sector in Section 2, which discusses the characteristics and key issues to address at the levels of individual provider, support institutions and the enabling environment. This is followed in Section 3 by a description of three approaches for developing the SACCO sector, highlighting the key advantages and disadvantages of each option in light of the experience in other countries. In Section 4, the roadmap for developing the SACCO sector in Rwanda is described, and Section 5 provides further details on the proposed implementation plan.

Implementing the recommendations presented in this report will have implications on the resources that will be required to support the development of the SACCO sector. Financial models have been developed, which build on the key recommendations provided in this report, and elaborates on the likely costs and economic implications of developing the SACCO sector in Rwanda, given a number of assumptions.[6]

[4] OPM has undertaken this assignment in collaboration with with the Centre for Economic and Social Studies (CESS), a consultancy firm based in Kigali specialising in the conception and execution of monitoring and evaluation, analysis and training in the field of quantitative and statistical economics and social sciences.

[5] The OPM Rural and Microfinance Specialist and Project Manager (Maria Abigail Carpio) also conducted follow up meetings with a number of key stakeholders in Rwanda for this assignment from 27 to 31 May.

[6] There are two financial models (Excel files) that have been constructed under this assignment: (i) a financial model covering the market preparation and development phase, as well as the consolidation of the sector; and (ii) a financial model covering the option of establishing a Cooperative Bank at a later stage. Both financial models are accompanied by notes explaining the results, and have been submitted together with this report.

2 Diagnosis of the current state of SACCOs

In this section, the characteristics of the SACCO sector in Rwanda are analysed - at the provider, regulatory/policy, and support levels of the financial system. Each of the sub-sections that follow begins with a summary of the key factors that have contributed to the development of successful SACCO sectors in other countries, followed by an interpretation of these key success factors in terms of the current situation in Rwanda.

2.1 SACCOs as financial service providers

2.1.1 Defining and differentiating SACCOs among other financial service providers

A cooperative institution is defined as an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through a jointly and democratically controlled enterprise.[7] Despite the diversity of cooperative institutions across many regions of the world, they are united by a set of shared values and principles, the most crucial and definitive among which is that they are membership-based organisations. As such, SACCOs are distinguished from other financial service providers in that they are owned by members and financial services are commonly targeted towards this pool of members only. The members of a cooperative are united by a form of social bond, typically determined by their employment, income source or economic activity.[8]

The uniqueness of the SACCO also relates to an underlying tension between its economic and social foundations. Its strength is that it is membership-based and its members have a sense of ownership of the institution: it is in the interest of members that the institution is established and its operations sustained. As financial intermediaries, SACCOs finance their loan portfolios by mobilising member savings and shares rather than using outside capital. On the other hand, its members are at the same time the clients of the services it provides, which creates moral hazard and incentive problems. Moreover, because members of a SACCO are bound together by a social bond, the emerging relationships between the members and between them and the institution tend to be less business-oriented compared, for example, to the relationship between consumers and commercial banks. Thus, promoting the interest of members, as owners who have rights to the services of the institution, needs to be tempered with the understanding that, for a SACCO to succeed, it must also be founded on **strong business principles**. This involves having access to markets, being able to provide the services that are needed by its members, and operating profitably and sustainably.

It is therefore not surprising that in many countries, where cooperatives were developed outside existing traditional networks (i.e. motivated or pushed by parties outside a certain social setting, such as by governments or donors), it was hard to convince people that cooperatives could effectively respond to their needs, because they were seen as alien or

[7] See: United Nations: Cooperatives at Work. (www.un.org/esa/socdev/social/cooperatives/documents/CoopsAtWork.pdf).

[8] In some countries, cooperatives tend to be like traditional social structures that have embedded within them strong social and economic networks. When properly organised and effectively mobilised, this can prove to be a successful business model.

artificial, or even as an extension of government or political authority. In such cases, it proved challenging to promote the concept of **cooperative ownership**.[9] Without the sense of true cooperative ownership, the governance of SACCOs becomes problematic as it rests on the presumption of the members' mutual self-interest and no amount of regulation or supervision can take the place of sound internal governance.

Another important feature of successful cooperative financial institutions or SACCOs is that they tend to **specialise in financial services**. This means that almost 100% of their assets are invested in financial activities. Through specialisation, the strategy, policies, management and governance of the organisation is more easily made clear.[10] It is important to note that being specialised in financial services is in itself difficult for most SACCOs. The management and board need to understand the complexities of credit administration, investment and liquidity management and the issues to be resolved in day-to-day operations. The challenge is even amplified when we consider those SACCOs with large or growing amounts of assets.

To support SACCOs as they become larger and more mature, as their loan portfolios also grow in size and complexity, and as they start offering a wider range of services, the **development of a standard accounting system** is seen as an important early step. This is geared towards producing accurate, consistent financial statements that permit management and the elected leaders to take appropriate actions. Such a system must provide for precise definitions of indicators and their accurate calculation, and the information generated must also serve as the basis for external regulation and inspection by relevant authorities.

For systems and internal controls to be effective, the managers and leaders of the SACCO must also be adequately trained in the interpretation and use of the information generated. This is a characteristic that is consistent in all the success stories: **training of the institution's elected leadership and its employees is vital to their success**. Better-trained leaders and employees of SACCOs will be able to go into greater depth in analysing each element of the institution's financial management system to better serve the needs of savers and borrowers. The elected leaders (i.e. the board) need the tools to carry out their governance function, which at the very basic level should cover an understanding of their role as board member, the importance of savings mobilisation and of sound credit administration.

[9] This has been observed, for example, in the experience of some of the transition countries – such as Azerbaijan, the Kyrgyz Republic and Mongolia – where the vast majority of cooperative financial institutions are in effect controlled by one or a few people, who initiated the formation of the institution given the prospect of obtaining external financing, or the desire to avoid the regulation associated with other legal forms. See Andrews (2006).

[10] This was an important finding in a review of credit unions that operated in Honduras in the early 1990s: some of the institutions invested in other non-financial projects and ended up broke. As earnings diminished, shares and deposits also went down. Investing in non-financial activities meant that the manager had to make decisions and actions that were outside his area of expertise. Moreover, the non-financial activities also distracted the manager from adequately overseeing the financial operations, which resulted in a decline in the overall performance of the credit union. Investments in other activities, especially when medium to long term, absorb liquid reserves and can make it difficult for the credit union to respond to short-term demands for loans or deposit withdrawals being made by members. This also results in a form of mixed or unclear signalling to the market, which could lead to a situation where members lose their confidence in the institution. See Arbuckle (1994).

Tied to this is having an **appropriate compensation policy** in place that will attract and retain committed and well-qualified staff. The compensation policy needs to be competitive and performance-based. As cooperative financial institutions grow, they will require more highly skilled employees to perform increasingly complex tasks. Committed employees who have been instrumental in the growth of the institution are a resource that should be continually trained: they need to have up-to-date technical skills.

In the box that follows, some of the common mistakes made by cooperative financial institutions, discussed by Westley (2005) in the context of some Latin American countries, are outlined.[11]

Box 2.1 Common pitfalls of credit unions

- **Low loan rates and little capitalization of profits**: Loan rates in Latin American credit unions are typically set so that very little or no profit is earned. Moreover, a large proportion of any profits that are earned is frequently paid out in dividends to members. Consequently, credit unions typically have little institutional capital for future expansion or to buffer negative shocks.
- **Opaque financial information and undisciplined financial practices**: Problems in this area include underreporting of loan delinquency, failure to write off overdue loans, overstatement of profits and capital by such accounting devices as deferring operating expenses or amortizing them over several years, and overstating asset values. Such practices render financial statements meaningless and raise risk perceptions.
- **Inadequate risk management**: Many credit unions believe that members have a right to borrow up to a certain multiple of share capital. Loan applications do not differentiate loan types. Loan appraisal and collection efforts are often weak. Modern credit unions greatly relax or eliminate these share-multiple ceilings and seek detailed information to properly assess risks.
- **Low salary levels**: Credit union salary levels typically are set well below those paid elsewhere in the financial sector, which often results in low effort and morale, high turnover, and a general inability to recruit and retain high-quality staff. This frequently undercuts credit union performance and financial health.
- **Low deposit rates** : Deposit rates are often well below commercial bank rates, despite the fact that, because credit unions are typically riskier institutions, a competitive credit union deposit rate would normally be expected to exceed the bank rate. In the past, when credit unions have raised deposit rates to this an appropriate level, deposit mobilization has often increased sharply, greatly expanding the outreach of the credit unions and their capacity to offer loans.

Source: Westley (2001); cited in “Access to Financial Services in Brazil” (p. 143), a study led by Anjali Kumar; The World Bank, 2005.

2.1.2 Characterising SACCOs in Rwanda

The SACCOs currently operating in Rwanda can be classified into two main groups: (i) Umurenge SACCOs; and (ii) non-Umurenge SACCOs.

- **Umurenge SACCOs:** This group consists of those SACCOs that were initiated and formed with the support of the government, as a component of the National Savings Mobilisation Strategy. One SACCO was organised for each of the 416 sectors in

[11] See Westley (2005).

Rwanda. Many of these institutions are still very young, having been formed in the years 2009-10.

- **Non-Umurenge SACCOs:** This group consists of those SACCOs that were already operating prior to the introduction of the Umurenge SACCOs. There is a diverse set of institutions within this category – they differ in terms of size, geographical spread, rural/urban orientation, age, etc. Some of the SACCOs in this category share similar characteristics with the Umurenge SACCOs in the sense that they have also been initiated by government (i.e. by some ministries or government agencies).

Table 2.1 below provides a snapshot of the distinguishing features of Umurenge and non-Umurenge SACCOs. In Table 2.2, the key figures depicting the size and scale of operations of the two groups are also provided.

Table 2.1 Distinguishing Umurenge SACCOs from other SACCOs in Rwanda

	Non-Umurenge SACCOs	Umurenge SACCOs
Total no. of institutions operating (as of March 2011)	89	416
Products/services offered	• Offer both savings and credit services to their members	• 355 of the Umurenge SACCOs are licensed to extend loans • Payments services are provided, especially in areas characterised by a lack of financial institutions
Location and coverage	• Outlets tend to be based in urban and peri-urban locations, although some outlets are located in more rural/remote locations • Some SACCOs draw their membership from those in the same trade (e.g. teachers) or interest group (e.g. youth, women)	• Located in sectors, covering both urban and rural areas • The vast majority maintain only one branch or outlet • Membership is based on individuals residing in the same locality

The figures in Table 2.2 below underscore a number of important characteristics that further differentiate Umurenge SACCOs from non-Umurenge SACCOs:

- Umurenge SACCOs are reaching a larger number of individual members in absolute terms (roughly 27% more than non-Umurenge SACCOs), which is driven by the number of institutions (416) under this category. However, on average, Umurenge SACCOs tend to be smaller, with roughly 2,000 members – in contrast to non-Umurenge SACCOs that have 7,500 members on average.
- Umurenge SACCOs also appear to reach a poorer clientele, given their average savings balance per member.[12] For non-Umurenge SACCOs, the average savings balance per

[12] The average savings balance is typically used as an indicator of an institution's depth of outreach. It is, however, important to note that other factors can also help explain a lower average savings balance: for example, savers may opt to deposit lower amounts if there are perceived risks associated with keeping their savings in certain financial institutions.

member over the last three years is roughly US$ 90, which is almost three times the average savings balance held by members of Umurenge SACCOs. This distinction is not surprising considering the differences between the two categories in terms of the location of the institutions and the tendency for non-Umurenge SACCOs to reach individuals with employment and who are relatively better off.

Table 2.2 SACCOs' key operational highlights

	Non-Umurenge SACCOs			Umurenge SACCOs (data as of 30 June 2011)
	2008	2009	2010	
Total no. of institutions	98	98	93	416
Total no. of members	686,952	714,154	699,587	959,976
Total volume of savings mobilised (in million Frw)	38,316.95	48,929.84	23,904.18	14,647.90
Total volume of shares (in million Frw)	n/a	4,960.70	6,648.99	2,789.15
Average savings balance per member (in million Frw)	55,778.21	68,514.41	34,168.99	20,254.62
(In US$)	*$94.54*	*$116.13*	*$57.91*	*$ 34.33*
Gross loan portfolio (in million Frw)	42,321.85	50,143.93	33,607.73	1,765.13
Ratio of loans to deposits	1.105	1.025	1.406	---

Source: BNR and Rwanda Cooperative Agency (RCA) database.

Notes: The total number of members for Umurenge SACCOs, as is shown above, covers subscribed members only (i.e. those members with fully paid up shares, rather than the entire pool of 'registered' members). The total number of Umurenge SACCO members with active accounts, on the other hand, is 723,188.

The table above shows a marked decline in the volume of savings mobilized by non-Umurenge SACCOs between 2009 and 2010, which can be partly attributed to the reduction in the number of institutions in this category, including the re-classification of one of the larger SACCOs (Zigama CSS) which is currently applying for a banking license.

The Umurenge SACCOs are currently financially supported by the government. The Government of Rwanda (GoR) provides up to Frw 500,000 for each Umurenge SACCO per month (which is channelled through the RCA) to cover salaries of three technical staff per SACCO. At the moment, none of the Umurenge SACCOs are able to operate independently of this government support.

On the other hand, some non-Umurenge SACCOs are already demonstrating operational self-sufficiency.[13] To understand what is driving the sustainability/profitability of these

[13] Operational self-sufficiency is a measure of financial efficiency – which is equal to the total operating revenues divided by total administrative and financial expenses. If the resulting figure is greater than one, the organisation under evaluation is considered to be operationally self-sufficient – i.e. these institutions are able to cover administrative costs with client revenues. Beyond operational self-sufficiency, however, is financial self-sufficiency, which indicates whether or not enough revenue is earned (a) to cover all of the operating, financial and loan loss expenses, as well as (b) to maintain

institutions, we looked at available data covering SACCOs that are members of the Association of Microfinance Institutions in Rwanda (AMIR).[14]

- **Services and outreach**: In this sample, non-Umurenge SACCOs tend to reach a slightly better-off clientele, with savings balances of Frw 65,520 (roughly US$ 110) on average per member. Moreover, borrowers in these SACCOs avail of loans in the amount of Frw 520,848.00 (roughly US$ 880) on average per borrower.
- **Efficiency**: The SACCOs in this sample had an operating expense ratio equivalent to 23%, which is almost twice the average of credit unions in Sub-Saharan Africa.[15]
- **Loan portfolio quality**: The SACCOs in this sample registered PAR>30 levels equivalent to 6.6%.[16]

Despite the large average loan sizes offered by these SACCOs, they still register high operational expense ratios – which could be driven by the costs associated with other activities (e.g. savings mobilisation), as well as a greater need to follow up on outstanding loans.[17] The data, however suggests that these SACCOs are able to compensate for this lower level of efficiency (i.e. higher operating expense ratios) by realising a yield on their portfolios (through interest rates charged on loans) that more or less allows them to cover their operating costs. If these SACCOs, however, decide to reach further down the market (i.e. by offering loans that are smaller in size) and at the same time maintain their level of sustainability, without compromising the affordability of their services, it will be imperative that they improve on their level of efficiency and loan portfolio quality.

2.1.3 Key issues at the provider level

There are a number of important issues that need to be addressed in order to improve the performance of individual institutions.

As has already been highlighted in a recent assessment undertaken by the BNR, RCA and MINECOFIN, many of the SACCOs – and especially the Umurenge SACCOs – suffer from

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the value of capital in the organisation. It is important to note that unless 100% financial self-sufficiency is reached, the long-term provision of credit services will be undermined by the impact of inflation and will require continued reliance on donor funds.

[14] It is important to note that this dataset covers only 43 of the non-Umurenge SACCOs, and cannot be used to represent the performance for the entire sector. Performance data for all non-Umurenge SACCOs could not be made available for this study.

[15] This covers those credit unions in the region that report to the Mix Market. (See CGAP/MIX (2011): Sub-Saharan Africa Microfinance Analysis and Benchmarking Report 2010.) Reporting financial institutions in Sub-Saharan Africa continue to show high operating expenses, having the highest expenses worldwide, with operating expense ratios of 19%, compared to global levels of 14%. The high operating expenses are noted to be attributable to high staff expenses, which is characteristic of markets where skilled labour is scarce; high transaction costs (especially in reaching rural areas); and the high cost of managing savings. There is also consistently high and increasing (credit) risk, which also results in high operating costs, given the need for staff to spend additional time following up on outstanding loans.

[16] The SACCOs in this sample appear to have relatively better loan portfolio quality than the entire pool of non-Umurenge SACCOs. According to the BNR, the average non-performing loan rate (for all non-Umurenge SACCOs) was 9.6% at the end of December 2010.

[17] Typically, it is more expensive for financial institutions to extend smaller loans.

weaknesses in terms of their governance, which is rooted in a **poor sense of cooperative ownership** among members. Good governance ensures the sustainability of these institutions. Without good governance the advantages of the SACCO model (compared to other models of extending financial services) tend to be undermined.

The issue of weak governance and poor sense of ownership can be explained (and therefore addressed) by considering the following factors:

- The Umurenge SACCOs and indeed even some of the non-Umurenge SACCOs were motivated or pushed by parties other than the members themselves. As such, people do not quite understand what these institutions are for; they have not been able to fully internalise the messages they received from outsiders and other stakeholders (e.g. sector and district officials) about the benefits of being a member of a SACCO and what their membership actually entails. Without a sense of true cooperative ownership, the governance of SACCOs becomes problematic as it rests on the presumption of the members' mutual self-interest: if members do not understand their rights and responsibilities, there will be no one who can hold SACCO leaders and managers accountable.
- More importantly, those parties and stakeholders involved in the promotion of SACCOs also have limited understanding of what is needed in order to make SACCOs work. In the last year, many local government officials have been driven by the objective of encouraging a large number of their constituencies to become members of (Umurenge) SACCOs. Data collected by district cooperative officers (DCOs), for example, show sector targets for SACCO membership, which are typically computed on some estimate of the total adult population in a given district. Local government officials cannot be blamed for wanting to push more and more people to become members of SACCOs: a number of Executive Secretaries in the sectors, for example, have indicated that in their *Imihigo* (performance contract), there are specifiic targets for mobilising SACCO members. Thus, the massive promotion to get as many people as possible to become members of SACCOs is considered by many local government officials as part of their job.
- In some sectors and districts, the level of mistrust also appears to be linked to what some users of financial services experienced during the last crisis in the microfinance industry. A number of microfinance institutions (MFIs) went bankrupt in 2006 and many, if not all, of these institutions suffered from weak governance and insufficient capital.[18]

Weak governance and a poor sense of cooperative ownership is a critical issue and helps explain many other constraints that the SACCOs face. There is a clear need for financial education not only among the targeted/potential users of financial services of SACCOs, but also, and perhaps even more importantly, among those parties and stakeholders involved in the promotion of SACCOs.

[18] In Bugesera district, for example, the DCO noted that some individuals who had lost some of their money during the crisis in 2006 said that they felt wary about these 'new institutions' (i.e. the Umurenge SACCOs). However, the DCO expressed confidence that trust in the system can be built over time. Unlike the MFIs that went bust, she notes that the Umurenge SACCOs are already entering their second year of operation, while the failed MFIs operated for less than a year. It will be a question of how long SACCO services can be maintained in its present set up (i.e. as institutions supported by the government), and whether the risks that come with collecting and intermediating deposits can be properly mitigated.

- Understanding the role of members in a SACCO needs to take into account: (1) that the interests of borrowers can subsume those of savers (or vice versa); (2) that the boards of directors can favour one or the other interest group, which could undermine the financial basis of the cooperative; and (3) that members can opt for short-term gains, which may have implications on the long-term profitability of the SACCO. Thus, cooperative member education is crucial to ensuring that the board of directors and manager truly represent the broader membership/interest group and undertakes decisions that are in the best interest of the SACCO as a social and business organisation.
- It will be crucial to ensure that the objectives and motivations of various stakeholders are aligned with the principles of good practice in institution-building and overall provision of financial services. These principles are founded upon the understanding that financial transactions are built on trust between users and providers of financial services.

