

# The Rural Finance Landscape

A practitioners guide



partageons les connaissances au profit des communautés rurales  
sharing knowledge, improving rural livelihoods

**Agrodok 49**

# **The Rural Finance Landscape**

A practitioner's guide

Ton de Klerk

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Author: Ton de Klerk

Editor: Marilyn Minderhoud-Jones

Illustrator: Olivier Rijcken

Design: Eva Kok

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# Foreword

Microfinance can help poor and marginal communities develop their economic capacities. In recent years, there has been a rapid increase in the number of microfinance institutions and clients. However, microfinance services remain limited in rural areas which are often sparsely populated and poorly developed in terms of economic and physical infrastructure. Efforts are, therefore, needed to identify ‘rural finance’ approaches -savings and lending systems- that respond to the needs and capacities of poorer clients and rural entrepreneurs.

Rural financial services vary in scale and objective. Community-based savings and lending groups, for example, make small but essential amounts of money available to their members. Where agricultural production, processing and marketing is more capital intensive the demand for more formal financial service providers is stronger.

This Agrodok describes current savings, lending, and insurance practices, identifies the service providers working in the informal, semi-formal and formal sector and discusses current approaches and methodologies. It targets those who want to know more about rural finance as well as development practitioners concerned with identifying the financial services most appropriate for their project or organisations.

Designing and executing rural finance programmes requires ‘expert’ knowledge. Although this Agrodok pays some attention to good practices in rural finance, it is not a training manual. It does not set out to show readers how they can develop and implement programmes. The Useful Addresses list contains the addresses of organizations that can be consulted when this type of assistance is needed.

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The author, Wageningen, 2008

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# 1 Introduction

Rural finance refers to financial services such as savings, lending, insurance and remittance services that can be provided by a variety of actors. These actors can be friends, relatives, shopkeepers, traders, money lenders, traditional savings and lending groups, microfinance programmes or banks. Rural finance is a term used to cover those financial services provided in rural areas for agricultural as well as non-agricultural purposes.

Within the rural sector different groups and categories of individual require services designed to meet their particular needs. While poorer groups might need savings facilities and micro-credit to cover production costs and emergency expenses, farmers and farmers' organizations involved in cash-crop production will probably require larger amounts of credit to finance production, inputs, processing and marketing.

## 1.1 What is rural finance?

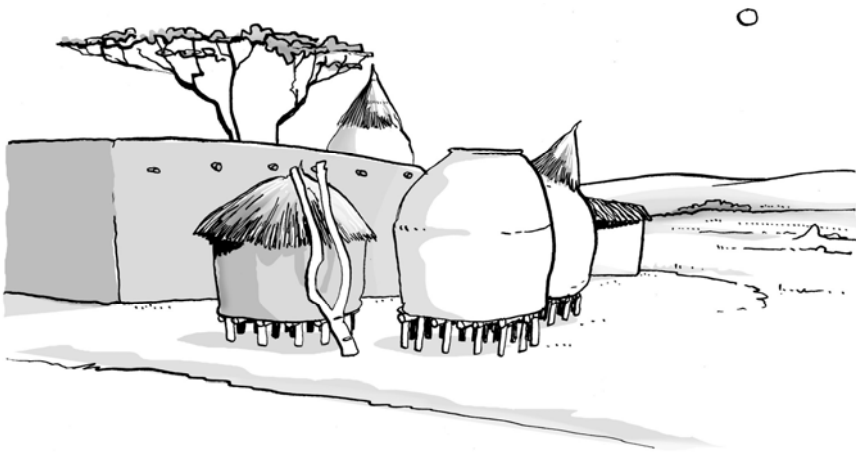
Rural finance is the provision of financial services, including savings, lending, insurance and remittance services to rural households and entrepreneurs.

All rural households save, although the amount will vary from household to household depending on the capacity, motivation and determination of the farm family.

- At harvest time, subsistence farmers will sell part of their food crop but they will also try to store as much as they can to carry them through to the next harvest and build up their reserves.
- Some of the money received from the sale of cash crops will be saved to meet future household expenses. It will either be saved in cash or used to buy small animals, jewellery or other valuables that can be sold when money is needed (savings in kind).
- Income flows from non-agricultural activities such as trade or wage labour are not evenly distributed over the year. For this reason peo-

ple save to have enough money for when there is little cash available.

- People save to prepare themselves for recurring expenses such as school fees, for special occasions like marriages and funerals and for unforeseen events such as sickness or poor harvests. They also save so they can make investments later.



*Figure 1: Farmers store as much food as possible to carry them through to the next harvest*

Borrowing patterns vary. Some people borrow regularly, others very occasionally. Poor people are often forced to borrow and contract debts because they need money to pay for everyday expenses or cope with medical and other emergencies. Business (wo)men and farmers borrow to obtain working capital and pay for investments. In cash economies producers borrow because they need capital.

Savings can be seen as a form of insurance to be used when problems arise so the household does not get into debt. Access to lending can be seen as a form of insurance. Social capital - the willingness of friends, relatives and others to help each other in emergencies - is also a particularly important and common form of insurance.

Recently, financial service organizations - insurance companies, banks and microfinance organizations – have been exploring the possibility of developing insurance services for the poor. These include health and life insurance and, on a smaller scale, animal and crop insurance. However, this is a relatively new field and much still needs to be done.

Remittances form an important part of rural income. Relatives who migrate in search of cash employment send money back to assist their families. This money is often used to meet immediate family needs, to pay for emergencies or school fees or invested in building. Remittance money is not generally used to finance the development of economic activities.



*Figure 2: Relatives who migrate in search of employment send money home to their families*

If migrants deposit part of their remittance in a savings account at a local bank or microfinance institution, these funds can be lent out again. This means that more capital will be available for investment in local production and local development will be strengthened.

Local banks and microfinance institutions depend on external funds, loans from donors and larger banks to build up their loan capital. It is



not always easy to get external funding and it is usually more expensive than funds acquired through clients' savings. Remittances provide local banks and microfinance institutions with the opportunity of becoming less dependent on borrowing from external funds.

