

# **GREATER EQUALITY OF OPPORTUNITY ON THE MARKETS**

Paper on Hivos' policy sector economic activities

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**Fout! Bladwijzer niet gedefinieerd.**

## **1. Policy development**

### **1.1 Brief historical review**

Since its foundation in 1968, Hivos has been supporting organisations that contribute to the economic development of the poor. This support from Hivos is aimed at improving access to credit and supporting services, stimulating organisational development and encouraging forms of production that are environmentally sound and respecting human dignity. In the period up to 1995, about 20% of Hivos' partner organisations were active in this sphere. An overview is presented in Annex 1. Organisations operating in the economic sector are supported with credit and/or grants, depending on the nature of the activities to be financed. Grants are given for training, advice and organisational development. Just under 50% of the financing in the economic sector is targeted on direct productive activities and takes the form of credit. Annex 1 shows the types of activity for which credit was provided in 1995.

From 1971 onwards Hivos provided credit via the Hivos Loan Fund. Up until the end of the eighties the Loan Fund was financed mainly by private lenders. Because of the growing demand for risk-bearing loans and guarantees, it was decided in 1991 to restructure the Loan Fund and divide it into a (no-risk) General Loan Fund and a Risk-Bearing Loan Fund. The latter was given greater scope by placing in the fund not just private resources but also cofinancing money assigned to Hivos. With this fund Hivos took the well-considered risk of providing credit in local currency for all kinds of development-related organisations and activities that would not otherwise gain access to credit.

November 1993 saw the adoption of Hivos' business plan entitled "A two-track strategy", in which, among other things, the economic sector was made one of Hivos' policy spearheads. This decision was given added impact through the cooperation with Triodos Bank. In February 1994 Hivos and Triodos Bank launched the North-South Plan. In the same year the General Loan Fund was incorporated in the North-South Plan.

A second step in the cooperation with Triodos Bank was the founding of the Hivos Triodos Fund (HTF), in which Hivos' development expertise is combined with the banking know-how of Triodos Bank. On 1 January 1995 the Risk-Bearing Loan Fund was incorporated in the HTF. Hivos' services are made available to the HTF largely free of charge. The idea is that this form of support will enable the HTF to break even.

### **1.2 Aim of this paper**

The aim of this paper is to define the economic objective and develop it within the framework of Hivos' overall policy. This paper also provides information on Hivos' basic points of departure in taking decisions concerning economic activities. It is important, particularly for the organisations in which Hivos has a participation, that these basic points of departure be formulated as clearly as possible (see section 3.5).

Finally, this paper offers a framework for clearer analyses and choices within national and local contexts. It forms a basis for more uniform assessment of applications at the various Hivos offices. The choices made in the paper are translated into practice in a separate "Manual for supporting economic activities".

### 1.3 Link-up with previous policy papers

The paper forms part of a policy development process whose main elements comprise:

- a. Policy documents before 1988: emphasis on individual responsibility and choice and hence also on individual direct loans.
- b. 1988: the paper "Volwaardige participatie of de toegang tot macht" (title of English version: "Full participation: a question of power"): the importance of organisational and institutional development and operating together with the partner organisations in the social arena forms a new aspect.
- c. 1989: "Hivos leningen notitie" (title of English version: "Memorandum on loans"): shift away from direct loans for producers and towards guarantees for, and participations in, financial institutions.
- d. 1993: "Hivos op twee benen" (title of English version: "A two-track strategy"): stimulation of ethical saving and investment and support for measures to promote the economic self-reliance of the poor form together one of Hivos' two main policy tracks.

The North-South Plan brochure, which was published in 1993, does not have the status of an official policy document. But it does show how Hivos' thinking developed. The brochure emphasises the development potential of low-income groups and the importance of access to markets, while observing that the market mechanism also has its shortcomings and needs corrective action. The main points contained in the above-mentioned documents form the basis for the present policy paper. New subjects that will be developed include:

- cooperation with organisations that play a role on the market (2.7);
- conditions governing cooperation relationships (3.2);
- mixed financing (3.3);
- credit characterized by type (3.3) and period (3.4);
- combining economic objectives with social and environmental objectives (3.7);
- Hivos' specific role (4).

### 1.4 Policy development in practice

Hivos develops its policy on the basis of an analysis of the problems confronting partner organisations. Hivos is concerned mainly with small-scale producers who are usually keen to collaborate with each other, in some cases within the framework of a cooperative. A large part of Hivos' support goes to the rural economy. Hivos supports organisations that are active in agriculture, fisheries and forestry, the processing industry and agricultural services. To an increasing degree, Hivos is also providing support for small entrepreneurs in towns.

Because of the differences between North and South in terms of climate, culture and wages, there are opportunities for sustainable and profitable production in the South, but various problems arise here.

Small-scale producers can operate efficiently in a number of sectors, but they are not always able to fully exploit their competitive position, since large concerns have more political influence.