Stakeholders need to understand what factors will contribute towards the development of the SACCO financial market and, likewise, what will cause distortions. If the intention is to build financial institutions that will have a lasting positive impact on financial access, the policies and actions need to be aimed at building institutions able to provide a range of services required by the target group. As SACCOs evolve, their role in intermediating the savings they are able to mobilise will need to be strengthened. There are two important points that need to be discussed in this respect:

- As has already been pointed out in a number of studies, there are **severe capacity constraints** among SACCOs, especially among Umurenge SACCOs, that need to be addressed. The capacity-related issues comprise both institutional and human resource (skills) needs, and affect individual SACCOs as well as the existing SACCO unions. These constraints encompass: (i) the quality of leadership and management – i.e. the control and governance of institutions; (ii) the institutional systems/processes required for institutions to function and achieve their objectives as financial service providers; and (iii) the facilities they need to deliver services (e.g. building quality and location).[19] These issues affect the capacity of financial institutions to deliver inclusive financial services – i.e. their ability to effectively reach low-income groups.
- It is important to underscore that SACCOs are savings-led institutions.[20] These institutions have the potential to reach unbanked populations and provide them with a safe way to store their savings. At the moment, however, there appears to be **too much emphasis placed on access to credit** by various players in the market – i.e. much more than access to savings or any other financial service that especially low-income groups need. Even the provision of savings facilities appears to be strongly linked to promises to make loans available in the future. Moreover, loan amounts provided by credit-granting SACCOs are typically computed as multiples of members' savings balances, which also helps explain the difficulties that financial institutions often cite in meeting the demand for

[19] The constraints in terms of the quality of human resources/skills are inextricably linked to broader human resource capacity issues that affect the financial sector as a whole, and appear to be more pronounced in areas outside Kigali City (OPM, 2009: Census of Existing Skills in the Financial Sector in Rwanda).

[20] It is interesting to note, for example, a comment made by a presenter at the last ACCOSCA SACCOs Leaders' Forum: "*In Africa, credit unions are known as Savings and Credit Co-operative Societies (SACCOs) to emphasize savings before credit.*" Law No. 40/2008 establishing the organisation of microfinance activities in Rwanda defines a SACCO as a cooperative established for the purpose of accepting deposits from its members in order to make them increase in value, provide loans and other services and financial products.

loans among their members. The figures in Table 2.2 show, for example, that non-Umurenge SACCOs on average provide loans equivalent to 1.4 times the value of savings they are able to mobilise.

Moreover, among financial institutions that have cited problems regarding the quality of their loan portfolios, there is a tendency to perceive non-repayment of loans as being driven (mainly) by the lack of willingness among borrowers to honour their debt obligations, rather than the inability of some borrowers to make effective use of the loans they access. Many of the credit-granting SACCOs tend to assume that loan defaults are largely caused by the lack of borrower discipline, when in reality, a poorly performing loan can also be explained in terms of inappropriate product design and poor appraisal of loan applications (for which the financial institution / lender is responsible).

It is important to recognize that the BNR has been cautious by allowing some licensed Umurenge SACCOs to only disburse 20% of the value of their deposits as loans. But at the moment, the weak governance of these institutions and their severe capacity constraints – which require ample time to build – can mean that these SACCOs' are exposed to a high likelihood of loan losses. Interestingly, those Umurenge SACCOs that have recently been granted licenses to offer loans have indicated their plan to offer loans in the amount of Frw 100,000 to as much as Frw 700,000. These amounts appear too large or inappropriate when we consider the typical clientele of Umurenge SACCOs (e.g. smallholder farm-based households with irregular and low incomes). How do these amounts relate to the real capacity of borrowers to service loans in such amounts, considering especially that these SACCOs tend to reach low-income target groups? Have Umurenge SACCOs (that have been granted licenses to offer loans) received adequate training in the development of suitable loan products and the administration of loans? If indeed training was provided, have SACCOs demonstrated that they have fully internalised what they learned during the training? Have systems been adequately developed within these SACCOs to allow SACCO leaders to effectively administer loans, including establishing systems to track loan repayments?

2.2 Support institutions

2.2.1 Support mechanisms in the development of the SACCO sector

The development of the SACCO sector also requires the setting up of support mechanisms that are crucial to the functioning of individual cooperative financial institutions. In some countries, apex organisations have been set up in order to carry out support activities. In others, associations or networks of SACCOs have been created to function as apexes. The use of an apex organisation to gain some degree of standardisation and economies of scale is a common approach to make the provision of training, equipment and software cost-effective. Similarly, stronger or larger SACCOs may favour the establishment or development of their own associations or networks (that fulfil functions similar to those envisioned for apex organisations) or the provision of central services by banking institutions outside the cooperative sector.

The experiences, however, show that such organisations can face a number of challenges – mainly the difficulty of reconciling the realities of a start-up situation with the vision of establishing an apex or a network that is owned and controlled by the individual SACCOs. During the start-up phase, institutions lack the managerial and financial capacity to own and control an apex or a network. These issues are, however, not limited to the experience of newly established or under-developed cooperative financial systems. In many other countries, there is continuing debate over the role and structure of the tiers, and structures are observed to be continually evolving.[21]

While there are clearly strong arguments that favour the formation of such apex organisations or unions/networks of SACCOs, this is often a process that takes a relatively long time to establish – especially in countries characterised by a larger number of weak SACCOs. In many countries, interventions have therefore also been designed to support capacity building at the union/network level, alongside support that is provided to individual SACCOs.

In discussing the role of unions/networks of SACCOs, an important issue often emerges: the purpose and impact of **external funding**. Unions or networks are typically assumed to act as vehicles for channelling funds for on-lending by SACCOs, which can be detrimental to their development. There are significant problems arising from the incompatibility of external funding (assistance through loans or grants) with the concept of a member-owned and controlled self-sustaining financial institution. On the level of the SACCO as a provider, this may create the incentive for (new) members to join only on the basis of possibly obtaining loans financed by external funding. In the event that such funding ceases to be available, members may leave the institution and/or the newly set-up institutions may close down altogether. SACCOs are most effective when members feel a sense of ownership of their cooperatives. Resources derived from the state or from other donors, especially when directed towards the poor or other disadvantaged populations, create strong disincentives for repayment. If on-lending programmes are made available (e.g. as part of the services provided by unions/networks), larger and more mature SACCOs are viewed as more suitable vehicles for these programmes, just as some commercial banks participate in development finance programmes. However, it should be noted that the use of external financing clearly makes these larger SACCOs more bank-like and to a certain extent removed from the concept of cooperative financial institutions.[22]

As has been demonstrated in the experience of other countries, external funding is better used in supporting the development and implementation of standardised management systems, accounting and reporting formats, etc. In addition to technical assistance, there may be a role for grant financing to support an initial start-up phase of individual SACCOs and of the networks they form. This constitutes building capacity within newly established institutions or those that are showing signs of growth.

2.2.2 Characterising unions and other support institutions in the SACCO sector in Rwanda

There are a number of SACCO unions operating in Rwanda, which include Union des SACCOs Umutanguha (UCU), Union of Coopec SACCOs, CLECAM, and CMF. These unions are typically networks involving non-Umurenge SACCOs, but this is expected to change with the merging of a number of non-Umurenge and Umurenge SACCOs that is

[21] In Canada, for example, the Desjardins Caisse Populaire (credit union) system has recently removed its middle tier of regional federations, devolving to a two-tier system in an effort to reduce costs and increase standardisation.

[22] In fact, PEARLS, which measures key areas of a credit union’s operations (and stands for Protection, Effective financial structure, Asset quality, Rates of return and cost, Liquidity and Signs of growth) establishes that the target for external finance should be zero. PEARLS is a monitoring system used by the World Council of Credit Unions (WOCCU).

already starting to take place. The services provided by the existing unions vary, although many of them are involved in the extension of capacity building for member-SACCOs, which is often carried out in cooperation with other associations such as AMIR.

A number of the unions are also acting as channels of external finance for on-lending by their member-SACCOs. Access to these external on-lending funds is often used by the unions to attract or encourage SACCOs to become a union member.

The biggest problem confronting unions in Rwanda is institutional capacity. According to AMIR, none of the existing unions are sustainable and, like SACCOs, they also suffer from severe capacity constraints. Terrafina and AMIR are among the institutions currently supporting capacity building of SACCO unions.

Apart from unions, there are also a few linkage-banking initiatives being tested in some parts of Rwanda. Ecobank and Kenya Commercial Bank (KCB) are, for example, already starting to engage some of the SACCOs in the Southern and Northern provinces. In these partnerships, (i) SACCOs are encouraged to place their deposits or hold accounts with the partner banks; (ii) SACCOs can act as Western Union Sub-agents, enabling receipt of transfers in some sectors; and (iii) partner banks offer training for SACCO managers and in some cases, even provide equipment such as computers. These linkage-banking initiatives are still at the very early stages of development. It will, however, be meaningful to consider whether these partnerships will in practice prove to be beneficial to both the SACCOs and interested banks, and whether these can be replicated in other parts of the country.

2.3 The enabling environment

2.3.1 Characterising the enabling environment to support the development of SACCOs

The quality and appropriateness of the policy, legal, and regulatory environment within which SACCOs operate affects their ability to grow into strong, sustainable institutions with wide outreach.

There are a variety of approaches adopted across a number of countries, reflecting differences in countries' financial landscapes as well as the level of development of the cooperative financial sector across many countries.

- There are cases where financial cooperatives may enjoy certain privileges compared to other financial institutions. For example, some countries have more relaxed regulation for financial cooperatives in terms of entry capital (e.g. in Brazil), and in some cases, more relaxed capital adequacy ratios (e.g. in the United States).[23]
- In some cases, there are more stringent requirements for financial cooperatives – e.g. in terms of the reserve requirements on deposits. In Brazil, for example, while financial cooperatives are not required to place reserves with the Central Bank, they are obliged (by the central cooperatives) to place 90% of demand deposits and 25% of time deposits in liquid instruments.[24] Thus, the amount of loanable resources becomes substantially lower than for banks. This prudential requirement is imposed because of the lack of access to deposit guarantees by financial cooperatives.

[23] See Kumar (2005).

[24] Central cooperatives are institutions that form part of the tiered approach in Brazil.

- There are also other restrictions practiced in other countries, such as imposing minimum capital requirements and restricting deposit mobilisation for those that do not meet these requirements. This is the case, for example, in Bolivia, where only those credit unions with capital of about US$ 200,000 or more are eligible to be supervised by the bank superintendency and thus permitted to operate and mobilise deposits.[25]

The expectation that drives the imposition of such restrictions is that some unregulated credit unions will merge and become regulated entities. Those existing credit unions that are barred from taking deposits will simply close down. The problem, however, is that mergers between financial cooperatives are ridden with a number of obstacles. One of the obstacles cited in many studies is that each credit union has a relatively large number of owners. This makes a merger much more difficult than in the case of corporations, where a majority of the shares often belongs to a smaller number of shareholders.[26]

The policies and the legal framework therefore need to take these factors into account and be consistent with the nature and values of SACCOs in order to be implemented effectively. The legal and regulatory framework is, however, only appropriate to the extent that **regulators are able to effectively supervise** covered institutions in practice. Financial regulators often have limited human resources to supervise even the large institutions that present the greatest systemic risk to the financial sector. In the past, some central banks have been forced to devote a significant portion of their limited financial and human resources to the supervision of small institutions, many of which lacked the capacity to meet the prescribed governance standards and reporting requirements.[27]

It is, therefore, critical to ensure that the legal framework for SACCO regulation and supervision properly considers:

- the level of risk presented by the sector (including the relative risk presented by SACCOs of different sizes);
- the capacity of the institutions to meet prescribed regulatory requirements; and
- the ability of the regulator to supervise a diverse group of SACCOs.

Direct supervision of all SACCOs (especially if the sector is characterised by a large number of individual institutions) creates a strain on supervisory capacity, and delegation of supervision therefore appears to have its advantages. To reduce the costs of supervision, several countries have adopted alternative methods of indirect supervision. The various forms are described in Box 2.2.

[25] See Westley (2001).

[26] See Westley and Branch (eds.) (2000).

[27] In Brazil, for example, all financial cooperatives are supervised by the Central Bank, which places a heavy burden on the Bank's supervisory capacity.

Box 2.2 Forms of indirect supervision

Auxiliary supervision – In this approach, the government agency in charge of the supervision of the financial system retains responsibility over the supervision of financial cooperatives, but is supported by private agents. The latter may include federations or associations of financial cooperatives or banks. The function of these agents basically covers supervision or on-site inspection. The authority to intervene or sanction a financial cooperative remains with the public agency, and regular reviews of the performance of the private agents are conducted by the said agency. This is the case in Germany and the United States.

Delegated supervision – In this approach, all supervisory functions are carried out by the private agents themselves, and extend all the way to implementing interventions and sanctions. In this case, the public agency's role is limited to the design of the regulatory framework and conducting reviews of the performance of the delegated supervisor. This is the practice in Peru and Costa Rica.

Hybrid supervision – This is an approach applicable to countries where there are variations in the degree of openness and size of cooperative financial institutions operating. This approach combines the criteria of size and openness, in which a few financial cooperatives would be under the direct control of the Central Bank, while the rest (a large number of small financial cooperatives) would be under delegated supervision by the cooperative networks or other third parties. This approach is used in Bolivia, Chile, Colombia, and Ecuador.

Source: Adapted from Cuevas and Fischer (2006).

The effective supervision of SACCOs requires not only clarity in terms of the approach to be used, but also the accountability of parties involved. The United States and Germany have very strong and organised indirect supervisors of the cooperative sector: they are highly trained in the supervision of financial cooperatives, and are subject to periodic inspection by the banking supervisors.[28] There is a clear delineation between supervisory roles and representative roles for these indirect supervisors, which reduces conflicts of interests for the parties involved.

It is meaningful to point out that in countries where supervision of financial cooperatives was deemed to have failed, the experience was not that there were inherent difficulties with the drafting of laws and regulations, nor with the training of staff and development of policies and procedures for the supervisory agency or body. In the experience of the Kyrgyz Republic and Mongolia, for example, laws and regulations have been defined. There was, however, a lack of commitment at the policy level related to a clear framework for regulation and supervision and the implementation of such a framework and/or the enforcement of regulatory requirements. Moreover, these failed experiences also show that sequencing is important. In China, for example, it has been noted that the history of changing responsibilities and conflicting roles of the different parties and agencies involved has contributed to the lack of clear lines of oversight and accumulated losses in its financial cooperative sector.

In summary, the objectives of regulation and supervision need to be clarified, and the intensity of regulation and supervision should be matched to the risks of the activities undertaken by SACCOs.

[28] These are the National Credit Union Administration in the United States and the Regional Federations of Local Cooperatives in Germany.

2.3.2 Laws and regulations directly governing MFIs and SACCOs in Rwanda

The OPM team analysed the legal and regulatory framework for MFIs and SACCOs to evaluate the extent to which this framework follows good practices in SACCO regulation. While the regulatory framework generally supports SACCO development, the team identified a few issues in the *MFI Law* and the *Law on Cooperatives* that could affect the growth and sustainability of the SACCO sector. Table 2.3 lists these issues, along with our recommendations for addressing them.

Table 2.3 Issues identified in the MFI Law and Law on Cooperatives

	Summary	Challenge	Recommendation
MFI Law			
Definitions and Art. 47	The MFI Law defines only'*unions*' and '*confederations*', while the Law on Cooperatives defines '*unions*', '*federations*', <u>and</u> '*confederations*'. Furthermore, Art. 47 of the MFI Law refers to '*unions*', '*federations*' (not '*confederations*'), and unnamed higher financial organs.	Conflicting definitions – both between the MFI Law and the Law on Cooperatives and within the MFI Law itself – may lead to confusion regarding the type and number of tiered institutions that are permitted.	Revise the MFI Law (and the Law on Cooperatives, if necessary) to harmonise terms and ensure clarity.
Art. 21	Requires prior approval by BNR of all directors and officers/managers of an institution.	Prior approval of all changes of management and the Board of Directors is burdensome, both for MFIs and for the BNR. Furthermore, there is an inconsistency between Art. 21 of the MFI Law – which requires prior approval – and Art. 11 of the MFI Regulations, which requires notification within 10 days of a change, along with submission of relevant documents to allow the BNR to ensure that the MFI has conducted proper due diligence. The latter approach is more feasible and less burdensome, yet it would not appear to fully comply with the prior approval requirements of the MFI Law.	Revise Art. 21 of the MFI Law to eliminate reference to prior approval of directors and managers before they can perform any activities. Instead, require notification, as detailed in Art. 11 of the MFI Regulations.

	Summary	Challenge	Recommendation
Art. 24	Prohibition on serving as a director of multiple MFIs or as director of an MFI and of any other enterprise.	There is already a limited pool of potential volunteer board directors, particularly in rural areas. Prohibiting board members from serving as a director of any other enterprise will discourage volunteers.	The conflict of interest concern is already addressed in the MFI Regulations, Art. 37, which provides procedures for recusal and for avoiding influencing decisions in which a director has a conflict of interest. Therefore, the Law can be amended to remove the prohibition on serving as director of another enterprise.
Art. 30	Addresses the circumstances under which Category 2 MFIs may not be able to comply with certain prudential norms.	The text refers to 'prudential norms defined in Articles 29 and 30'. However, it appears that the text is referring to Articles 26 and 27.	Revise text accordingly (for all three languages).
Art. 46	Requires the BNR to approve both the decision of a SACCO to disaffiliate from a union and the decision of a union to remove a SACCO from its union.	There may be good reason to ensure that unions may not unilaterally remove member SACCOs, particularly if Art. 45 is eliminated, thereby ensuring that unions do not bear the financial burden of funding such institutions' operating deficits. However, limiting the ability of a SACCO to disaffiliate from a union would have anti-competitive effects. If a member SACCO is able to meet all prudential requirements without union support or would prefer to affiliate with a different union, it should be permitted to do so.	Revise to limit prior approval to cases where the union decides to remove a SACCO from the union. Note that this should be done in conjunction with the elimination of the Art. 45 requirement to cover member SACCOs' operating deficits.

	Summary	Challenge	Recommendation
MFI Law, Art. 97-98, Law on Cooperatives, Art. 66	Upon liquidation, Art. 97 permits the Central Bank to order that a member of the board of directors or a senior executive repay the SACCO's debts if they are implicated in its bankruptcy. Art. 98 provides for the Central Bank to order the seizure of the personal assets of these directors or senior officers under certain circumstances (such as using the SACCO's assets for personal gain). Furthermore, Art. 66 of the *Law on Cooperatives* allows board members to be held individually or jointly liable for any losses sustained by the SACCO.	Both Art. 97 of the *MFI Law* and Art. 66 of the *Law on Cooperatives* are very general and severe. It would appear that board members (and senior executives, in the case of the *MFI Law*) could be held liable for losses sustained by a SACCO, even in the absence of proof of breach of fiduciary duty or gross negligence. Exposing board members and senior executives to such risk could discourage qualified individuals from working with SACCOs, particularly the weakest institutions that are most in need of such assistance.	Consider revising Art. 97 of the *MFI Law* and Art. 66 of the *Law on Cooperatives* to protect board members and senior executives from liability for actions taken in good faith, and limit personal liability to cases where a breach of fiduciary duty has been established.
Law on Cooperatives			
Art. 10	Prohibits membership in more than one cooperative '*with similar activities operating in the same area*.'	Without further regulatory guidance, it would be difficult in practice to determine whether a cooperative's activities were sufficiently similar and/or within the same overlapping area for the purposes of this article. Furthermore, a broad interpretation of such a provision could limit economic activity by stifling healthy competition.	Consider removing this provision, or issue regulations that clarify how this provision will be interpreted in practice. If the latter approach is chosen, it is recommended that this provision be interpreted narrowly to ensure that such a provision does not negatively affect competition and consumer choice.

2.3.3 Effective supervision of SACCOs

As noted above, for reporting and other regulatory requirements to be effective, SACCOs must have the capacity to meet such requirements. Moreover, the regulator must have sufficient capacity to effectively supervise these institutions. In practice, the hundreds of newly-established Umurenge SACCOs have struggled to comply with reporting requirements under the *MFI Law* and *Regulations*, and the BNR lacks sufficient human resources to effectively supervise all of these institutions, many of which require significant capacity-building assistance.

Reporting requirements

The *MFI Regulations* attempt to address this issue in part by creating different regulatory requirements for Category 2 and Category 3 MFIs. Category 2 MFIs are defined as those institutions with deposits of less than Frw 20 million (approximately US$ 34,000). These MFIs are limited to one point of service, unlike Category 3 MFIs, which may open multiple branches and other points of service.[29] Category 2 MFIs are not required to have their annual financial statements certified by an approved MFI external auditor.[30] Furthermore, Category 2 MFIs are not required to submit data to and obtain data from the credit bureau, nor are they required to maintain credit files on all borrowers.[31]

In addition, the *MFI Regulations* anticipate the possibility that Category 2 MFIs may find it difficult to comply with other reporting requirements applicable to all SACCOs. These reports include the following:[32]

- **Monthly:** Report on financial position; annexes detailing calculation of liquidity ratio, sector risk assessment, overdue loans, loans to staff and directors and connected persons, list of 10 largest debtors and depositors, calculation of solvency ratio, results achieved, and information/statistics on loans and depositors.
- **Quarterly:** Recovery status of doubtful, litigious and contentious assets; list of names of payments in arrears; status of litigious files in legal proceedings.
- **Annual:** Financial statements; internal control report.

If a Category 2 MFI is unable to fully comply with these reporting requirements, it must report to the Central Bank on the reason(s) for non-compliance and describe steps that it will take to come into full compliance.

