Communal Credit Committees: A Convenient Source of Credit

Making credit available to rural communities in Costa Rica through Communal Credit Committees (CCCs) has proven to be an appropriate source of credit for these communities and appears to have displaced the use of other more expensive and less flexible sources, such as informal lenders and banks. CCCs are organizations managed by members of rural communities with logistical, technical, and administrative support from the Fundación Integral de Desarrollo Rural (FIDERPAC) and the Fundación Unión y Desarrollo de las Comunidades Campesinas (FUNDECOCA). This model, based on interpersonal relationships among community members, has helped to improve clients' payment performance and to strengthen the social fabric in beneficiary communities.

Ensuring that productive activities have access to credit has been a constant issue throughout the world and in particular in developing countries, where access to credit is more severely limited. Approximately 60 percent of Latin American firms report that they face some degree of restriction on access to credit, and this figure is even higher for small and medium-sized businesses.[1]

In Costa Rica, lack of access to financing is the most significant limitation for small businesses. Approximately 40 percent of small business owners identified this as the major obstacle to growing their business.[2] The primary sources of financing for micro, small and medium-sized businesses are retained earnings and loans from commercial enterprises, rather than from the formal financial system. Market segmentation also exists, with the result that only a small group of businesses has access to the formal financial system.[3]

The logic behind projects that aim to increase access to credit is that eliminating the restrictions to access faced by microentrepreneurs—and entrepreneurs in general—will enable them to invest and grow their businesses, and therefore generate employment and increase economic activity in the country.

Since 2011, the Social Entrepreneurship Program has supported the Fundación Integral de Desarrollo Rural (FIDERPAC) and the Fundación Unión y Desarrollo de las Comunidades Campesinas (FUNDECOCA) in expanding access to credit in rural areas of Costa Rica. FIDERPAC and FUNDECOCA have promoted access to credit since the 1990s through the creation of Communal Credit Committees (CCCs), community-based credit organizations that funnel seed capital from FIDERPAC or FUNDECOCA to community members. The CCCs are created from existing community organiza-

1 Kuntchev V. et al. (2014) "What Have we Learned from the Enterprise Surveys Regarding Access to Credit by SMEs?, Enterprise Analysis Unit, World Bank.

2 Enterprise Surveys, the World Bank. Costa Rica, 2010.

3 Villalobos, 1996; Beck et al. (2002); Monge-González et al. (2007).

tions such as Community Development Associations.[4] To create CCCs, FIDERPAC or FUNDECOCA staff members diagnose a community's financial needs and explore the interest of its members in forming such a group. Then, at least 30 community members receive training in different areas, such as teamwork and the need to organize to solve community problems; the basic elements of sound organization; the need for planning; how to identify community problems and their causes and consequences; the organization and regulation of a credit committee; credit committee operating procedures (including the collection process); and appointment of a credit committee board of directors. When the community members have completed their training, which can take several weeks, the process begins of setting up the CCC.

Each CCC operates in a decentralized manner, as if it were a branch office, with a certain degree of autonomy in operations management and control.[5] In addition to providing operational support and supervising the CCCs, FIDERPAC and FUNDECOCA contribute to their institutional strengthening. As of June 2012, FIDERPAC had created 74 CCCs serving 3,311 clients (an average of 45 clients per CCC); and FUNDECOCA had created 53 CCCs serving 2,890 clients (an average of 54 clients per CCC). All CCCs are located in rural communities in the provinces of San Jose, Puntarenas, Alajuela, and Heredia.

The Multilateral Investment Fund's approval of the Social Entrepreneurship Program operation attracted interest in the study of the CCC model. Given that it was not feasible to randomize CCC locations and consequently design an experimental evaluation, a study was proposed to examine households that had had CCC exposure for a period of at least three years and compare these with households in similar communities that did not have a CCC.