Small producers, particularly in rural areas, generally have poor access to financial services. This is because of the geographical distance from credit institutions, the fact that the poor cannot offer any security for loans, and the relatively high cost of credit, in addition to small producers' low level of training/education.

Deregulation and trade liberalisation in developing countries lead to shifts in the patterns of production. Those groups that are the quickest to react to these changes can gain economic advantage. Retraining and adaptation are called for in the case of those operating in economically and socially weak sectors.

The poorest groups in particular need training and advice on these points in order to be able to respond successfully to these developments.

A final category of problems is connected with the functioning of unregulated markets: what initially may seem to be cost-effective production methods can have negative consequences for the environment, lead to degrading working conditions or reinforce existing discriminatory conceptions of the roles of men and women in society.

The problems outlined above have not diminished in recent years. The way in which Hivos tackles these problems has changed, however. Hivos' experience with failures and successes and the desire to operate as effectively as possible have been decisive factors here.

## **2. Market access: an institutional approach**

### **2.1 Introduction**

This chapter stresses the process aspect in poverty and Hivos' institutional approach thereto. The objective within the economic sector is emancipation and poverty alleviation through economic self-reliance. Hivos contributes to this by helping the poor to earn an income via the market as workers or entrepreneurs.

The market mechanism has a number of shortcomings. Private organisations can help to improve market access and compensate for the shortcomings.

### **2.2 Poverty, impoverishment and marginalisation**

The term poverty refers to the state of having a low income. Income is created through productive use of resources (e.g. land), through exchange (e.g. wage labour), or by claiming socio-cultural rights (e.g. the right to support from an employer in times of crisis, the right to health care from a state clinic). The term impoverishment refers to the process that leads to poverty. Marginalisation is the exclusion of social groups from sources of income and political influence.

The terms poverty, impoverishment and marginalisation take on concrete meaning only within the socio-economic context of a country. Each country determines where its own poverty line lies. In each country political influence is exerted in accordance with a characteristic pattern. Each government decides itself the areas in which and the extent to which it wishes to withdraw from the market. Each country and each culture assigns certain roles to men and women in the production process. Women are in many cases discriminated against as regards access to credit and means of production, for example. That is why Hivos prefers to use country-specific studies as a means of identifying activities and organisations that qualify for support.

### **2.3 Hivos' institutional approach**

Hivos applies the institutional approach to support for the development of the poor in the Third World. Promotion of social movements and organisations is a major objective. Where poverty and impoverishment are partly the result of exclusion, it is necessary to build up organisations and, in some cases, a network of organisations in order to gain a position of power. But organisations have also direct economic advantages, such as the exchange of information and better access to credit. In principle, Hivos supports organisations only.

Support for poor and marginalised groups does not preclude cooperation with other actors in society, such as government and banks. To the extent that they have means of improving the position of poor groups, they can be effective partners. The social role and own objectives of these parties must, however, be taken specifically into account.

### **2.4 Emancipation and economic self-reliance via the markets**

The promotion of economic self-reliance is an important part of the process of poverty alleviation and emancipation. Besides being a goal in itself, creation of a stronger economic base is a step towards political recognition.

Economic self-reliance can best be achieved by securing a good income via the markets. This can be

done via the labour market as wage-earner or via product and credit markets as independent entrepreneur.

## 2.5 Market shortcomings

The market mechanism does not eliminate inequality in starting positions and has other shortcomings:

- a. Unequal starting positions lead to inequality in income and concentration of the sources of wealth and power in the hands of a small group. Training and organisational skills are needed in order to operate in the marketplace. Additional requirements are information on potential markets and credit.
- b. Many primary commodity producers' organisations are dependent on international trade, where developments are often unpredictable. A number of importers have expertise in this field, but they are not always able to secure the cooperation of their bankers, particularly in the case of new producers' organisations in less stable countries.
- c. Another problem is the fact that some costs are not taken into account when fixing prices. "External costs" occur when the production or consumption of a good has adverse consequences for other parties. The cost of these adverse consequences is not taken into account in fixing prices and is not therefore borne by the producers or consumers concerned. In many production sectors this leads to damage to the environment and to human health, and it ultimately reduces the scope for future generations to meet their needs.
- d. Unregulated production can lead to degrading working conditions. Child labour, very long working days and unacceptable risks to workers stem from the lack of alternatives for the poorest groups in developing countries.
- e. The negative consequences of production and consumption for man and the environment can be corrected in a number of ways, for example by laying down rules aimed at reflecting external costs in prices or by legal regulation of production methods. It is often not possible to lay down such rules at national level, or they are not imposed for various reasons. The creation of alternative markets with approval marks can contribute to a solution. Some private organisations can play an important role here.

## 2.6 The role of government

The role of government in the economic sphere is changing. Confidence in the ability of the state to guide economic development has diminished considerably. Lack of success means that government in many countries is withdrawing from all kinds of economic activities.

But the role of government remains essential where it is a question of laying down and supervising the legal framework for economic activities, providing public goods and services and contributing to the development of the population through education and health care. Government could also take on the task of compensating for shortcomings in the market mechanism.