The team recognises the importance of regular SACCO reporting, and it supports the policy of expecting Category 2 SACCOs to provide detailed reports on their activities. At the same time, many board members of Umurenge SACCOs have limited formal education. Therefore, in order to ensure that the Board of Directors of such SACCOs can effectively oversee the activities of the director and other staff, reporting templates should be simplified to the greatest extent possible.

[29] Regulation No. 02/2009 on the Organisation of Microfinance Activity, Art. 2.

[30] Regulation No. 02/2009 on the Organisation of Microfinance Activity, Art. 29, 33.

[31] Regulation No. 02/2009 on the Organisation of Microfinance Activity, Art. 17-20.

[32] Regulation No. 02/2009 on the Organisation of Microfinance Activity, Art. 33.

Having reviewed the current reporting templates for MFIs, we have noted that most of the reporting templates can be further clarified for individuals with limited formal education, and in some cases simplified, without compromising their legal or practical application. Two examples are provided in Annex C of this report.

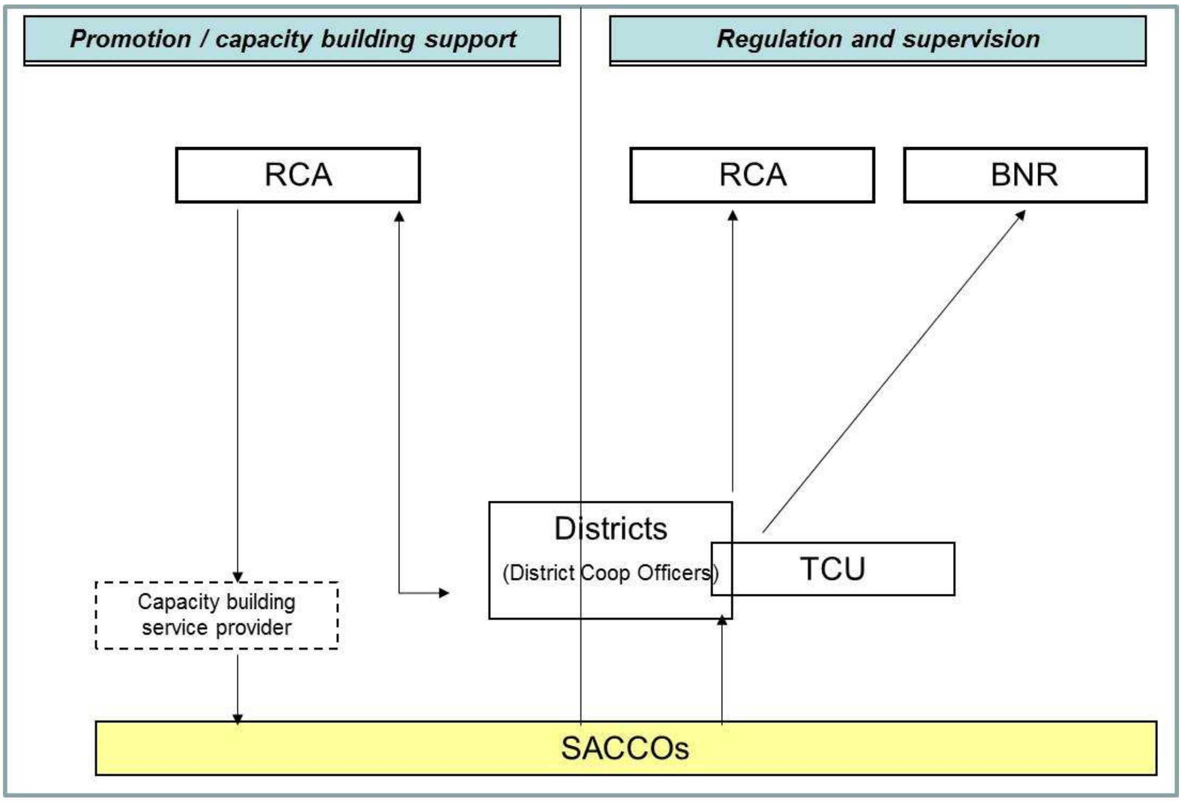
Capacity to enforce laws and regulations

It should also be emphasised that, as the BNR is only starting to build its capacity to supervise all SACCOs (with the recent introduction of TCUs at the districts), we recognise that there are limitations to how effectively the BNR can supervise a large number of SACCOs currently operating in the country. Some SACCOs have already been observed to be in violation of a number of stipulations in the Cooperative Law - e.g. the requirement to hold General Assemblies. While fulfilling the requirements under the Cooperative Law falls under the jurisdiction of the RCA, the BNR – as financial supervisor – will also need to keep track of those institutions unable to meet the requirements specified for cooperatives to operate in the country. SACCOs that fail to meet these requirements in effect cease to be cooperatives, which is a requisite for having been granted licenses to extend financial services as SACCOs.

Clarifying the roles of various stakeholders

There are several actors currently involved in the supervision process, alongside promotion/capacity building, as is depicted on the figure below. These actors include the BNR inspectors/supervision team, the RCA, the district cooperative officers (DCOs) and local government officials (at sector and district level).

Figure 2.1 Actors involved in the supervision and promotion of SACCOs



There is a need to harmonise the approach to supervision – given fragmentation in the approach used for supervising Umurenge and non-Umurenge SACCOs. A more harmonised supervisory structure will need to cover the most appropriate form of supervision (e.g. whether through a form of delegated supervision or otherwise) and the quality of supervision required, given the differences among the SACCOs currently operating in Rwanda and between SACCOs and the unions.

2.3.4 Other important issues in the enabling environment

While a more exhaustive analysis of all potential challenges for SACCOs in the Rwandan business environment is beyond the scope of this assignment, the discussions carried out with key stakeholders revealed a number of important business environment challenges. The following are some issues identified by stakeholders that may be relevant to the long-term sustainability of the SACCO sector.[33]

Registration of collateral is difficult and costly for low-value loans. Currently, collateral registration services are still concentrated in Kigali. Furthermore, collateral must be valued by an independent professional, which costs at least Frw 150,000 (approximately US$ 250). This system is not deemed practical for low-value loans (i.e. Frw 200,000 or less), particularly to clients who reside far from Kigali. AMIR has recommended that collateral registration services be decentralised, that the registrar accept a property valuation that is mutually agreed upon by the client and the MFI (without requiring independent valuation), and that registration fees (currently pegged at Frw 20,000) be waived for low-value loans.

Due to the limited outreach of commercial courts, MFIs often find that it is not cost-effective to pursue defaulting clients in court. There are only three commercial courts of first instance (in Musanze, Nyarugenge, and Huye), and many MFIs and their clients reside far from these courts. AMIR has also recommended increasing access to commercial courts nationwide. Furthermore, they recommend that the Law on Mediation Committees be revised to permit such committees to accept cases with values of up to Frw 1 million (approximately US$ 1,700), which would allow the vast majority of MFI loan disputes to be settled outside of the commercial courts.

AMIR has noted that interest earned on deposits is subject to a 15% tax, which AMIR believes discourages formal saving and encourages low-income families to continue to save informally. While the extent to which this is true in practice is unclear, the government could take steps to actively encourage low-income Rwandans to develop a culture of saving in formal financial institutions. For example, the government could subsidise savings rather than credit, as there is strong evidence from other countries that channelling subsidised credit through SACCOs leads to a weaker sense of community ownership, increases dependency, and is ultimately a key cause of SACCO failure.[34] In contrast, well-run matched savings programmes encourage low-income individuals to save by offering to match each unit of savings with 1-3 units from governments and non-profit institutions.[35] A recent study in

[33] Correspondence with Rita Ngarambe, Executive Secretary, Association of Microfinance Institutions in Rwanda.

[34] As Westley and Branch have noted, there is now a consensus that "*donors and governments, which propped up so many of these credit unions with subsidized, targeted credit programs, also played a major role in diverting credit unions away from the path of becoming efficient, sustainable intermediaries*." See Westley and Branch, eds. (2000).

[35] In other words, an individual who saved Frw 1,000 could receive a matching grant of Frw 1,000-3,000, thereby increasing his/her total savings to Frw 2,000-4,000.

the state of Massachusetts in the United States showed that low-income participants in matched savings programmes saved an average of 10% of their total monthly income, well above the national savings rate of 6%.[36]

2.3.5 Overarching issues

There is a need to move beyond a 'crisis management' mode and into a more strategic policy approach to develop the SACCO sector in Rwanda. This is relevant not just in terms of the design of the supervisory framework, but also in terms of other policy measures that provide the incentives / disincentives for institutions to perform – such as, for example, policies with regard to the extension of wholesale loans to SACCOs and other financial institutions by government entities. This also includes addressing important strategic questions such as the distribution of Umurenge SACCOs across the sectors: are SACCOs needed in all sectors and can enough business be generated in (all) sectors to allow the sustainability of individual SACCOs?

In developing the strategy and roadmap, it will be important to consider the current state of development of the SACCO sector in the country versus other traditional approaches used to develop SACCO sectors. Some of these approaches are described in greater detail in the section that follows.

[36] See Drew (2011), p.4.

3 Analysis of approaches used to develop a sustainable SACCO sector

In this section we discuss the three key approaches that can be applied in Rwanda. These approaches are not mutually exclusive and the roadmap for developing the SACCO sector may indeed (especially in the long term) include combinations of various approaches or incorporate a mixture of some of their elements.

3.1 Establishing a cooperative bank

3.1.1 Lessons learned from the experience of other countries

Europe serves as the cradle of cooperative banking, with the first cooperative banks having been set up in Germany in the nineteenth century. This model has since spread to many other European countries and can also be found in Japan and Canada.

While cooperative banks across countries may have different structures, they do share some common features, such as maintaining ownership and democratic control by members. One of the purposes of cooperative banks is to encourage the ownership of capital among a large number of shareholders (who could be individuals or institutions), which means that members are involved in the decision-making process.

Unlike credit unions, however, cooperative banks are often regulated under both banking and cooperative legislation. Moreover, unlike credit unions (especially larger credit unions or tightly integrated federations that also have bank-like characteristics), cooperative banks provide services such as savings and loans to non-members as well as to members. Some cooperative banks even participate in the wholesale markets for bonds, money and equities, and a number of them are even traded on public stock markets. This means that cooperative banks are partly owned by non-members.

Cooperative banks also tend to be more integrated than credit union federations. Local branches of cooperative banks may elect their own boards of directors and manage their own operations, but most strategic decisions will still require approval from a central office. This is in contrast to federations where strategic decision making is often retained at a local level or by the member institutions, and federation members will only share back-office functions and other services provided by the network.

Compared to commercial banks, cooperative banks tend to enjoy greater proximity or a sense of closeness to members and customers, especially in the case of some cooperative banks that traditionally maintain strong banking relationships with small and medium-sized enterprises (SMEs). Many cooperative banks also tend to be more highly capitalised than commercial banks. This is considered an asset but also a necessity, given that cooperatives are typically unable to raise funds on the capital markets as easily as commercial banks. For cooperative banks to grow, other financial instruments to attract capital are needed – including, for example, the use of membership certificates and securities.

The strongest criticism of the cooperative bank model is the dilution of ownership by outside stakes, which render the institution as only semi-cooperative.

- As cooperative banks raise outside capital, this creates a second class of shareholders who compete with the members for control of the institution. In some circumstances, the members may lose control, which can mean that the bank ceases to be a cooperative. Accepting deposits from non-members may also lead to a dilution of control by members.

- Furthermore, decision making in cooperative banks also tends to take longer than in other banks, which can further create tensions between members and non-members. The bottom-up governance and the capital restrictions of cooperative banks could also mean that they these institutions face certain limitations in expanding and growing the business.

3.1.2 Application of the cooperative bank model in Rwanda

The experience of Banque Populaire du Rwanda (BPR) is important to consider in discussing the application of the cooperative bank model in Rwanda. Although BPR is a licensed commercial bank (and not, strictly speaking, a cooperative bank), it does have cooperative bank-like qualities and is rooted in the cooperative movement in Rwanda. It started in 1986 as the Union des Banques Populaires du Rwanda (UBPR), an alliance of cooperative financial institutions operating in the county. It was later transformed into a commercial bank. The majority of shares (65%) in the bank are still currently held by the members of Rwandan financial cooperatives that constituted the old UBPR.[37] On the other hand, a minority stake in the bank is owned by the Dutch cooperative bank, Rabobank (35%).

The transformation of BPR, and particularly the participation of outside owners, has helped address fundamental problems and challenges the institution faced. New products and services are being offered to members and the public at large. However, the experience of BPR in this transformation process (especially in the last three years) illustrates the tension between members and non-members described earlier. While BPR still continues to maintain its position as the financial institution with the widest outreach in the country – covering an estimated 1.3 million clients in Rwanda (as of the end of 2010)[38] – it will nonetheless be meaningful to explore whether the institution's transformation has likewise brought about any shift in the institution's mission and target-market orientation over time.[39]

It is not the intention of this report to suggest that such changes are likely to occur or that BPR's transformation has had a negative impact. The intention is merely to point out that such a tension between member and non-member owners might exist in cooperative banks and that these tensions could mean that a cooperative bank model might not be the appropriate model to reach rural areas and poorer target groups.[40]

[37] BPR currently has a total of 617,332 shareholders.

[38] See BPR Annual Report 2010.

[39] For example, it will be meaningful to look into whether the transformation has resulted in the closure of some bank branches (especially in more rural areas) or an increase in the average savings balance held by customers (which could mean that the institution is starting to reach a better-off clientele).

[40] It is interesting to note that BPR has established the Shareholders' Affairs Department, which is tasked to look after the relationship with over 600,000 shareholders and to maintain close bonds with all stakeholders through their representative bodies (i.e. the Advisory Committees and the Advisory Boards). BPR's management has expressed its commitment to improve the two-way communication between shareholders' committees and the management/board of BPR.

While the cooperative bank approach does indeed present certain advantages – especially in terms of the likely lighter burden on supervision, when compared to the other options – there are other more significant factors that needed to be considered:

- Establishing a cooperative bank will require considerable time to develop (i.e. much more time than what would be required with other approaches). This includes the time required to (a) draft any amendments in the legal and regulatory framework that would allow for the establishment of a cooperative bank or any other special tier of banks; (b) identify and seek the participation of other (private) shareholders to meet capital requirements for the cooperative bank; (c) undertake negotiations with interested parties / investors; not to mention the time required to (d) consolidate the interest among hundreds of SACCOs that will agree to form part of / establish the cooperative bank.
- Establishing a cooperative bank will be costly (and indeed more costly than the other options), which is also why participation of other private shareholders will be required. Significant investments will be required in order to bring participating SACCOs up to speed (e.g. in terms of basic branch operations, MIS, accounting systems, human resources, etc.). The amount of resources required (and indeed the time required) to make such changes will be significant, especially if what are targeted are Umurenge SACCOs – which are still at a very nascent stage of development.
- There are a number risks to consider – above all, the tendency to render the institution as only semi-cooperative, given dilution of ownership by outside stakes.
  - As cooperative banks raise outside capital, this creates a second class of shareholders who compete with the members for control of the institution. Accepting deposits from non-members may also lead to a dilution of control by members.
  - Cooperative banks also tend to be more integrated than federations of cooperatives.
  - Furthermore, decision making in cooperative banks also tends to take longer than in other banks, which can further create tensions between members and non-members. The bottom-up governance and the capital restrictions of cooperative banks could also mean that these institutions face certain limitations in expanding and growing the business.

This last point is emphasized, given its implications on access to finance especially in rural areas. The important question that underlies the argument presented above is: will the cooperative bank approach be the suitable model (at present) to ensure broader and deeper reach of financial services? More specifically, will a semi-cooperative institution (i.e. with outside / non-member shareholders) indeed be able to provide services to areas that are currently not being reached by other banks and financial institutions – and which SACCOs may have certain comparative advantages in reaching and therefore be able to provide services to?

While our analysis underscores that the cooperative bank approach may not be the most suitable option to consider for developing the SACCO sector in Rwanda given its present condition, there may be scope to consider this option at a later stage – i.e. as SACCOs and the sector as a whole evolves and develops.

Table 3.1 below provides details on the factors to be considered when assessing the application of the cooperative bank model in the case of Rwanda.

Table 3.1 Establishing a cooperative bank: Factors to consider

Description	• Membership may consist of individual SACCOs, and/or SACCO unions – forming a cooperative bank will require a sizeable pool of strong SACCOs and/or SACCO unions (to raise the necessary capital and scale up operations to meet the necessary regulations); • Participation of other (private) shareholders to meet capital requirements will be necessary.
Supervisory structure	• Among all the approaches (presented in this report), this is the model that will have the least burden on the BNR, as it will only need to supervise the cooperative bank. • However, if the other larger SACCOs and/or unions are permitted to exist outside the cooperative bank (in other words, if several models exist alongside each other), then the BNR will also supervise those institutions that are not part of the cooperative bank.
Main cost drivers	• Capacity building – for members and boards of SACCOs that will form the cooperative bank; • Significant investments required in order to bring participating SACCOs up to speed (e.g. in terms of branch operations, Management Information Systems (MIS), accounting systems, human resources, etc.).
Drivers of revenue	• Once established, the cooperative bank will be able to develop and offer a variety of products and services that would enable it to generate revenue. If it continues to focus on the low-income market segment, revenue may be driven by the provision of transfer / payment services, micro-loan products, etc.
Key risks	• Could present significant challenges in terms of balancing the interests of SACCO-member-owners and other (private) owners, especially given that the vast majority of SACCOs currently operating in the country are still at a very nascent stage of development; • A shift in the mission and target-market orientation may occur over time, given the commercial interests of other owners.
Main benefits (versus other options)	• Will reduce supervision requirements to a small number of entities (which could be just a singular cooperative bank or the cooperative bank as well as other institutions that might opt and be permitted to exist outside the cooperative bank); • Could facilitate professionalisation and formalising of the operations of SACCOs – but will require a considerable amount of resources /investments and time.

3.2 Promoting consolidation and the formation of networks of SACCOs

3.2.1 Types of networks and services provided to member-SACCOs

The networking of financial cooperatives was first successfully executed by the Raiffeisen credit unions of Germany in the 1880s. Since then it has been achieved or attempted in hundreds of settings and with many variations worldwide. Both the credit unions of modern America and the cooperative banks of modern Europe emerged out of this process. The fundamental principles of good practice in network-building among financial cooperatives are well established; and while there have been many failures, most of these can be attributed to a fairly clear deviation from these fundamental principles. The key principles of good networking are summarised in Box 3.1.

Box 3.1 Founding principles of good networking

1. SACCOs are full financial intermediaries that must effectively serve both small borrowers and small savers. Large or subsidised external borrowings impair the quality of savings products and the demand for them.

2. SACCOs are a wholesale marketplace. Networks must provide services demanded in that marketplace at an acceptable quality and price. Failure to do so will lead to bankruptcy or loss of competitive position.

3. As with any other marketplace, the buyer (the SACCO) should have a choice of different vendors related to any specific service.

4. Networking must be initiated and financed by SACCOs themselves. Networks that are externally financed usually fail, and SACCOs that are externally financed usually fail in efforts to network.

5. There is no best practice in service mix or institutional structure for a wholesale network. The array of services offered and the institutional structure should, however, respond to market demand.

Networking is a mechanism in which SACCOs link together to secure goods and services at a lower price and higher quality than they could secure on a stand-alone basis. Networking also provides an incentive for SACCOs to standardise their operations and submit to more rigorous external supervision, in order to access services available to network members. This is because greater buying power, combined with greater standardisation, creates opportunities to access many products and services that are in demand from their members, and that would not be available to stand-alone SACCOs.

For example, a network may procure specialised information management software, mobile phone applications, access to the national automated teller machine (ATM) system, various types of insurance, card-based payment systems and funds transfer services for its members. Once its wholesale business achieves a level of scale and standardisation, a network can usually negotiate a connection with the rest of the formal banking system – in particular, the national funds clearing and payments system and the national credit bureau.

Networking between SACCOs can be informal and/or formal:

- **Informal networking:** Networking may simply involve one SACCO lending to another, or an accountant in one SACCO helping an accountant in another to understand the process of book-keeping. Informal networking is common both in the early stages of SACCO sector development (before federations or unions become fully established), and in the latter stages, as an alternative source of supply. Such forms of informal networking should not be discouraged. In addition to other benefits, they provide clear market signals to networks about areas where they need to improve. It also acts as a check against network monopoly.

- **Formal networking:** This involves the systematic exploitation of scale (given a large base of members or assets) in a SACCO sector, to deliver services at a lower cost and higher quality than would be possible under less formalised conditions. Several networking mechanisms are possible – e.g. establishing federations, companies, educational institutes (for training), etc. Different types of networks may offer a different menu of services; but most mature networks provide a range of services. These are described in more detail in Table 3.2 below. These services may be offered by multiple networking institutions, or by a single cooperatively-owned company (i.e. a union or a federation).

