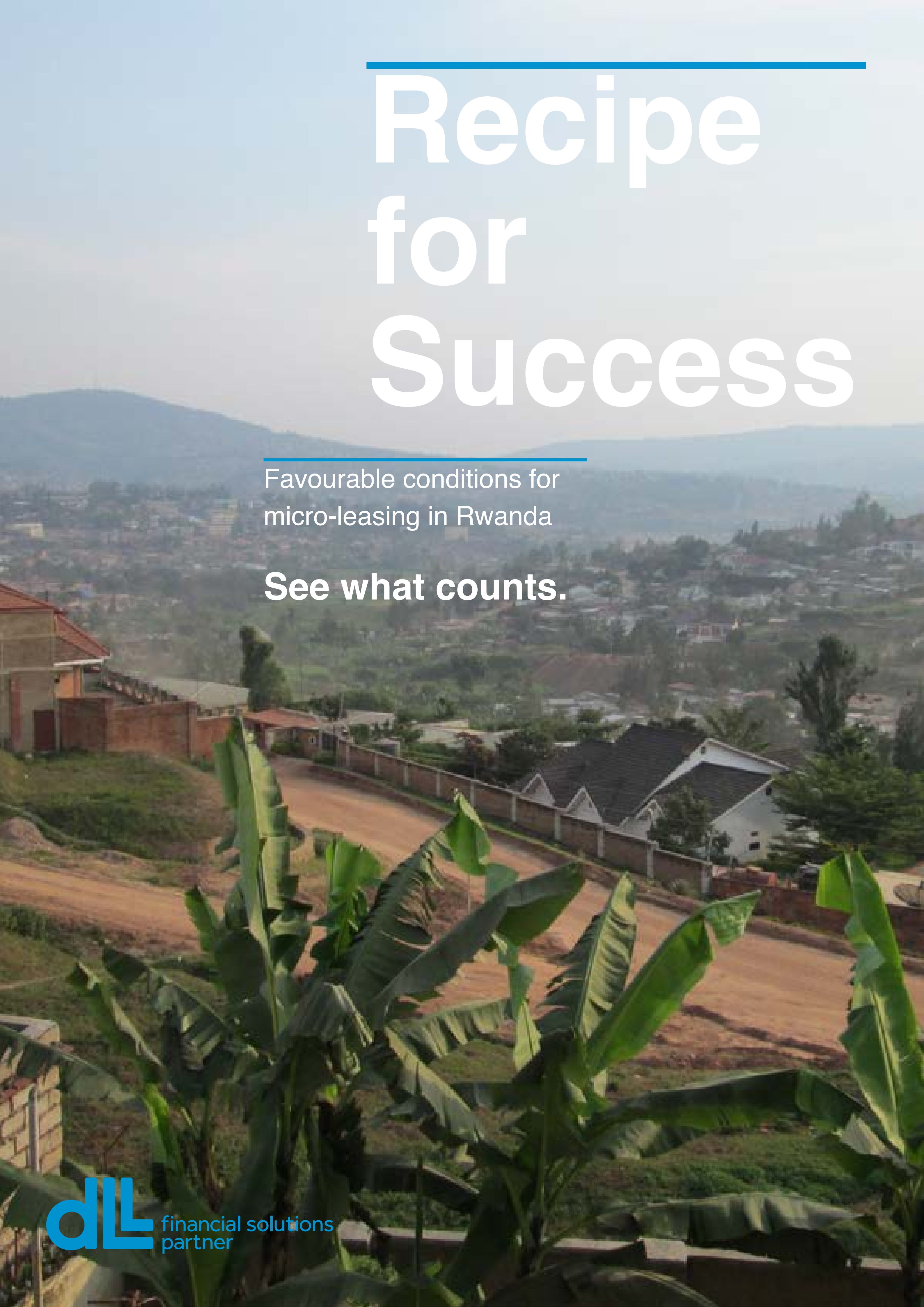

Recipe for Success

Favourable conditions for micro-leasing in Rwanda

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Offering advantages over loans for micro and small businesses, micro-leasing is a potential financing instrument for use in least developed countries (LDC). While there is as yet only limited experience with micro-leasing, a recent project in Rwanda has shown considerable demand for this form of credit. Conducted by DLL in cooperation with the Rabobank Foundation and the Association of Microfinance Institutions of Rwanda, the project identified a number of necessary conditions for successful market introduction of micro-leasing. These include having an accommodating taxation and legal system in place; adequate capacity and commitment of participating financial organisations; and a potential customer base that is underserved by existing financial service providers and seeking a mechanism to stimulate entrepreneurial activity.

Micro-leasing to stimulate economic growth for micro-entrepreneurs

As the term infers, micro-leasing enables low-income individuals and micro-entrepreneurs to gain access to relatively low-cost equipment to enhance their economic livelihood. Leasing as a means of asset financing is a long-standing financial instrument in developed economies and gaining a foothold in emerging economies, albeit often in less sophisticated forms. Very recently, leasing has been identified as a potential financing tool to stimulate economic growth for micro-entrepreneurs at the bottom of the pyramid in least developed economies. In fact, International Finance Corporation (IFC) advocates leasing as a service to reduce barriers to financial inclusion and to help finance commercial activities (Kirungi et al., 2009). Many other international institutions, both private and public, have recognised that access to financial services is critical in facilitating economic growth and reducing income inequality (see: http://www.cgap.org/publications).

For several years, microfinance institutions (MFIs) have shown interest in diversifying their products and services, and recognise that micro-leasing has the potential to meet financial needs not satisfied by traditional microfinance approaches (Baas and Henderson, 2000). As focus on micro-leasing increases, commercial financial institutions are also increasingly attracted to this business opportunity.

AMIR office entrance in Kigali, Rwanda

Micro-leasing offers advantages over traditional credit products