Unfortunately, governments in many developing countries are not yet really able to perform these core tasks. Laws and rules are not clearly and definitively established, and specific interest groups exert disproportionate influence on policy and the use of resources. In this context, not just economic but also political entrepreneurship is needed, if economic organisations for poor groups are to be successful. But government agencies sometimes participate in credit programmes and support small-scale commercial activities through the provision of information and training. In such cases Hivos can seek cooperation or alliance.

## 2.7 The role of private organisations

Private organisations of many kinds are actively involved in tackling the above-mentioned problems. The business community puts the emphasis of course on economic objectives, such as increasing the market share and maximising profit. The development NGOs tend to want to solve many problems at once and often evolve initially into multipurpose organisations engaged in the provision of training, advice and credit, etc. Quality sometimes suffers because of the multiplicity of activities.

Between these two extremes there is a whole range of more specialised and service organisations. As a lead-up to its activities in the economic sphere, Hivos looks at a number of markets - the labour market, the markets for primary commodities, processed products and related services, including credit.

On this basis Hivos seeks forms of cooperation with the most appropriate organisations. In practice, the following types of organisation (classed according to core activity) are encountered:

- a. Producers (primary and secondary sectors), mainly organisations of farmers, processors and artisanal producers.
- b. Providers of services (tertiary sector); in the commercial sphere these are mainly traders, carriers, providers of credit, insurers and to a limited extent commercial consultants and trainers. Within this group local credit institutions, exporters and importers of primary commodities play an important role.  
In the ethical sector there are organisations devoted to strengthening the position of producers (providers of vocational training, consulting firms, market research firms, organisations specialising in the better communication of market data, approval mark organisations, etc.).
- c. Interest groups and lobbying organisations. Within this group one finds trade unions, organisations that lobby for the environment, fair trade, debt relief, reform of structural adjustment programmes, etc. There are many forms of cooperation among these organisations, both in Europe and in the South.

In principle, Hivos can enter into cooperation relationships with all these kinds of organisation. The manner of cooperation is elaborated in the chapters that follow.

### 3. Objectives and instruments

#### 3.1. Objective

On the basis of the approach set out in chapter 2, Hivos defines the objective for the economic policy sector as follows:

To improve employment and income opportunities.

Within the economic sector Hivos supports organisations that contribute to the achievement of this objective. This can be done in a number of ways, such as:

- a. improving access to credit
- b. providing advice and training
- c. stimulating protecting of interests and lobbying
- d. stimulating organisational development
- e. providing finance

Hivos attaches major importance to the economic sector within its overall policy. This is reflected in its plan to devote 35% of the new funds that become available each year to the above objective. Hivos is cooperating with over 100 organisations (as at 1/96) that are active in the above areas, i.e. 20% of the partner portfolio.

The economic objective can (in the short term) conflict with social and environmental objectives. Combining objectives implies looking for a suitable balance. This is elaborated in section 3.7.

In the following section the minimum requirements for cooperation are formulated.

#### 3.2 Conditions governing cooperation relationships

In addition to a demonstrable contribution towards achievement of the above economic objective, a number of supplementary conditions are formulated by Hivos for each cooperation relationship:

- a. Each cooperation relationship should ultimately result in an improvement in the position of the poor and/or poor groups. This means feasible objectives, a realistic estimate of the resources required and willingness to make adjustments during the process when objectives are not being achieved. Support by Hivos often involves a package of measures comprising in many cases credit as well as a subsidy and advice. Once the decision to provide support has been taken, there is a joint responsibility to ensure that the organisation and the activities will be successful.
- b. Local backing: Hivos provides support through organisations with a local basis.
- c. Orientation towards the target group: In its policy and the implementation thereof the organisation must demonstrably take account of the interests of the target group. The influence can be either direct (through an elected management committee in the case of a cooperative) or indirect (through objectives laid down in the organisation's constitution).
- d. Concentration on core activities: The organisation is expected to draw up a precise statement of its objectives and activities and on the basis thereof make a distinction in its bookkeeping and organisationally between the various activities. This is particularly important where there is a combination of commercial and non-commercial activities within the same organisation.
- e. Separate status for commercial activities: Production activities aimed at securing an income from the market should at least break even if they are to make a structural contribution towards

achievement of the above objectives. Activities that satisfy this requirement are referred to in this paper as commercial activities. Commercial activities qualify for financing only if they can be expected to break even in the foreseeable future (3 years). This period is differentiated according to the credit period in section 3.4. Section 3.3. lays down supplementary rules for the financing of commercial activities.