Table 3.2 Common services provided by networks, by stage of network development

Stage of development	Type of service	Common delivery agent
Primary (focus is on meeting wholesale demand, especially for services that help to build member trust)	Stationary, account books, safes, software and other operational supplies	Simple federation or specialised company
	Technical training (directors, managers, credit officers, accountants etc.)	Federation or specialised educational institution
	Basic external auditing	Simple federation or specialised firm
	External resolution of internal or local disputes	Simple federation
	Credit life and basic life insurance	Simple federation or specialised company
	Help people start new SACCOs	University extension service or NGO
	Shaping of national reporting and prudential standards	Simple federation and supervisor
Mezzanine (focus is on expanding and deepening the wholesale market, especially for services that maintain or increase member trust)	Liquidity management services	Federation
	Access to national clearing system	Federation
	National payment services	Federation or mobile banking company
	Participation in national credit bureau	Federation
	Life, home, auto etc. insurance	Federation or specialised company
	Loan syndication	Informal networking, federation or specialised company
	System-wide research and development	Federation
	Specialised products (e.g. mutual funds, sharia-compliant loans etc. etc.)	Federation
	Market intelligence and sector-wide data aggregation	Federation
	Information management software development	Specialised software firm
	Human resource development	Federation or specialised educational institution
	Mobile banking applications	Specialised firm
	External auditing	Specialised auditing firm
	Stabilisation fund (targeting zero losses of savings, even when SACCOs fail)	Federation or supervisor
	External borrowing	Central finance facility, usually housed in a federation

Stage of development	Type of service	Common delivery agent
	Insurance (credit life, health, life etc.)	Cooperatively owned company, often specialised
	Government relations	Federation
Advanced (in systems with financial inclusion; focus is on enhancing competitive positioning)	Deposit insurance	Government initiative, or cooperatively financed agency
	Shared branching	Network of self-selected SACCOs
	Co-branding	Network of self-selected SACCOs
	Government relations	Federation

A useful example is the case of SIFFE in Guatemala, which is a group of strong credit unions within a national federation (FENECOAC) that share a common suite of financial products and provide services to retail members of the entire SIFFE system across the country. SIFFE member-credit unions notify FENACOAC of retail transactions at their branches that are carried out by members of other credit unions. FENACOAC then facilitates clearing of transactions (by same-day debiting of the account of one member in favour of the other). SIFFE members also participate in a reserve pool. As part of their networking agreement, they keep 20% of deposits in liquid cash at all times, with at least 10% at FENACOAC. This ensures protection for both normal and unusual levels of demand for immediate withdrawals by members.

Any credit union in Guatemala can join SIFFE, so long as it is prepared to comply with the federation's operational policies, financial disciplines and performance standards. Compliance is monitored by FENACOAC regularly and rigorously, with qualifying credit unions displaying the SIFFE logo (on their buildings, etc.) as part of their public identity and branding. SIFFE credit unions must, however, be FENACOAC members. They receive preferential interest rates on deposits and loans from FENACOAC's central liquidity fund, and technical and financial support for computerisation of their operations and for high potential branching initiatives.

Cooperatively-owned networks, if well managed, have a strong competitive advantage in the wholesale marketplace because, in the absence of outside shareholders, they can be trusted by SACCOs to always put the needs of the SACCO system first (if the SACCOs fail, the networks fail too). However, this competitive advantage is often undermined by poorly functioning management teams whose complacency is often driven by the knowledge that their market position is protected by legislation. Thus, even if there is a requirement for the service provider to be cooperatively-owned, SACCOs should still be able to exercise the freedom to access services outside their respective cooperative network if they chose to.

The negative impact of external borrowing

As has already been pointed out in earlier sections of this report, external borrowing by SACCOs and by SACCO networks has been a major source of many failures that have taken place in the history of financial cooperatives. The underlying reasons explaining why external borrowing is common in early-stage systems, even when SACCO leaders and other key stakeholders are fully aware of the risks, are provided in Table 3.3.

Table 3.3 Sources of excess leverage risk

Source of risk	Description
Demand for credit is **very visible** and concentrated among educated, elite individuals.	In rural communities where most people save at home, demand for savings may seem invisible and often significantly underestimated.[41]
Demand for savings may seem **almost invisible**	Small savers may not declare their requirement for savings facilities (compared to, for example, loans) – especially in situations where low-income populations may have received messages about 'how much people need credit to escape poverty'. However, any household that successfully addresses periodic expenses (weddings, schooling, health care, consumer goods, business equipment, working capital, etc.) saves. And losses from saving at home can be a major drain on the rural economy.[42]
Sound management of savings is technically more complex and **requires more local commitment** than credit management.	Sound savings management requires commitment to a systematic process of building and maintaining trust among the local population over an indefinite period of time. This implies a sustained commitment to completing and maintaining current record-keeping, regular internal supervision, speedy and effective dispute resolution, careful cost management and diligent attention to the quality of loan portfolios.
Initial expectations lead to "**elite capture**" followed by institutional failure.	When SACCOs are formed, there is often an expectation that their main role is to provide credit, which results in people who need large loans taking control (either directly or through their proxies) and borrowing. Once one or two large loans are clearly not being repaid, smaller borrowers stop repaying and voluntary savings stop.

In the history of many SACCO sectors, unions or national federations of credit unions have emerged, which functioned primarily as a channel for the delivery of external funds to SACCO-members. This is, for example, also illustrated in the experience of FENACOAC in Guatemala.[43] The experience in Guatemala, as well as in other countries where unions have been exposed to external borrowing, shows that dependency on external borrowing had several costs:

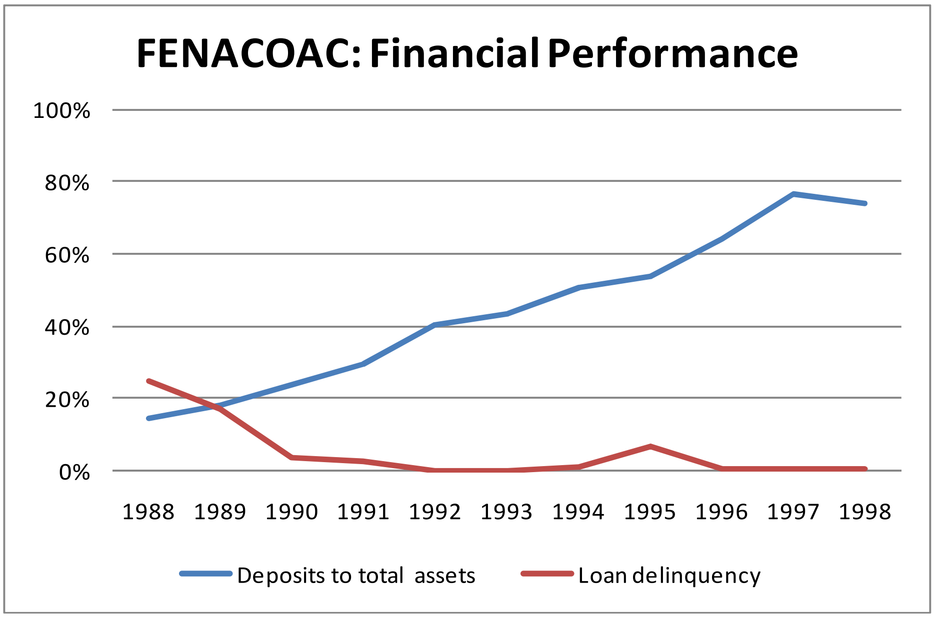
- The needs of poor savers were ignored, as the rising tide of external credit reinforced traditional wisdom that savings are best kept at home.
- Many people, including senior local leaders and credit unions leaders, viewed the money as funds owed to them. A culture of non-repayment therefore ensued, impairing the development of financial markets. Credit union leaders viewed their members as beneficiaries in need of external help, not as owners whose support they depended on for their offices.

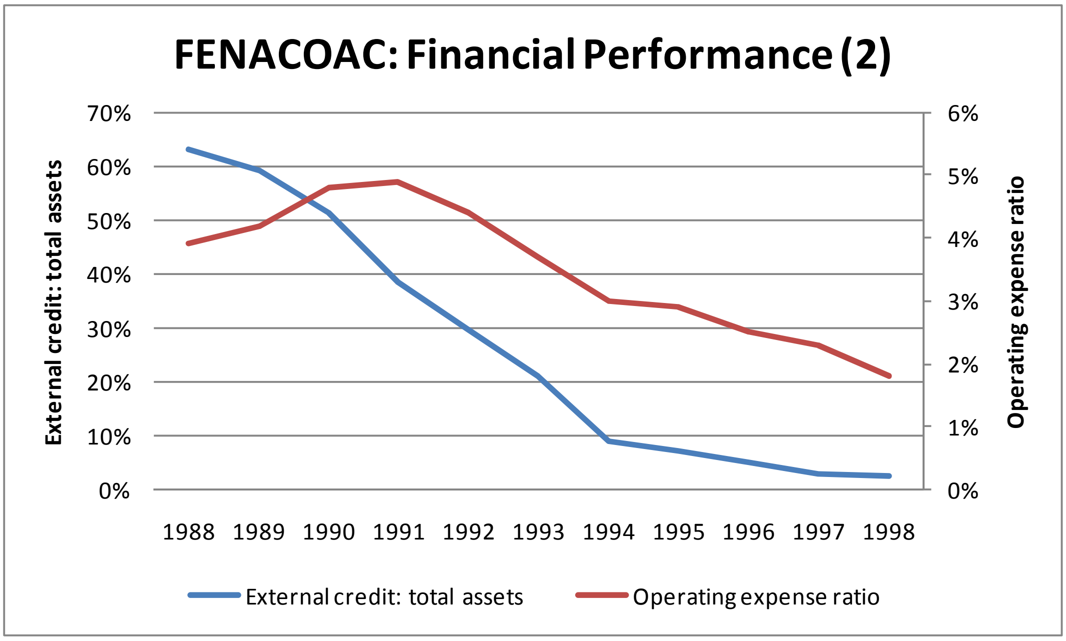
[41] For example, a major World Bank study of Grameen Bank borrowers found that borrowers relied for two-thirds of their business expenses on savings (rather than credit) (Khandker, 1998) – i.e. the existence and continuation of these businesses depended more on savings than on loans.

[42] In Uganda, for example, such losses are estimated to be equivalent to 25% of savings (Wright, 2000).

[43] See Cifuentes (2000), pp. 239-49.

Figure 3.1 Transformation of FENOCOAC





Rectifying such a situation can be costly and can take a long period of time. In Guatemala, for example, FENOCOAC, with technical support from WOCCU, had to implement an aggressive savings mobilisation campaign that enabled the transformation of credit unions' traditional dependence on FENACOAC, so that they can attain financial autonomy. This involved shifting the emphasis of staff and capacity-building towards focused financial specialisation and taking practical measures to achieve greater credit union integration. This had to take place without sacrificing the fundamental cooperative character of the system, so that the drive to achieve financial depth would not be lost in the drive towards efficiency and high performance. The figure above depicts the evolution of such a process, which spanned ten years.

The focus on savings meets a critical financial need among poorer populations; this also requires a strong emphasis on professionalisation of control systems, financial reporting, and governance. Weak institutions typically fail to realise the potential for savings among existing or new members, while strongly performing ones are able to expand steadily and could even begin opening branch offices in neighbouring communities.[44]

3.2.2 Application of a networking model in Rwanda's SACCO sector

The present situation of the SACCO sector in Rwanda favours an effective networking strategy for the following reasons:

- The relatively high density of population in most areas provides the potential for local markets for SACCOs. Many of the SACCOs, including the newly established Umurenge SACCOs, already have thousands of members, which imply that there is potential capacity to achieve adequate economies of scale to serve local markets (at the SACCO and network levels).
- There are a number of 'SACCO assets' at district level that can be tapped to facilitate or encourage consolidation of the sector. These include, for example, the existence of TCUs at district level.

There are, however, at the same time, a number of risks that also have the potential to work against this approach – and therefore need to be mitigated. These include the following:

- While some capacity-building assistance has already been provided to some SACCO leaders and managers in the past year, there is still a need to further develop the human (skills) capacity in many areas of the country – especially in terms of strengthening leadership and (financial) management capacities, founded on solid understanding of the principles of cooperative financial institutions and good practice in expanding access to financial services.
- There appears to be a strong credit-oriented culture among many SACCOs and among local authorities in rural areas, which works against effective savings mobilisation – and by extension, against accountable member-based (decentralised) governance systems. This goes hand in hand with the hidden nature of the demand for savings (i.e. the habit of saving at home), which leads to a more gradual consolidation of local governance.
- The risk of elite capture (which could accompany the process of consolidation and network-building) can be mitigated through cooperative membership education ensuring the alignment of incentives of stakeholders involved in the promotion of SACCOs and network-building in the sector.

[44] In Guatemala, for example, the stronger credit unions faced increasing demand for access to their funds from members who were traveling and trading around the country. Moreover, surplus liquidity began to build up in stronger credit unions and in FENACOAC`s central liquidity pool, while the demand for external loans from FENACOAC dropped steadily. FENACOAC responded to the demand for funds by negotiating a rigorous set of financial standards for the strongest credit unions in their network. They conducted market studies to identify areas where new branches would break even quickly and perform well. Furthermore, they provided loans to institutions that were performing well in order to expand their branch networks into targeted areas. The modernisation of operational procedures and elimination of most subsidised services in FENACOAC led to a drop in operating costs from 4.9% in 1988 to 1.8% in 1998.

Table 3.4 below summarises the factors to be considered when assessing the application of this option in the case of Rwanda.

Table 3.4 Promoting networks of SACCOs in Rwanda: Factors to consider

Description	• To facilitate formation of unions (and, eventually, a national federation), activities will be likely to include: - Supporting capacity building for two to three specialised private audit companies, that will analyse and grade the performance of SACCOs (especially Umurenge SACCOs); - Supporting capacity building for existing unions to enable greater membership coverage (where appropriate), and provision of services that can be offered to member SACCOs; • Poorly performing (Umurenge) SACCOs can be merged with others, or be transformed into branches or agents of other SACCOs or linked to other financial institutions.
Supervisory structure	• Supervision by the BNR will be focused on the network-level entities (i.e. the unions and national federation), and a smaller number of larger SACCOs (that may opt not be members of unions); • Unions will be delegated authority to supervise individual member-SACCOs.
Main cost drivers	• Capacity building – for audit companies, for the unions/federation, for the SACCOs; • Rating of institutions (technical assistance); • Some start-up costs for the unions (e.g. management/accounting systems, etc.)
Drivers of revenue	• Membership fees (annual) from member-SACCOs; • As the unions mature, they may offer other services to their members, which would allow them to generate additional revenues.
Key risks	• Pressures / temptation to undertake external lending; • Some SACCOs may fail even before governance is consolidated; • Resistance by leaders of some SACCOs to participate in networks; • Balancing building networks versus the need to build strong SACCOs who will own and manage the networks.
Main benefits (versus other options)	• If successful, this option has the potential to: - achieve deepest financial inclusion, in both scale and scope; - effectively tap a new wholesale marketplace; - effectively develop emerging leadership capacity in the Umurenge SACCOs; - reduce governance risks especially among Umurenge SACCOs; and - reduce supervision requirements to a small number of network level entities.

3.3 Establishing linkages with banks

3.3.1 Rationale for establishing linkages between financial institutions

While informal and semi-formal financial service providers have certain comparative advantages in providing services to low-income and/or rural-based clients, there is still a large proportion of the demand for financial services that is left unmet, given the limitations in the scale and scope of operations of these types of providers. Not only are they unable to provide services to a growing number of clients, given the limitations in their available funds, but these providers are also often limited in their capacity to provide the full range of products their clients need.

In many countries, partnerships between formal financial institutions and informal or semi-formal financial service providers have been tried and tested – and many of them show very positive results.[45] Nevertheless, it is important to note that there are significant costs associated with establishing these linkages and making them work.

- For a linkage scheme to be successful, strong institutions are required. On the part of the informal / semi-formal providers, this means having the commitment and track record in sustainably providing financial services to low-income clients. In many cases, these institutions are characterised by their long-term presence in (informal/semi-formal) financial markets, some of them even considered as indigenous and strongly linked to the way informal markets are organised and operate for centuries.
- To be able to link these providers with formal institutions like banks requires a common business platform. How can the practices in more informal financing relationships or less sophisticated financial institutions be reconciled with the practices of institutions that operate in the formal sector?

It is important to note that in many of the successful partnerships, institutions have had to bear a part of the transaction cost in order to make the partnership work: both parties need to be able to find a common ground and ensure the alignment of their social and business interests and objectives.

3.3.2 Partnerships between SACCOs and other financial institutions

It is useful to highlight the experience of CRDB Bank in Tanzania and its partnership with some SACCOs in the country.[46] There are important lessons that can be drawn from this experience, which would be useful to consider in Rwanda.

In the 1990s, CRDB Bank embarked on a transformation process, with technical and financial support from Danida, which owned a stake in the bank. Following the initial set of reforms undertaken by the bank, CRDB realised that the institutional restructuring it implemented somehow alienated many Tanzanians from the bank's services. As CRDB recognised that it would be too costly for the bank to directly provide services to the lower-end of the market, it explored an alternative model of linkage-banking based on the following assumptions (Piprek, 2007):

- There was a considerable number of community-based financial institutions operating in the country (i.e. SACCOs);
- There was a large demand for financial services in rural areas and community-based institutions appeared to be well placed to meet this demand on a self-sustaining basis if they had the necessary capacity and access to capital; and
- Improved outreach could be facilitated by establishing a network (between the bank and other partner institutions).

[45] See Stone and Carpio (2010).

[46] See Piprek (2007) and OPM (2009) for a more extensive discussion of the experience of linkage banking between CRDB Bank and SACCOs in Tanzania.

The first linkages were formalised in 2001 in four pilot regions. The implementation was carefully planned, and the process was not without its challenges. The experience entailed a lengthy process of negotiations with various stakeholders. Identifying and selecting partner-SACCOs was difficult especially since many, if not all, of the SACCOs did not maintain adequate records. Thus, the criteria for selecting partner-SACCOs also focused on the following:

- The SACCO leaders/management's commitment to learning;
- The SACCO leaders/management's commitment to making time available (for training, etc.);
- The SACCO's willingness to provide CRDB with required information;
- The SACCO's experience with/prevalence of fraud; and
- The management situation in the SACCO (especially whether leaders / managers were demonstrating interest and willingness to resolve issues and address problems).

The entire experience involved a process of building relationships with the SACCOs over time and establishing mutually negotiated agreements, rather than a quick assessment of SACCOs' historical performance. The partnerships with the SACCOs entailed providing assistance in terms of:

- Management and governance structure;
- Systems and reporting, including assistance in the procurement of office equipment; and
- Human resource training.

Over time, some of the SACCOs participated in an on-lending facility offered by CRDB Bank, which is backed by a guarantee provided by Danida and by the deposits the SACCOs have to place with the bank.

CRDB prides itself on having had an overall successful experience reaching unbanked populations indirectly through its partnerships with SACCOs. This linkage scheme is considered an important contribution to overall market development, as the capacity of an increasing number of institutions (SACCOs) has been developed and strengthened through partnerships with CRDB Bank. But CRDB is aware that these operations rested on having adequate human and financial resources and knowledge of the sector.

Addressing the gap in terms of the SACCOs' institutional capacity required a considerable amount of resources on the part of CRDB. In order to ensure that there would be an increasing number of better performing SACCOs, the use of a subsidy was justified: Danida's contribution (especially in terms of helping to finance the training and support extended to SACCOs by CRDB), as well as the contribution of other development partners like the Financial Sector Deepening Trust-Tanzania, meant that it has facilitated an undertaking that would not have otherwise been possible to pursue by a purely commercial organisation.

Given that the approach requires an upfront investment that is considerable in size, it is difficult to imagine the replicability of such a model on a commercial basis (i.e. solely undertaken by other (private) financial service providers). Moreover, building institutional capacity does not only require financial resources but also entails a longer-term view as results take time to materialise.[47] While some commercial banks with relationships with other donors may have the means to pursue similar business models, it will be important for them to bear in mind that this approach requires them not to be governed by the desire to reap immediate benefits.

3.3.3 Application of a linkage-banking scheme in Rwanda's SACCO sector

There are some linkage-banking schemes involving the SACCO sector in Rwanda that are slowly developing. These are, however, still at a very early stage. As already noted in earlier sections of this report, Ecobank and KCB are two of the banks exploring partnerships with some SACCOs. At the moment, however, there are indications that the relationship seems to be limited to opportunities for the banks to tap the savings and shares (mobilised by the SACCOs) and to cross-sell some of the services they provide (e.g. money-transfer and cash-collection services). On the other hand, these banks have indicated that in the medium to long term, they envisage that the relationship between them and the SACCOs may evolve to include making ATMs available in SACCO branches upon request, providing training to SACCO staff, appointing SACCOs to act as Western Union agents for the bank, and providing on-lending facilities to SACCOs.

