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# 11 Reasons *for the possible failure of a* Revolving Fund

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*"It appears to be a characteristic of human nature that we learn more effectively from errors -our own or other people's- than from successes. Exposing our errors can be painful, but we must do so in order to allow others to avoid making the same mistakes."*

Rolando Bunch

*Dos Mazorcas de Maíz: Una guía para el mejoramiento agrícola orientado hacia la gente.*  
Vecinos Mundiales, Oklahoma, 1985

## Introduction

The present document seeks to explain some of the reasons why failures have occurred in the use of Revolving Funds destined for the support of such activities related to farming and stockraising as they are practiced by the small-scale rural producer of agricultural products. Some of the points discussed here can be applied more widely. However, the Revolving Funds destined for petty business or for the support of urban micro-enterprises undoubtedly have their own distinctive features.

Our analysis, which principally refers to the region of the Altiplano and the inter-Andean valleys, is based not only on the experience of NGOs, but also on those of other types of institutions which implement Revolving Funds in their effort to assist small scale farmers.

In the course of this document, generalizations will be formulated for which exceptions can no doubt be mustered, also they will not take into account the whole range of known experiences in this area.

Accent is deliberately placed on problems, and the intention is to achieve in the reader the kind of positive critical disposition which will both enable him to avoid repeating the most frequent errors and assist him in making the best use of the instrument of Revolving Fund service.

We should like to express our gratitude to our colleagues and friends whose suggestions permitted the improvement of this document in its first version. Nonetheless, we do not consider this version to be definitive; on the contrary, it remains open to additions and changes.

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*The opinions here expressed are personal and do not necessarily represent the institution's official position.*

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## 1. Who owns the Revolving Fund is not clearly established

Mostly, these funds have been constituted as donations from agencies of external assistance; only exceptionally are we dealing with credits. Given the fact that "the money has come in the name of the farmers", a certain ambiguity persists with regard to who actually owns the Revolving Fund in question. Obviously, the resources are destined for the farmers, but it is the institution which has contracted them in the first place and which is responsible for their correct administration, as well as for the relevant financial reports required by the donor agency.

The fact that we are dealing with donated funds

should not impede a clear definition with regard to the ownership of the sums involved. Another source of ambiguity is the profit-making impediment attached to these resources, given their nature (generally they arrive as donations) and the legal statutes governing the non-profit institutions which promote them.

Some of these funds are administered jointly with the local organizations and are meant to be self-managed by the farmers in time. This fact contributes even further to obscuring the ownership or property of the Revolving Fund, introducing in addition the noxious practice of judge and party in a delicate matter such as the collection of outstanding debts. As a result, it is not always clear who (and on what basis) should be collecting the loans involved.

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## 2. The farmers organization is not designed to manage credits

As has been mentioned, some institutions practice the joint administration of the Revolving Fund or an administration left entirely in the hands of the farmers who receive the credits.

In the great majority of the rural communities there exist well functioning traditional social organization (generally trade-unions) who articulate and communicate to the outside the needs of the community. The addition of the task of administering a Revolving Fund, may debilitate and overtax the local organization be to the point of actual crisis

It can be argued, that a social organization is an entity created by a collective need to administer its resources. This is in fact the case in rural communities, but the structures are actually too weak, and the management capacity insufficient for managing these tasks. The absence of adequate accounting (the management of a Revolving Fund is very demanding in this respect), can lead to internal conflicts and mutual accusations between the leadership and their constituents, even when actual peculation or thefts have not actually occurred.

It would therefore appear that the solution should lie in the creation of economic organizations but this experience too has not been positive. As a rule, the economic organizations suffer the same difficulties outlined for their social counterparts. The exceptions to this trend correspond above all to organizations which operate at an intermediate level.

We should however point out that we are referring here to the local organization as administrator of the Revolving Fund and not as a recipient of credit.

But above and beyond the subject of credit, it is worthwhile pointing out a further risk incurred in the creation of economic organizations isolated from their social counterparts in the community: generally created by the donor institutions and endowed with important resources, they in some cases enter into competition with the local social organization (the traditional holders of power), thus dividing the community into rival factions.

## 3. The Revolving Fund is only a part of a whole range of activities

A large majority of institutions are engaged in a diversity of activities (technical assistance, job training, etc.), where credit constitutes a complementary concern. Thus the success or failure of a given project is not measured judging by the results of the credit extended, but by the degree to which it has strengthened the organization, increased production, contributed to agricultural diversification, etc.

