
3. Lending policy

SELECTION OF THE TARGET GROUP

Studies in many countries show considerable variation in the income levels of fisherfolk. Often governments attempt to restrict the benefits of lending programmes to the poorer members of the fishing community. Given the tendency of many credit programmes to provide the greatest benefits to more well-off members of the community, some restriction of participation in the programmes is generally warranted. Where access is to be restricted, programme managers must decide the target population for the programme and the operational criteria to restrict benefits as much as possible to this population.

Ideally, the population seen to need programme assistance should be the same as that targeted operationally. Often it is not possible to achieve this ideal. In some cases, clear criteria exist; often criteria which eliminate most of those who should not benefit from the programme also eliminate a few who should. If exceptions are allowed, charges of favouritism can be levelled, occasionally with good reason.

Possible criteria

Type of boat, processing and marketing equipment. If the wealthier elements in the community are to be excluded they can usually be identified by the type of boat they own or by the type of marketing and processing equipment they use. For example, in some countries where revolving credit funds are to be established, ownership of a trawler would indicate a level of wealth above that of the target population.

Non-fishing assets. Possession of substantial non-fishing income-producing assets might be a criterion for excluding certain possible applicants if the target population is defined as that which depends principally on fishing for its income.

Physical presence in fishery activities. In most cases, revolving loan funds will be established to help people who are actively engaged in fishing and related activities, such as marketing and processing. If so, non-fisherfolk can be excluded by establishing physical presence on the craft or at the site of fishery activities as criteria for participation in the lending programme. Members of the community will know who fishes and who merely owns a boat and takes a share of the catch without active participation in the work of fishing.

Income. Because it is difficult to measure accurately, income is not usually a clear criterion for inclusion or exclusion from participation. In surveys respondents tend to understate their incomes; when applying for loans, there is probably a tendency to overstate income.

Gender. Credit programmes should take account of the credit needs of women, which should not be restricted to fish processing and marketing but also include fish production and non-fisheries economic activities (see Guidelines - Women in Fishing Communities, FAO, Rome, 1988). Procedures for credit delivery should ensure that women are legally entitled to sign loan agreements and act as guarantors for loans.

Borrower self-selection. Another way to restrict the use of revolving fund benefits to low-income fishermen is to make loans available at such low levels that wealthier elements have no interest in applying for them. In many cases, small loans repayable over a reasonably short period of time can make significant contributions to increasing the incomes and well-being of artisanal fishermen without attracting the interest of larger fishermen or traders in the same village. Such a system merits consideration.

ASSESSMENT OF CREDIT NEEDS AND FUNDS PROGRAMMING

The first step in the assessment of credit needs in a given area is the analysis of available statistics and information such as the total number and lifespan of the various types of fishing craft and gear presently operated, information on numbers and types of installations and equipment presently used for handling, processing and distribution of fish, information on future trends in availability of aquatic resources, fishing efforts, consumer demand and prices.

Based on this type of information, an assessment can be made as to how many fishing craft, fish culture installations and equipment, as well as installations and equipment for fish handling, processing and distribution, should be introduced every year to continue fishery activities at the same, reduced, or at increased levels. This assessment does not indicate the need for credit but defines the investment requirements.

To determine how much of the total investment requirement can be met by credit and how much can be covered by savings and capital mobilization within the fisheries sector itself, investigations should use quantitative as well as qualitative methods.

If resources are available a representative random survey sample could be undertaken. In most cases, a smaller sample will serve. It should cover all the major socio-economic sub-groups amongst the fisherfolk communities and also include the various sub-regions.

The quantitative part of the investigation should be carried out with the help of a questionnaire which addresses the following issues:

1. Personal characteristics, such as sex, age, religion, languages, secondary occupations, literacy, family
2. Income, including seasonability of income from fishing and from other occupations
3. Property, including fisheries property and non-fisheries property
4. Expenses, including expenses for food and clothing and for festivals and ceremonies
5. Credit, including sources, terms and purpose of credit.

The qualitative investigation should be carried out with the help of a guideline for the conduct of group discussions which should address issues such as the present source of finance for investments, savings or credit, and, in the case of the latter, the sources, amounts, interest rates, terms and conditions and future credit demands. Annex 1.1 shows samples of the questionnaire and group discussion guidelines.

When deciding which activities can be financed by credit, only those activities whose financial and economic viability are already proven should be considered. Experimental activities, technologies and methodologies should not be financed on credit but with research and development funds.

