

**THE PROCESS OF ADAPTING A LENDING TECHNOLOGY:  
FINANCIERA CALPIA IN RURAL EL SALVADOR**

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# The Process of Adapting a Urban Lending Technology: Financiera Calpiá in Rural El Salvador

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## 1. Introduction

In the last decade or so, poor people around the globe have seen a growing number of organizations offering them financial services (with a heavy emphasis on credit). In Latin America, this growth in the supply side has not been uniform. Most of the successful organizations in this part of the world have bloomed in the urban areas. This has not happened due to a lack of interest in the rural population, but to the challenges encountered in the development of appropriate technologies for the rural environment. There are organizations that have dedicated their effort and attention in the provision of financial services in the rural areas, but there is no parallel with the outreach and sustainability already reached by some urban MFOs (Microfinance Organizations).

Therefore, it is important to understand the few organizations that are successfully reaching the rural areas. One of these organizations is Financiera Calpiá in El Salvador<sup>2</sup>. Calpiá is a leader in Latin America that has been prominent in the innovation needed to further expand the frontier of finance (Von Pischke, 1991). An understanding of the technology of a MFO such as Calpiá's, the problems it has solved and the challenges it still faces is fundamental to be able to draw lessons about what can and what can not be done in rural lending.

However, the understanding of the mechanics and procedures of a lending technology is not enough to be able to replicate it. One has to be extremely cautious and take into account the environment where it functions (Is there a conducive regulatory framework? What does the target market look like?), the people needed for this venture (Is there enough human capital?), and finally the organization that ties these elements together (Is there an institution with the appropriate set of incentives?).

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<sup>2</sup> In Nahuatl, Calpiá means a small box used to store savings, usually under the ground.

## 2. Why Rural Lending is Difficult?

“Any lender faces risks each time a loan is disbursed. This occurs because lenders sell a product (loan contract) for which they do not receive the price (principal and interests) immediately. They only receive a promise of (uncertain) future repayment. This is why lenders care about the future behavior of their customers. The lender’s ability to correctly predict repayment is crucial for their success” (Navajas, 1999). The manner in which a lender resolves these problems is called lending technology. Different lenders use different lending technologies to accomplish similar results. For example, moneylenders use informal mechanisms to guarantee repayment where, in contrast, commercial banks base their technology in establishing formal mechanisms to guarantee repayment.

As any lender, rural lenders also have to resolve problems of information and uncertainty, but the hurdles to overcome are more formidable (Gonzalez-Vega, 1999; Zeller *et al.*, 1997), including:

- (a) A greater heterogeneity of the clientele. Rural dwellers differ not only in their skills but also in a number of characteristics of their surroundings (land quality, irrigation possibilities) and of their cultural background (languages, customs).
- (b) A greater exposure to systemic risk. Droughts, floods and sudden variations in prices (especially commodities) are examples of shocks that can easily wipe out all crops in a region. These shocks are part of rural life and are reflected in a high covariance in incomes.
- (c) A greater dispersion of the clientele. The dispersion increases transaction costs to both borrowers and lenders.
- (d) The seasonality of rural activities. Rural life, especially for farmers, centers around sowing-and-harvest-time, creating periods with limited liquidity (when loans are needed) and other periods with excess liquidity (when deposit facilities are needed). This, in turn, makes liquidity management (local intermediation) for specialized rural lenders more difficult.
- (e) The rigidity of agricultural cycles. Rural lenders cannot use frequent payments as a monitoring device since, most of the time, one lump payment kind of loans are the only ones that fit the demand. This limits the type of lending technologies that can be used in the rural areas.
- (f) The size the transactions. The level of poverty that persists in the rural areas affects the loan amounts. They are typically small and they do not tend to grow over time (e.g., the fertilizer needs of a small farmer in each agricultural do not vary too much). The small loan amounts in addition to high fixed costs difficults cost recovering.

- (g) The lack of assets that could be used as useful collateral for a lender. In some countries (e.g. Bolivia), there are legal constraints about which plots of land may be used as collateral. In other cases, enforcing contracts is very difficult or extremely costly.
- (h) The absence of standardized information. Tools such as such as financial statements or credit histories do not exist in rural areas. Their absence increases the cost of evaluating creditworthiness.