The Study

The study proposed to measure the effects of a CCC in the community using variables such as access to credit, credit characteristics, and the behavior of beneficiaries using credit. For this purpose, all CCCs created in 2002-2009 were selected (18 of FIDERPAC and 12 of FUNDECOCA). For the selection of control communities, information at the community level was used from the 2000 National Population and Housing Census. Communities with similar characteristics (control group) to those communities served by the 30 CCCs (treatment group) were identified.[6] In 93 percent of the communities with CCCs and 96 percent of the control areas, interviews were conducted in households with members belonging to Community Development Associations (which form the foundation of CCCs).

According to the 2000 census, households located in communities with CCCs had an average of four members; more than 80 percent of the heads of household could read and write, and 53.7 percent were wage earners. Regarding access to basic services, more than half of these households had access to electricity and 95 percent were connected to water through a public network. In approximately 70 percent of the households, the occupants owned the house and only 5.7 percent of the households had dirt floors. On average, the characteristics of these households were very similar to the national average, and their access to basic services and their dwelling conditions were even above the national average.[7]

4 Community Development Associations (ADCs) are formal organizations with legal entity and territorial status that are promoted by the Costa Rican government and made up of neighbours that share economic and social improvement objectives for their community. ADCs are authorized to coordinate with state institutions on promoting and developing improvements in roads as well as in services such as public health, education, recreation and environmental protection for their communities. As of March 2014, there were more than 3,200 ADCs with more than 347,000 people working as volunteers in these organizations, which are part of the National Department of Community Development (DINADECO).

5 The board of directors of each CCC is responsible for the various stages of the credit process in their communities: receiving the applications, analysis, approval, formalization of credit, and recovery of funds.

6 Variables include age, gender, education and occupation of the head of household; plus size of home, living conditions, access to basic services, and property assets.

7 According to the 2002 National Population and Housing Census, 90 percent of households at the national level had access to water through the public network and 38 percent had access to electricity. About 65 percent of households owned their homes and 6.4 percent

Once the treatment group and control group were identified (by means of 2000 census data), information was collected from a sample of households located in these communities in mid-2013. Households were randomly selected for interviews. In total, 1,212 households in CCC communities and 1,315 in control communities were interviewed. To ensure that the households analyzed were mutually comparable and similar, matching techniques were used for the selection of the interviewed households; these were the households in control communities most similar to the households in treatment communities.[8] This technique made it possible to obtain a common support for the households, so for the purpose of this analysis, 2,372 households were used (1,140 in treatment areas and 1,232 in control areas).

BOX 1. CCC Client Characteristics

According to the 2013 survey data, nearly 24 percent of the households that obtained one or more loans in the last three years were clients of a CCC. Some 25 percent of CCC clients are below the poverty level, and 50 percent are considered vulnerable (with a daily per-capita income of $10 or less). Average loan amount ranged from US$195 to US$28,145.

The households on average included four members, and 23 percent were headed by women. Only 18 percent of heads of households had a secondary education. Members of these households have resided in their communities for more than 29 years on average, and 90 percent own their own homes. Nearly nine of every ten households had a cell phone.

Approximately 47 percent of the households reported having their own business with monthly sales averaging US$1,218.

Results

As expected, the households in treatment areas had greater access to credit provided by CCCs. For households in control areas, the amount of credit provided by CCCs was nearly 17 percentage points higher than for households in treatment communities (see Figure 1). Although this difference appears modest, it is higher than

the results reported in experimental evaluations, where the difference fluctuated between 10 percent and 13 percent.[9]

However, access to credit in general, irrespective of the source, is the same in both groups. According to study results, the proportion of households that obtained one or more loans during the last three years was statistically the same in both treatment and control areas (42.1 percent treatment and 39.4 percent control). Average loan amounts in the last three years were higher in treatment areas (US$5,485) than in control areas (US$4,329).