Micro-leasing is an extension of the scope of financial services and products tailored to the needs of low-income individuals, micro-entrepreneurs, and small businesses. Traditionally, banks do not provide microfinance services because of the higher marginal costs of processing credit applications and portfolio management of small amounts. Furthermore, typical clients, such as low-income individuals and micro-entrepreneurs, often do not have a credit history to assess their creditworthiness or any form of collateral such as fixed assets that can be secured to support transactions.

In the past 30 years, innovation and creative structures to overcome these issues have led to a proliferation of institutions offering microfinance services and products ranging from lending to micro-savings, transfer of remittances and micro-insurance (Dowla, 2004). Initially, many MFIs were funded by grants and microcredit provided by non-profit, non-government organisations (NGOs). Subsequently, microfinance has moved into new segments and grown into a more commercially oriented industry (Lützenkirchen and Weistroffer, 2012). Efficiency gains in the last ten years have led to MFIs becoming more self-sufficient, regardless of whether they are profit-oriented or not.

MFIs have an interest in micro-leasing, which offers advantages over more traditional credit products, such as loans. As leasing reduces the need for collateral, the risk of lending to micro farmers is reduced because property ownership is not transferred to the lessee until the lease term is completed. This provides the MFI lessor with collateral—the leased asset—that can be repossessed more easily in the event of default. This feature means that leasing can satisfy the financial needs of micro and small entrepreneurs who are not granted investment loans because they cannot provide sufficient security even though they may have viable business plans.

As a lease is granted on the basis of the enterprise's cash flow rather than on credit history, leasing gives micro-entrepreneurs with scarce financial resources the opportunity to run a business on a limited budget or increase an operation's productivity through new capital investment. At the same time, leasing increases borrowing capacity to finance working capital.

In many cases, leasing offers potential tax incentives compared to a loan. Under legislation in many countries, the end user can claim the entire lease payment as tax deduction while only the interest on annual payments can be deducted in the case of a loan (Bass and Henderson, 2000).

Furthermore, once a loan is granted, the MFI has limited control over the use of funds, increasing the risk of a misallocation of funds. Leasing mitigates this concern as the financial solution is tied to the investment.

