

*Our latest note looks at whether grants for technical assistance can lower interest rates and increase lending for rural borrowers by making small financial institutions more efficient.*

### **Can Technical Assistance Sow the Seeds for Rural Finance?**

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Government interventions to lower interest rates and expand credit to the rural sector are common in developing countries. Some of these policies, like interest rate subsidies, though well-intentioned, can be distortionary and achieve opposite results.

Interventions that tackle constraints that prevent the market from allocating credit on its own may achieve better results. One such constraint often present in rural areas is lack of technical capacity. Rural financial institutions are often ill-equipped to screen, monitor and manage risk and to price products. This lack of capacity increases operational costs which are passed on to borrowers in the form of higher interest rates and less lending.

A potential intervention to address these capacity constraints consists of technical assistance for financial institutions. We study the effects of such a program in Mexico, that is being run by the development finance institution *Financiera Nacional de Desarrollo Agropecuario, Rural, Forestal y Pesquero* (FND).

#### **Grants for Technical Assistance**

FND's core activities include lending directly to rural firms and providing second-tier financing to financial intermediaries.

To strengthen these activities FND also runs a capacity building support program (*Programa de Apoyos*). This program provides grants for capacity building to financial intermediaries with the goal of getting them ready to receive FND loans and more broadly to develop sound financial institutions that can responsibly reach more rural borrowers.

The program started in 2004 and has disbursed grants to different financial institutions each year. We study the impact of the grants that were disbursed between 2004 and 2008.

Although grants can be used to purchase equipment or boost the capital of financial institutions, most grants were for technical assistance, provided through a network of accredited specialists. Examples of technical assistance include credit risk management, capacity building for management and staff and IT systems selection. The average size of these grants was USD\$4,000.

#### **Study Design and Data**

We focus on the impact of the program on credit unions, which make up 20 percent of the financial intermediaries that have received grants through the support program. We chose to look at credit unions since they are supervised by the National Banking and Securities Commission (CNBV), which houses a repository of their financial data.

From the CNBV, we obtained financial statements for all credit unions operating in Mexico from September 2002 to December 2012. We merged this information with an FND-provided list of credit unions that obtained a grant through the support program. This results in data for 124 credit unions, of which 65 received a grant in different years from 2004 to 2008.

We estimate the effects of FND grants using a difference-in-difference estimation that relies on the comparison of never treated and ever treated credit unions over time, as well as by considering the timing of treatment.

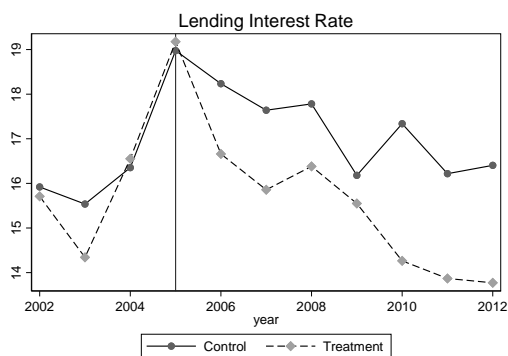
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We also use propensity score matching to create treatment and control groups that have identical pre-program means and changes in outcomes variables. To check the robustness of our results we implement four different matching techniques.

## Results

- The program lowered lending interest rates by up to 2.6 percentage points, from a pre-program average of 17.8 percent (figure 1).

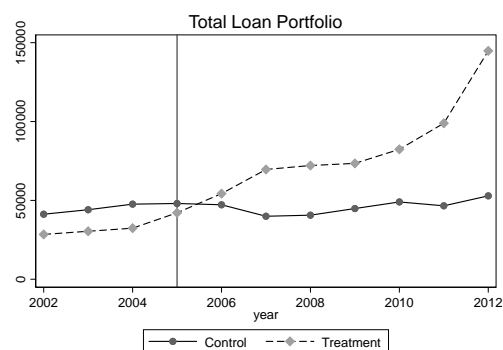
**Figure 1: Average lending interest rates for credit unions in the treatment and control group (caliper matched sample)**



- This drop seems to be due to reduced operating costs and a lower non-performing loans ratio. That is, the support program helped credit unions to make their operations more efficient and to better screen and monitor borrowers.
- We also see an increase in returns-on-assets (ROA) due to the program.
- Finally, the program increased the value of the loan portfolio by about 50 percent (figure 2). About half of the credit unions

that received grants also received loans from FND. We conduct several checks to make sure this result is not driven by FND loans. In fact, the effects are similar if we only look at those credit unions that did not receive an FND loan.

**Figure 2: Average total loan portfolio for credit unions in the treatment and control group (caliper matched sample)**



## Policy Implications

In the context of the program we studied in Mexico, technical assistance allowed rural credit unions to increase their operating efficiency and reduce their non-performing loans ratio. Part of these gains translated into higher returns for the credit unions, but they were also passed on to the final borrowers in the form of more credit at lower lending interest rates.

While government support to rural financial institutions is often provided in the form of interest rate subsidies, guarantees or credit lines, this study suggests that technical assistance may be an equally important tool to consider for supporting the development of financial institutions.

For further reading see: Bruhn, Miriam, Rekha Reddy, and Claudia Ruiz Ortega. 2018. "Sowing the Seeds for Rural Finance: The Impact of Support Services for Credit Unions in Mexico." [World Bank Policy Research Working Paper No. 8483](https://www.worldbank.org/en/research/working-papers/8483).

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