As the use of agents and technological applications in banking become more developed in Rwanda in the coming years, there will be greater scope to encourage banks and other financial institutions to consider establishing mutually-beneficial partnerships with SACCOs. However, the main hurdle will be investing in the capacity building of SACCOs: this requires not only considerable financial resources, but also a longer-term commitment on the part of banks.

At the moment, most, if not all SACCOs (and especially the Umurenge SACCOs) maintain current accounts at BPR, where the savings and shares mobilised by the SACCOs are kept. All of the SACCOs interviewed in this study have reported that they receive no interest on their BPR accounts. Both Ecobank and KCB recognise that providing SACCOs with interest-earning accounts is something they would consider for partner-SACCOs. They do, however, point out that given the nature of savings mobilised, especially by Umurenge SACCOs that are rural-based, it will be challenging to offer an interest-earning deposit product to these SACCOs.[48]

Table 3.5 below provides details on the factors to be considered when assessing the application of the linkage-banking option in the case of Rwanda.

[47] CRDB, for example, notes that it has taken them as much as three years to train some SACCOs before any considerable degree of confidence is built between them and these partner-institutions.

[48] Savings balances among Umurenge SACCOs typically fluctuates heavily over a 12-month horizon, which is a reflection of the cash balances held by most households in rural areas and who belong to the low-income market segment.

Table 3.5 Establishing linkages with banks: Factors to consider

Description	• Will require investments in building the capacity of partner-SACCOs; • Linkage-banking can be encouraged alongside other approaches – e.g. some SACCOs who participate in linkage-banking schemes may or may not belong to SACCO unions and networks; • Relationships between banks and SACCOs could evolve (in the long term) in such a way that some SACCOs may end up becoming a branch of the bank (i.e. if the SACCO members determine that it is in their/community's interest to undertake such a transformation); • Some SACCOs may also become 'agents' of the bank (although the regulations on the use of agents in Rwanda will still need to be developed/further clarified).
Supervisory structure	• The burden of supervision by the BNR will not be affected if a linkage-banking scheme is implemented - i.e. supervision will still be focused on the networks / unions (should they exist) and other individual operators.
Main cost drivers	• Capacity building – for the participating SACCOs, as well as for the participating banks; • Technical assistance: in terms of developing products (including payments interface between the institutions), developing criteria for selecting partner-institutions; • Some start-up costs for the participating SACCOs (e.g. management/accounting systems, equipment, etc.)
Drivers of revenue	• Both banks and participating SACCOs can derive revenues from linkage banking arrangements: - For banks, revenue can be driven by fees and charges in providing of cash management services to SACCOs, and those associated with the other products / services that may be offered wholesale (to the SACCO) or on a retail basis (to members of partner-SACCOs) - For SACCOs, revenue can be driven by agent fees (charged to the partner-bank) and interest earned on deposits.
Key risks	• Banks might be tempted to offer external lending to SACCOs, which would undermine the nature of SACCOs as savings-driven institutions, especially if banks are unable to perform adequate appraisals of SACCOs (as institutional borrowers) and if external credit is provided before capacity is adequately built in the SACCO; • Monopoly risks (that are disadvantageous to SACCOs): if there are banks that decide to make the necessary investment to build a network of SACCO partners, this could lead to exclusive agreements between some SACCOs and some banks; • Public's perception of risk in SACCOs participating in the linkage scheme should be safeguarded: a SACCO's participation in a linkage scheme does not mean that its deposits are guaranteed by the partner bank.
Main benefits (versus other options)	• If successful, a linkage-banking option has the potential to: - provide the platform for a more integrated financial market; - enable learning between the banks and SACCOs; - provide a platform for developing leadership/managerial capacity (especially in Umurenge SACCOs).

4 Structuring the recommended option

Given the foregoing analysis of the advantages and disadvantages of various approaches used to develop SACCO sectors, it is the recommendation of this study to undertake consolidation of the sector (through mergers and formation of networks) This recommendation is grounded upon our analysis of what can and needs to be done to respond to the most pressing issues confronting the SACCO sector and facilitate it to develop and become sustainable. This approach is also viewed as the approach that will help to facilitate greater financial inclusion in the long term.

The consolidation of the sector will, however, not only be a matter of merging institutions and requiring the formation of Unions among SACCOs. In order to successfully arrive at a structure that functions well in the long term, strong institutions (both SACCOs and Unions) that are capable of effectively providing services to their target markets and of operating sustainably will be required. In other words, the micro foundations of the SACCO financial services market need to established and strengthened first and foremost.

The proposed roadmap encompasses two stages:

- A market preparation phase; and
- SACCO sector consolidation - facilitating mergers and building networks between SACCOs.

While it is recognised that some degree of overlap is possible or may even be necessary in rolling out the activities under each stage, it is important to emphasise that the activities proposed in Stage 1-Market Preparation Phase are crucial and, to a great extent, serve as the foundation for successfully implementing the activities in the second stage. The proposed timeline for implementing the activities under each stage is provided in the last section (Section 5) of this report.

The activities proposed in each stage are designed to respond to the key issues confronting the sector (and especially the Umurenge SACCOs), which broadly encompass problems relating to the governance and ownership of SACCOs and how well these SACCOs are managed (both in terms of the quality of institutional leadership and management in place, as well as their supervision).

The goal is to organize the sector following a tiered structure that would allow us to rationalize the number of institutions operating, and thereby facilitate the development of stronger institutions and enable a form of delegated supervision – however avoiding, as much as possible, any negative consequences on the access to financial services.

4.1 Stage 1: Market preparation phase

The market preparation phase is aimed at building the micro foundations for the development of the SACCO sector. In this section, the various proposed components of the market preparation phase are discussed.

Component 1: Engage all relevant stakeholders in dialogue to present and discuss the roadmap

A series of market consultations is being proposed under this component. The market consultations will be guided by the following key objectives:

- To present and discuss the proposed roadmap for developing the SACCO sector, highlighting the issues that need to be addressed and the roles/involvement of various stakeholders at each stage;
- To draw feedback from various stakeholders – especially with regard to their assessment of the feasibility of the proposed timeline for implementing activities and undertaking reforms, and identifying any other issues that may have been overlooked or may not be adequately addressed in any of the proposed activities;
- To organise platforms for discussion or formalise feedback mechanisms that will be vital as the sector develops. (This can include the setting up of working group/s for high-level sector discussions that will comprise stakeholders in the private, public and non-government sectors.)[49]

These consultations could also be used to help determine whether and indicate where legislative and regulatory reform might be necessary to support a smooth implementation of the proposed activities to develop the SACCO sector and to encourage good market practice.

It is important to note that market consultation requires a genuine dialogue, which can take time, and should not be rushed. This should also be seen as a continuous process, enabling stakeholders to engage in dialogue as different sets of activities take place and further reforms are undertaken. Key stakeholders in the public sector such as MINECOFIN, BNR and RCA will need to take full account of the message they receive from the market (i.e. from private sector entities), and all parties involved in the consultation process (including market participants) should be guided by the need to build consensus. These actions will help to ensure that the new/proposed measures will be more robust, i.e. that the proposed measures are deemed more efficient from the market's point of view and that the incentives of all stakeholders involved in the process are aligned with the principles of good practice.

Component 2: Carry out a massive information campaign targeting all relevant stakeholders/actors involved in developing SACCOs

This component is crucial. As highlighted in previous sections of this report, there are various actors in the public sector involved in the supervision and promotion of SACCOs in the country. The assessment of the current situation reveals that there are gaps and significant differences in the information that is received and transmitted by various actors involved in the process of supporting and promoting SACCOs. It is therefore proposed that a massive information campaign be implemented that will target all the relevant actors, including:

- All directly relevant ministries and agencies: MINECOFIN, BNR and RCA;
- All other ministries that may be indirectly involved or undertake activities that have an impact on the functioning of SACCOs: MINAGRI, MINALOC, Ministry of Youth, Ministry of Gender, MINEDUC, the Rwanda Development Board;
- Local government offices: district and sector officials; and
- Relevant national programmes such as the Vision Umurenge Programme (VUP).

[49] It is important to note that the BNR and other stakeholders are engaging in Access to Finance Forums (AFF) in each district, which can be a useful platform to involve relevant actors in discussion. The AFF are platforms where local authorities, commercial banks, MFIs, SACCOs and other financial institutions, the TCUs, and development partners meet and discuss the constraints relating to access to finance both on the demand and supply sides and work out how to address them (BNR Monetary Policy and Financial Stability Statement, 9 August 2011).

The information campaign will need to take into account the differences among various stakeholders in terms of their understanding and appreciation of: (i) what is required in order to achieve improved levels of financial inclusion (i.e. the principles of good practice in financial service provision); and (ii) the nature of SACCOs and what is required in order to develop SACCOs into institutions that can effectively and sustainably provide financial services to their members.[50] It may be necessary to hold 'road shows' in various parts of the country where stakeholders can be convened.

The key objectives of the information campaign will be to:

- Promote a better understanding of the financial system and of what is required to achieve greater financial inclusion in the country;
- Develop a better understanding of SACCOs (i.e. what makes them special/different from other types of financial institutions and what is needed for SACCOs to work effectively);
- Correct any wrong messages that may have been transmitted/shared in the past – e.g. regarding the importance of credit over savings, especially in the lives of low-income individuals;[51]
- Clarify the role of government (including especially local government units) and what principles should guide their relationships with SACCOs; and, in the process,
- Ensure an appropriate degree of protection for users of SACCO services.

Component 3: Implement financial education activities for users of financial services/members of SACCOs

It is widely acknowledged that financial literacy levels in Rwanda are low: people, especially in the rural areas, need basic financial capacity training. Moreover, it is important to recognise that users of SACCO services have also been the recipient of mixed messages and incomplete information from various stakeholders regarding the importance of SACCOs and of their roles and responsibilities as members and owners of SACCOs.[52] Thus, financial education for users of SACCO services should consider the need for:

- Basic cooperative member education – to serve as the foundation for stronger governance of SACCOs;

[50] Given the different stakeholders that will be targeted during the information campaign, it will be useful to develop information materials that are easy to follow and which the target audience can relate to – e.g. using examples/case studies drawn from local life/everyday situations that can help to demonstrate where problems are and how these can be addressed.

[51] It is important to point out, for example, how many stakeholders seem to believe that as government funding to support SACCOs may soon run out, SACCOs now need to become sustainable; and to become sustainable, SACCOs need to start providing credit to their members. This line of reasoning is flawed in that, to begin with, (some) un-sustainable SACCOs will not have adequate capacity to extend loans (i.e. to intermediate the savings of their members), and their doing so would not make them sustainable but would, on the contrary, expose them to the risk of incurring losses and of eventually collapsing.

[52] For example, based on visits to SACCOs and interaction with some of their members, not to mention what was also pointed out by some stakeholders who have also visited SACCOs in various sectors, we note that some Umurenge SACCO members indicate that they felt they did not have any choice but to join SACCOs. Some SACCO members who were interviewed during the survey have also expressed how they perceive the SACCOs to be 'owned' by the managers (and not by its members).

- Building trust among SACCO members – to enable better understanding among members about the value or benefits they can derive from being a member of a SACCO;
- Developing an understanding of the financial services being offered and the range of financial institutions that offer them (i.e. to help consumers make informed decisions about where to place their savings and accessing other services); and
- Addressing situations where consumer confidence in financial institutions, especially in SACCOs (or in the financial system as a whole), may have been compromised, given negative experiences in the past.

Undertaking a financial education campaign will require developing a pool of local trainers and other relevant experts (e.g. experts who can help develop the training content and methods that can be used to reach different market segments). This in itself will require a considerable amount of time to develop and cannot be rushed. The quality of trainers/facilitators and other relevant experts who will be instrumental in this process of rolling out a financial education campaign will be vital to the success of the campaign.

The financial education campaign will be likely to need a pilot phase, where training content and methods could be initially tested (e.g. in a small number of sectors or villages) and revised accordingly to reflect the lessons learned during the pilot phase.

Component 4: Capacity building of SACCO and SACCO union leaders

Along with financial education, building the leadership and management capacity among existing SACCOs and SACCO unions need to be continued and strengthened. The experience and capacity of institutions that have been involved in institutional capacity building (for SACCOs and other MFIs) could be leveraged. This includes institutions such as AMIR, Terrafina Microfinance and the Rwanda Development Bank (BRD) Advisory Services. These institutions have not only been able to develop some of the necessary tools to support capacity building among SACCOs, but have also developed a pool of trainers (local experts) that can be tapped and further strengthened.

It will, however, be crucial that the capacity-building strategy for SACCOs is grounded upon a shared understanding of the nature of these financial institutions and the overall aims in terms of the strength of institutions that are expected to operate and grow in the coming years.

In terms of **delivery**, capacity-building activities are expected to be delivered over several years, and will overlap with a number of activities proposed in Stage 2 (consolidation of the sector). Capacity-building support is expected to evolve as the sector goes through a process of consolidation, addressing the needs of the newly-formed (or merged) entities. (Further details on the delivery of capacity-building support and adapting it to the needs of various categories of institutions are provided in the succeeding section.)

As the provision of capacity-building support to SACCOs will require considerable financial and human resources, priority should be given to those institutions that present the greatest financial/systemic risk.

- This will include existing unions that have the potential to attract other SACCOs in their membership.
- SACCOs that have expressed interest to merge with other SACCOs (or have already merged) should also be prioritised.

- Capacity-building support should also be developed specifically for Umurenge SACCOs, given their sheer dominance in the sector (in terms of the current number of operators). It will, however, be crucial to prioritise those institutions that are already extending or are about to extend loans to their members. (If some credit-granting Umurenge SACCOs fail (given high loan default rates), the costs of 'repairing the market' or addressing the repercussions of such failures will be too great, as other countries' experience demonstrate.)

In terms of **content**, the main objective for delivering capacity-building support to SACCOs, especially in the first two years, will be to ensure that the basic cooperative principles and governance arrangements are installed and observed within these institutions. This will require coordination with other related activities, especially with financial education activities (described in Component 3 above). The table below describes some of the key concepts/topics that should be covered under skills development.

Table 4.1 Capacity building for SACCOs: Skills inventory

	Key concepts/topics
Leadership (board members)	• Understanding of their role in representing the interests of members • How to screen/recruit managers and other staff • Basic principles - Knowledge of cooperative principles and SACCOs' key characteristics - Knowledge of other forms of business organisations (partnerships, business corporations, etc.), and how they differ from the cooperative model - Knowledge of the multi-tiered structure of the cooperative movement (when put in place) • Knowledge of regulations applied to cooperatives and SACCOs • By-laws and Governance Processes - Knowledge of bylaw drafting - Knowledge of options for participatory democracy - Knowledge of different roles of members, board and management - Conflict resolution skills - Role of policies and approaches for policy development • Business Planning Skills - Understand the uses of business plans - Knowledge of the appropriate format of business plans - Knowledge of the proper presentation of financial information - Knowledge of the factors which need to be considered and how cash flow is calculated - Knowledge of how cash flow relates to viability and minimum required net income • Diagnostic and Problem-Solving Skills - Problem-solving approaches - Recognising the stages of business development and its implications - Performing site observation visits - Diagnosing client business problems - Addressing emerging opportunities and potential problems.
Management (for SACCO manager, accountant, loan officer)	• Business Evaluation Skills - Market research and analysis - Strategic market planning - Break-even analysis - SWOT analysis - Identifying members' goals (and minimum financial needs)

	Key concepts/topics
	- Risk/benefit analysis • Credit Administration - Appraisal and decision-making processes - Measuring delinquency - Loan-recovery measures - Making appropriate loan loss provisions and building capital • Accounting Knowledge - Understand the need for and requirements of an accounting system - Knowledge of bookkeeping procedures - Knowledge of taxation issues - Audit preparation
Other special topics (for more advanced/larger institutions)	• Product development and pricing • Assessment and modelling of risk • IT/MIS development

It is important to note that many SACCOs may not have the financial means to pay for the training/capacity-building support; it will therefore be useful to consider subsidising training fees (especially during the first two years) in order to accommodate all SACCOs in the capacity-building programmes. Moreover, considering that in most, if not all, cases, board members are not remunerated, scheduling the training sessions will also need to make room for the fact that board members may be engaged as employed individuals or in their livelihoods during the day. It will therefore be helpful to consider conducting training sessions during after-work hours and/or during weekends.

4.2 Stage 2: SACCO sector consolidation – facilitating mergers and building networks between SACCOs

4.2.1 Process of consolidation: Options for institutions

The recommendations put forth in this report are centred around building a SACCO sector that will: (i) enable individual institutions to deliver services to individuals, especially those who are outside the reach of other financial institutions, and (ii) enable them to provide such services on a sustainable basis. While the introduction of Umurenge SACCOs in all 416 sectors of Rwanda has addressed the need for a more widespread supply of financial services (especially savings and payment facilities), many of these institutions are too weak to continue operating, especially if government funding/support were to be withdrawn soon. As demonstrated in many other countries that have undergone important SACCO sector reforms in the past decade, developing a framework that will encourage building and strengthening of networks between SACCOs and consolidation of the sector, especially for a sector characterised by a large number of individual operators, can help to facilitate the achievement of economies of scale in the provision of services.

Recognising, however, the differences in terms of the characteristics of the local markets (i.e. between sectors), as well as the differences between the individual SACCOs currently operating in Rwanda, it is important to emphasise that the process of consolidation – whether in the form of mergers between individual institutions or membership of individual SACCOs in unions – should not be seen as prescriptive (i.e. not all SACCOs should be required to merge or become union members). There are a number of options that individual

SACCOs may consider, depending on their particular situations and their assessment of the opportunities (benefits) presented to them among the options available.

Consolidation based on geographical spread and coverage of institutions

Consolidation of SACCOs – i.e. whether organising them into networks/unions or merging two or more SACCOs – based on their geographical location seems to be one of the best ways forward in order to minimise the cost of providing centralised services.

- In terms of mergers, this approach could facilitate the creation of SACCOs that will then determine their own branch network (i.e. the number of branches/outlets and in which sectors it should and can maintain branches) based on an assessment of the business volume that can be generated by respective sectors. In some cases, therefore, organising SACCOs (and especially Umurenge SACCOs) into district-based SACCOs might be the appropriate approach. It will be important that this process be treated carefully to ensure that SACCOs retain their independence and deep connection with their communities (and avoid creating a situation where the newly-established district-based entities are removed from the concerns of their individual members who reside in various sectors).
- On the other hand, there will be districts where a number of the larger and more established SACCOs, as well as some SACCO unions, are already operating, as well as districts where there is scope to build such unions and encourage others (especially the Umurenge SACCOs) to become members of these unions.

The identification of the coverage areas will be a key consideration here. At the moment, given the administrative structure of Rwanda and the availability of certain 'SACCO-related assets' at district level (e.g. the TCUs and DCOs that are tasked with providing assistance and guidance to emerging SACCOs), it is foreseen that much of the 'first-level consolidation' of the sector may happen at district level. To help identify and clarify the coverage areas (as guidance is provided to the individual SACCOs), it might be useful to map the coverage areas of existing networks/ unions. A simple rule such as defining the number of SACCOs for a specified coverage area (e.g. one SACCO per sector or district), when used as a national standard, may not necessarily be practicable, given the different characteristics of sectors and districts.[53] In fact, some unions or even larger individual SACCOs may operate across several sectors and districts. A certain degree of flexibility will therefore be required in setting the requirements for the early, transitional stage of the process.

SACCO networking: Strengthening existing and establishing new unions

There are already a number of SACCO unions operating in Rwanda and the approach will need to build on this existing institutional capacity.

- In some cases, the membership of existing unions may be expanded to include other SACCOs not yet part of unions.
- In other cases, however, new unions may need to be established to specifically address the need for SACCO networks in certain geographic locations. There may be cases of geographic locations where the existing union/s are already catering to the needs of SACCO members that are defined by a shared bond and where expansion of

[53] Key stakeholders have expressed a strong interest in determining how many (Umurenge) SACCOs are actually needed in the country. In Annex C, we provide a framework for analysing the distribution of Umurenge SACCOs.

membership by including other SACCOs (e.g. Umurenge SACCOs) may present problems both to the union and the non-member SACCOs.

The entire process of establishing and strengthening SACCO unions will need to be approached gradually, ensuring that individual SACCOs indeed determine for themselves and make the necessary decisions regarding which unions they should be a part of. In order to enable these SACCOs to make such informed decisions, they will need to be informed of the options available to them. It is important to emphasise that SACCO networks need to be considered as institutions that emerge organically to meet specific needs of the individual institutions. Thus, to create them means that (i) there must be a sufficient number of SACCOs to justify the operations of a network, and that (ii) there must be needs among the individual institutions that the network can deliver.

In the case of Umurenge SACCOs, the options will be similar to those available to other non-Umurenge SACCOs that are also not yet members of unions – i.e. either to explore mergers with other SACCOs or to seek membership in a union (whether an existing union or one that is to be established).