Rural finance covers informal, semi formal and formal institutional savings and lending arrangements.

Households and individuals can save by storing their cash themselves or by investing it in valuables such as jewellery or (small) animals. Some individuals will save through traditional savings and lending groups. In some countries there are money collectors who regularly collect savings from rural producers and entrepreneurs. The main providers of loans to the poor are family, friends, shopkeepers, pawnshops, traders, moneylenders and landlords as well as traditional savings and lending groups. Because they are not regulated by law, this type of saving and lending activity is said to belong to the informal sector.

The formal financial sector is controlled by law and consists of banks that are regulated by banking law and - in countries where this sector is regulated - microfinance institutions.

*Table 1: Rural finance: informal, semi-formal and formal sectors*

<b>Rural finance</b>		
<b>Informal sector</b>	<b>Semi-formal sector</b>	<b>Formal sector</b>
<ul style="list-style-type: none"> <li>➤ Friends</li> <li>➤ Relatives</li> <li>➤ Shopkeepers</li> <li>➤ Traders</li> <li>➤ Pawnshops</li> <li>➤ Landlord</li> <li>➤ Money lenders</li> <li>➤ Money collectors</li> <li>➤ Traditional saving and lending groups</li> </ul>	<ul style="list-style-type: none"> <li>➤ Micro finance programmes of NGOs, in countries where the sector is not regulated by law or where small-scale financial activities of unregistered organizations are allowed</li> </ul>	<ul style="list-style-type: none"> <li>➤ Banks</li> <li>➤ Microfinance programmes in countries where the sector is regulated by law</li> </ul>

In some countries the microfinance sector is not regulated but development organizations are allowed to collect savings and lend on a small scale. This type of organization is typical of the 'semi-formal' financial sector. In the semi-formal sector the NGO microfinance programmes and the small-scale financial activities of unregistered organizations predominate.

Rural finance targets the rural farm and non-farm population and includes both agricultural finance and rural microfinance.

Rural households are involved in agricultural as well as non-agricultural activities: small restaurants, crafts, hairdressing, food processing and trade are amongst the ways cash is earned. The standard lending practice of most microfinance programmes is based on short-term loans. This type of lending strategy is well adapted to short business cycles. Petty traders, for example, may need credit to buy stock which they hope to sell within a few days or weeks. Once products have been sold and the loan repaid, the trader can begin a new (short) business cycle. Because income has been generated relatively quickly the loan can be repaid - in instalments - over a short period of time and repayments can be started soon after a loan has been disbursed.

Agricultural activities, however, require a different type of financial support. Loans made to help farmers increase their agricultural production must take into account the time crops and livestock need to mature. Farmers can face difficulties if they have to start repaying loans too quickly and they have no other source of income like money earned from non-agricultural activities or from crops harvested and marketed at different times of the year. If farmers or rural entrepreneurs install new equipment or infrastructure they cannot expect immediate results. These types of investment require mid- or long-term loans.

Risks within the agricultural sector often extend beyond the individual farm household to affect a whole region. Crops can be destroyed by drought, floods or insect pests. Herds can be devastated by disease and hunger. Unpredictable markets also threaten farm livelihoods and incomes. Since such events affect large groups of farmers at the same time, they represent a high risk for microfinance programmes and banks because many clients will have repayment problems. For this reason, financial service providers are reluctant to extend their services to a risk-prone agricultural sector. Specially adapted rural finance programmes are required to deal with these types of risk.

## **1.2 Specific needs**

There are different approaches to rural finance. The needs of a specific target group or the characteristics of a region determine the approach selected. The financial needs of the poor or those living in marginal areas will not be the same as those who have access to more resources. Poor households depend largely on subsistence agriculture. They are not in a position to take risks and their on- and off-farm activities are usually small scale and yield little income. Savings services - tailored to their capacities and needs - are very important to them.

Farmers with access to more resources often produce and market cash crops. They earn more and are able - and willing - to take more risks. They often need credit so they can invest and improve their production.

### **Marginal regions**

Many regions, especially in rural Africa are only marginally involved in the market economy. Low rainfall, poor soil fertility as well as inadequate infrastructure are among the factors that make it difficult for farmers to produce for market. The unfavourable terms of international trade and the growing dependence of urban communities on imported foods has also disadvantaged local farming and pastoral communities.

Farmers in marginal regions prefer to minimise their risks. They practice multiple cropping and meet their basic needs by growing crops that require little capital input. They do not commit themselves fully to the market economy because they are unable to take the risk that bad weather and poor prices may destroy their crops, income and food supply. However, they do need cash to pay for services and goods and they raise it either by selling farm products or - if this is not possible - by engaging in non-agricultural activities.



*Figure 3: Non-agricultural activities such as basket making can provide rural households with much needed cash.*

Because their economic and financial capacity is limited, households in marginal areas do not need much capital and non-agricultural activities are usually conducted on a small scale. Rural families do not need loans but they do need to save. The conventional way of dealing with emergencies and recurrent expenses is to sell valuable assets such as livestock and equipment. If farm families have access to savings facilities they can put aside part of their earning to meet future expenses and in this way avoid going into debt or having to sell their assets.

### **Box 1: Seasonality of income, expenditure, savings and credit in Arusha, Tanzania**

Because of the seasonal fluctuation in income in rural areas, the poor save money during high income seasons so they have enough cash for the months when money is scarce. This practice is known as 'income smoothing'.

In the Arusha district of Tanzania, farmers can expect to earn money in the period July to December when crops ripen and there are jobs in the tourist industry. People save part of this income to carry them through the period January to June when there is little money around to meet school fees and household expenses. Health bills also tend to be higher in the period January to June because there is more illness and disease at this time of year. Households rely on a combination of savings and loans to meet their expenses in these difficult months.

From: *Use and Impact of Savings in Tanzania*. L. Mutesasira. *Micro Save*, August 1999

### **Marginal groups**

Landless labourers, small landowners and women predominate in marginal groups. Because they earn little cash from agriculture and other activities, they can benefit from saving facilities that help them 'smooth' their income.