Access to credit through CCCs appears to have displaced other sources of financing in treatment areas, such as informal lenders and banks. For example, 36 percent of the credit granted to households in control areas is provided by informal sources, while this portion is only 28.8 percent in areas with CCCs (see Figure 1).[10] Among the informal lenders, the financing comes primarily from commercial business such as suppliers of agricultural products, supermarkets and grocery stores. Another example of the displacement caused by CCCs is access to credit through the banking system: 35.1 percent of households in control areas have loans from banks (public or private), compared with 29.4 percent of households in communities with CCC.

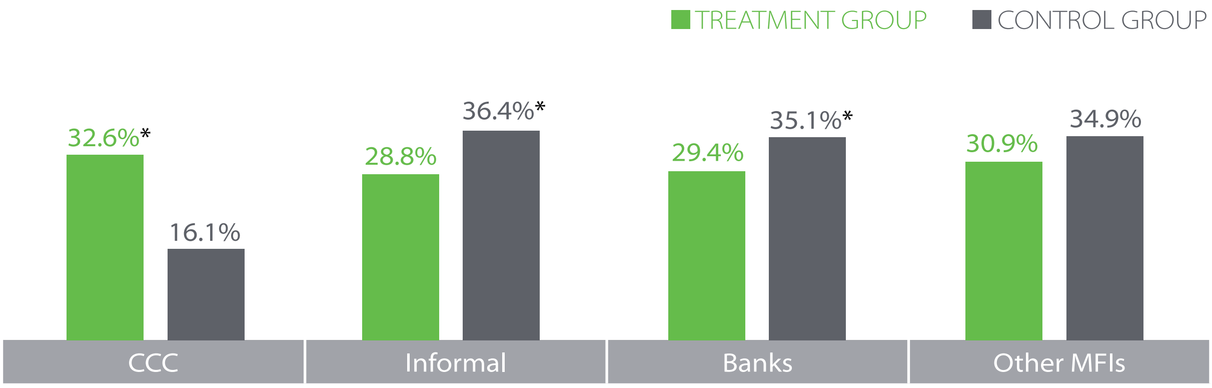
of the households had dirt floors.

8 The variables used for this analysis were selected such that a priori they were not affected by the program: age, gender, head of household education, size of home, number of family members ages 19–65, access to potable water, and payment of municipal taxes.

9 Banerjee et al. (2013), "The Miracle of Microfinance? Evidence from a Randomized Evaluation."

10 The most common sources are family members, friends, merchants and informal lenders, among others.

FIGURE 1: Acces to credit by financing sources



* Statistically significant

Although there are differences in access to credit through banks, there are no differences in terms of access to other financial services offered by regulated institutions. Data shows that there are no statistical differences in access to checking accounts (6.8 percent treatment and 7.1 percent control) or savings accounts (50.8 percent treatment and 50.6 percent control), debit cards (51.5 percent treatment and 52.2 percent control) or credit cards (9.0 percent treatment and 8.3 percent control), or in access to insurance policies (14.3 percent treatment and 15.7 percent control). All these results suggest that households in communities with CCCs have the same availability of financial services from banking institutions as households in control areas. The reduced use of bank credit therefore appears to indicate that households in treatment areas prefer CCC loans because of their convenience.

Households in CCC communities take greater advantage of electronic banking services than households in control areas. Even though access to the Internet (12.1 percent treatment and 11.1 percent control) and computer ownership (28.5 percent treatment and 29.3 percent control) is similar in both groups, households in treatment communities make greater use of electronic banking services (7.5 percent) than those in control areas (5.1 percent).[11] Given that the transactions associated with CCC loans are made within the same community, eliminating the need to travel to cities, it is likely that this also reduces the need to go to the bank for other transactions (such as transfer of funds and payments for public and private services, among other things) and explains the greater use of electronic banking by households in communities with CCCs.

Access to credit through other financial entities is the same in both groups. Access to financing through credit unions, savings and loan societies, and other financiers is statistically the same in treatment and control areas (see Figure 1).