- f. No lasting dependency: It must be clear how Hivos' involvement can be (gradually) phased out, with adequate prospects of continuity of the activities.
- g. Own initiative: Own initiative is a precondition for continuity. The degree of own initiative is therefore an important criterion in assessing entrepreneurship. Support in the elaboration of projects, in running an enterprise or in managing an organisation can be given only at the request of the applicant.
- h. Maximum utilisation of local facilities: Local advice, training and credit facilities must be utilised to the maximum extent possible. Only if there are no suitable local services available for good initiatives, can Hivos act as intermediary in securing the necessary services, for example by providing support to existing local credit institutions. Where organisations need training or advice, a suitable local organisation that can meet this need must be sought.
- i. Meeting social and environmental standards: Hivos expects its partner organisations to satisfy minimum requirements as regards respect for human dignity, equal treatment and protection of the environment. Accordingly, Hivos does not support any activities that cause permanent and preventable damage to the environment. The rights laid down in the Universal Declaration of Human Rights and in international conventions on labour and working conditions should be respected. In doubtful cases there should at least be a formal statement of intent to improve the situation within the foreseeable future. Details of these standards are to be found in the relevant policy papers.

### 3.3 Financing instruments

Hivos receives financing applications for both commercial and non-commercial activities. As a rule, commercial activities are only financed with credit subject to conditions designed to ensure that there is no distortion of competition. The provision of credit is in itself a commercial activity. Credit is to be understood here as any form of financial commitment that on the basis of contractual provisions can be terminated or revoked and for which the recipient pays a price.

Non-commercial (supporting) activities are subsidised. Hivos' policy can imply that producers with a weak starting position can temporarily receive credit with elements of a subsidy, supplemented with support on a subsidy basis.

In practice, it has been found that subsidies have to be kept separate from credit as much as possible and that therefore separate financing channels are necessary, preferably with separate legal personalities.

Adequate support is, however, essential, if the objectives set here are to be achieved. Hivos seeks to coordinate the provision of credit with the annual flow of subsidies. New credit is set off against funds that have become available or have been repaid (on average about 20% of the portfolio annually) or against new funds.

Hivos uses various methods for its financing. In order of preference it involves: guarantees, participations, loans, subsidies and combinations of these four instruments. They are dealt with briefly below.

#### a. Guarantees

Hivos provides guarantees to credit institutions for the benefit of producers' organisations. Dependency

is thereby minimised, and this instrument is also easy to apply. No money is transferred and there are no exchange risk problems. If producers are unable to obtain credit on reasonable terms via local financial institutions, because they cannot offer any security or because the economic risks are too high, Hivos can provide a partial guarantee for the amount borrowed. It is then up to the credit institution and the borrower to agree the terms (such as interest rate and period). Responsibility for monitoring the reliability of the borrower and repayment lies with the credit institution. As a rule, Hivos does not give 100% guarantees, since the credit institution would not then have any incentive to carry out its task properly. A separate category of guarantees relates to credit for trade in commodities such as coffee, cocoa, tea, bananas and honey. Hivos can provide guarantees here, subject to a number of conditions. Details of these conditions are given in section 3.4.

#### b. Participations

If a guarantee does not offer sufficient scope, Hivos is also prepared to participate with capital. A participation can take the form of shares, venture capital or participation with a fixed-interest.

A participation can be subordinated in favour of local savers. A participation is the appropriate instrument when a local credit institution needs capital, but not enough capital is available from local savings. The capital must be provided for a fairly long period in order to guarantee the continuity of the credit institution.

When Hivos participates in a credit institution, it seeks to maintain the real value of the participation. To achieve this the participation will have to increase annually by the rate of inflation. During the period of the participation that portion of the interest that is earmarked to cover inflation is in principle retained in the fund.

As financial participant in a credit institution, Hivos is in a position to exert influence on policy.

The framework for determining Hivos' position is indicated above and will generally be fleshed out within the national context. In principle, Hivos will be represented each year at the discussion of annual report and will assess whether the credit policy satisfies the conditions set. Hivos always seeks to set out its own position in advance in contractual terms as far as possible. Hivos will not directly intervene in the credit operations.

#### c. Loans

Loans are granted to producers' organisations. The duration of the loan agreement and the repayment period are linked to:

- the production cycle in the case of short-term loans (< 1 year)
- the life of the capital goods financed in the case of medium-term loans (< 5 years)

A separate category of short-term loans comprises credit for trade in commodities such as coffee, cocoa, tea, bananas and honey. Hivos can finance such trade, subject to a number of conditions (see 3.4).

#### d. Subsidies

Grants are used in the case of non-commercial activities, but even in the case of commercial activities there can be (elements of) subsidisation, for example for starting-up expenses. Commercial activities can be financed with grants only in exceptional cases, which must be duly justified. Generally mixed finance is offered, i.e. a combination of subsidy and credit.

In both cases it has to be shown that the conditions of competition will not be structurally affected by the subsidisation and that the activity in question will be able to break even within the foreseeable future. A central factor in this appraisal is the weak starting position of Hivos' target groups. The

possible reasons for subsidies include:

- The fact that research, training and advice cannot be financed entirely from any future loan without incurring extremely high financial costs.
- High project development costs in the preliminary phase.