Credit can be supplied to marginal groups wishing to undertake (new) income generating activities. However, it is essential that a careful study is made of the proposed activity to ensure that it will make enough money for farmers to repay their loans and continue production. Costs and risks can be reduced if the working capital or investment can be (partly) financed from the producers own capital or savings. Risks can further be reduced if activities are started on a small scale using only small loans. As their experience increases and risks decline, farmers will be in a better position to take on larger loans and extend production.

### **Rural entrepreneurs and stakeholders in the value chain**

Farmers producing for market and traders and artisans doing business on a significant scale, need money to buy inputs, hire labour and invest in the future of their enterprise. Often their own financial reserves

are small and they need access to appropriate credit facilities to keep their businesses going. If credit is not available on acceptable terms, farmers may cut back on investment and - as output declines - cease to market their products.

A new approach is to analyse the bottlenecks in production and marketing and identify ways in which producers can attract added value to their products and activities. This involves evaluating the production or value chain as a whole. At farm level the production chain may begin with an initial input of seed, fertilizer, labour and the purchase of livestock or machinery. Once agricultural products are ready for market, farmers, traders and other rural entrepreneurs may consider processing them to increase their market value. Marketing the product and the price consumers are prepared to pay for the goods on offer is the final link in the chain.

Farmers can add value to their product at any point in the chain. They can improve their production efficiency, bargain over the price of inputs or try to sell their products in new markets. Farmers who are directly involved at different stages in the chain will benefit from the added value achieved through processing and selective marketing. More money can also be earned when farmers' organizations start to explore new markets and begin marketing products themselves. Rural finance has an important role to play in this process. It can provide the funds needed to pay for inputs and the cost of production, processing and marketing.

Regions, sectors, producers and producer organizations with development potential need specifically tailored credit facilities. Credit facilities can be of particular help to those involved in cash crop production. However, the extent to which individual farm households or producers can benefit from credit facilities will depend on their access to land, knowledge and other critical assets.

If development is successful, farmers and other rural entrepreneurs will be able to improve their living conditions, invest in production

and have more opportunity to save. As rural incomes improve, the demand for insurance services is likely to increase. As their capital investment increases, farmers who can afford to pay the premiums will consider insuring themselves against possible risks.

**Box 2: Case study Savannah Farmers Marketing Company, Ghana**

In an attempt to help alleviate poverty, the *Association of Church Development Projects (ACDEP)* in Ghana has developed a strategy to improve the income of small-scale farmers by making them part of the value chain. The *Savannah Farmers Marketing Company (SFMC)* was created and given the responsibility of finding markets that offered farmers a good price for their products. Credit was extended to farmers groups' that took part in the project.

The farmers involved were members of local farmer-based organizations and these organizations sold their products at a fixed price to the *SFMC*. The *SFMC* signed contracts with several large companies. These contracts set out pricing policy, quality standards and the services to be provided. The products purchased from farmers' groups are sold directly to these companies.

The *SFMC* buys certified seed and this is made available to farmers on credit. It also provides credit for land preparation services and farmers receive agricultural training when necessary. After the harvest, farmers bring their crops to fixed collection points. The crops are inspected and then stored ready for sale. Once the farmers have been paid they repay their loans.

The project has been extremely successful and more and more farmers have joined the scheme. As a result the *SFMC* decided to concentrate on marketing – where it had considerable experience – and hand over credit-related activities to two rural banks.

Now a small unit within the *SFMC* liaises with these banks and helps farmers obtain credit. The unit assesses farmers' credit applications and provides the banks with a list of farmers it considers credit worthy. The banks themselves must then decide which farmers are eligible for micro loans and it is the banks that carry the risk if loans are not repaid.

There are plans to create two separate business units. The first - the *SFMC* – will focus on marketing. The second - *ACDEP Financial Services (AFS)* will be responsible for all credit-related activities. The *AFS* will assess and monitor credit applications and pass its recommendations to the rural banks. As soon as credit is given to clients, *AFS* becomes responsible for monitoring loan repayment and retrieving unpaid loans.

In this way it may be possible to overcome the problem of credit applications from vulnerable farmers – especially those from farmers living in more remote areas – being rejected by the banks. It is hoped that *AFS* can become a strong, profit generating unit able to operate beyond the current client base of the *SFMC*.

**From:** *Study Support Methodologies for Rural Finance among the Dutch MicroNed members*. MicroNed, The Hague, the Netherlands (2007)



## 2 Financial services, products and methodologies

As the field of rural microfinance continues to develop, more products and services targeting the specific needs of farmers, pastoralists and rural entrepreneurs are becoming available. The importance of savings has often been undervalued but an analysis of the role it can play in rural society emphasizes its importance.

Attention must be paid to the way in which the limited outreach of microfinance in rural areas affects access to and the availability of credit. Ways of overcoming this problem are being developed and because financial services are important for all categories of the rural poor, these new facilities and approaches need to be explored. Insurance services are also being developed to mitigate the risks and uncertainties faced by rural producers.

### 2.1 Savings

Many microfinance organizations only supply credit and the importance of savings - especially for the poor – continues to be underestimated. The experience of traditional savings and credit groups, community-based savings and lending groups and savings and credit co-operatives show that the poor need savings services more than credit facilities.

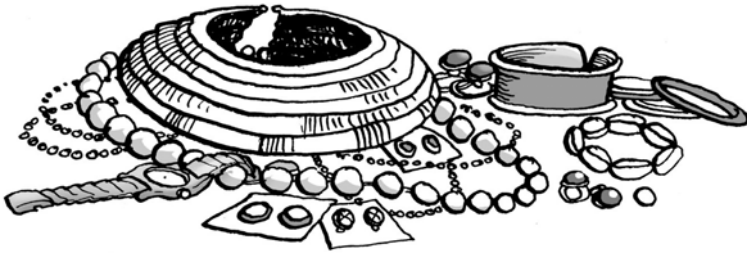
#### The functions of savings

Savings services can have the following functions:

- *Income smoothing*: In rural areas incomes are often irregular. This is as true for agriculture as for other economic activities. However, money is needed throughout the year. If cash is saved when it becomes available, it reduces the risk of money running out when it is most needed.
- *Safe place*: Many households do not have a safe place to keep their money because there are no local banks or financial organizations.