In short, in addition to the typical problems encountered with lending to the poor, rural lenders have to deal with additional problems due to the characteristics of the rural setting (from dispersion to agricultural cycles).

### **3. A Rural Lender in El Salvador<sup>3</sup>**

Financiera Calpiá initiated operations in 1988 as a non-regulated financial intermediary. Seven years later (by 1995) Calpiá became part of the regulated financial system. When it started, its target market were the micro and small enterprises in the urban areas (the productive poor). The expansion to the rural areas occurred only when the urban business was already consolidated.

The rural expansion is being undertaken one step at a time. Three elements could be considered as key factors in the development of the rural services:

- (1) a lending technology already developed for the urban poor;
- (2) a careful selection and training of the personnel needed for the rural environment, and,
- (3) a policy of understanding each new sub-market before entering into it.

These elements together comprise the basis for the development of the rural lending technology of Calpiá. For the sake of clarity, the essential elements of the technology of Calpiá (that are shared in both, the urban and rural operations) are described first. Then, the differences observed in the rural version of the technology are discussed. Finally, conclusions and challenges to be resolved are presented.

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<sup>3</sup> The information was gathered as part of the larger research agenda of the BASIS CRSP in El Salvador (Gonzalez-Vega, 1998; Schreiner *et al.*, 1998). The project is being implemented by the Rural Finance Program at The Ohio State University and the Departamento de Estudios Económicos y Sociales at the Fundación Salvadoreña para el Desarrollo Económico y Social (FUSADES).

### 3.1 The Philosophy of Calpiá

The design of the lending technology used by Calpiá is based on general principles that were originally developed for the urban areas, but that now are also applied in the rural scenario. These principles may be understood by the way Calpiá looks at its clients (demand), and the type of services offered to them (supply).

Calpiá understands that in its target market:

- (a) The household-firm (farm) is an indivisible economic unit of revenues and expenses. Thus, repayment capacity and willingness to repay must be evaluated accordingly.
- (b) A larger number of alternative sources of repayment is always better. Diversification of the household's activities facilitates risk control.
- (c) A long-term relationship is more valuable (available credit) than a one-time transaction.
- (d) Poor households have assets that could be used as collateral. Calpiá understands that collateral is useful if it serves as an incentive for repayment (because it decreases the expected gains from default for the borrower and it serves as a powerful signal to prospective borrowers of the seriousness of the organization), even though it may have a very low retail value (e.g., liens on household appliances).

In response to this demand, Calpiá offers services with the following basic characteristics:

- (a) Loans tailored to individual demands. Tailoring terms and conditions to individual demands allows clients to be able to take advantage of a wider set of productive opportunities.
- (b) A long-term relationship in which a stream of financial services is offered (not only one-time loans).
- (c) Loan officers are the most important link (and most of the time the only link) between Calpiá and its borrowers. In order to take advantage of this personal contact, loan officers are in charge of most lending activities (screening, monitoring, and enforcing loan contracts). Thus, Calpiá exploits the benefits of economies of scope at the loan officer level.
- (d) Since the loan officer's behavior determines the quality of the services provided by Calpiá, there is a process of careful selection and training of loan officers. In addition, there is system of monetary incentives based on the performance of each officer's portfolios.

- (e) Promptness in the loan granting decision. Calpiá evaluates potential borrowers in timely fashion and acceptance as well as rejection is done very rapidly.
- (f) An in-depth analysis and monitoring of its clients' use of funds. This is not done because Calpiá is interested in the specific use of funds. Rather, Calpiá is concerned only about a change in the risk profile of the borrower. As long as the risk profile remains unchanged (even if the original proposed used of funds has changed), loan officers will not be concerned at all. Calpiá understands that their clients perceive changes in their productive opportunities better than anybody does.
- (g) Permanent monitoring in the form of casual visits or greeting customers plays a meaningful role in these markets. It reinforces the relationship borrower-lender and signals the seriousness of Calpiá.
- (h) An efficient management and information system (MIS) that supports the loan officers' activities (e.g. arrears information is transmitted on a daily basis).
- (i) Non-traditional assets (with high incentive value, but low resale value) and traditional assets (such as house mortgages) are accepted as collateral; and
- (j) Contracts are enforced to ensure repayment and as a signal for other clients (credibility).