After determining investment requirements and credit needs and demands, it is important to assess how much of the demand can realistically be met by the revolving fund. The organizational preparedness of the participating bank (if any), the role and capacity of other suppliers of credit as well as operational conditions, such as communication and logistics, must all be taken into account.

There is a strong tendency to overestimate the effective demand for credit in the initial years of a lending programme. These over-estimates are usually the result of optimistic assumptions about the percentage of the target population which will take out loans at the start of the programme; in part they may be due to pressure from donors to “move money” as quickly as possible. In projects with an initial duration of three to five years (not counting possible extensions which are not part of the planning horizon at the start of the project), there is strong pressure to disburse a substantial proportion of the revolving fund as soon as possible. This pressure comes from project reporting requirements or from impending mid-term evaluations. “Amount or percentage of revolving fund disbursed” will be a key indicator of project success to national and international agencies providing technical and financial support to projects and to donors in the case of donor-supported projects.

It takes some time to carry out the research necessary for proper project design. It will also take time to inform fisherfolk in the target population about the existence of the programme and about the terms under which loans are available. Therefore, disbursements during the first year are likely to be low, perhaps between 10 and 25 percent of the amount available in the revolving fund. In a successful programme where viable projects are abundant, a target by the end of the second year should be in the 50-75 percent range. A loan recovery rate of 75 percent should be expected. This value should be adjusted up or down as soon as reliable statistics are available to project management on actual loan recovery. By the end of the third year, 100 percent disbursement is likely in successful projects. If investment opportunities within the target population are not exhausted and if loan repayment is reasonably good on initial loans (85 percent or better), it might be useful to seek additional funds either internationally or by

requesting local financial institutions to use their own funds in lending to the target population. However, especially in the early stages of the project where a record of loan recovery is yet to be established, project staff should always consider whether the loan is going to be repaid. Achieving satisfactory disbursement targets should not be a substitute for commonsense judgements on loan recovery, the primary goal of a lending programme.

To justify projects, very ambitious objectives are set and similarly ambitious workplans developed. If during implementation it becomes obvious that objectives and workplan are unrealistic, project managers should prepare a revised workplan which is achievable. It is better to reduce the workplan than to raise the limits on loan sizes to “move more money” and so come closer to achieving disbursement targets. When the workplan is changed, corresponding changes should be made in the estimates of when funds are required for the lending programme and when funds will be available from loan recoveries. If inflation of the local currency or devaluation are serious risks, funds from external agencies should be kept in foreign currency accounts and exchanged as needed or kept in local currency in time-deposits scheduled to mature as required. In many countries there is a real advantage in keeping all project funds supplied from foreign currency accounts (possibly converting local currency into foreign currency). Keeping money in foreign currency accounts protects against devaluation and indirectly against inflation; the ability to exchange it as needed for local funds provides the project with flexibility to meet unforeseen loan demand which local currency time deposits do not provide.

Projected returns of loaned funds to the programme account based on loan repayment should be readjusted every month on the basis of repayments in previous months. It is extremely important to keep individual loan accounts locally and up to date. Loan repayment aggregates are then available to branch and project managers a week after monthly closing of accounts at the latest. Computerization could facilitate the availability of this information. Field officers should also provide monthly reports at staff meetings on conditions which have affected recent loan repayments and which are likely to affect them in the future. This information is crucial if loans can only be made from transfers or repayments to the revolving loan fund. If funds for

loans are provided by a local banking institution, project management may be less involved in loan funds planning because the bank will be directly responsible. Funds planning in coordination with the local banking institution is still required to ensure sufficient funds to reimburse the bank are available.

Annex 1.4 shows a format which can be used for funds planning as discussed above. It should be revised monthly. It contains information on scheduled loan repayments which will be available for further disbursements and indicates actual and scheduled loan disbursements from presently available funds, as well as the total scheduled disbursements, subdivided by number of loans and total loan amount under each loan category and for each region.

SELECTION OF BANKABLE ACTIVITIES AND PREPARATION OF LENDING PROGRAMME

After credit needs have been determined and demand for credit assessed, individual economic activities to be supported by credit should be defined and their financial viability established. The main purpose of the financial analysis of individual economic activities to be financed by a project-operated revolving loan fund or by a credit programme for fisherfolk is to assess whether the net revenue generated by a certain activity is sufficient to:

- (a) repay the loan on financially viable terms and
- (b) generate enough incremental income for the borrower to sustain herself/himself and dependants, after meeting all costs of production, including the cost of labour.

The problem is usually to find economic activities which meet these criteria rather than to select from various activities which meet them. Those with the highest profitability could be undertaken by the target group for the project.