Micro-leasing project in Rwanda

In June 2012, DLL in partnership with the Rabobank Foundation established a micro-leasing project in Rwanda. DLL sees micro-leasing as a promising vehicle for extending access to finance mechanisation for micro and small entrepreneurs in key emerging markets. In developing and introducing micro-leasing in Rwanda, DLL gained first-hand experience with this financing instrument, and developed a potential blueprint for future initiatives by DLL and partners.

The project is coordinated locally by the Association of Microfinance Institutions in Rwanda (AMIR), Terrafina Microfinance, a joint microfinance programme of ICCO, Oikocredit International, and the Rabobank Foundation. Together with DLL and the Rabobank Foundation, AMIR selected four MFIs (Duterimbere IMF S.A., Goshen Finance, Rwanda Microfinance Limited, and Umutanguha) from the AMIR network to introduce micro-leasing with the aim of further professionalising these organisations as well as creating added value for their customers.

The project is developing this new financial product offering together with all stakeholders in a cooperative, locally driven approach. Leasing consultants from DLL and the personnel of the four local MFIs are working closely together in the field to develop and create leasing products that meet local needs and the requirements of MFIs customers.

The project start-up phase concluded in August 2012 with a general conference organised by AMIR and the Rabobank Foundation for major microfinance players in Rwanda and other key stakeholders interested in replicating this initiative. The MFIs agreed on a pilot phase in which each MFI independently introduced micro-leasing to their respective markets and customers, with periodic monitoring and support from DLL consultants.

The MFIs translated the lessons learned during the start-up phase to turn the concept of micro-leasing into sustainable business plans. By November 2012, the MFIs booked €20,000 of micro-leasing contracts, and had well over €350,000 in prospective business (awaiting the finance product to be implemented). Most of this portfolio focused on motorcycles, but also included cars, milk coolers, sawing, sewing and carpentry machines. Moreover, all participating organisations are confident about their pipelines of prospective customers for micro-leasing.

Rwanda is fertile ground for micro-leasing

Rwanda's history and recent development provide fertile ground for microfinance and the introduction of micro-leasing. Rwanda is also one of the focus countries in Africa for the Rabobank Foundation. The country's economy suffered severely during the 1994 civil war and since then has been gradually recovering. While national poverty rates approached two-thirds of the population immediately after the war, poverty rates have declined to around 45 percent and are expected to continue this downward trend.

About 90 percent of the population is engaged mainly in subsistence agriculture, and the rest are involved in mining and food processing. The country's main sources of foreign exchange are tourism, minerals, coffee, and tea. Since the early 2000s, gross domestic product (GDP) has rebounded with an average annual growth of 7 to 8 percent and inflation has been reduced to single digits. The population is young and growing (median age: 19 years) and the political environment has stabilised with lower levels of corruption than elsewhere in the region (Transparency International, Corruption Perception Index 2012). These factors combine to make Rwanda an interesting market for international investors (for data and trends of foreign direct investments in Rwanda, please see: http://www.indexmundi.com/facts/rwanda/foreign-direct-investment).

According to the World Bank's Global Index, one-third of the adult population had an account with a formal financial institution in 2011. Nonetheless, financial inclusion via a formal bank or other informal institution has been growing in the last four years, as shown in a national survey in 2012 (Murenzi, 2012).
The MFIs are a conduit in helping to rebuild Rwanda

economically and increasing participation in the formal financial sector. Since the first NGOs starting exploring small credits for female entrepreneurs some 20 years ago, Rwanda's microfinance sector has been rapidly transformed. Microfinance in Rwanda has now evolved into organised and managed limited companies providing financial solutions to low-income people in order to support economic development and reduce poverty. MFI customers are typically low income but economically active, and medium income, small business owners.