The criterion is the degree and quality of the applicant's own initiative and only indirectly the quality of the dossier presented; on request, the applicant can be helped with a subsidy in the preliminary phase to develop its initiative better.

Certain types of expenditure do not have any direct impact on costs or on the conditions of competition and therefore qualify in principle for subsidisation:

- training and advice
- initial major expenses with a low depreciation rate
- development and application of people-friendly and environmentally sound technology
- protection of interests

#### e. Mixed finance

The term mixed finance is used when credit is combined with a subsidy. The subsidy can be clearly separate from the credit, or it can have the form of credit that is provided at less than cost. In the first case it is desirable that the two flows of money should come from two different organisations. For example, Hivos and Triodos Bank have set up the Hivos Triodos Fund to provide credit lines.

In the second case the ultimate aim should be to offer credit to the borrower on normal terms in line with the market.

Providing credit from the Netherlands with supporting advice is expensive, particularly if other credit institutions play a role between Hivos and the ultimate borrower. Having many intermediaries adds to the cost of credit. Partly because of the costs, Hivos in principle fulfils a temporary role and aims to transfer the operation to the best possible local credit institution.

### **3.4 Long-term, short-term and medium-term credit**

The above-mentioned three credit instruments (guarantees, participations and loans) can be applied for various periods. Long-term credit caters best for the need for continuity in the provision of local credit, but in international trade in agricultural commodities, for example, there is a need for short-term credit. Where there is a demand for medium-term credit, local credit institutions are generally involved, leading to a long-term relationship between them and Hivos.

Credit is provided only if the activity is viable, this implies a.o. that it can break even within a certain period. This period should run parallel with the credit period.

#### **Long-term credit**

Credit institutions usually require guarantees or participations for a fairly long period. The credit can run on, provided Hivos and the recipient reach agreement on this before expiry of the contract.

To this end an evaluation is conducted not later than in the fourth year. If the outcome of the evaluation is negative, or there are other problems, the participation has in principle to be repaid, or the guarantee is terminated. The advantage of this set-up is that the recipient credit institution is offered continuity, and Hivos is able to give substance to the conditions set.

The following elements are assessed at least once every four years:

- output and efficiency
- How economic, social and environmental objectives are balanced against each other

- how more backing is being created among local savers for support for local activities via local credit institutions.

The demand for long-term credit in the form of guarantees and participations is increasing. Administration of participations and shares requires specific attention, since in addition to the above-mentioned four-yearly assessments Hivos also wishes to make use of the opportunity to actively fulfil the role of participant/shareholder. Participations and shareholdings form part of Hivos' balance sheet together with the related provisions. Given the specific administrative aspects of this high-risk form of financing, Hivos is considering creating a specific participation fund.

Specific attention is needed in the case of credit institutions that:

- are just being set up. They have no track record and for that reason have difficulty in attracting funds;
- have to increase their capital resources by means of shares. An exit route will have to be agreed in such cases;
- are focused on producers with little scope for development;
- are focused on innovative ideas in the sphere of the environment and social conditions, for example.

### **Short-term credit**

Short-term credit is provided in the form of guarantees and loans. The average period is three months and the maximum six months. Short-term credit requires faster decision-making. As a long-distance provider of credit, Hivos is able to provide short-term credit in exceptional cases only. Such an exceptional case is trade credit for products sold under the Fair Trade and Max Havelaar approval marks. Hivos considers it important to act here as a financial bridge.

The conditions for credit from Hivos are:

- The approval mark organisation must keep up to date sufficient data on the recipient; (reliable) data will then be immediately available.
- The credit must be in the form of documentary credit, with at most 60% of the estimated market value of the product being advanced; the underlying documents will then limit the risk.

There is a demand for this form of credit from producers of tropical agricultural commodities such as coffee and cocoa. Under a special arrangement the appropriate producers are informed in good time of the technical and financial details of the operation.

Hivos also wishes to provide limited scope for the financing of non-approval-mark products (e.g. marketing of sesame seed).

### **Medium-term credit**

Medium-term credit is provided in the form of guarantees, participations and loans. The maximum period is four years. It is generally a question of credit for productive investments to be repaid in accordance with a predetermined schedule.

Local credit institutions are encouraged by Hivos to take on this task.

## **3.5 Cooperation with local credit institutions**

The fact that Hivos receives technically feasible credit applications from local producers' organisations indicates that local credit institutions do not always adequately provide credit. Hivos' response to this situation is not to provide credit direct but to create/improve access to local credit. In practice, a suitable credit institution can almost always be found, albeit with some difficulty.

Hivos also receives applications from local credit institutions that wish to improve and expand their

services. To qualify for support, a local credit institution will have to satisfy Hivos' conditions for cooperation relationships (see 3.2). The provision of credit is in principle a commercial activity, and to be eligible for financing by Hivos it must be capable of breaking even in the not too distant future.

Supplementary criteria help to determine the choice of a local credit institution as partner. A prime factor is expertise in credit management, but special attention is also paid to the composition of the available capital and related to this the ability of the credit institution to bear risk itself. Considerable capital resources (of savers, members or shareholders) are a prerequisite, and the credit institution must itself effectively take a risk with each credit operation.