- It is proposed that reviews of all 416 Umurenge SACCOs be undertaken by selected (private sector) auditors, who will then assign quality ratings to each SACCO (taking into account the quality of management and governance in the SACCO and assessment of its capacity to undertake the changes necessary to improve performance).[54]
- Following this rating process, individual Umurenge SACCOs can then be provided advice on which specific options they might consider.[55]
    - There might be a few cases of Umurenge SACCOs that will be deemed to have the potential to grow and develop in the next two years, with capacity-building support.
    - The vast majority of Umurenge SACCOs are, however, expected to only have the option of either merging with another SACCO or joining a union in order to ensure that it grows and develops into a sustainable financial service provider.
- The rating process will therefore produce a clearer categorisation of Umurenge SACCOs, which will also inform the capacity-building interventions that might be required. This will also help to reduce the number of capacity-building activities (i.e. training seminars, on-site coaching, etc.) to a manageable level, and focus on people and institutions that are likely to yield maximum return on investments.

Functions of unions

SACCO unions are important as they will fulfil support functions for and act as a representative of member-SACCOs. Ideally, unions can play an important role in the

[54] Ideally, this process should be done before any SACCO training is implemented as it provides a critical input into which SACCOs and who should be trained. This would also help to ensure that capacity building resources are managed effectively and competition for good governance is stimulated. Some details of the proposed rating process and restructuring of poorly-performing SACCOs are provided in Annex D.

[55] It is useful to note that a similar approach is being undertaken in the case of rural banks in Ghana, which have very strong SACCO-like characteristics. These rural banks are all member-owners of and linked to the ARB Apex Bank. While some rural banks are considered star performers, there are a number of individual institutions in the network that are too small and have been consistently performing poorly. The ARB Apex Bank, through an International Advisor, is therefore embarking on a study of its member-rural banks as a first step towards facilitating mergers between some of the individual institutions.

provision of capacity building (and technical advice) to member-SACCOs. In Rwanda, however, most, if not all, of the existing unions suffer from institutional weaknesses and severe capacity constraints that would not make them capable of fulfilling this role effectively. Thus, as discussed in Stage 1, it is recommended that the capacity-building needs of existing unions be prioritised and adequately supported. In many other countries that have witnessed the collapse of SACCO networks, their failure has been largely attributed to capacity issues within the organisations themselves, funding constraints, and how this has prevented them from keeping qualified personnel within their organisations. On the other hand, stronger SACCO unions may even, in some cases, function as ‘incubators’ of SACCOs, where they assist with the development of younger SACCOs and ensure that they become sustainable institutions in the long term.

The capacity-building support for SACCOs relates not only to ensuring that there are adequate skills in the leadership and management of these organisations, but also to helping set up adequate systems within these organisations. For example, a union may consider offering liquidity management services or assist members in developing important organisational policies (e.g. in terms of credit administration, product development, marketing, and recruitment, etc.). SACCO unions may also link with commercial banks, to which the transactional banking business of SACCO-members can be outsourced. As the sector evolves and matures, some unions may also be best placed to provide central IT service solutions and allow member-SACCOs to share in a common IT platform. The approach to development must allow the gradual addition of services and responsibilities over time.

SACCO unions could also perform representative functions, especially in policy dialogue, and serve as the link (for a larger number of individual operators) to key policy stakeholders in the sector.[56] As representative bodies, unions can act as a watchdog in ensuring that there is harmony in the entire sector. This will ease the burden on the part of the relevant government agencies in having to deal with a multitude of individual institutions that may cover a wide spectrum of institutional issues and capacities.

Key issues

In terms of the challenges related to funding, the dependence on donor funds (i.e. external support) is a clear threat. The experience of many unions in other countries shows how supporting such institutions can lead to dependence on external funding and can destroy the membership-based nature of these institutions.[57] Thus, while unions may at the initial stage be supported by external (donor or government) funding, these organisations must be set up with a clearly articulated objective of achieving operational sustainability within a given period.[58] Within this period, unions should have a clear plan in terms of (i) the number of SACCO-members that should form part of the network, (ii) the range of services they will

[56] At the moment, this role is being filled by AMIR, which acts on behalf of institutions operating in the microfinance sector. AMIR could very well be the appropriate institution to carry out this function during the early stages of development of SACCO unions. Over time, capacity can be built within network-level entities, which would allow transferring the function to the appropriate organizational home (e.g. a national federation).

[57] In South Africa, for example, many externally supported networks that became donor-dependent were noted to have collapsed when donor and government support was withdrawn.

[58] In the experience of Terrafina, for example, unions typically need approximately three years of support.

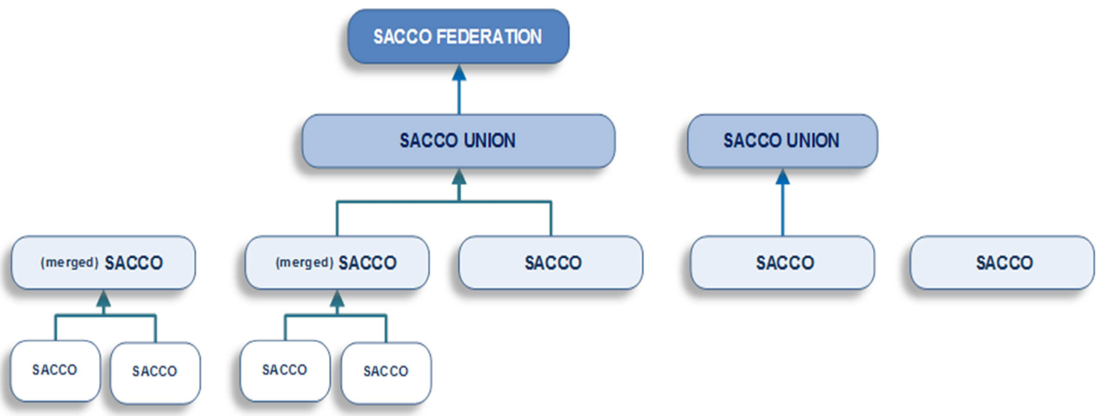
offer members, and (iii) the pricing of membership fees and charges for centralised services to be provided by the network to members.

Moreover, some government development funds are also currently being channelled through SACCOs and unions that are essentially on-lending mechanisms designed to target specific populations (e.g. youth, women, teachers, the extremely poor, etc.). In order to effectively build a sustainable SACCO sector, it will be meaningful for the government to rationalize lending programmes that are implemented by various government agencies, especially those that are extended through SACCOs.[59]

4.2.2 Proposed structure of the SACCO sector

Given the options available to individual SACCOs discussed above, the resulting structure for the SACCO sector in Rwanda will follow what is illustrated in Figure 4.1 below.

Figure 4.1 Proposed structure of the SACCO sector



In this structure, existing individual SACCOs may either:

- (i) merge with other SACCOs that may or may not become members of SACCO unions;
- (ii) become a member of a SACCO union; or
- (iii) continue to operate as individual SACCOs.

[59] In the last two decades, many countries have adopted policies and measures to reinforce a market-oriented approach towards the provision of microfinance services. In the Philippines, for example, the National Credit Council (NCC) was created in 1993 mainly to rationalize and optimize government credit and guarantee programmes. It also aims to institutionalize consultation linkages and policy dialogue to encourage a higher level of private sector participation in credit delivery in rural areas. The NCC is an inter-agency body chaired by the Department of Finance. In 1998, the Social Reform and Poverty Alleviation Act was also passed into law, which further emphasized the importance of MFIs by establishing the People's Development Trust Fund to provide grants and other financial assistance, excluding equity, to deserving MFIs for capacity building. The Agriculture and Fisheries Modernization Act was also passed in 1998, calling for the rationalization of all agriculture-related credit programmes of the Government. The law and the presidential directive prohibit government line agencies from directly implementing credit programmes and instead make use of capable / eligible financial institutions in channelling government funds to their targeted clientele. This is to avoid direct competition with the private sector and to prevent market distortion.

Even though the last option is available to larger SACCOs, such larger SACCOs may, however, be encouraged to become members of unions if such an option presents opportunities for larger SACCOs (e.g. availability of services that may be offered by the network, which the larger SACCO may not be able to access or provide on its own).

4.2.3 Strengthening supervisory capacity

It is important to emphasize that the BNR, as the supervisor of financial institutions, should supervise the financial activities of SACCOs. This is a role that cannot be fulfilled by the RCA. However, the RCA should continue to supervise SACCOs as cooperatives (i.e. ensuring that these institutions continue to uphold cooperative principles in their day-to-day operations). These two functions are linked in that a SACCO's failure to meet certain requirements for being a cooperative would be ground for revoking its license as a SACCO or a cooperative financial institution. Thus, collaboration between the BNR and RCA in the fulfilment of these supervisory functions should be strengthened.

Given the proposed structure of the SACCO sector (as shown above), BNR will then supervise the activities of a smaller number of institutions that will consist of:

- A few large SACCOs that operate independently (i.e. not as a member of union); and
- SACCO unions.

SACCO unions shall be tasked with supervising their member-SACCOs and will work closely with the BNR in fulfilling this role, especially in the early stages. As the sector evolves and matures, there may be cases where unions may have SACCO-members that will grow in scale and expand to such an extent that they need greater supervision; as such, these SACCOs will then have to be subjected to BNR supervision (even if they continue to be members of a SACCO union).

The regulatory requirements for the categories of institutions to be supervised by the BNR will need to be implemented consistently and properly enforced. It will, however, be useful to ensure that mechanisms are in place to provide feedback to relevant authorities and address any complaints from market participants – especially in the early stages.

Considering that the SACCO sector is still at a nascent stage of development and that capacity will still need to be built, it is recommended that the BNR uses the more traditional off-site supervision and on-site inspection methods. This will also provide an opportunity for recommending any specific changes to policies and operating procedures, if and when deemed necessary for the development of the sector. The on-site inspection process focuses on operational audits while off-site supervision will make use of various performance indicators or ratios and trends in the financial reports. The key step will be to undertake a review of the indicators in discussion with the relevant stakeholders. The objective of this dialogue will be to develop a better understanding of SACCOs and how they are differentiated from other financial institutions, including MFIs, and therefore would require the use of a slightly different set of indicators to measure their performance and risk profile. SACCO unions should be involved in this process, as this will also allow them to better understand the supervision process and their role in exercising delegated supervisory functions with respect to their member-SACCOs.

It will also be important to consider harmonising the content and methodology used in supervising those institutions under BNR with that which will be used when SACCO unions supervise their SACCO-members.

As BNR fulfills its role as the financial services supervisor, it will affect the institutional capacity of SACCOs and unions: these institutions will need to develop in such a way that they are able to meet the prescribed/applicable regulatory requirements. It will therefore be crucial to ensure that capacity-building efforts are linked to the need for these institutions to meet regulatory requirements.

In the current set-up, RCA is spearheading capacity-building initiatives for the SACCO sector. It will therefore be meaningful to ensure that close collaboration between the RCA and BNR is maintained and further strengthened. RCA's capacity will need to be strengthened if it is to continue to champion the provision of capacity-building support to SACCOs, given that capacity building of these institutions will need to go beyond developing an understanding of basic cooperative principles, and also ensure that SACCOs develop their capacities not only to adhere to BNR regulatory requirements, but also to create greater depth in financial service provision. It is also recommended that RCA work closely with support institutions such as AMIR that are already active in the provision of capacity-building services to some MFIs and SACCOs.

5 Implementation plan

5.1 Determining the cost of implementing the proposed roadmap

The financial model (Financial Model 1) that accompanies this report provides details on the activities, the costs of implementing them and the assumptions underlying how the proposed recommendations (i.e. the roadmap) might produce the desired results. There are a number of important activities proposed that need to be implemented to address the issues highlighted in this report and which, it is hoped, will enable the sector to develop over time. Many of these activities will, however, require significant human and financial resources. While there will be costs that market participants could and should be able to bear, the initial phase will definitely continue to require financial commitments from the government and its development partners, without which it will be difficult to see through the development of the sector as proposed.

There are a number of important points that need to be emphasised regarding the cost of developing the SACCO sector in Rwanda:

- The recommendations and the cost of implementing them take into account the stage at which the SACCO sector in Rwanda is currently at and what can improve the current situation, without compromising financial access.
- It is, however, recommended that analyses of the cost-effectiveness of proposed measures and the interaction between them be undertaken at various stages of implementing the recommendations. It will be important that policymakers and other key stakeholders consider that, as the market evolves (at various stages when the recommendations are implemented), the proposed measures will have an impact on market behaviour and the efficiency of the financial system in Rwanda that may also change over time.[60]
- There will be limitations in terms of the degree to which certain uncertainties (or risks) can be quantified. This is especially true in terms of identifying all the factors that will be relevant and how changing factors within the organisations themselves (i.e. the SACCOs and/or unions) and in the broader financial sector environment might affect how the recommendations will produce the desired results.[61]

5.2 Proposed set-up for implementing the roadmap

Implementing the proposed roadmap to develop the SACCO sector will require a range of interventions and considerable efforts to coordinate work between various implementing

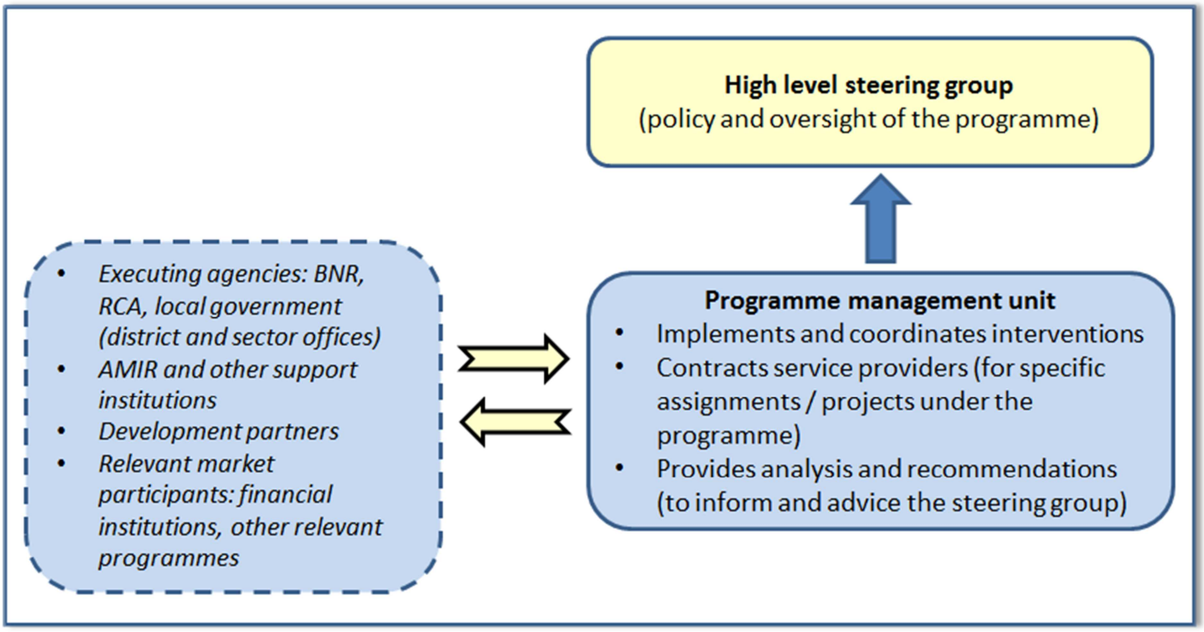
[60] For example, as the results in Financial Model 1 demonstrate, various assumptions can be made regarding the possible take up of SACCO services, which will have implications on the capacity of SACCOs to generate revenues and cover the cost of delivering services to its members. While it is hoped that the proposed market preparation activities will help build trust among potential users of SACCO services, the desired outcomes may actually take more time to materialize.

[61] For example, it is important to point out that, in the process of implementing the recommendations, some (Umurenge) SACCOs may already undergo severe problems that would bring about their collapse, which would create a burden on the supervisor and might require crisis-management or other interventions to prevent further escalation of risks (e.g. if the reputation of SACCOs in general starts to be questioned by the public). This is important to consider, especially since many (Umurenge) SACCOs with weak institutional capacity are already licensed to grant loans to their members.

agencies, other stakeholders supporting SACCOs, and market participants. It is therefore proposed that two key organs be established to oversee and manage the implementation of activities in the proposed roadmap. These include:

- **A high-level steering group** – that will provide policy guidance and oversight of the programme; and
- **A programme management unit** – that will implement and coordinate the proposed interventions / activities.

Figure 5.1 Organs for implementing and overseeing the programme



The steering group will consist of representatives of relevant government agencies, development partners and the private sector. It is recommended that the steering group be chaired by a representative of MINECOFIN or BNR. The steering group will determine how to mobilise the necessary funds to implement the programme and the entity that will exercise fiduciary responsibility over the use of these funds.

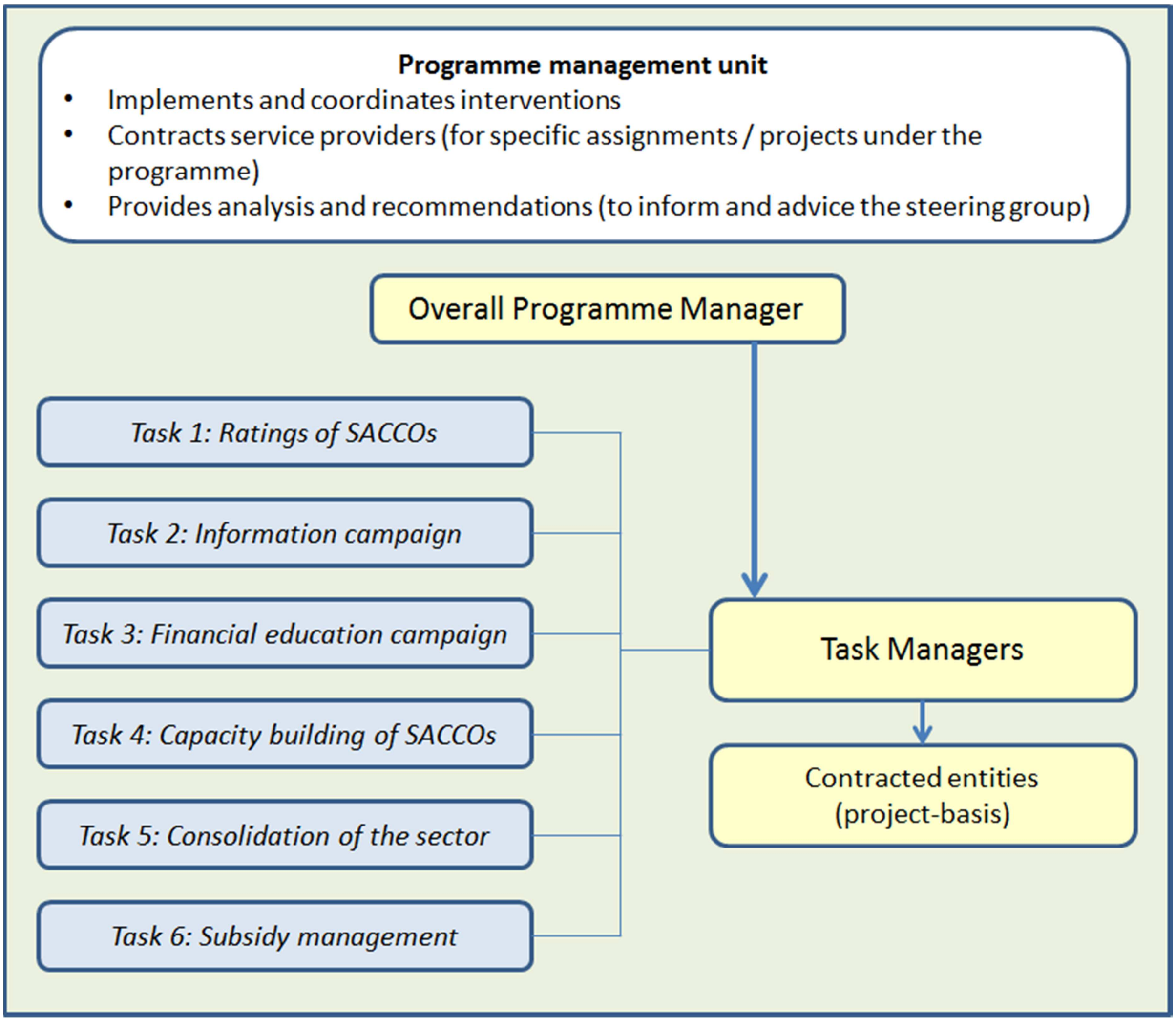
The programme management unit (PMU) will report to the steering group and will be tasked to implement and coordinate the interventions proposed for developing the SACCO sector.[62] The PMU will not necessarily directly implement the interventions and activities in the proposed roadmap; it will, however, on behalf of the steering group, undertake to contract the services of individual experts or entities that are qualified to deliver the services required in the implementation of the roadmap.[63] The PMU will coordinate the work of various

[62] The PMU may be a contracted entity that will nominate a team consisting of an overall programme manager and task managers (as shown in Figure 5.2).