Given this diversity, the possibilities for specialization are minimal. As it is generally considered that the management of credit does not require specialists, frequently the extensionists who are made to handle such credits do not have any preliminary training.

Normally, these extensionists work out the project, extend technical assistance, provide credit and are then entrusted with its collection. In other words, here too a dual relationship is established, on the one hand between the technical expert and the beneficiary, a relationship which is assumed to be horizontal, and on the other between the debt collector and the debtors a relationship which by its nature is vertical.

Thus, not only the extensionists, but even the institution itself find themselves ignoring the distinction between their credit-extending function and that of promotion, and as a rule the latter is favored at the expense of the former.

## 4. The other activities are free of charge or subsidized

If the assistance in infrastructure, technical aid, job training, etc. imparted by the institution is free of charge or subsidized, many recipients of credits will find it difficult to comprehend that the "credit" which has been supplied to them by the institution (in the form of seeds, fertilizers, some tools, etc.) has to be repaid.

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## 5. Subsidies and credit are confused

Although its purpose is altogether different, often the Revolving Fund ends up as a form of subsidy to agricultural production.

The principle of subsidies as such is not in question. In cases where subsidies are justified it is advisable to explain this intention, the extent of their durations etc.; and in such cases it is not recommendable that a Revolving Fund be established.

There are regions, especially on the Altiplano, where agricultural production is limited in scale and high in risk, for which reason it appears to be more appropriate to subsidize the infrastructure of production (above all irrigation and the conservation of soils).

On the other hand, there are rural activities which can in effect sustain credits. Freely available credit has fostered a number of these, notably the fattening of cattle.

## 6. By means of the Revolving Fund, attempts are made to introduce innovations which have not been validated at farm level

Often the Revolving Fund is utilized as a strategy to introduce technical production proposals (the famous "packages"). In other words, credit is only given to those farmers who implement the technical recommendations of the institution.

The majority of these proposals are the result of research undertaken in Experimental stations or of technical recommendations on a purely theoretical level which have not been validated by experience in the fields.

Generally, these schemes are more expensive and labour-intensive than those traditionally applied by the fanner. The availability of manual labour within the farming families or their economic capacity to sustain the new form of production are not taken into account at all. It is assumed that the income-yielding capacity is so great, that it will permit adequate savings for reinvestment.

On the other hand, the injection of additional resources for the exploitation of soil and water can implicate a rupture of the fragile ecological balance in the intervention zones, which may put in question the sustainability of the proposed system.

To explain portfolios in default, many reports abound in justifications based on the negative influence of natural phenomena. Said negative influence is often due to the fact that, besides being concentrated in one area, the crops introduced with the help of a Revolving Fund are often more susceptible to plagues, frost, hail or drought. A similar situation is found to occur with the introduction of improved animals.

Finally, it is seldom taken into account that the commercialization of the resulting produce has to be realized in markets and on a scale which are insufficiently known.

Many failures can be explained by the technical aspects of the project rather than by the actual credit itself.

## 7. It remains unclear who assumes the risk

Since the technical proposal has been realized by the engineer, even if the farmer has neglected his work commitments, in the event of failure he will deny any personal responsibility.

What should be produced, how and when this should be done and for what end production should be undertaken, are questions which the farmer normally answers applying reasoning which is geared to survival rather than a logic oriented towards the market.

It is a known fact that the Andean farmer does not bet on one sole crop and that he does not sow on one date alone or in one plate only. This diversity is an integral part of his strategy, hence his resistance to

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innovations which concentrate production. Frequently, the technicians complain that the farmer does not devote the requisite time nor the best land to the production proposal of the Revolving Fund.

In consequence, the rural family while not spurning the innovations proposed, will integrate them into their own system, which agricultural work with other types of labour carried out even outside of the community. Some farmers refer to the Revolving Fund as a "yapa" (tip, windfall), in other words, as something additional which reaches the community and which has to be accepted as such.

## 8. Collective production is favored at the expense of the traditional method of production based on the individual

Some of the Revolving Funds compel the farmer to produce in groups, when according to established tradition, production has always been carried out employing members of the individual family.

Often the farmer joins an association in order to obtain credit (above all when credit in kind are involved), only to continue producing on a family level.

It should also be pointed out that the farmer does not sow on just any random day. The days indicated for sowing are fixed on the basis of prevailing weather conditions and of the advantageous configuration of the stars. These favorable days are devoted to seed-planting in the individual family plot: joint sowing along with other beneficiaries of the Revolving Fund can safely be postponed.