Hivos has an order of preference in making its choice of local credit institution:

- a. Savings and credit cooperatives. These are generally membership organisations and make use of internal financing. These organisations are not usually subject to supervision by the Central Bank; in some cases they come under a Ministry of Cooperatives.
- b. Ethical banks. These organisations are supervised by the Central Bank and their credit policy demonstrably takes account of social and environmental concerns, as well as business objectives.
- c. Ethical credit institutions. As b. but without supervision by the Central Bank.
- d. Special funds. These are funds focused on the environment or employment for a specific target group.
- e. Commercial banks. These organisations pursue business objectives (profit, growth and continuity). Cooperation with these organisations accordingly means a special contract providing for explicit orientation towards the target group and integration of social and environmental objectives in credit policy.

In practice, Hivos receives applications mainly from organisations in the first four categories and seldom from commercial banks and other providers of credit. By means of credit studies Hivos has now identified in most countries a number of organisations that provide credit on a cooperative basis or on the basis of ethical considerations.

### 3.6 Contract currencies and interest

Hivos sets out from the premise that credit contracts will be concluded in the currency in which income is earned. It is difficult in practice for local organisations to cover themselves against exchange risks. If earnings are in local currency and this currency is very unstable (high inflation), consideration can be given to using a hard currency in the contract.

For administrative reasons, guarantees are always given in a hard currency.

When it provides credit to a credit institution, Hivos will stipulate conditions concerning the interest on loans to target groups. In principle, the market rate of interest will be taken as basis. If there are reasons for deviating from this, interest will be fixed at such a level that at all events the cost of local credit management is covered.

This means in practice an interest rate that is the sum of:

- inflation
- + real interest on savings
- + cost of credit management
- + provision for possible default or late repayment

In the case of direct loans to producers' organisations or fixed-interest participations in credit institutions, the same principle is applied but excluding the provision for default.

### 3.7 Combining economic objectives with social and environmental objectives

Section 3.2 sets out the minimum conditions that need to be met. It is also possible to pursue social and environmental objectives in cases where these minimum requirements are exceeded. There are no problems if this furthers achievement of the economic objective. But pursuit of social and environmental objectives can also impact unfavourably on profits and employment. The pros and cons of the various options will then have to be weighed up. In this weighing-up process a hierarchy will emerge. In this process Hivos has the task of facilitating access to alternative markets, for example direct marketing or marketing under an approval mark.

Hivos can make grants available for examining whether a particular project can be implemented using an alternative technology that is preferable, for social and environmental reasons, to locally known methods. In the case of a structural difference in cost, there must be a prospect of continuity, for example through access to separate markets (via approval marks) or through regulation that is expected.

#### The environment

Objectives include finding sustainable technologies and stimulating sustainable production. The "Milieu Notitie" (Memorandum on the environment) of 1989 sets out Hivos' policy on these points. Hivos prefers to cooperate with organisations that seek to combine these objectives with a production process that covers its costs. In the agricultural sector, for example, this is the case with organisations that are members of the Organic Movement.

#### Human rights, women and development

Among the objectives are emancipation of groups suffering discrimination and marginalisation, and creation of good working conditions. Women are more affected by poverty and marginalisation than men. Equal participation of women in production is being stimulated. Women can be specifically helped to become economically self-reliant by providing access to land, credit, information and vocational training. Hivos' policy in these areas is presented in the papers "Hivos and Human Rights" of 1996 and "Gender, Women and Development", also of 1996. Hivos seeks cooperation with organisations that combine these objectives with a production process that covers its costs. This is the case, for example, with organisations that are members of the Fair Trade Movement.

### **3.8 Organisational development**

Cooperation with Hivos is possible only if producers and providers of credit organise. Here a combination of economic, social and environmental objectives is sought, while keeping commercial and non-commercial activities separate. It is difficult for many organisations to meet these conditions. In such cases a process of organisational development is necessary, and Hivos can provide support for this. Hivos stresses the importance of concentrating on core activities. The following questions are important in determining the core activities:

- Which activities are the most relevant to development?
- For which activities has the organisation sufficient expertise and experience?
- On what is the confidence among the target group primarily based?

When concentration on the core activities has been accepted, one can expect that activities will be adequately separated organisationally and from the bookkeeping angle. It will then be possible to define each individual activity and determine whether it is compatible with the organisation's objectives.

Once the core tasks have been determined in this way, Hivos can at the request of partner organisations also make funds available for policy development, orientation towards the core activities and training of staff.

Incidentally, Hivos itself concentrates on core activities. Through the cooperation with Triodos Bank,

which has led to the setting-up of the Hivos Triodos Fund, Hivos has transferred management of the credit portfolio to an institution with expertise in that field. Hivos itself concentrates on establishing contacts with local development-related organisations, on making risk funds available and on playing a supporting role in the provision of training and organisational advice. This is part of the more extensive cooperation that Hivos is seeking, which will be dealt with in the next chapter.