[63] The range of activities proposed require specialised skills / know-how that will be difficult to find in any singular entity. (For example, some entities may be qualified to implement financial education programmes, but not be experienced in undertaking ratings of financial institutions or in supporting SACCOs through mergers, etc.) More importantly, given that the PMU will likely spend a considerable amount of time coordinating the work of various stakeholders involved in the process, it is

stakeholders – including the executing agencies, support institutions, development partners, and relevant market participants. The PMU will also seek feedback from these various stakeholders, as it provides analysis and recommendations to the steering group for issues that may arise in the course of implementing the roadmap.

Figure 5.2 Proposed programme management unit



Note: It may not be necessary to assign a different Task Manager for every task outlined in the figure above. Some of the tasks may be bundled up under one Task Manager – e.g. one Task Manager could be responsible for Tasks 1 (Ratings of SACCOs), 5 (Consolidation of the Sector) and 6 (Subsidy management).

The table below provides details on the services that are likely to be needed to implement the programme, for consideration of the steering group.

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recommended that the PMU should primarily be a team consisting of individuals with strong programme management skills.

Table 5.1 General details of services required to implement the programme

Tasks	Services to be provided by the PMU	Services likely to be contracted out to service providers
Ratings of SACCOs	• Coordinate work and output of team undertaking the rating of SACCOs with concerned agencies (e.g. BNR) • Coordinate dissemination of information (e.g. rating results) to SACCOs, in collaboration with BNR	• Develop a rating system and undertake rating of SACCOs, including a proposed plan applicable for each category of SACCO
Information campaign	• Conduct training of individual experts who will participate in the information campaign	• Roll out the information campaign (in the various districts / sectors)
Financial education campaign	• Coordinate work with other relevant on-going initiatives (e.g. the National Financial Education Strategy) and institutions undertaking financial education activities in the country	• Design modules and deliver financial education to existing (and potential) SACCO members
Capacity building of SACCOs	• Coordinate work with on-going capacity building programmes delivered by other institutions; • Determine specific requirements (e.g. skills inventory) of SACCOs and unions under each category (i.e. following rating and in the course of consolidation)	• Design modules and deliver capacity building support – Note: Different types of service providers may be needed, depending on the specific requirements of each category of institutions, and as institutions and the sector evolves.
Consolidation of the sector	• Coordinate work with concerned agencies (e.g. BNR and RCA), especially with respect to institutional restructuring, transition arrangements for newly-merged entities, issuance of new licenses, etc.	• Facilitate mergers between SACCOs • Assist institutions (especially newly-merged entities and newly-formed SACCO unions) to prepare business plans
Subsidy management	• Coordinate work with concerned agencies (e.g. MINECOFIN, BNR and RCA), especially in determining milestones to signal the pull-out of subsidy from institutions	

5.3 Timing and sequencing

Implementing the recommendations will, as is discussed in this report, need to be taken as a process, i.e. the activities will need to be paced (some requiring a more gradual approach). Moreover, some interventions follow a certain sequence. Policymakers and stakeholders who will be involved in helping to develop the SACCO sector in Rwanda will need to take serious consideration of the trade-off between the speed of institutional building and the quality of / impact on financial inclusion. It will be critical to take measured steps over a five year timeframe in order to stand maximum chances of success. There are serious risks that result from unduly rushing interventions, which could lead to even further lengthening the time required to achieve the desired results – e.g. given a situation where market distortions are created as a result of rushed interventions. Some of the proposed interventions, for example, require a process of developing skills and know-how within institutions that, at the same time, needs to be complemented with cooperative membership education. The experience in other countries shows how institutions need time to develop.[64] Moreover, the success of the proposed roadmap to develop the SACCO sector requires that the potential beneficiaries – i.e. the existing SACCO members and the unbanked populations that may be targeted for expanded reach of SACCO services – will become aware of and fully participate in the process. Inducing *meaningful* participation can be challenging, especially in light of certain misconceptions that SACCO members may have regarding their roles and responsibilities as owner-members of SACCOs.

The table below outlines the recommended activities / measures and the proposed timing to guide their implementation.

[64] In Kenya, for example, there has been significant growth and innovation in the SACCO sector over the last ten years, with new services offered to an expanding membership base. However, this development has been accompanied by an increasing level of risk and concern that the institutional capacity of many SACCOs to manage risk has not developed at the same pace.

Table 5.2 Proposed timeline for implementing the recommendations

	Year 1				Year 2				Year 3				Year 4				Year 5			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Stage 1: Market Preparation Phase																				
Component 1: Engage all relevant stakeholders in dialogue																				
Hold market consultations.																				
Organize / formalize discussion forums (e.g. working groups).																				
Respond to stakeholder feedback.																				
Undertake periodic reviews of proposed measures.																				
Component 2: Carry out information campaign targeting all relevant actors involved in developing SACCOs																				
Identify and define categories of actors / stakeholders (target audience).																				
Develop materials / content of information campaign.																				
Develop pool of experts to implement capmpaign.																				
Roll out information campaign.																				
Component 3: Implement financial education for users of financial services / members of SACCOs																				
Develop a strategy for financial education.																				
Develop a pool of local experts to implement financial education.																				
Develop content and materials to be used.																				
Conduct pilot and revise content/format, as needed.																				
Roll out financial education.																				
Component 4: Deliver capacity building for SACCO and Union leaders																				
Review current / on-going capacity building initiatives (in light of roadmap).																				
Develop other tools, content needed.																				
Develop pool of local experts to implement financial education.																				
Roll out capacity building programme for SACCOs.																				
Roll out capacity building programme for Unions.																				

	Year 1				Year 2				Year 3				Year 4				Year 5			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Stage 2: SACCO sector consolidation																				
Preparatory phase leading to sector consolidation																				
Identify and review coverage areas of existing SACCO Unions.		■	■																	
Identify geographical areas (i.e. districts) where there are no networks currently operating.		■	■																	
Incubate national SACCO rating system and conduct first rating																				
Identify and select auditors to undertake rating of the 416	■																			
Build capacity of auditors through workshops and piloting of national SACCO rating tool.	■																			
Conduct review and rating of Umurenge SACCOs. (*Classify as 'A' (well governed'), 'B' (weakly governed) or 'C' (suspend deposit privileges).)* Identify key areas of weakness and target	■	■	■						■	■							■	■		
Specify options available to Umurenge SACCOs: e.g. continue independently, join a Union, *reorganize,* merge or *become an*			■																	
Restructure poorly performing SACCOs			■																	
Report back to General Assemblies of SACCOs on specific results of ratings. *(Offer the members the opportunity to replace poorly*			■																	
Monitor performance.			■	■	■	■	■	■												
General sector risk management																				
Identify opportunities for mergers and acquisitions.			■	■																
Suspend licenses of unsalvageable SACCOs.				■	■	■	■	■												
Identify and implement options for C-rated SACCOs.				■	■	■	■	■												
Negotiate and implement mergers and acquisitions.					■	■	■	■	■	■	■	■								
Support mergers between SACCOs																				
Identify requirements for supporting mergers and secure TA to assist mergers between institutions.				■																
implementing SACCO mergers.				■	■															
Implement mergers between SACCOs.					■	■	■	■												
Deliver capacity building to newly merged entities.					■	■	■	■	■	■	■	■	■	■	■	■	■	■	■	■
Issue licenses to newly merged entities.						■	■	■	■											

	Year 1				Year 2				Year 3				Year 4				Year 5			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Support establishment of SACCO Unions																				
Develop (local) expertise to support the process of supporting the development of Unions.																				
Assist existing SACCO Unions in expanding Union membership.																				
Facilitate formation of new Unions (in applicable areas).																				
Deliver capacity building to existing Unions.																				
Deliver capacity building to newly formed Unions.																				
Issue licenses to newly formed entities.																				
Strengthen supervisory function																				
(including consultations).																				
Undertake necessary legal/regulatory reforms (following feedback from stakeholders / market participants).																				
Deliver capacity building for BNR inspectors and RCA.																				
Deliver capacity building for SACCO Unions.																				
Provide necessary input to capacity building programmes targeted at SACCOs and Unions.																				

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Annex A Terms of reference

DEVELOPING SUSTAINABLE SACCOS IN RWANDA

1. INTRODUCTION

These terms of reference (ToR) focus on the development of Savings and Credit Cooperatives (SACCOs) in Rwanda to become fully sustainable and thriving financial service providers, especially to the rural poor. The focus will be on the Umurenge SACCOs, since these have been as one of the components of the National Savings Mobilisation strategy and are far more numerous than other SACCOs (see section 2 below). However, the study should also include other formal SACCOs. These are already being affected by the introduction of their newer brethren and are likely to provide some lessons as to how to get the whole SACCO sector to the point where it is fulfilling its intended role as a major provider of financial inclusion, especially to the agricultural sector and other rural households and businesses.

This study will be funded by Access to Finance Rwanda (AFR), with a substantial contribution from the UN Capital Development Fund's Building an Inclusive Financial Sector in Rwanda (BIFSIR). However, the winning bidder will be accountable to a working group representing not only these funders but also key stakeholders from both public and private sectors (see section 2).

2. BACKGROUND

In 2007 the Government of Rwanda (GoR) put in place the Vision Umurenge Programme (VUP) to help tackle extreme poverty in Rwanda. The following year the FinScope survey of demand for financial services and barriers to access demonstrated that 52% of the then adult population aged 18 and above were totally excluded from any form of financial service, even from informal groups such as *tontines*. Partly in response to this, at the beginning of 2009 the GoR established a third leg of VUP to address the problem of financial inclusion. This entailed setting up 416 SACCOs - one in each sector in each District of the country. These are the "Umurenge SACCOs".

The other two legs of VUP are direct cash transfers to the poorest and disabled and a system of public works so able-bodied people can be paid for their labour. The Government initially agreed to fund the operating costs of the Umurenge SACCOs on a declining basis for the first three years, seemingly on the assumption that they will be self-sustaining at the end of that period.

According to figures from the Rwanda Cooperatives Agency (RCA), as of November 2010 the total number of members who had bought shares in Umurenge SACCOs stood at 502,349 and these had contributed share capital of some RwF 1,676m ($2.9m). In addition, Umurenge SACCOs held deposits totalling about RwF 2,452m

($4.2m). It should be noted, though, that these were still a fraction of the deposits held by MFIs at 30 June 2009 - RwF 14,525m ($25.6m)[65].

After formation the only operations Umurenge SACCOs are initially permitted is to sell shares to and take deposits from members. Once the National Bank of Rwanda (NBR – the central bank, which by law has to regulate all SACCOs) has approved a SACCO's business plan, vetted the management team and assessed its ability to intermediate members' deposits, it can grant a full licence, at which point the SACCO can start lending. At the end of 2010 the BNR had granted four full licences to Umurenge SACCOs, although it was processing a further 15 applications.

In addition to the Umurenge SACCOs there are a substantial number of other, longer established SACCOs in Rwanda. As of the end of September 2010 there were some 83 other SACCOs and two SACCO unions (source BNR). A few of these – especially those for professions such as teachers - are sizeable, with membership running into many tens of thousands.

However, taken as a whole, the SACCO sector remains fairly weak and vulnerable. For instance, SACCOs in aggregate have very poor quality loan portfolios, with non-performing loans (NPLs) representing 56.4% of total outstandings at the end of June '10[66].

In addition, both the BNR and RCA have noted a number of serious weaknesses with Umurenge and other SACCOs. These include:

- Low skills in microfinance sector as a whole, which undoubtedly contributes to poor governance, high NPLs and low performance of the majority of microfinance providers, compounded by high staff turn-over in the Umurenge SACCOs in particular

- Lack of financial education in Rwanda, which probably contributes to a continuing culture in some areas of non-repayment of loans

- Weaknesses in the judicial system to allow SACCOs and other microfinance providers effectively to recover unpaid interest and principal on loans, and to deal with fraud and embezzlement.

[65] If Zigama CSS (the MFI for police and military personnel) were included, this figure for total MFI deposits would rise to RwF 42,497m ($74.8m)

[66] MFIs' loan portfolios fare better, but are hardly sound. At the end of 2009 43.5% of all MFIs had NPLs greater than 10% and this proportion has been steadily increasing over the past three years (source: BNR)

In November 2010, a team comprising representatives from the Ministry of Economic Planning and Finance (MINECOFIN), the BNR and RCA undertook an assessment of the Umurenge SACCOs. The team visited 220 out of the total of 416 Umurenge SACCOs. The main findings of the assessment pointed to a number of important requirements for these SACCOS to be sustainable:

- Mobilization of increasing numbers to join Umurenge SACCOs
- Appropriately sited offices to attract more members, as well as increased share capital and savings
- Development of a greater sense of ownership among SACCO members, especially of their rights and responsibilities
- Weak governance of SACCOs, made more difficult in a number of cases by interference from local authorities
- Linkages with existing financial institutions to provide (*inter alia*) wholesale finance, greater security of funds, sharing of credit risk
- Consolidation of SACCOs where there are many in order to avoid unfair competition and borrowing from one SACCO to repay debts owed to another
- To mitigate effects of a developing culture of non-repayment of loans
- Financial education for SACCOs and members, not least to address repayment issues and to enhance the sense of ownership
- Capacity building of SACCOs, their management and boards
- Supervision of SACCOs, which should be feasible, effective and affordable.

AFR and the SACCO Sustainability Study (SSS) working group being set up to oversee this study are now seeking consultants to undertake this critical study and develop a practical sets of measures and an action plan to ensure SACCOs as a whole fulfil their potential and intended role.

3. THE OBJECTIVE OF THE ASSIGNMENT

The overall goal of the study is to develop a strategy and concrete road map that will lead to the Umurenge SACCOs and indeed entire SACCO sector becoming not just sustainable, but able to grow and increase outreach in terms of numbers of people served, savings mobilised and loans provided, particularly in rural areas. Without sustainable and thriving SACCOs, it is likely to be considerably more difficult to make financial markets work effectively in rural areas, especially for the poor. The timeframe over which this can feasibly happen should be assessed by the consultants.

4. SCOPE OF WORK

The study should focus on how Umurenge and other SACCOs can more effectively contribute to making markets work for the poor. The consultant should therefore seek to identify gaps in the enabling environment, adverse demand-side factors[67], supply-side constraints[68] and financial infrastructure, as well as making recommendations for how these gaps should be closed. When assessing gaps and other weaknesses, the consultant should consider what is likely to work most effectively in the Rwandan environment. In part, this assessment should also draw on best practices in other countries with similar conditions and problems to those facing SACCOs in Rwanda.

The scope of work is likely to comprise at least four key elements:

4.1 DIAGNOSIS OF THE CURRENT STATUS OF SACCOS IN RWANDA

This element will assess the current status of the economic and financial health of SACCOs, as well as the calibre and extent of managerial, other human resources, systems and procedures applied in both Umurenge and other SACCOs. The consultant will inevitably have to do this by sampling the existing 416 Umurenge and 85 other SACCOs (see section 5). The consultant should pay close attention to the quality of data and other information available and identifying any weaknesses and problems associated with this. This will also entail assessing the systems adopted to gather and analysis data and other information in SACCOs.

The consultant will necessarily have to take some account of the factors affecting the real economy in rural areas – including non-farm rural sources of income[69] and major differences between different areas of the country[70]. The assessment will also have to assess financial demand and supply-side pictures and the key constraints to growth and thus financial activities in rural areas. To the extent possible, existing competition and competitors should also be described as they threaten the sustainability of the Umurenge SACCOs. The most recent demand-side information is likely to come from the 2008 FinScope survey. However, other relevant studies have been done over the past three years which will be made available to the selected consultant – for example the supply-side survey and the skills audit, both commissioned by DFID (see section 6).

[67] Including financial products and services yet to be applied and tailored to rural markets, and levels of financial literacy and understanding of the role of credit, savings, insurance and money transfer in developing rural economies

[68] Not least the lack of well-trained and competent staff, as well as weak risk management, in SACCOs

[69] These might include the sale of labour, trade and other services

[70] Other issues should include the impact of limited access to markets on choices between food and cash crops, and the limitations of rain-fed agriculture on seasonal planting and thus on financing requirements

In the context of both agricultural and non-farm sectors, it will be important to note the need to build rural financial institutions that can respond to the financing needs of small and medium sized enterprises (SMEs). Commercial banks are not serving the SME segment of the economy anything like adequately. On the other hand, SMEs are likely to be a key engine of overall economic growth. The extent to which restructured SACCOs could fulfil this role will be an important element to consider.

4.2 OPTIONS AND MODELS FOR SACCO SUSTAINABILITY

In this component the consultant should assess suitable options for SACCOs to develop and achieve sustainability. The consultant may also consider one or more models to help SACCOs achieve economies of scale, afford professional management and appropriate systems that support the overall goal. Those models may involve forms of consolidating SACCOs (including possibly Umurenge and other SACCOs) and developing networks or hubs at levels higher than the Umurenge. One model put forward as a recommendation in the recent assessment of the Umurenge SACCOs (see sections 2 and 6) is for the introduction over the longer term of an Umurenge Cooperative Bank. This model should be assessed alongside others proposed by the consultant. The consultant should identify: (a) the strengths and weaknesses of these different models in order to recommend a preferred option or options; and (b) the impact that Umurenge SACCOs are having on other microfinance providers operating in their sectors. It is possible that more than one model may be recommended if the consultant believes that one "size" will not fit all circumstances.

As part of this modelling work the consultant should make explicit assumptions about key drivers such as loan volumes, interest rates charged, loan losses and provisions, cost of funds, SACCO overheads and thus overall profitability. At any higher network, hub or Cooperative Bank level, the models should include fees charged to SACCOs, (fixed or variable according to transactions), margins on any wholesale funding provided and deposits taken, overheads and (conceivably) costs associated with covering any SACCO loan losses.

It will be important for the consultants to identify other countries with comparable environments and issues to those in Rwanda where, in their opinion, SACCOs have been successfully developed and now thrive. In addition, lessons should also be drawn from other East African Countries where SACCO development remains constrained. This will require not only information from a literature review but, crucially, hands-on experience to ensure that the lessons learned (both positive and negative) can be tailored and thus applied in practice in Rwanda.

The economics of whatever model or models the consultant proposes should be demonstrated using a financial model. This should cover not only one or more types of SACCO, but also the economics associated with any networks hub or bank operations, since these too need to be sustainable as well. Finally, the model(s) should be stress-tested to assess what combination of circumstances could lead to the failure of individual SACCOs, networks, hubs or all of these. Key variables used in the stress-tests should be discussed with the SSS working group before being applied in the models.

In this component the consultant should also identify:

- Likely requirements for capacity building to support SACCO sustainability and then growth. Consultants should liaise closely with the team currently engaged by the Rwanda Cooperative Agency (RCA) to assess capacity building requirements for Umurenge SACCOs[71]
- Developments in financial infrastructure that could enhance access and deepen financial services, including the application of mobile phone, electronic point of sale (POS) and other technology relevant to rural areas in Rwanda.
- Developments in physical infrastructure that may risk or delay achieving SACCO sustainability. While infrastructure development is outside the scope of this study, weaknesses may adversely impact on the ability of SACCOs to achieve the aim of Government policy.

4.3 Enabling Environment

The present policy, legal and regulatory environment relating to SACCOs should be analysed in this component. This will not need a detailed critique of the relevant national policies, laws and regulations, but should focus on perceived gaps or other weaknesses that impinge on their effectiveness, including in the way current regulations are implemented in practice[72]. Some of this work may be done by desk research, but other elements will require dialogue with relevant public and private sector stakeholders.

Two of the key questions that should be addressed in this element of the work are: (i) how appropriate (or otherwise) is the current environment for fostering a sustainable SACCO system; and (ii) what needs to change to ensure such a system can take root to meet the current and likely requirements from individuals and businesses? This means that models developed and proposed shall also take into consideration the supervision requirements of the SACCOs, and the capacity of BNR and RCA to perform an adequate depth of surveillance and supervision.

4.4 Recommendations, Priorities and Implementation Plan

The consultants will review the options and models identified in the earlier phase and recommend priorities for their implementation. The basis for setting priorities will be agreed between the consultant and the SSS working group beforehand.

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[71] AFR can provide contact details for these consultants

[72] This does *not* imply drafting specific amendments to the current laws and regulations

Clearly, however, one factor will be the speed with which substantially more people in rural areas can gain access to finance. It is worth stressing that "access" means much more than simply whether someone can join a SACCO. Its meaning also covers issues such as whether the financial service being offered is appropriate to a client's needs, affordable, proximate, provided by a sustainable entity and – crucially – whether the resulting service and the institution offering it is trusted by clients.