Since projects deal with rural credit and development banking, not with commercial credit and banking, it needs to be stressed that even though financial viability is necessary, the profitability of the investment is not the

only important criterion; basic criteria for selecting economic activities to be financed through credit are:

- (a) creation of employment and income, particularly for the disadvantaged and poor sections of artisanal fishing communities, especially women and young people, and
- (b) contribution to the supply of cheap animal protein to meet the nutritional needs of poor sections of the rural and urban populations.

For most economic activities to be financed by project-operated revolving loan funds or through bank credit programmes, disbursements will be made once, revenue received will follow similar patterns every year, and periods of loan repayments will not usually exceed five years.

Analysis of the activities to be financed through credit can therefore be simplified. Without discounting costs and benefits, the Benefit/Cost ratio can be calculated in terms of the Annual Return on Investment at current prices and the annual and monthly net revenue, based on which loan repayment schedules can be prepared and the incremental income of the borrower assessed.

To evaluate further the economic benefit to the artisanal fisheries sector, the Net Value Added can be calculated, either in percentage terms or by monetary unit of investment. In addition to the Net Profit generated by the investment, the Net Value Added also includes wages/salaries generated by the investment as well as fees/taxes, if any. Annex 1.2 shows the lending programmes, as well as the financial analysis of the activities included in the lending programme of a fisheries credit programme in India.

If the economic activity to be financed with the help of credit is more complex (with more than one disbursement, changing pattern of in- and out-flows, and long time periods of amortization) and should a more precise indicator of financial viability be required, it is necessary to follow more sophisticated methods of financial analysis, which are briefly described below. These methods should also be used to determine the level of interest rates which can be charged on loans without endangering the financial viability of the activity.

For loan-financed activity to be financially viable, it must have a higher Internal Rate of Return (IRR) than the rate of interest charged on the loans.

Other commonly used means of evaluating the financial viability of projects are Net Present Worth (NPW), and Benefit/Cost Ratio (B/C). For the purpose of the relatively simple investment projects likely to be financed from revolving funds, it is likely that all these measures will give the same answer as to whether a fisheries activity is likely to be financially viable at the interest rate charged under the revolving fund. All these measures discount future benefits and costs. (Discounting is the reduction in the value of future benefits and costs compared with the same benefits and costs occurring at the outset of the project being evaluated). They presume there is a value to having money now rather than later or, conversely, that paying later is better than paying now. The appropriate financial discount rate to use in discounting future income (or costs) for the projects under consideration is generally the rate of interest charged on fisheries loans financed by the revolving fund. Thus if the interest rate is 10 percent, one dollar of investment or income today is equivalent to US\$ 1.10 invested or earned a year from now. Similarly with interest compounded annually and added to principal, a dollar today would be equal to \$ 1.21 two years from today ($\$1.00 \times 1.10 \times 1.10$). What this example shows is that income (or expenditures) in the future are worth substantially less than present income (or expenditures). Reduction in worth depends on the interest rate and the periods over which it is compounded. It also shows the power of compound interest in raising the value of debts unpaid for any substantial period of time (or of savings held in an interest-bearing account).

It is imperative to understand that each measure of the financial viability of investment projects is only as accurate as the assumptions made in its calculation. If costs are underestimated or benefits and sale prices exaggerated, the results of the calculations are meaningless. Because predicting the values which these variables will have at some future date, often months or years away, is more an art than a science, it is better to be conservative by estimating costs on the high side and sale prices and production levels on the low side. Even under moderately bad conditions the viability of the project can be judged as to its ability to meet the requirement of producing

sufficient income to pay all associated costs, including the servicing of debt finances of the project.

Internal Rate of Return (IRR). The IRR is the discount rate which would make discounted incremental costs equal to the discounted incremental benefits derived from the project. Except for rare cases not likely to be encountered in most small-scale fisheries projects, the set of incremental costs and benefits will generate a unique financial rate of return. If the financial rate of return is greater than the interest rate at which money can be borrowed, it indicates that a project is profitable and can effectively be funded if there is no shortage of loan funds. There is a temptation to rank projects based on their IRR. If project A has an IRR of 30 percent whereas project B has an IRR of 20 percent, A is seen to be a better project than B. If the funds needed can be obtained at 15 percent, then both should be funded along with any other projects with IRRs of 15 percent or higher.