It can be difficult to withstand the impulse to spend money if it is kept at home.

- *Liquidity*: Many people in rural areas buy animals, jewellery or other valuables when they have cash. Saving in kind, however, does have some disadvantages. It is not always easy to sell goods or animals when cash is needed and if they are sold the amount of money raised may either exceed or be less than the amount required.
- *Insurance*: If households are able to save they will be in a better position to avoid going into debt when emergencies arise.
- *Financial provisions*: Savings can be used to meet the costs of occasional - but expensive - events such as marriages and funerals. They can also be used to finance a child's education.
- *Investments*: Farmers and other rural entrepreneurs save so they can invest in the development of their farms and business without having to rely on loans.



*Figure 4: Farmers often buy jewellery, livestock or other valuables and sell them later when they need cash.*

Banks and microfinance institutions also benefit from the savings deposited by their clients:

- They can use the savings deposited by their members/clients for their loan funds instead of having to borrow from other sources. Capital acquired in this way will be cheaper than borrowed capital. It also reduces their dependency on external agencies.
- Many organizations use the savings deposited by individual clients as a guarantee for outstanding loans. If there are repayment problems, the client's savings will be confiscated.

- A financial organization can assess a client's repayment ability by analyzing the way he or she saves. Clients who save regularly are low risk because they have shown they are able to consistently save money from their normal income.
- Some organizations link the maximum credit they grant to clients to the amount the client has saved. A regular savings pattern indicates that clients will be able to repay their loan from their normal household or business income.

### **Obligatory versus voluntary savings**

Many microfinance organizations oblige their clients to save. Before clients can apply for a loan they must have saved for a specific period of time and/or have saved a certain amount. Sometimes clients are obliged to continue saving after they have received their loan. This is called *obligatory saving*.

While obligatory savings are useful for microfinance organizations, the conditions imposed are often not favourable to the client. For example, clients may not be allowed to withdraw their savings until the loan has been fully repaid or they may receive little or no interest on their savings. Obligatory savings do not encourage clients to have a positive attitude towards saving.

Many people - especially the poor - feel they are unable to save. Setting money aside on a regular basis can be difficult for those with very small incomes. However, experience has shown it can be done. If financial organizations collect savings regularly – daily, weekly or bi-weekly, for example, and the amounts are kept small - a dollar a week or just a few cents – they can gradually build up their reserves.

Some people refuse to save with banks or microfinance programmes either because they have little confidence in the type of organization or they think that traditional forms of saving are just as effective. If financial service organizations are to attract farmers and rural entrepreneurs into *voluntary savings* schemes, they must ensure that their schemes are tailored to the needs and capacities of their prospective

clients. For example, clients should know they are free to withdraw their savings if necessary, that they can save small amounts at frequent intervals and that interest will be paid on any money they deposit.

## **2.2 Credit**

### **Limited rural outreach**

After informal sources, microfinance organizations are the main providers of credit to low income groups in developing countries. However, they have a limited presence in rural areas, especially in the less populated and economically under-developed parts of Africa and Latin America. Where microfinance organizations do exist, the poorest groups are often unable to access their services.

Microfinance organizations tend to avoid rural areas for several reasons:

- Except for some countries in South Asia such as India and Bangladesh, for example, rural population density tends to be low and communication infrastructure poor. This means that setting up microfinance programmes, monitoring business and keeping in touch with clients will involve a lot of travelling and high transport costs.
- In many rural areas agricultural productivity is low and the income generated by rural businesses is small. There will not be many prospective clients unless the microfinance organization is prepared to serve clients with limited savings and borrowing capacity. This means they will have to handle savings and loans involving quite small amounts money. Providing such services often proves too expensive for microfinance organizations.
- Profit margins in agricultural production are often low and farmers are not able to pay the high interest rates microfinance organizations charge for their loans.
- Many microfinance organizations - like other financial institutions in the formal sector such as banks - ask for collateral to guarantee loan repayment. But in rural areas the poor have no land, buildings or salaries to offer as collateral to guarantee loan repayment.

- Agriculture is a high risk occupation. It is also an activity that involves high *co-variant risk*. This means that if drought, storms, disease or unfavourable market conditions occur a *large number of clients will be at risk at the same time*. All clients will face the same repayment problems and - for this reason - microfinance organizations are reluctant to extend their services to marginal and risk-prone agricultural areas.



*Figure 5: Transport and communication costs are high for farmers, traders and microfinance organizations when infrastructure is poor*

## 2.3 Different credit delivery systems

### Individual loans or group loans

When an individual applies for a loan, the financing organization will ask the loan applicant either for the names of individuals who will guarantee repayment if he or she cannot repay the loan or for collateral such land or a house that can be confiscated if the borrower defaults.

Many poor people do not have the type of asset that can be used as collateral and they may find it difficult to find somebody willing to act as their personal guarantor. For this reason many microfinance organizations have replaced individual loans with group loans where the group accepts responsibility for repaying the loans taken out by its members.

This approach is known as the *solidarity group approach*. Clients are organised in small groups of between 5-20 members and they meet on a regular basis. During their meetings members deposit savings, repay the instalments due on their loans and discuss loan applications. Loans are also disbursed.

Because these groups select their own members, there is a high level of common understanding and trust. Individual members who apply for loans are not asked to provide collateral themselves. Instead each group member accepts responsibility for ensuring that the loans made to its members are repaid. This can be done in one of two ways. Either group members agree that they will all contribute to repaying the debt of a member who defaults on his or her loan repayments. Or group members will not be entitled to new loans until every group member has repaid his or her outstanding loan. In this case, if the group wants to access a new loan, they will either have to put social pressure on the defaulter to repay, help the defaulter with his or her repayments or repay the loan themselves.