Given the characteristics of the guarantees required by the different sources of credit, a greater proportion of borrowers in CCC communities provide collateral security than in control areas. On average, 65.5 percent of households in treatment communities report having provided some type of guarantee for the loan received compared with 59.5 percent of households in control areas. This is explained by the greater proportion of credit coming from informal sources (which do not require a guarantee) in control areas. It is noteworthy that in treatment communities, fiduciary-type guarantees are more common (66.6 percent treatment vs. 57.4 percent control), and that these guarantees are preferred by CCCs; and that in control communities, collaterals in the form of immovable assets are more common (1.3 percent treatment vs. 6.7 percent control), and that these guarantees are preferred by banks. The data does not indicate differences in the proportion of borrowers in either group that provide mortgage guarantees.

Households in treatment communities demonstrate better performance on loan payments. The proportion of households that report having fallen into arrears on their payment installments is 15.8 percent in treatment communities and 22.1 percent in control communities. These results could be related to the CCC intervention model. As previously described, CCCs operate in small communities (80 to 100 inhabitants) and members of the board of directors of each CCC make the credit decisions. Like the applicants, the board members are neighbors in the community. The proximity of the credit grantors and the applicants could contribute to a greater sense of obligation to repay. This hypothesis is based on the fact that social pressure influences individual decisions about repayment, as previously demonstrated in the relevant literature.[12] In addition, this closeness facilitates the flow of other types of information, which enables members of

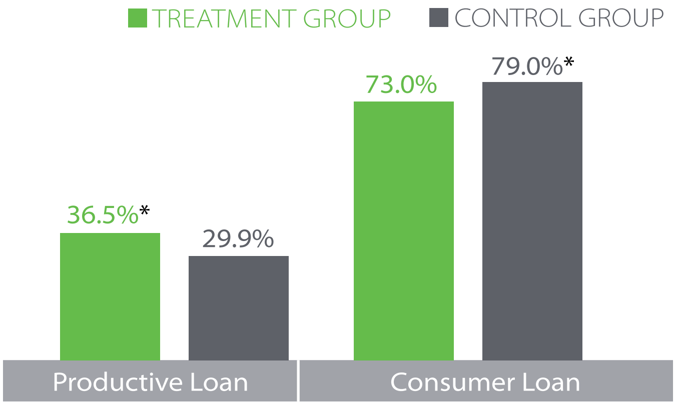
11 According to the survey, 56 percent of the households that reported using electronic banking services did so through the Banco Nacional. Other households used another public bank (33.5 percent) and, to a lesser extent, a private bank (4.4 percent). Both groups demonstrated the same proportional use of electronic banking through the above-mentioned entities.

12 Feigenberg (2014), "Building Social Capital through Microfinance", NBER.

the board of directors to better evaluate the credit worthiness of an applicant.[13]

Another important difference between the groups is the reasons that applicants request a loan. Households in treatment communities seek credit for commercial purposes to a greater extent than households in control areas;[14] households in control areas apply for loans mainly for consumption.[15] These results are consistent with the type of credit offered by CCCs, which is primarily for commercial activities (see Figure 2).

FIGURE 2: Reasons applicants request a loan



* Statistically significant

Greater access to credit appears to have encouraged entrepreneurial activities in households headed by men, but not in those headed by women. The proportion of households headed by men that reported having their own business in 2013 is greater in communities served by the CCC (45.1 percent) than in control areas (40.3 percent). According to the 2000 census, at the community level, the proportion of households headed by men who were self-employed or employers was the same in both groups.[16] It is worth pointing out that the scale of businesses, however, is very small. On average, the number of employees is less than two persons (in both groups) and in the case of households located in communities served by CCCs, the number of unpaid business employees is less than in the control areas. Finally, no significant statistical differences were found between the percentage of small business owners in households headed by women in treatment and control areas.