Net Present Worth (NPW). The NPW is the difference between the discounted incremental benefits and the discounted incremental costs of a project. (It is also called Net Present Value by some economists). If the NPW is positive (that is, discounted benefits exceed discounted costs), it indicates that the project is financially viable at the interest rate used for discounting. Computationally, it may be easier to derive the period-by-period incremental benefit or cashflow and discount the cashflow rather than discount costs and benefits individually; this procedure is normally used with financial hand-calculators. Both procedures yield the same result.

Benefit/Cost Ratio (B/C). The B/C is derived by dividing a project's discounted incremental benefit by the discounted incremental costs. If the ratio is greater than 1, it indicates that the project is financially viable at the discount rate used; a ratio of less than 1 indicates that benefits are less than costs. One advantage of the B/C is that it shows how much costs would have to rise before they would be exactly equal to benefits ($B/C = 1$); for example, a B/C of 1.53 indicates that costs would have to rise by 53 percent before they would be equal to benefits. Alternatively, taking the reciprocal of the benefit/cost ratio (cost/benefit ratio = $1/1.53 = 0.65$) and subtracting it from unity gives the proportion benefits would have to fall before benefits would equal costs (35 percent). Benefit-cost ratios are often ranked and used as a

selection criterion between competing projects; however, such comparisons discriminate against larger projects with substantial benefits but high costs. In comparing small and large projects, total wealth created may be a better criterion than simply comparing B/C ratios. Examples of how the IRR, the NPW and the B/C are calculated are given in Annex 1.2.

Assessment of the financial viability of a proposed fishing investment activity is only worthwhile after technicians have determined that a proposed activity is technically viable. Technical viability depends on local conditions and should be assessed by project staff in consultation with local experts. Any of the above measures can be used to determine which fishing activities are financially viable at particular discount rates (loan interest rates). Conservative assumptions (high estimated costs, low estimated production levels and product prices, longer than expected execution times) should be used in their calculation. Particular attention should be given to delays at various stages of bringing the projects/activities on stream and their impact on both costs and projected income. Projects and activities that are very sensitive to delays require careful consideration by project managers. Projects and activities that require large amounts of credit compared to that currently being used by local fisherfolk should be given second priority to those representing only a modest increment in the credit (both informal and formal) already being used by fisherfolk in their productive activities. Projects presenting extraordinarily high B/C ratios (greater than 2) or IRRs (above 100 percent) should be viewed with great scepticism; if they are so profitable, local fisherfolk would be carrying them out already, borrowing money if necessary from local moneylenders. The projects and activities most likely to be successful are those already being adopted by the most progressive or well-off fisherfolk in the community. These projects provide an indication of the improvements that can be made without major changes in the local fisheries environment.

In village and individual surveys and other research carried out prior to the establishment of a revolving fund credit programme, identifying the bankable activities should be a priority. Once the most common activities and projects are identified, accurate information on the costs and benefits obtained by local people who are already carrying them out should be

obtained. Where projects involve bringing in new technologies, those elements of the new technology that can be purchased locally should be determined. Technical data should be provided by the experts recommending the introduction of new technology; costs should be sought from local suppliers, importers or external suppliers. Particularly if new technologies are to be introduced, their technical feasibility must be assured through trials carried out for at least one fishing season. Once technical feasibility has been established, financial analysis can proceed based on best available estimates of costs and benefits. Standard analysis should be prepared for all the most common activities and projects and standard loan appraisals and loan schedules developed for use by loan officers.

A decision will have to be made concerning whether or not to fund consumption expenditures in the lean season and to provide boat owners with money to loan to crew for the same purpose, if this is standard practice for obtaining and keeping a crew, as it is in many parts of Asia. Ordinary consumption expenditures can be viewed as prepayments for both family labour and labour provided by hired crew. If such expenditures are not funded by the credit programme, borrowers will resort to fish dealers and other informal lenders, to whom they will pay higher interest rates and assign a higher priority for loan repayment.

One of the primary borrowing needs of poor families, particularly non-migratory fisherfolk, is housing loans. Although a housing loan is not directly productive, homes may be used as the location of small-scale trading and cottage industries carried out by non-fishing household members, especially women. This aspect should not be ignored when deciding whether or not housing can be funded under the programme. From the bank's point of view, housing loans are quite secure because of the mortgage guarantee required. Defaults are unlikely as long as the borrower understands that foreclosure is a real possibility. One problem is whether the amounts involved are small enough to be repaid within the time span of the project given other loans and obligations the borrower may already have.

Loans should not be used for repayment of outstanding debts. If this principle is adopted, loans for the purpose of consolidating debts owed to a variety of creditors will not be permitted.