## **Centralised and decentralised financial organizations**

While group loans can solve collateral problems in marginal and impoverished areas, the cost of providing financial services to rural producers and entrepreneurs remains high.

It is expensive to keep credit agents in the field and management and administrative staff in central offices. Solidarity groups can - to some extent - offset field costs when group members take on the responsibility of collecting savings and repayments, dealing with defaulters and assessing loan applications. Nevertheless, organizational costs will still be substantial. Credit agents need to monitor the groups and carry out administrative tasks while the cost of communication and administration involved in maintaining rural financial services is relatively high.

Operational costs can, however, be reduced considerably when local groups take over the monitoring and management of savings and credit on a voluntary bases such as in community-based saving and lending groups, village level self-help groups and village banks. Such organizations, together with credit and saving cooperatives, are categorised as *member-owned organizations*. They have significantly lower costs than centrally managed types of microfinance organizations, banks and other *non-member organizations*.

Decentralised, member-owned organizations are often better adapted to clients needs and can bring more social pressure to bear on members who default on loans. Experience suggests that member organizations are also more effective in providing financial services to the poor in isolated rural areas than non-member organizations. For extremely poor groups and communities living in marginal agricultural areas, community-based approaches are extremely appropriate.

## **Alternative sources of credit**

Rural entrepreneurs and those engaged in cash crop production frequently need credit facilities. Farm inputs must be paid for, seasonal labour employed and investments made. When there are no banks or

microfinance organizations that can provide the necessary financial support alternatives are needed:

- Traders are a traditional source of credit for farmers. Some organizations have developed a system known as *trader credit*. Traders provide farmers – on a credit basis - with the inputs they need to cultivate their crops and maintain their herds. These loans are repaid at harvest time. Traders deduct the loan from the income farmers earn from the sale of their crops. Banks and microfinance organizations find it convenient to work through traders because they have local networks and understand the communities in their area. They can also provide low cost credit. If banks and other funding agencies cooperate with traders they can avoid the expense of setting-up new networks of offices and appointing credit agents to manage rural business.



Figure 6: Traders traditionally provide farmers with credit



- *Out-grower advance schemes* and *contract farming* are particular forms of trader credit. Farmers enter into a contract with traders, wholesalers or food processors prepared to provide cash advances and supply inputs on credit. In return farmers agree to sell their harvest to these contractors.

### **Dealing with rural collateral problems**

- *Warehouse receipt schemes.* Farmers stock their produce in warehouses. In return they get a receipt that they can use as collateral if they want to apply for a loan. This arrangement can be used, for example, by farmer cooperatives if they decide to store their products until prices rise or if farmers have to wait for payment from buyers. Under the warehouse receipt scheme farmers do not have to wait for payment.
- *Leasing.* If production is partially mechanised, farmers may need mid- or long-term loans to buy and maintain equipment. Many financial institutions consider that the risks attached to providing long-term credit are too high. Leasing can be an alternative in such situations. The leasing company provides farmers with equipment for a few years on a contract basis and farmers pay off the lease in periodic instalments. At the end of the lease period the leasing company either repossesses the equipment or offers to sell it to the farmer. As the equipment leased to the farmer remains the property of the owner and can be easily withdrawn if the farmer defaults on payments, it is less risky than lending. Withdrawing the equipment is also simpler than claiming the collateral offered to guarantee a loan because legal constraints and weak judicial systems often make it difficult to take possession of assets offered as collateral.

### **Box 3: Lending methods**

#### *Loan size*

Loan size is determined by the clients' plans and his or her repayment capacity. Experience has shown that it is better for a new borrower to start with a relatively small loan. High risks should be avoided. New clients have to build up a relationship of trust with their financial service provider. They have to show they have the capacity to generate enough income to repay their loans. However, the loan should not be too small. It should be large enough for rural producers to launch economically viable enterprises and generate enough income to repay the loan, cover household and business costs and make savings and investment possible.

#### *Loan terms*

Credit can be extended for various lengths of time. Short-term loans have to be repaid within 1-12 months, mid-term loans within 1-3 years. Long-term credit can be extended for periods of more than three years.

Most microfinance programmes only provide short-term loans for a period of three to six months. This approach is well adapted to economic activities with a rapid turnover of capital but less well adapted to agricultural activities.

#### *Repayment terms*

Most microfinance programmes require their clients to repay their loans relatively quickly - often within 3-4 months - and in monthly instalments without a period of grace i.e. a delay before the first instalment has to be paid.

It is debatable whether this type of system is appropriate for agricultural loans. It might be more effective if the repayment schedule attached to agricultural loans followed the agricultural cycle. Then farmers would only be required to repay their loans after they had sold crops or livestock. However, such a system does not take into account the advantage of being in regular contact with clients. When repayment problems are identified at an early stage appropriate action can be taken.

Farm families often have other sources of (non-farm) income or cultivate a variety of crops that can be harvested and marketed throughout the year. This makes it possible for them to repay their loans in regular instalments soon after the loan has been granted. The repayment system can, if necessary, be adapted to the clients needs. The first instalment(s) can be kept relatively small, for example, so that they only cover the interest rate or a small part of the total loan amount.

## 2.4 Insurance

Insurance services can help farmers and rural producers cope with events that threaten their livelihood such as the death, illness or injury of family members, poor harvests, cattle disease and theft.

### **Coping with risk: traditional mechanisms**

Traditionally, farm households and rural producers build up reserves when times are good. They save income in cash or kind and ensure they have sufficient food reserves to carry them through more difficult times. Membership of traditional saving and lending clubs enable farm families to save and prepare themselves for possible future expenses. The burial and funeral societies that are widespread in Ethiopia, for example, provide an example of this type of traditional insurance. Family relationships and local networks are also important sources of financial support in times of need.

#### **Box 4: Burial societies and funeral associations: the *iddir* in Ethiopia**

*Iddirs* are traditional burial societies or funeral associations. They are found in all parts of Ethiopia except Tigray. In 2007, the *Global Action Poverty Group* made a study of 15 Ethiopian Peasant Associations. Of the 1500 households involved in the research nearly 90% belonged to at least one *iddir*, 21% belonged to two and 20% were members of three *iddirs* or more. Only 4% of households said they did not belong to an *iddir* because they could not afford the monthly payments.