### **3.2 The Rural Version: What is different?**

The process of adapting and transferring a lending technology to a different setting is not easy. Calpiá has slowly moved to the rural areas. It has been an arduous process of learning-by-doing and taking baby-steps to ensure success (Buchenau, 1997; Navajas and Gonzalez-Vega, 1999).

The learning process has not stopped. However, there are already some lessons that can be learned from the Calpiá's approach to rural lending:

- (a) The stock of knowledge needed to understand agricultural activities is much more complex than what is needed in urban environments. Therefore, Calpiá tends to hire only loan officers with formal training in agriculture and, if possible, with some practical experience in agriculture.
- (b) The process of entering into each new market (opening a new rural branch) follows a market study. Loan officers of Calpiá conduct the market studies. These loan officers are, in most of the cases, new to the organization and the ones who will be in charge of the new branch. The objective of the market study is two-fold. First, it serves for a better design of products (getting to know the demand) and second, it gives loan officers a first taste of their market.

- (c) Lack of diversification associated with systemic risk is an acute problem in the rural areas. This problem is tackled at three levels. First, at the household level. Calpiá emphasizes diversification of the household. This requirement does not appear to be problem for the small farmer, who is diversified anyway, but it is a limitation for medium and more specialized farmers. Second, at the rural portfolio level. Calpiá responds to a global demand of credit. All rural activities (not only agricultural) are potentially fundable. Finally, at the level of total portfolio. The nexus urban-rural allows Calpiá to decrease overall risk. This happens not because one activity is necessarily less risky than the other, but because correlation between rural and urban activities tends to be low.
- (d) The type of assets accepted by Calpiá is diverse. In order of importance: household appliances and furniture, machinery, cattle and mortgages (on the house, the plot or both). Household appliances and furniture are preferred because they are easier to move and sell (in case of default) than larger and more specialized items (such as machinery). These requirements do not preclude tenants from having a loan. Calpiá has shown that lending to farmers who do not own land is possible. Consequently it has extended the universe of rural borrowers in a great degree.
- (e) Another innovation is the responsiveness of Calpiá to the rural conditions. Seasonal credit is offered in peak seasons and terms and conditions of the loan contracts consider agricultural cycles.
- (f) Accessibility to the household is a key component of the technology. It permits a continuous contact between loan officers and borrowers (allowing monitoring) and seizing collateral assets if necessary (so contract enforcement is credible). Thus, creditworthy farmers living in remote areas with difficult access are not considered potential clients.
- (g) The differentiation of Calpiá vis-à-vis the competition. Calpiá tries to differentiate itself from the competition by offering a service with little red tape (in opposition to the *Banco de Fomento Agropecuario* - the Salvadorean Development Bank) and by having a vocation for permanency (in opposition to NGOs).
- (h) The process of expansion has been followed cautiously. Loan officers evaluate all loans, no matter how well a borrower has behaved in the past. In urban areas this is no longer necessary since preferred clients are granted a credit line after they accumulate a good repayment record. Routine evaluations in rural areas obviously increase costs, but these evaluations allow Calpiá to learn more about this new market niche.

#### **4. Conclusions**

Financiera Calpiá is one of the few examples of a Latin American MFO being able to transfer and adapt its technology to the rural areas. The process has not been easy. It takes time to learn about the characteristics of the new environment. In this new environment, Calpiá has used different strategies (as described in section 3.2) to overcome problems of information and uncertainty.

Four features stand out in Calpiá's strategy of expansion. First, its portfolio diversification at three levels (at household level, at the rural portfolio level, and at the total portfolio level with the rural-urban nexus). Second, the monitoring of changes in the risk profile of its clients without targeting any specific activity. Third, an emphasis in collateral assets that the poor have without excluding tenants. Fourth, the importance given to the selection and training of its loan officers.

There are, however, still problems to be resolved when we want to talk about replication. The lending technology of Calpiá is not designed to deal with more specialized farmers. In the same token, specialized rural lenders without an urban nexus will find more difficult to deal with systemic risk. Also, a great deal of its success is due to its human capital, where most of its loan officers have an undergraduate degree in agricultural sciences. In countries where human capital is scarce, wages could pressure at an unsustainable level. Finally, rural lending is expensive, so a MFO with a vocation for sustainability must price its products accordingly. In some settings, to charge high prices (interest rates and others) may be politically infeasible.

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