#### **4. Hivos' role**

On the basis of the policy framework already set out, Hivos looks for the most suitable partner(s) and determines its own role in a cooperation arrangement:

1. A donor-recipient relationship involving a grant by Hivos aimed at improving employment and income opportunities. 70% of the (now over 100) economic partner organisations fall into this category.
2. A credit relationship involving (additionally) the provision of credit by Hivos. 30% of the economic partner organisations fall into this category, but half of them also fall into category 1.
3. A relationship with service institutions (advice, training, insurance, etc.) which are commissioned by Hivos to provide services (at a charge). Hivos is seeking to promote further growth in the number of Southern organisations in this category, in relation to the number of Northern consultants.

These three roles can also be performed by a consortium of equal partners jointly pursuing the same goal. Generally a small number of organisations will be involved, and policy coordination will be needed in order to operate jointly. Financing methods will be brought into harmony with each other. There will preferably be an input of own expertise from the various consortium members. A consortium relationship can in principle be entered into in any of the above roles:

- several donors jointly provide a subsidy to the same recipient;
- several providers of credit jointly finance an activity. It is important here for the risk to be apportioned according to the contribution;
- several organisations jointly commission a credit study in a particular country.

The three roles, within a consortium and outside, are examined below.

##### **4.1 Donor**

This role involves subsidisation through the financial support given and through the provision of services by Hivos free of charge. In this role, Hivos is organisation-oriented and process-oriented and operates on the basis of a planned pattern of expenditure. Hivos maintains a subsidy relationship with 70% of the partners in the economic sector. By far the majority are located in the South. In the North Hivos can give support on a more modest scale to organisations that are engaged in activities such as lobbying in international fora, defending the interests of specific groups in the South and developing fair trade and environmental approval marks.

##### **4.2 Provider of credit**

In this role financing is linked to viability on the markets. Hivos has an (indirect) credit relationship with 30% of its partners. The majority of them are located in the South. The most important categories of recipients are:

- cooperative savings and credit cooperatives. Direct participation by the target group and the use of own local resources are characteristic features of these organisations.
- ethical banks, via the INAISE network, for example. Combination of objectives is a characteristic feature and there is comparability with Hivos' objectives (see 3.7).
- commercial banks in an intermediary role, preferably via a separate desk or facility. The contract with the bank stipulates the conditions under which use may be made of the facility (see 3.2).
- exporters and importers of Southern produce, particularly in the sphere of fair trade and/or organic production. If short-term trade credit is needed adapted rules apply (see 3.4).

The Hivos Triodos Fund occupies a special position as recipient of credit. HTF is involved in the provision of credit by Hivos to many of the above-mentioned categories of borrowers/partner organisations. Through a long-term guarantee covered by funds out of the cofinancing programme, Hivos in principle bears a maximum of 90% of the risk that HTF runs.

#### **4.3 Commissioner of services**

Hivos maintains relations with commercial service organisations, such as consulting firms, training institutes, insurers and providers of credit. Hivos enters into this type of relationship preferably at the request of partners in the above-mentioned categories. In this role Hivos is assignment-oriented (payment when the assignment has been completed).

#### **4.4 Role conflicts and consequences**

Hivos concentrates on the roles of donor and commissioner of services and delegates the role of direct provider of credit as far as possible to organisations specialising in that field. Delegation means that Hivos continues to cover the risk and retains final responsibility, but remains in the background in the relationship with the ultimate recipients.

Analysing problems, putting forward solutions and taking a calculated risk in the process are part of Hivos' policy. This role in the background takes on shape in Hivos' relationship with credit institutions and in particular in the cooperation relationship with Triodos Bank and HTF (see separate brochure on the North-South Plan).

## **5. Final remarks**

As part of the process of developing policy in the economic sector, Hivos presents in this paper a number of new policy orientations. Besides systematising the experience gained since the Memorandum on Loans (1989) and the restructuring of the Loan Fund (1991), this paper sets out fairly recent orientations based on experience in the credit sphere outside the more traditional development cooperation sector.

The most important decisions can be summarised as follows:

- the separation of grants and loans from both the policy and the administrative angles;
- the creation of an allied but independent legal entity to carry out the credit operations;
- the emphasis on working with local credit institutions of many kinds;
- the use of participations as an instrument of development;
- the use where possible of the customary trade channels as lever for economic development;
- preferential treatment for approval mark organisations in the area of fair trade and organic production.

Hivos intends to evaluate the benefits and practicability of these decisions after a period of three years, partly as a component of its usual evaluations and partly as a separate exercise.