The members of an *iddir* typically meet once or twice a month and make a small payment into a group fund of about 1 or 2 birr (US\$0.10c). The *iddirs* are rather formal organizations. They often have written rules and keep records of contributions and payouts. When a member dies, the *iddir* makes a payment to surviving family members either in cash or in kind. The average amount paid by the *iddirs* in the study was about 100 birr (US\$5). In addition to providing this form of life insurance, about a third of the *iddirs* also make cash payouts or provided loans to members when emergencies arise.

Source: *Collective action and vulnerability: Burial societies in rural Ethiopia*. S.Dercon, J.Hoddinott, P.Krishnan and T.Woldehannna. Global Poverty Research Group. (<http://www.gprg.org>). April, 2007.



*Figure 7: Loans from family, friends and other informal money providers help poor rural households cope with the cost of medical treatment*

Poor people are particularly vulnerable to risks. They often have few reserves and little savings. In addition they have limited access to lending facilities and their social networks are generally smaller and less effective than the social network of wealthier groups. Therefore, savings and lending products that are specifically designed to help marginalised and poor communities deal with the risks that threaten their livelihood are extremely important.

### **Special insurance products**

Recently financial service organizations - including insurance companies, banks and microfinance organizations - have started to experiment with special insurance products for the poor. At present considerable attention is being given to the development of health and life insurance schemes and - to some extent - products that cover crops

and animal health. This is a very new field, however, and much work still needs to be done. Experience shows that one of the greatest challenges to the successful development of insurance products for the rural poor is ensuring financial sustainability. Many schemes are small scale, their administration complex and there is always the risk that the microfinance organization will not have sufficient reserves to meet high claims because its client base is too small.

In a study of micro insurance in the 100 poorest countries in the world carried out for the *Micro Insurance Centre* (2007), J.R Roth and his fellow researchers found that there is very little micro insurance available for the poor. In South and Central America only 7.8% of the poor are covered by some form of insurance and this figure is itself unrepresentative because it includes Peru where 40% of the poor have access to insurance. In India and Africa the percentage of poor people covered by insurance are 2.7% and 2% respectively. It is widely recognised that much still needs to be done in this branch of microfinance. However, it is a considerable challenge to provide a cost effective and sustainable insurance service.

Some risks only affect individual households. These individual, specific or *idiosyncratic* risks include disease, death and theft. Other risks, however, may affect large numbers of individuals and households within a particular region. These risks are referred to as *common* or *covariant risks* and include natural calamities such as low or extremely high rainfall, outbreaks of disease, plant and animal pests, low product prices, war and epidemics such as HIV/AIDS. This type of mass /covariant risk is difficult to insure since the insurer is exposed to high losses if an entire population is affected by a calamity.

Pilot insurance schemes exist to cover individual or *idiosyncratic* risks. These provide the rural poor with health and life insurance and make it possible for them to insure their property and livestock.

Several microfinance programmes have *credit-life insurance* schemes. These are often obligatory and are designed to ensure that if the bor-

rower dies the loan will be repaid. The borrower takes out life insurance for the period of the loan. If he or she dies the outstanding debt will be paid out of the insurance fund. Some microfinance programmes with schemes to provide farmers with loans to buy cattle have also developed similar arrangements to cover the risk that animals may die or be stolen. Farmers pay a cattle insurance premium so that if anything happens to their animals their loans are covered.

Health insurance schemes are usually based on the payment of monthly premiums. Some cover the cost of hospitalization; others include the cost of medicines. Life insurance programmes pay compensation to the family of the deceased at the time of death and may also meet funeral costs.



*Figure 8: Farmers face many risks*

## **Common or co-variant risk**

Uncertain weather conditions, pests and disease as well as fluctuating and unpredictable market prices mean that agricultural is a risky business. Insurance is needed but since these hazards involve *common* or *covariant risks* it is not easy to develop appropriate insurance products. The insurance agency itself can be exposed to high losses if a calamity strikes an entire region.

Assessing each farmer's crop and livestock losses in the aftermath of a natural disaster or in cases of recurrent drought or excessive rainfall involves an enormous amount of work. Experiments are being carried out using *index-based insurance* to reduce costs. Instead of visiting the fields of each farmer to assess how much has been lost, the insurance agency estimates farmers' losses on the basis, for example, of deviations from such indicators as the normal rainfall figures for the region. The average loss per farm surface is then estimated for an entire region using these 'proxy' estimates. The results will later be used to calculate how much compensation a farmer should receive. Some, however, express doubts about applying index-based crop insurance in remote areas. Unfortunately weather trends are changing and local rainfall records can no longer be relied upon to provide good approximations.

### **Box 5: Credit life insurance and emergency loans offered by *PULSE*, Zambia**

*PULSE* (*Peri-Urban Lusaka Small Enterprise*) began lending in 1995. Founded by *CARE International* its aim was to fight urban poverty by making it easier for micro and small enterprises to access credit. It offered two types of business loan: *Ntemba*, a group loan product for micro traders and small business loans designed for individuals. *PULSE's* experience with insurance began in 2000 with a self-managed insurance scheme called *Borrowers Protection Fund (BPF)*. *BPF* was designed to provide credit life insurance to clients. Premiums ranged from 1-3% of the loan depending on its size and the terms of repayment. The *BPF* paid off outstanding loans. The scheme grew and *PULSE* realised that it would be better if it were managed by an insurance company. In cooperation with *Madison* - a local insurance company - a *Credit Life Assurance Scheme* was developed to replace the *BPF*. This scheme ensured that loans were paid off if a borrower died before he or she had finished paying for a loan or could not repay loan instalments because of illness.