Most activities financed by MFIs in Rwanda fit into the following categories:

- Agriculture: mostly small-scale subsistence farming with little mechanisation
- Production/Craft: small and medium-sized companies producing baskets, clothes, simple handmade products; and juices and simple processed foods
- Transport: cars, motorcycles, and tricycles for the transport of goods and people
- Services/Trade: in rural and urban areas including wholesale food, retail food and clothing, and trading agriculture and livestock
- Consumption: generic consumer loan
- Real estate/Construction: mortgages for expansion and improvement of buildings for commercial (rental, restaurants, stores) or personal use

The micro-entrepreneurs turn to MFIs because they have difficulties in meeting the credit criteria required by the conventional financial system. In addition to loans for business purposes, MFIs provide short-term personal credits and savings. Loans are often used to purchase assets for business purposes such as motorcycles and bicycles, sewing and weaving machines, wood processing equipment, and food processing machines. The MFIs tend to have a physical presence in a specific area and also to have an affinity with specific target groups based on religion, gender and age. Currently, the microfinance industry in Rwanda is

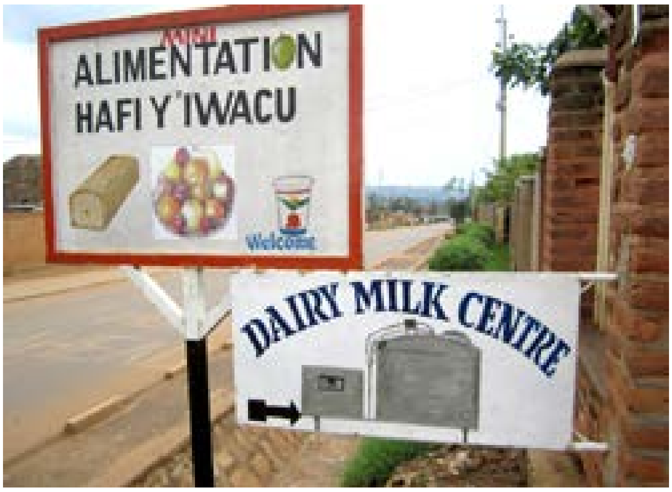
Motor bikes for public transport

reaching a level of maturity at which even the commercial banks are entering the upper segment of the market served by MFIs, focusing on small and medium-sized entrepreneurs.

Leasing gradually being introduced in Rwanda

In 2006, a Leasing Development Programme was set up under the Rwanda Competitiveness and Enterprise Development Project, sponsored by IFC and the Netherlands Ministry of Foreign Affairs. This programme aimed to create new financing opportunities for businesses in Rwanda by promoting leasing as an alternative financing mechanism locally.

The first leasing products were introduced in 2008 when commercial banks such as FINA Bank and Banque Commerciale du Rwanda entered this market. In 2011, the leasing market in Rwanda represented about $60 million (RWF 34 billion), or 1 percent of GDP. All leases are financial leases (hire purchase) and focus predominantly on vehicles (65 percent), machinery (7 percent), and other assets (28 percent). The large share of vehicles is attributable to the transparent and thriving secondary market, acting as a risk hedge against default.



Milk cooling center, a typical business to benefit from micro-leasing

More favourable legal and tax frameworks needed for micro-leasing

Credit and saving activities of MFIs are highly regulated and governed by the National Bank of Rwanda, which also supervises all leasing operations. Current regulations contain requirements on solvency, provisioning of all overdue loans in arrears in accordance with incurred delays in instalment payment, loan size, and security levels. This regulation also stipulates that all MFIs are required to have a profit-related target. In 2005, legislation regulating leasing operations in Rwanda specified that all limited companies can operate as lessors. This means that all banks, stand-alone leasing companies, and microfinance institutions can start leasing operations without licensure.

Under the current accounting framework, leasing transactions in Rwanda differ from international standards. The Rwandan tax code diverges from other legislation as it places leasing at a cost disadvantage compared to a loan. Only the legal owners of the assets are able to claim depreciation. This reduces the incentive for end-users to finance their assets via leasing, where the ownership of the asset is only formally transferred at the end of the lease. Another disadvantage of the local tax code is the inclusion of value-added tax (VAT) in each instalment paid by the end user because leasing is regarded as a service.