Cases have been observed in which the interest of the farmer who has made available his land for collective production, in fact lies in the possibility he sees of subsequently taking advantage individually of the fertilization of his fields when the beginning of the next agricultural cycle comes around.

## 9. Small portfolios with high administrative costs are established

By its very definition, credit on a small scale involves high administrative costs, which in turn require a high volume of loans to be covered.

The proliferation of small Revolving Funds principally concentrated within a limited geographical area, does not allow the funds in question to cover the minimal fixed costs involved in their administration.

Furthermore, a large majority of the established Revolving Funds extend their credits, and even sometimes accept the repayment of the resulting debts, in the form of produce. This procedure increases the costs to an even greater extent, given the fact that it entails additional expenditures for the acquisition and the transport of the produce, for its storage before and after the harvest and for its more complicated form of administration. Generally these expenditures are not accounted for, given the fact that they form part of the activities subsidized by the project.

In addition, there are instances in which the recovered product is not of high quality, thus reducing the actual amount which has been recovered and if we add the losses incurred in storage (due to putrefaction, loss of water content or simple abstraction), a rapid decapitalization of the Revolving Fund can hardly be avoided.

## 10. The interest rates fixed are low or non-existent

Based on the justification that, considering the weakness of their economy, the farmers' access to credit must be facilitated, many of the Revolving Funds operate with very low or zero interest rates. The costs of operation, costs of risk and financial costs (which, because we are dealing with donated funds, normally are zero) are subsidized, which creates a total dependence on the institution providing the subsidy, and this in turn limits the possibilities of sustaining the service.

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## 11. Loan guarantees are neglected

Because we are dealing with credits the use of which are determined by both the lender and the borrower in defining the use of the credits extended, in most cases the guarantees securing repayment are not adequately worked out.

It is assumed that the guarantee lies in the success of the project, but as has been indicated, it is rarely clear who bears the responsibility for success or failure, and who in effect assumes the risks remains largely undefined.

The guarantees are generally group-based: it is assumed that the group will apply pressure to secure repayment, But it should not be forgotten, that there may also be group-based resistance to repay. There exist examples of this occurring.

### Preliminary conclusions

Obviously, there are other reasons which can explain the failure of a Revolving Fund. The severe inflationary process experienced in Bolivia a few years ago, for instance, was the principal cause for the demise of various Revolving Funds; the lack of concern for the establishment of clear rules (for procedures methodology, controls etc.) on the part of the institutions which administer these credits can also be blamed. In short, the interested reader may add more reasons to our list or question the reasons we have mentioned, thus fulfilling the purpose of this document.

A large part of the problems outlined above are not new: many of them have been overcome or are in the process of being surmounted by the institutions which work with rural credit in Bolivia.

Various institutions specialized in the extension of rural credit operate with appropriate interest rates, apply guarantees, have sizeable portfolios (or at least larger ones than those of the traditional Revolving Funds) and suffer default levels which are lower than those Commercial Banks are experiencing with the same poorer population segment. The need to cover all costs involved in the concession of credit is still a matter for discussion.

Increased specialization opens up greater possibilities for a more professional management of credit and for credit coverage on a larger scale. The credits extended by these institutions are not restricted to specified investments or limited to a narrow geographical area. Diversity and a broader coverage provide the requisite experience and spread the burden of risks.

There are cases in which the promoting institution which obtains external financing for its Revolving Fund transfers its management and administration to a specialized entity under a specific agreement, or, if the volume of the portfolio justifies it, the institution itself may create a specialized credit entity separate from the rest of its other activities.

Thus coverage has been extended in other areas of the farming economy, thus applying a wider concept of rural development as opposed to the exclusive support of agriculture and animal husbandry.

By means of portfolio lending, the farmer is given the option to decide at what time and in what activities to invest the resources placed at his disposal and, as a result, to assume whatever risk may be involved. A similar situation is produced when the farmers themselves put forward the original proposal for the project to be financed by the credit in question, a situation which does not prevent subsequent technical assistance by an NGO or by another institution promoting development. In fact, there are instances in which the entity providing the credit encourages the farmers to decide to which institution they wish to apply for the technical assistance needed to realize a given project.

It is not enough to avoid the mistakes made in the past, but the mere fact that a conscious attempt is made to do so already constitutes a contribution towards the creation of a sound system of rural finance designed to benefit the farmers who require funds for the development of their activities and who are in a position to pay for the credits they demand.

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7. It remains unclear who assumes the risk
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