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RURAL FINANCE – WHAT IS SO SPECIAL ABOUT IT?

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1. OBJECTIVE

With the promotion of rural finance (RF) stakeholders and donors work towards opening up the access to financial services for the rural population and especially it's poorer strata.

2. SUPPLY SIDE

In general the rural areas are hardly served by commercial banks and other financial institutions and the access to financial, but also other services are limited.

In the 70s and 80s the government owned Development Banks filled partly the gap through directed credit for agricultural production and some development projects offered loans (through the so called revolving funds) to promote technology and other innovations. Today, where there is agricultural credit, it is usually related to cash crop production (financing of inputs and labour for the production through the purchaser, trader or processor), to trade or to material/input purchase (suppliers).

In some places village banks and savings and credit cooperatives have evolved and offer services to their members. They complement and partly replace loans from family members, neighbours, and moneylenders but in many cases don't lend long term and bigger amounts, which are needed for agricultural production or investment (risk, periodicity, availability).

3. DEMAND SIDE

Rural households mostly have farm and non-farm activities and their needs for financial services are manifold: secure and easily disposable saving accounts, short and long term credits, small amounts for emergencies and bridging periods before harvest, longer term and bigger size credits for production and investment purposes (equipment, housing).

4. FRAMEWORK CONDITIONS – ENVIRONNEMENT

The development of the rural areas and the creation of income and in the longer term assets for the rural families depend on access to markets in close by rural towns, in the capital and in neighbouring countries. The rural areas today have to be interlinked with the bigger towns and cities of a country, its markets and services. Besides transport, access to information, to technology (production, storage and processing, product design) and to inputs (raw material, seeds, pytho-sanitary products) are crucial.

The national governments' interest in rural areas is in many cases directed to the availability of cheap food products for nourishing the population in the big cities and in promoting cash crops for export. This "policy" translates into price control or imports of food crops and in the control of export crops (price competitiveness, state monopolies etc.).

Law enforcement in rural areas is often lacking and in some countries debt forgiveness especially with regard to farm credits has become an electoral propaganda instrument.

5. RURAL FINANCE: WHAT HAS TO BE CONSIDERED

5.1 Products and services

A wide range of products is necessary from emergency loans to production and investment loans, i.e. short and long term as well as small and bigger amounts. The timeliness of the service for production and trade loans is crucial (planting season, few or no alternatives).

Monetary savings are in competition with short term (animal fattening) and long-term investment (herds) possibilities. However from a risk point of view, it can be expected that clients distribute their risks and will save also in the form of "bank-savings" if these are liquid (disposable) and within reach.

5.2 Princing

Transaction costs are usually high on the side of the financial institution (money transfer, information, etc.) as well as on the clients' side (travelling, opening hours, group meetings etc.). Infrastructure, especially roads and electricity are often lacking and make communication difficult and expensive. In many cases settlement is dispersed and/or population density is low.
If there are no commercial banks in near towns, money transfer (and therewith also security) becomes an issue.

Profitability, especially in agriculture is generally low, while at the same time the risks of farm investments are high. (In a bad season all farmers might be suffering losses (covariance of risks!)).

Liquidity management with regard to term management (short term money - long term demand) and investment policy is complex (seasonality of demand and distance to commercial banks) and demands highly qualified staff.
To find and keep well trained staff for the rural areas is not always evident (motivation/incentives). At the same time training of personnel and often also of the clients/members has high costs.

The lack of competition in the delivery of financial services in rural areas doesn't per se favour efficiency and control on prices. In general it can be said that delivering financial services in rural areas has its cost and interest rates therefore are high.

5.3 Social capital

Social links and control are still more prevalent in rural areas. This allows in some cases to replace the lacking collateral and/or the missing possibility to enforce contracts legally with social capital. It also allows for decentralisation of some management tasks

5.4 Access to non-financial services and markets

As mentioned earlier (see point 4) access to markets and non-financial services are crucial if the delivery of financial services shall be effective with regard to income generation and asset building in the rural areas.

6. RURAL FINANCE: WHAT IS NEEDED

6.1 Downscaling or upscaling

Getting commercial banks to serve people in rural areas and particularly small farmers (downscaling) is probably even more difficult than getting them to serve small businesses and a poorer clientele in town. (See example of the green banks of IMI etc.). At the same time the building up of rural financial institutions is time and money consuming (up-scaling).
At best a close collaboration can be negotiated/installed between a decentralized system (savings and credit groups, village banks, co-operatives etc.) and a commercial or development bank (linkage). This allows eventually to mobilize savings, to transfer money and to negotiate additional credit funds (a loan) etc.

6.2 Innovation

Innovation is needed to cut down on costs on the side of the financial institution but also on the side of the client: Self-management of decentralized units by the clients; optimisation of opening hours of the counter; delivering financial services through mobile units; choosing of central locations for safety, cost and accessibility reasons (community buildings, post offices, market places etc.); credit scoring instead of guarantees; credit cards to allow access in market places and towns; insurance products (mutual insurance) to secure credits and serve social needs (health, funeral); leasing (hire-rent) of equipment and the like; special savings products for schooling, housing, storage; utilization of social capital and control when and where feasible; introduction of an incentive policy for staff to attract competent staff; lobbing at the provincial and national government level (get visibility and attention) for the special problems and potentials of the rural areas.

6.3 Portfolio diversification

For risk mitigation but also from a liquidity management point of view the portfolio of the financial institution should be diversified: different types of clients, activities and products (farmers, traders, employees, not just men, entrepreneurs, youthf; farm and non-farm activities; consumption and production credits, sight- and term deposits, small and bigger credits/clients).

6.4 Investment in institution building and time

Donors should be ready to invest in the institution building to help to cover the development costs: Often constructions are needed at an early stage to accommodate the business and “demonstrate” security to the clients. Building up of the accountancy and the management information system (informatisation) might be a next step where help is needed. In addition to an internal controlling system, identification of auditors, or if necessary training of auditors or government supervisors, with regard to the specifities of rural finance and its risks, might be a necessary task.

Training of the staff and the board is a regular issue. Part of the “extra” cost, due to the non-availability of trained manpower, could be borne by a donor. Networking and exchange with the “outer” world, participating in pilot projects (cost coverage and/or risk sharing) and product development are other fields where support is needed.

Important is that the donors and the supported financial institutions depart from a realistic timeframe: development of the financial sector in rural areas takes time and costs. The outlay of the system should be made for a growing number of people served, including clients with very small incomes, and aim at cost coverage in the longer run. A good equity base, clear ownership structure and access to credit lines are therefore a pre condition.

6.5 Inducive government policies for rural development

The regulatory framework as well as the supervisory role of the government has to take into account the special liquidity requirements in not easily accessible areas, the problems of communication where they exist, as well as the question of co-variant risks, seasonality and social links in places where they are still functioning. Interest rate ceilings are certainly not the appropriate measure even when at least formal competition is lacking.

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