Toward the end of 2002, *PULSE* added *Thandizo*, an insurance product that covered the borrower and selected household members. *PULSE* also started to provide emergency loans to deal with economic stresses and risks that were not already covered by its business and insurance products. *Household emergency loans* were made available for periods of three months with repayments being required on a weekly, bi-weekly or monthly basis. The collateral for these household emergency loans could be a salary, personal savings, an employer's guarantee or the borrower's own repayment record. The size of the loan depended on its purpose. Loans of up to ZMK500,000 (US\$108) were made available to meet funeral costs and loans of ZMK3 million (US\$645) were made for school fees. The maximum loan for medical expenses was ZMK1 million (US\$216). The interest on these loans was 5.5% per month on a flat rate basis and borrowers were required to pay loan processing fees ranging from ZMK30,000 (US\$6.50) to ZMK200,000 (US\$43), depending on the size of the loan.

Source: *Good and Bad Practices*. Case Study No.10, May 2005; Madison Insurance, Zambia. CGAP Working Group on Micro Insurance.



## 3 Financial service providers

Financial service providers within the informal, semi-formal and formal sector offer a wide range of products and have developed many different approaches. Each has its own advantages and disadvantages. Costs, flexibility, outreach and saving and lending methods will determine how appropriate these services are for specific target groups and especially those living and working in poverty stricken and marginal areas.

### 3.1 Informal sector

#### **Friends, relatives, shopkeepers, moneylenders etc.**

The poor first turn to friends, relatives, local shopkeepers, traders, pawnbrokers, money lenders and landlords when they need to borrow money. Many people deposit savings with persons they trust or with money collectors.

Friends and relatives generally lend money without charging interest. Pawnbrokers, money collectors, shopkeepers and landlords, however, are often heavily criticised for exploiting and charging abusively high interest rates to those in financial need.

Despite these problems informal sources of credit have definite advantages. They are:

- **Easily accessible.** In some regions there are no financial service providers and borrowers have to travel to nearby towns to arrange loans. Informal lending takes place without the filling in of complex loan applications and there is no collateral involved.
- **Flexible.** There are no restrictions on the way the loan can be used. While microfinance providers are often only prepared to lend money for “productive purposes”, many borrowers require loans to buy consumer goods, for example, or deal with emergencies. Within the informal sector there is usually a degree of flexibility as far as repayment arrangements are concerned.

- **Able to respond quickly.** Moneylenders and pawnbrokers can pay out money quickly and shopkeepers and traders are able to supply goods bought on credit immediately.

So long as other financial service providers cannot offer this type of advantage, informal service providers will continue to be the main source of loans to the poor.

### **Traditional savings and lending groups**

Traditional savings and lending groups have many different names depending on where they are found: In some countries they are known as *merry-go-rounds* in others as *tontines*, *tandas* or *haqbad*s. Local names abound but traditional savings and lending groups have certain basic principals in common.

### **Rotating Savings and Credit Association (ROSCA)**

The most common form of traditional savings and lending is the *Rotating Saving and Credit Association (ROSCA)*. Community members voluntarily come together as a group on a regular basis and each time they meet they contribute a fixed amount of money. These contributions or savings are paid out immediately to a member of the group present at the meeting. A lottery may be held to decide who will receive this money. Once a member has received a payment he or she will no longer be entitled to take part in future lotteries. However, he or she will continue to participate in meetings and pay contributions until the cycle ends. A *ROSCA* cycle comes to an end once all members of the group have received a payment. At this point new members can enter the group, old members can leave and a new cycle of contributions and payments begins. Many *ROSCAs* continue for years although their membership can change.

The advantage of the system is that members commit themselves to saving for the entire *ROSCA* cycle. Each will receive one lump-sum payment making it possible for them to invest, buy equipment and other consumer items or pay school fees. The system is most popular

among women, but is also practised by men particularly by traders and those who, like civil servants, receive a regular income.



Figure 9: ROSCA women's group discussing savings

**Accumulating Savings and Credit Association (ASCA)**

*Accumulating Savings and Credit Associations (ASCAs)* go one step further. Unlike the *ROSCA* system, savings collected during regular meetings are not paid out immediately. They are set aside until enough money has been accumulated to provide members with larger loans or until members need to borrow money. At each meeting savings are collected, loan requests discussed, money disbursed and repayments collected.

*ASCA* groups usually have a limited life cycle of about a year and at the end of this time the money saved is distributed amongst group members. *ASCAs* are more difficult to manage than *ROSCAs* because

money is held in cash and records have to be kept to keep track of loans and repayments. This is probably the reason why they are less common than *ROSCAs*.

*ROSCAs* and *ASCAs* have many advantages.

- **Autonomy.** They are initiated by their members and do not depend on outside assistance. The members manage the groups themselves, decide on the amount and frequency of saving and determine their own loan conditions and procedures.
- **Social coherence.** Group coherence is assured because members select co-members themselves.
- **Adaptability.** The groups are generally made up of people in the same financial position. Some groups consist of women traders who have larger financial capacities and needs. In other groups rural women with limited savings capacity may get together to provide each other with financial support. Amounts saved will range from a few dollars a week in some groups to a few cents in groups where money is scarce.
- **Mutual assistance.** Members also join these groups for social reasons. The group provides them with the opportunity to meet regularly and relationships built up in the group can be a valuable source of support in times of trouble. Group members often assist each other in emergencies with advice as well as material and financial support. This is an important social resource and is sometimes referred to as *social capital* – a phrase that indicates the status of human resources in a community.

But traditional saving and lending groups also have their limitations:

- Some savings and lending groups last for many years but others have a limited life cycle. This means that they are unable to offer their members permanent access to financial services.
- They function well when there is good group leadership. However, there is always the risk of fraud.
- Members are often not capable of mobilising sufficient funds for those who have larger enterprises and need bigger loans.

- ASCAs only provide short-term loans and cannot help members who want to invest but need loans that can be repaid over a longer period of time.

## **3.2 Semi-formal sector**

The semi-formal sector is made up of NGOs and development-orientated organizations that offer financial services not covered by the legislation that regulates financial service providers.