The consultant will draw up an action plan for implementing the steps to achieve sustainability of the SACCO system in Rwanda. The consultant will also draw up a Gantt chart of other form of schedule showing proposed elapsed times, critical dates and links between main tasks. All work of the consultant shall be reviewed and discussed with the SSS working group. However, for practical purposes the working group will appoint four representatives to deal with the consultant on a day-to-day basis.

5. METHODOLOGY

One of the key elements of the consultants' methodology has to be to avoid "reinventing any wheels". Not only would this be inefficient, but the consultants would invariably lose time – a critical factor in this assignment (see section 8). This means that the methodology will include but not be limited to:

- Since there are 416 Umurenge SACCOs and 85 others (including two unions), it will be infeasible to assess all of these entities. The consultant will therefore have to draw a sample that should be as representative as possible in the time allotted. Criteria for what constitutes a representative sample should ideally include: size (as measured by membership and capital); economic activities in the same sector as the SACCOs; geography; licensing; and current financial status. The sample should include both Umurenge and other SACCOs. It will be up to consultants to determine the exact sampling methodology they think will work best, but this should be at least summarised in the proposals.

- The consultant will review the critical infrastructural requirements, both physical and financial, for development of SACCOs, identify gaps and recommend how these might be filled. Physical infrastructure and communications to rural areas will include power supplies, roads (taking into account problems with seasonal access) and telecommunications. Opportunities for new technology to improve access and increase the security of cash transfers under the VUP programme should be highlighted.

- Close coordination with consultants selected to undertake an Agricultural and Rural Financial Services Strategy (ARFSS). The scope of this assignment has a number of common features shared with these ToR. It will be important for both consulting teams to avoid any duplication and thus wasted effort and time. Also the two consulting teams will start working in Rwanda at much the same time, although the ARFSS study is likely to take rather longer to complete.

One point to note is that any assessment of different models identified (see section 4.2) ought to take account of what key stakeholders (not least the SACCO members) say they want from SACCOs and the services they would like to see them offering now and in, say, three years' time. It will also be important to hear what form stakeholders want SACCOs to take. For example, small, entirely member-controlled SACCOS that deal purely with their immediate communities suggests a different model to institutions that are professionally managed and capable of increasing outreach – in terms of not only people served but also the development of new products and services.

Stakeholders to be consulted should include representatives from local government from the cell to Umurenge to District levels. Local officials from Provincial Governors and District Mayors on down have been particularly active in getting Umurenge SACCOs established.

In terms of the actual approach the consultant is free to select the approach it considers will work best in options for SACCO sustainability in Rwanda. However, the consultant will be required to include the following:

- At the end of a two week inception phase, produce a brief inception report. This should set out any recommended changes to the methodology to be used to meet the requirements in the ToRs as compared with that set out in the proposal. The inception report should also include any changes to the proposed work programme for the rest of the study.

- Work closely with SSS working group as the principle counterpart on this study.

- Before the end of May, the consultant will present their main findings and recommendations to date at a stakeholders' workshop. This will include representatives from the SSS working group and other public and private sector stakeholders. At the same time, the consultant should make recommendations to the Government concerning public expenditure on SACCO development for the fiscal year 2011-12.

- Based on feedback from that workshop the consultant prepare a draft final report before submitting it to the SSS working group for final review and comment. This will then be fed into a final report to be submitted by the consultant.

5.1 Summary of Key Tasks

- Diagnosis of the current status of SACCOs in Rwanda

- Develop options and models (including financial models) for SACCO sustainability and test those financial models
- Review the enabling environment, identify any weaknesses and recommend amendments or additions
- Recommend preferred option(s) and model(s) for SACCO development sustainably to serve individuals and small businesses , identify priorities for implementation
- Where appropriate the investment requirements for the next three years and their potential sources (where possible), including recommended Government interventions in SACCO development
- Develop an action plan for implementing the recommendations
- Prepare an inception report
- Deliver a workshop for key stakeholders to present main findings and recommendations
- Draft a final report, present to and discuss with SSS working group
- Absorb comments from the SSS working group and deliver a final report.

6. INPUTS

The consultants will be provided with the following inputs as needed:

- Key documents that will be identified for literature review. These will include, but not be limited to:

  - Umurenge SACCOs Strategy, MINECOFIN, February 2009
  - National Microfinance Policy - implementation
  - Strategic Plan for the Transformation of Agriculture in Rwanda – Phase II, Ministry of Agriculture and Animal Resources (MINAGRI), February 2009
  - National Savings Mobilisation Strategy, MINECOFIN, March 2009
  - Census of Existing Skills in the Financial Sector in Rwanda, Oxford Policy Management, July 2010
  - Monetary Policy, BNR, 2010
  - Supply-side Study, Genesis Analytics, September 2010
  - Report on the Assessment of Implementation of Umurenge SACCO Program, January 2010
  - Sustainability issues of the MFI industry in Rwanda, report commissioned by AMIR and Terrafina Microfinance, August 2010.

- Other rural finance related policies, existing laws and regulations, national development strategies, and reports on recent studies.

- Furnished office accommodation, equipped with a desktop computer and access to the internet, photocopying, together with international and local telephone and fax services.

7. OUTPUTS

The consultants will produce but not be limited to the following outputs:

- An inception report as summarised in section 5

- A stakeholder workshop held before the end of May 2011 as outlined in section 5.

- A draft final report that includes:
  - A diagnosis of the current SACCO system (section 4.1)
  - Options and models for achieving SACCO sustainability identified and mapped out (as set out in section 4.2)
  - Recommendations for improvement in the areas of policy, legal, regulatory and supervisory functions related to SACCOs based on the model or models recommended
  - Action plan for implementation of the recommendations over the next three to five years. Where possible, the recommended public interventions should be costed to facilitate the budgeting process of key public institutions that should be engaged in their implementation.

- Revised draft final report for submission to the SSS working group

- Final report that incorporates comments from the SSS working group and other stakeholders.

8. LENGTH OF ASSIGNMENT AND URGENCY

The consultant is expected to undertake and complete the assignment within five months from the commencement date. It should be noted however, that the GoR in particular requires the consultants to produce by the end of May this year at least recommendations and outline costings for Government budgeting. The funders acknowledge that this is a particularly tight time-frame. However, if the GoR is to be asked to commit public funding to implementing any of the recommendations in the fiscal year beginning July 2011, then the Government will want enough solidly based recommendations to enable it to make such decisions. Otherwise, there is a risk that some key actions could be delayed for another 12 months. It will be up to the consultants to determine how they can meet this requirement, which has to be spelt out clearly in their proposals. Because of these time pressures, the consultants will be expected to begin work immediately on signature of the contract.

9. REPORTING REQUIREMENTS

1.	Submission of the Inception Report	4 weeks after commencement date
2	Present key findings and recommendations at a stakeholders'	No later than end of May 2011

	workshop	
3.	Submission of draft final report to the SSS working group	End of June 2011
4.	Final report	End of July 2011

10. PAYMENT SCHEDULE

- 20% of the contract price upon delivery of the inception report acceptable to the client
- 30% of the contract price after completion of the stakeholder workshop
- 20% of the contract price upon submission of the draft final report acceptable to the client
- 30% of the contract price upon submission of the final report acceptable to the client.

11. PROFILE OF THE CONSULTANT

The successful consultant is likely to have the following experience:

- Wide knowledge and experience of best practices in financial intermediation and risk management, microfinance, supervision and SACCO development, particularly in the Great Lakes region and East Africa, but also elsewhere in Sub-Saharan Africa
- Proven experience and knowledge of the co-operative movement and related issues in general
- Successful development of rural finance strategies in developing economies
- Considerable experience in sub-Saharan and preferably in the Great Lakes region and East Africa, especially Rwanda
- The team leader must have not less than seven years' experience in financial sector development, including (ideally) financial intermediation and risk management, microfinance, supervision and SACCO development
- The vision and capacity to think beyond conventional solutions to problems such as those facing Rwandan SACCOs.

Consultants should include in their teams one or more representatives who are highly experienced in Rwandan affairs, understand the nature and challenges of SACCOs, be able to engage effectively with a wide range of stakeholders and will have at least one team member fluent in Kinyarwanda and one in French. If they do not already have a presence and resources available in Rwanda, bidders are recommended to ensure that they include these, either by contracting local team members or by teaming up either with Rwandan or regionally based consultants with complementary skills and experience.

Bidders should note that, since there are limited qualified Rwandan partners, the client may assist in identifying some individuals or firms. It will be up to the bidders to decide precisely with which local or regional individuals or firms they decide to partner.

The ideal skills and qualifications required in the team of the consultants include:

1) An economist with a post-graduate degree relating to rural economy or microfinance
2) A human resource development specialist with a post graduate degree in this field
3) A financial analyst with experience in modelling plus a professional accounting/finance qualification. Additional post-graduate qualifications in finance and especially microfinance will be added advantage
4) A legal specialist, ideally with an LLB and post-graduate diploma in legal practice; must have wide experience in conducting regulatory reviews, especially relating to microfinance
5) A microfinance specialist with clear understanding of the risks presented by intermediation by SACCOs.

It should be noted that one team member can, depending on her/his education and experience, cover more than one of the above requirements. The composition of the team of experts is in any way the responsibility of the bidder.

Annex B Reporting templates for SACCOs

See accompanying file (in Excel): *SACCO Sustainability Study_Annex B SACCO Reporting template.xls*.

Annex C Determining the optimal number of Umurenge SACCOs

We recognise the importance of streamlining the number of SACCOs in Rwanda, particularly the number of Umurenge SACCOs, especially in view of the current level of funding/support extended to these SACCOs by the government, which cannot be sustained. The question of how many SACCOs are needed in the country is a question that cannot be fully answered within the scope of this present study: this will require more in-depth market research that can provide information on the effective demand for financial services across the various sectors and the current supply of financial services across these sectors.

The OPM team has, however, explored this question by undertaking a preliminary analysis of the current distribution of financial institutions in Rwanda in relation to population distribution and poverty levels. The key hypothesis is that population density and levels of poverty and economic activity will be among the most important factors to explain how branches and outlets of various financial institutions (i.e. banks, MFIs and SACCOs) tend to be distributed in the country. Areas that are less inhabited (considered remote) and/or too poor will tend to be among those characterised by a lack of or a smaller number of financial institutions. Such an analysis is meant to assist MINECOFIN and other key stakeholders in determining the optimal number of Umurenge SACCOs in the country. By mapping out the distribution of financial institutions, it is possible to graphically present which areas may be under-served by the financial institutions, and where Umurenge SACCOs may actually fill an important role.

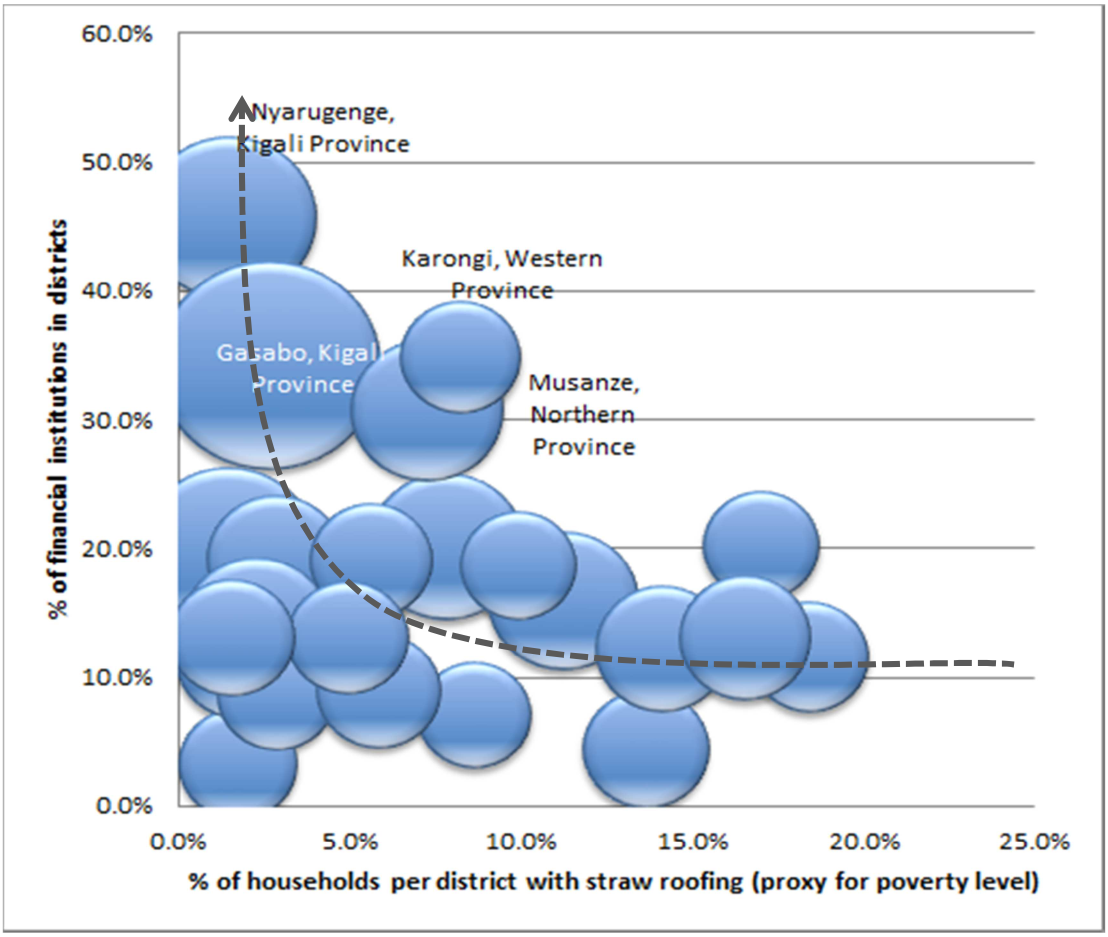
There are, however, a number of constraints in undertaking this analysis, of which we need to be mindful:

- More up-to-date poverty data (from the EICV) and population data (from the Census) will be ready only in the first quarter of 2012. In this analysis, we have therefore used the District Baseline Survey (2008) data, which do not account for any changes in population and poverty that have been observed in the country over the last three years, nor provide data down to the sector level. Nevertheless, the data does provide a number of useful indicators and results broken down by district.
- Another key limitation of the District Baseline Survey (2008) data is the non-availability of results for the Eastern province (i.e. on statistics published by the National Institute of Statistics in Rwanda). The data we used in the analysis therefore relate to only four of the five provinces in Rwanda and therefore form an incomplete picture. They remain, however, helpful to provide an indication of the current situation.

The figure below, Figure D.1, confirms that those districts with a larger share of financial institutions (Y axis) also tend to be among the more populated ones (as indicated by the relative size of the bubbles) and the least poor (X axis, where the quality roofing is used as a proxy for poverty).[73]

[73] The financial institutions presented here do not include the 416 Umurenge SACCOs.

Figure C.1 Distribution of financial institutions by district versus population and poverty level



Sources: Rwanda District Baseline Survey 2008 and OPM-collected data on the distribution of outlets/branches of financial institutions.

Notes: Figure D.1 compares the number of financial institutions in each district with the percentage of households in the district with straw roofing, which is used as a proxy indicator for the district's poverty level. A higher percentage of households with straw roofing indicates a higher poverty level. Each bubble represents a district and the size of the bubble represents the total population thereof.

The results above suggest that it would be useful to consider prioritising the availability of (Umurenge) SACCO services in areas that tend to be relatively less populated and poorer. It is perhaps in these areas (that have the least number of or no branches/outlets of other financial institutions) where SACCOs or other alternative providers of financial services would be most useful.

We should, however, emphasise that rather than approaching this question from a supply angle, determining how many and where Umurenge SACCOs ought to be established instead requires a demand-driven approach. While it will be important to consider areas where perhaps SACCOs can have a competitive advantage (compared to other financial institutions), not all less populated and poorer areas (or sectors) may be able to generate the volume of business required for SACCOs to operate and become sustainable. Moreover, there are many other factors that can explain/determine whether a SACCO will be the kind of financial institution best placed to address people's needs for financial services.

The recommendations presented and discussed in this report recognise the need to take into account the 'effective demand for SACCO services'.

Annex D Rating and restructuring of SACCOs: Implementation details

The SACCO rating system

The proposed rating of SACCOs will produce a segmentation of institutions based on an assessment of the institutions' quality of management and governance, integrity of information systems, transparency of retail interface, and overall performance.

The rating system will rank SACCOs using, for example, a scale of 1-100 that is fundamentally intended to capture member trust or confidence in the institution. The indicators to be used should be centred on the scale and trends in the volume of savings per member. This will involve a thorough analysis of the integrity of SACCO governance, based on the following categories:

- the quality of management and governance,
- the integrity of management information systems,
- the transparency of retail interfaces (taking into consideration capabilities in the target market),
- the depth, breath and scope of market penetration, especially on the savings side, and
- the overall financial performance, including balance sheet quality and profitability.

At the start of the programme, the capacity to rate SACCOs will likely need to be incubated. There may be existing local audit companies capable of providing rating services, but it may be too costly for them to carry out this job. Moreover, local audit companies may also have inadequate understanding of SACCOs (and especially of SACCOs at early stages of development). Local capacity can, however be developed with appropriate up-front investments. A qualified entity can be contracted to develop the rating system and build local capacity to undertake the rating of institutions. Capacity can, for example, be drawn from local experts who have knowledge of the SACCO sector (e.g. accredited trainers of AMIR), or fresh graduates (who majored in Business Management), who wish to work in rural finance.

The segmentation of SACCOs will provide information about the quality of managers and senior board members in Umurenge SACCOs. Leaders and managers of SACCOs that are considered well-performing (or deemed to have strong potential to develop) may be strategically deployed to assist in turn-around situations, in the formation of Unions, and could be used as a resource in training workshops. These leaders / managers could also participate in the process of consolidation by providing advice on mergers, where aplicable.

It may be useful to conduct more than one rating exercise over the five-year period. This will signal to all players the benefits resulting from improving their performance and rating, as well as the sanctions or penalties that may result from their failure to improve performance or from a decline in their ratings.

Incentives for good SACCO performance

Incentives must be provided for SACCOs to improve their performance. Some suggestions are provided below:

- Well-performing institutions could receive (in years 2-5) training in market research and business planning, and technical support in product development and implementation.

- Well-performing institutions could receive (in year 5) support in terms of investing in automation technology and can be networked. This would provide their members access to ATMs around the country, and enable them to access accounts through other SACCOs participating in their network.
- In the long term, well-performing SACCOs can be linked to mobile banking platforms.

Addressing quality-related issues

It is anticipated that the majority of Umurenge SACCOs face considerable governance problems, with more than half at serious risk of early failure. It is imperative that there be strong capable leaders, who can be deployed to support restructuring and turn-around efforts. As noted above, this pool of leaders can be identified in the course of undertaking the rating exercise.

SACCO problems are caused overwhelmingly by poor leadership. Some existing SACCO leaders may not have fully understood what they were getting into, and also not be prepared to make a commitment to the level of work and effort required to make SACCOs work. In some cases, SACCO leaders may be seduced by weak control systems and inadequate oversight.

It is therefore critical for members – especially in their role as the General Assembly – to ensure that the board and the staff are held accountable. If the members do not care what the leaders do, and do not take the SACCO seriously, the SACCO is doomed to fail. In situations where SACCOs are therefore deemed to suffer from poor leadership and management, the members must be prepared to elect a better board; this will give the SACCO a very good chance of initiating reforms and succeeding. The fact that the members may have elected a poorly-performing / unqualified board at the outset should not be held against them. (There is process of 'collective learning' that often takes place among SACCOs.) If members are informed of the issues and risks confronting their SACCO, learn from the experience and then take the appropriate actions, there is a very good chance of success. This process, in effect, transfers effective control from the government to the members of the SACCO.

Restructuring SACCOs

The process of restructuring poorly-performing SACCOs will therefore start with informing its members about the problems and risks confronting the SACCO. The rating report will need to be shared with the board of directors and the supervisory committee, who will then discuss the issues highlighted in the report and determine the next course of action (among options presented in the rating report). The next step may involve requesting that the supervisory committee call for an extraordinary general meeting to present the results of the rating exercise to the general assembly. The meeting (and subsequent meetings) with the general assembly should ideally be held in a public space (e.g. a community centre, or a school). These meetings will be monitored, paying attention to the degree of disclosure exercised by the board. During the meeting, the board will declare its commitment to undertake the necessary reforms to improve performance; and in subsequent meetings, the board will report to members the progress in achieving the desired results.

If after an agreed reform period (e.g. one year), no improvements can be noted on the performance of the institution, then the board will be asked to resign and the SACCO's license to accept deposits can be revoked. At this point, an interim strong SACCO leader may be seconded to the SACCO for a period of 6-12 months to lead a process that will result in either:

- the election of a new / competent board,
- a merger with another SACCO, or
- final dissolution of the SACCO and return of savings and shares to members (which could possibly be followed by the formation of a new SACCO in that sector).