In 2009, Ernst & Young recommended a framework in line with international standards enabling national institutions to adopt more leasing-friendly legislation. With support from the IFC, the Bank of Rwanda developed a proposal on leasing that would overcome the accounting and tax related obstacles mentioned above. When adopted, this leasing framework will also provide protection for a lessor in case of default, explicitly stating repossession conditions and procedures. The proposal was approved by the parliament in November 2011, but still awaits the President's signature to enter into law.

Building capacity and commitment for micro-leasing

While appropriate legal and regulatory frameworks are essential requirements for micro-leasing, the implementing entities need to develop expertise and capacity in this relatively new form of microfinancing. This was the focus of the DLL support in shaping micro-leasing products to the Rwanda context, customer needs and the interests of the MFIs themselves.

The four MFIs participating in the micro-leasing project differed in terms of their governance, processes, staff education, portfolio size, and type of clients. Three of the four MFIs offer both credit and saving products. Saving accounts are an important source of funding for micro credit loans, which can be salary advances, group loans, overdrafts and individual loans. Each organisation differs in resources and knowledge of financial products, with a sizeable knowledge gap identified between management and those in the field working day-to-day with clients.

Analysis carried out by DLL consultants identified a number of shortfalls that needed to be addressed in the four participating MFIs in developing and introducing micro-leasing products. To guide the MFIs through the operational and technological adjustments required, DLL consultants developed a micro-leasing process, which formed the basis for a customised roadmap for each MFI, from which their internal processes were designed (see Figure 1).