## **6. Annexes**

Annex 1: Statistical survey

Annex 2: Source documents

## Annex 1: Statistical Survey

**Table 1**

**Total expenditure (x Dfl. 1000)(\*)**

	1991	1994	1995
Cofinancing programme	36,637	42,230	48,658
Other government funds	11,077	10,247	7,595
EU-funds	2,601	1,736	1,719
Private funds	508	1,985	3,214
<b>Total contributions</b>	<b>50,823</b>	<b>56,198</b>	<b>61,186</b>
Loans	910	4,296	6,704
Cash in reserve (**)	-	-	-4,153
<b>Total</b>	<b>51,733</b>	<b>60,494</b>	<b>63,737</b>

(\*) Figures derived from the 1995 Annual Report

(\*\*) To cover the guarantees provided by Hivos

**Table 2**

**Funds raised (x Dfl. 1000)(\*)**

	1994	1995
<b>A. Contributions</b>		
Donations	622	563
Legacies	312	348
<b>Total private individuals</b>	<b>934</b>	<b>911</b>
Municipalities	49	71
Institutional funds	1,201	1,652
<b>Total</b>	<b>2,184</b>	<b>2,634</b>
<b>B. Loans</b>		
(former) General Loan Fund	228	196
North-South savings scheme	4,263	6,909
<b>Total</b>	<b>4,491</b>	<b>7,105</b>

(\*) Figures derived from the 1995 Annual Report

**Table 3**  
**Hivos expenditure according to main policy sector (in %)(\*)**

	Africa	Latin America	Asia	Europe/ Worldwide	Total
<b>Economic activities</b>	33	30	9	41	28
Culture	5	3	4	-	4
Gender, Women & Development	11	20	24	8	16
Environment & sustainable development	8	16	28	6	15
Human rights & Aids	18	9	22	11	15
<b>Total</b>	75	78	87	66	78
Other sectors	25	22	13	34	22
<b>Total</b>	100	100	100	100	100

(\*) Figures derived from the 1995 Annual Report

**Table 4**  
**Partnerorganisations and expenditure in the policy sector economic activities according to region (\*)**

	nr of partners (absolute)	idem (in %)	expenditure (x Dfl. 1000)	idem (in %)
Africa	50	27	7,552	33
Latin America	36	21	6,812	30
Asia	13	8	1,022	9
Europe/Worldwide	4	14	1,615	41
<b>Total</b>	103	19	17,001	28

(\*) Figures derived from the 1995 Annual Report

**Table 5**

**Partnerorganisations and expenditure in the policy sector economic activities according to region in 1991, 1994 en 1995 (\*)**

	1991				1994				1995 (**)			
	number (absolute)	idem (in %)	expenditure (x Dfl. 1000)	idem (in %)	number (absolute)	idem (in %)	expenditure (x Dfl. 1000)	idem (in %)	number (absolute)	idem (in %)	expenditure (x Dfl. 1000)	idem (in %)
Africa	29	25	3,560	19	24	14	3,637	19	50	27	7.552	33
Latam	49	27	5,731	51	17	9	2,485	10	36	21	6.812	30
Azië	18	15	334	5	8	5	1,236	13	13	8	1.022	9
Euro/WW	-	-	-	-	2	10	212	8	4	14	1.615	41
Total	96	22	9,625	19	51	10	7,570	14	103	19	17.001	28

(\*) Figures derived from the relevant Annual Report

(\*\*) Because of reclassification, these figures are not comparable with those for 1991 and 1994

**Table 6**  
**Economic partnerorganisations according to 1st and 2nd policy sector (\*)**

	Africa	Latin America	Asia	Europe/ Worldwide	Total
Economische organisa- tions	42 (84%)	28 (78%)	12 (92%)	4 (100%)	86 (83%)
Gender, women & development	6 (12%)	2 (6%)	-	-	8 (8%)
Culture & developmen	-	1 (3%)	-	-	1 (1%)
Human rights & aids	-	-	-	-	-
Environment & sustainable develop- ment	2 (4%)	5 (14%)	1 (8%)	-	8 (8%)
<b>Total</b>	<b>50 (100%)</b>	<b>36 (100%)</b>	<b>13 (100%)</b>	<b>4 (100%)</b>	<b>103 (100%)</b>

(\*) situation as at 1-1-1996

**Table 7**  
**Credit provide (Risk-bearing Loan Fund and Hivos Triodos Fund) in Dfl. (\*)**

	1991		1994		1995	
	number	sum	number	sum	number	sum
Loans	15	910,492	17	706,959	21	966,014
Guarantees	1	100,000	5	1,580,602	13	3,388,258
Participations	-	-	4	2,008,030	6	2,350,156
<b>Total</b>	<b>16</b>	<b>1,010,492</b>	<b>26</b>	<b>4,295,591</b>	<b>40</b>	<b>6,704,428</b>

(\*) Credit outstanding as shown in the 1995 Annual Report

**Table 8**  
**Recipients of credit in 1995 (in Dfl.)(\*)**

	number	sum
Credit institutions	9	3,664,600
Producers' organisations		
Fair trade/ Max Havelaar	9	1,514,868
Other	22	1,524,960

Total	40	6,704,428
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(\*) Figures derived from the 1995 Annual Report

## Annex 2: Source documents

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