Communities with CCCs demonstrate a higher level of organization and social participation. Both the Ministry of Public Works and Transport and the Ministry of Agriculture and Livestock promote programs fostering community development. Public Works and Transport provides materials to organized communities to improve their roads and highways, requiring the communities to provide the necessary human resources. Agriculture and Livestock provides technical assistance and technology transfer programs to organized communities to improve their productivity in farming and livestock activities. To access these programs—just as in the coordination of health and education projects—applications must come from the communities, because it is expected that communities that are more organized will be capable of succeeding with development programs. The study found that the proportion of households participating in the Agriculture and Livestock programs is greater in treatment areas (7.2 percent) than in control areas (5.1 percent).[17] In terms of community participation, households in treatment communities are more likely to be affiliated with some type of organization (34.4 percent treatment vs. 31.1 percent control). In particular, a greater proportion of households in treatment communities (15.3 percent) participate in the Community Development Associations than those in control communities (11.5 percent). In addition, more households in treatment communities (72.3 percent) than in control communities (64.5 percent) reported having witnessed improvements in the last 10 years in areas primarily related to access to health services (Basic Integrated Health Care Teams—EBAIS for its Spanish acronym) and education (new construction of primary and secondary schools).

Although the study cannot attribute causality, these last results are consistent with the logic of the CCC intervention model. CCCs are created in communities with greater organizational capacity, and where Community Development Associations probably exist to coordinate the promotion and development of these projects, or communities where a CCC is created are developing a better organizational and social fabric because of the training process on topics of community organization accomplished as part of the CCC creation process.

Postelnicu (2012), "Social Capital and Repayment Performance of Group Lending in Microfinance", Université Libre de Bruxelles.

13 Simtowe et al. (2006), "Determinants of Moral Hazard in Microfinance: Empirical Evidence from Joint Liability Lending Schemes in Malawi", International Association of Agricultural Economists, Annual meeting.

14 For example, acquisition of vehicles, machinery or tools; merchandise/supplies; purchase of animals; payments for labor or transportation and storage services, among others.

15 Included among these reasons are household consumption; purchase of electric appliances; purchase of lots, land or property; purchase or improvement of housing; education and health services, among others.

16 According to 2000 census data, at the community level the proportion of households headed by self-employed men was 42.1 percent in treatment areas and 40.2 percent in control areas. The proportion of employers was 2.8 percent in treatment and 3.4 percent in control areas. These differences are not statistically significant.

17 Initiatives to promote commercialization of agricultural products; support for agricultural production; improvement of agricultural infrastructure, research, and development of techniques to achieve increases in productivity; and sustainable resource management, among others.

Another interesting result of the study is the empowerment of women in the treatment areas. Although the data reveals a high percentage of participation by women in household decision-making in both groups, in the treatment communities women participate to a greater extent in decisions pertaining to household loan applications (83.6 percent in treatment communities vs. 80.3 percent in control areas).[18]

Policy Considerations

The credit methodology used by FIDERPAC and FUNDECOCA has offered local families access to alternative and convenient credit: transactions are conducted in their own communities without requiring trips to the city and on average the credits are greater in communities with CCCs than in the control areas. In addition, the credit model (focused principally on productive activities) appears to have encouraged the creation of businesses in those households headed by men.

A key aspect of the intervention is the creation of each CCC from a community base, which seems to have fulfilled an important social and community function. On one hand, the knowledge that members of the boards of directors have about their neighbors and vice versa has presented an advantage in the intervention model. Results of the study show that borrower households in treatment areas exhibit a better culture of prompt payment. Households in treatment areas also demonstrate greater participation in public initiatives that promote improvements at the community level, reflective of a higher level of social organization and participation.

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18 In four out of every five households, decisions pertaining to loan applications (for family businesses, savings, managing household accounts, having children, as well as the number of children, etc) are made by single women or in agreement with their partners.

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