Figure 1. Micro-leasing process flow

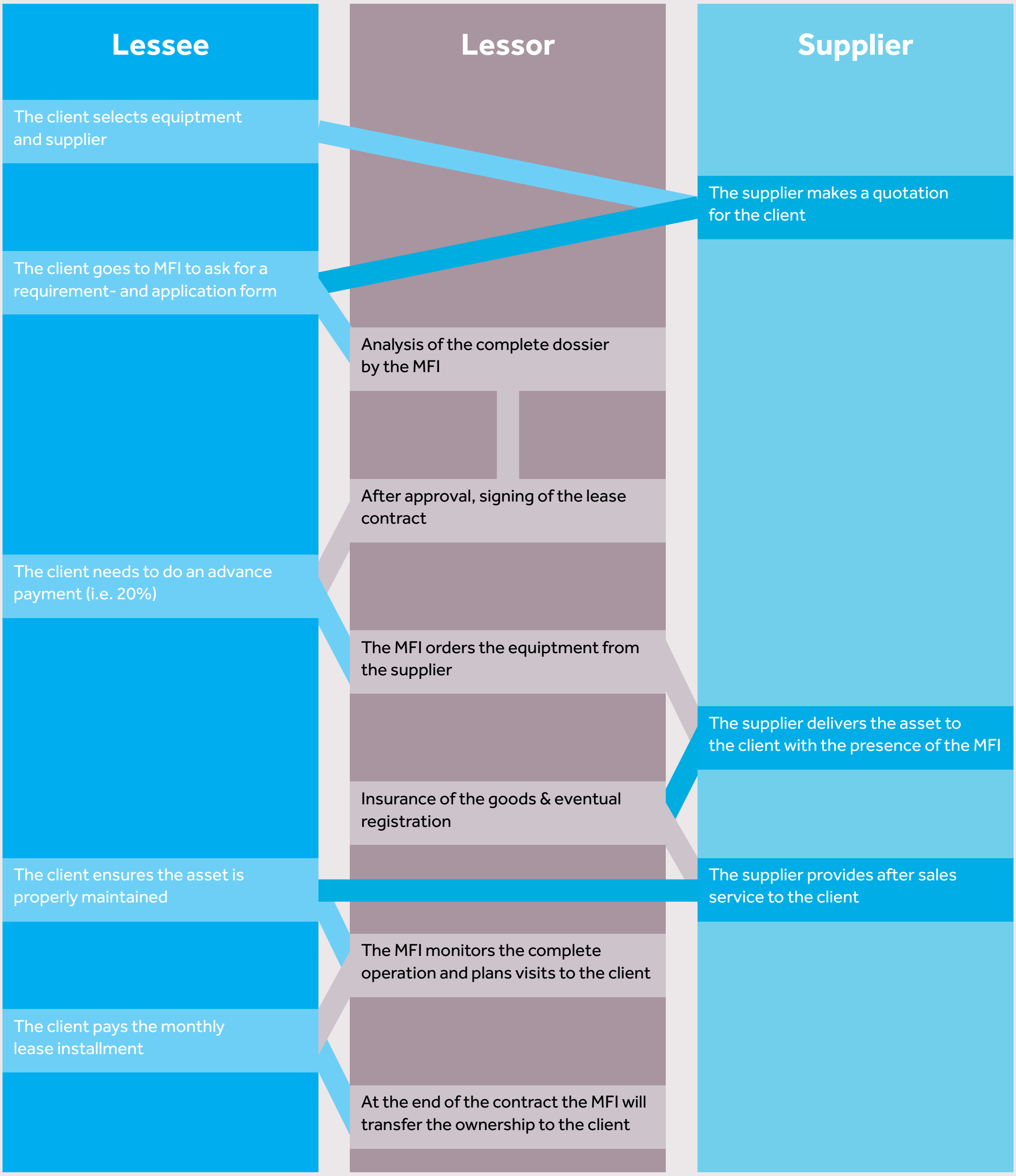


Figure 2. Asset types identified for micro-leasing in Euros

Asset Type	Average Investment	Average Lease Term (months)	Value Line 2 Years
Car	7,200	36	3,000
Carpentry machine	4,800	36	960
Freezer/fridge	300	12	96
Milk cooler	4,800	12	960
Motorcycle	1,530	18	630
Sawing machine	5,000	24	1,360
Sewing machine	360	18	240
Welding machines	1,800	24	1,200

Another challenge was to upgrade IT systems, which had been set up to handle basic credit loan structures. To manage lease contracts, each MFI had to upgrade their IT infrastructure to enable periodic instalments that also cover services such as maintenance and insurance, and include VAT.

The MFIs were encouraged to allocate capital for micro-leasing based on expected business volume. On average, the estimated portfolio for each MFI was around € 60,000 after the first year based on contacts with prospective customers.

DLL consultants conducted training sessions with the MFIs on specific features of leasing, including differences between leasing and loans, customer and MFI benefits, lease pricing elements, information on the Rwanda leasing market, and the legal framework. The MFIs also received formal training on operational management of the full leasing process from the initial customer request to the end of lease procedures. This included customer financial assessment, equipment ordering and delivery, insurance and maintenance, and early termination and repossession procedures.

The training sessions proactively involved the MFIs in product development. For example, maintenance for cars and motorcycles appeared to be a common challenge for all MFIs. A major concern was the ability of suppliers to price services for the length of the leasing contract given that maintenance depends on usage conditions that vary with customers. Collaboratively, the decision was made to exclude maintenance from the financed amount and leave the customer with responsibility for covering these costs.

Marketing to stimulate customer demand for micro-leasing

DLL consultants supported each MFI to develop a commercial strategy to market micro-leasing to their customers. The MFIs identified the assets with the best prospects for leasing (see Figure 2). The selection was based on criteria related to their existing customer base, their industry expertise, market prospective, and an assessment of repayment capacity for each sector serviced. To enable each MFI to gain expertise and experience with the management of the assets and the roll-out process, introduction of micro-leasing was limited to a maximum number of assets and to predefined locations mostly in the urban area of Kigali.

Furthermore, to make this new and unfamiliar financial product attractive to customers, the MFIs needed to employ a more consultative approach in which customers are advised and helped to understand the value of leasing versus a traditional loan. MFI sales personnel were trained in sales techniques such as devoting more time to listening to the broader financial needs of their customers, and positioning the new micro-leasing as an alternative solution.

The MFIs segmented their customers and adopted specific acceptance criteria for simpler credit reviews. Subsequently, promotional offers and price grids were prepared to build customer momentum for leasing. Promotional campaigns were designed and launched using awareness sessions in the field (community events), promotion on radio and television, posters and flyers, MFI websites, word of mouth among clients, cold-calling new customers, door to door solicitation, and advertising through equipment suppliers.

Micro-leasing project team in Kigali

Using the market strategy developed with DLL, the MFIs not only promoted micro-leasing via various media but also engaged in formal educational events to increase awareness of the opportunities provided by microfinance and micro-leasing. These events, which were attended at times by entire villages, were adapted to rural areas (where financial literacy is lower). Extended marketing events and initiatives have also been planned for the growth phase of the pilot.

Challenges and next steps for further implementation

The new business generated in a very short time has demonstrated the demand for micro-leasing in the marketplace. However, there are challenges for local MFIs and in Rwanda in growing micro-leasing. In the first instance, there is uncertainty about the legal environment. MFIs are moving forward in anticipation of the new micro-leasing legislation while continuing to exercise caution in growing their business. To give impetus, AMIR will lobby the parliament based on the current pilot results in 2013.

Some MFIs need to gain more understanding of micro-leasing in order to market and sell this product more proficiently. An essential aspect of this is to gain better insight into customer needs, and to this end, the MFIs are organising small customer focus groups.

An obstacle to micro-leasing for some customers is the down payment, and some MFIs are tempted to offer the product without asking for this initial payment. This could prove to be unsustainable if the risks are too high for the MFIs given their limited experience with leasing. Some creative solutions have been developed, such as combining micro-leasing with a savings product, for example, coupling with a savings account into which regular monthly payments are made to accumulate the amount for the down payment.

Furthermore, finding optimal equipment suppliers for assets, and build lasting commercial relationships is an ongoing process. The efforts made by MFIs to gain insights into equipment suppliers need to be documented and leveraged effectively to create preferred supplier lists with evaluation and rating. The MFIs have expressed a need for additional training in order to implement this knowledge sustainably in their organisations. Some MFIs have suggested organising a conference or knowledge-sharing event at which AMIR, the Rabobank Foundation, DLL, and the MFIs exchange experience.

Dedicated resources in the MFIs are essential for driving progress and disseminating knowledge and skills on micro-leasing internally, and organising training and consultation sessions with suppliers and customers.

Going forward, the collaboration between DLL, AMIR, and Rabobank Foundation will continue to ensure consolidation of the results obtained. AMIR will remain involved as the official sponsor to facilitate support by DLL consultants remotely or in the field as required by the MFIs. Follow-up aftercare visits by DLL to support MFIs on outstanding issues are planned in 2013 when all MFIs involved have completed implementation and signed the first micro-leasing contracts. AMIR involvement will need to expand when DLL involvement is completed.

The way forward from the perspective of the Rwanda experience

Experience with micro-leasing in Rwanda indicates a demand for this financing instrument for micro and small businesses. While a number of factors have contributed to successful implementation of micro-leasing in Rwanda, the key success factor is the contextual development and co-creation approach taken jointly by DLL consultants and local MFIs. Micro-leasing products have been shaped to the country context, the interest of the MFIs, and to customer needs. This was done by developing the product with the four MFIs cooperating in the project rather than developing products for these organisations. The contextual development ensures that end-user demands are met in terms of retained ownership, and that the products comply with local legal and tax frameworks.

This approach ensures a greater sense of ownership and engagement throughout the collaboration, and provides the foundation for a sustainable product with the potential to make a difference in Rwanda. The expertise accumulated in this project is the foundation for building further opportunities to implement micro-leasing products. The multi-stakeholder project approach and organisation with resources from DLL, Rabobank, and partners can be replicated in other geographic regions and markets. For DLL, this project represents a sound foundation for future micro leasing initiatives in other developing countries.

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