### **Community-based savings and lending groups**

Several NGOs have developed community-based savings and lending groups, village savings and lending association and self-help groups. Their programmes are built along the lines of traditional savings and lending groups. Since the principles underlying the traditional groups are well known to the target groups, it is relatively easy for NGOs to introduce these new programmes.

The programmes all start with savings. The amount saved is determined by the group members themselves. Groups vary considerably in size with the smaller groups having no more than three or four members while larger groups may have as many as 30 members. Loans become available to members as soon as enough capital has been generated through members' savings. The group is responsible for selecting beneficiaries, managing loans, monitoring repayments and deciding the conditions (interest rate, repayment period) under which loans can be made.

These programmes differ from the traditional *ROSCA* and *ASCA* systems because they have been introduced by external agencies - mostly NGOs. The NGOs promote the idea of setting up a savings and lending programme and introduce members to the general principles of the system. Emphasis is placed on group formation, leadership training and the setting up of a simple system to administer loans and financial transactions. Responsibility for managing newly created groups is

then handed over to the members although guidance in the form of monitoring, technical advice and assistance is still provided.

The *Village Savings and Loan Association (VSLA)* established by *CARE* in the early 1990s provides an example of semi-formal financial services set up at NGO level. *CARE* started to establish savings and lending services based on the traditional *ASCA* model. These proved to be successful and – in Africa in particular - several international NGOs including *Oxfam*, *PLAN* and *World Vision* started to promote the *VSLAs* concept.

### **Box 6: Use of savings payouts and loans in VSLAs in Zanzibar**

#### *Case study 1: Mwana Hamisi Mlenge*

Mwana Hamisi Mlenge and her husband are members of the Maendeleo group in Chwaka, Zanzibar. She operates a small business selling chapattis and handkerchiefs in town. Madam Mlenge joined the group in 2001. At the end of each *VSLA* cycle she received her savings plus a dividend. This dividend was generated from the interest paid by group members who had taken out loans.

*“I have received four payouts”, she explained. “The first payout was worth Tsh.15,000 (US\$25). I used part of it to pay school fees for my two sons and the balance I used to buy food and other household items for Ramadan. That payout really helped me because it came during the celebrations and I had a lot of pressure to pay my children’s school fees. I received what I expected and I was very happy. The second payout was Tsh.120,000 (US\$105). I used Tsh.60,000 (US\$50) to pay my sons’ school fees and I helped my husband extend our house with the rest. The third payout was worth Tsh.140,000 (US\$122) and I used all of it to pay for my sons’ school fees. The final payout was Tsh.160,000 (US\$140). I used Tsh.120,000 (US\$105) to pay for my sons’ school fees and the remaining Tsh.40,000 (US\$35) I spent on personal things.*

*“The payouts have played an important role in my life. They came at a very opportune time, during our religious celebrations. Through the payouts I have been able to educate my sons up to secondary level. I am sure that I will manage to pay even their college fees through my savings. Without this group my sons would never be where they are now.”*

## Case Study 2: Salama Ali Mjumbe

Salama Ali Mjumbe is also a member of the Maendeleo group. Over the past four years, she has borrowed six times. She took her first loan in 2001. It was for Tsh.15,000 (US\$13) and she used it to trade in *khangas* (lengths of cloth) which she bought for Tsh.1,800 (US\$1.50) and resold for Tsh.2,100 (US\$1.90). She said that she had no problem repaying her loan and repaid it within three months. She took out her most recent loan for Tsh.50,000 (US\$43) in July 2006 and again invested it in her *khanga* business. She now buys the *khangas* for Tsh.2000 (US\$1.85) and sells them at Tsh.2300 (US\$2.00). She was confident that she could repay her loan by the end of August 2006.

*"I have never had problems repaying my loans. The key to good loan management is proper planning and taking a loan when you really know what you want to do with it,"* she says.

The most significant loan she took was for Tsh.40,000 (US\$35) in 2004. She used it to buy iron sheets to roof her mother's house. *"I cannot forget the poor condition of my mother's thatched house before my intervention. Each time I visit my mother, I remember where the loan pulled her from."*

Source: 'Village Savings and Loan Associations: experience from Zanzibar'. E.Anyango, E.Esipisu, L.Opoku, S.Johnson, M.Malkamaki and C.Musoke. Published in 2006.

The advantages of this type of community-based or self-help group approach are:

- They are well adapted to the financial capacity and needs of the poor. Since savings can range from a few cents to a few dollars a week, access is assured even to the lowest income groups.
- Group members can take loans either to invest in production and trade or to meet the cost of emergencies and social and family obligations. Often small loans are taken out to cover occasional costs such as the purchase of agricultural inputs or to hire labour.
- Beneficiaries use their own savings to meet exceptional expenses. They no longer need to take out loans and risk the chance of falling into debt.
- Operational costs are minimal because the groups manage themselves. This makes it possible for them to keep interest rates low. Sometimes, however, a group may decide to charge a commercial

interest rate because it wants to build up its capital so it can provide more loans.

- An important advantage for group members is that the system is flexible and decisions are reached through a process of group discussion. Another advantage is that loans can be issued without much delay if sufficient capital is available.
- The experience of self organization can lead to the empowerment of the group and its individual members. The group provides a forum where members can find support, exchange experiences and undertake joint action.



*Figure 10: Using a Village Saving and Loan Association loan to carry out roof repairs*

Disadvantages of semi-formal organizations are:

- It can take a long time for the group to accumulate enough capital to meet its members' loan requirements.



- Organizational sustainability is uncertain. Much depends on the quality of leadership and members' commitment.

### **Revolving funds**

The conventional way for NGOs to set up a (savings) and credit programme is to establish an externally funded *revolving fund* from which loans can be disbursed to members or clients. NGOs use many different approaches and lending strategies in their programmes. Some use the solidarity group approach, others practice individual lending. Some NGOs require clients to accumulate some savings before they are entitled to take out a loan, others do not impose this type of condition.

Revolving funds differ from the community-based systems discussed above not only in their source of funding – which is largely external – but also in the way tasks are managed. Programme staff rather than group members deal with financial and loan administration as well as the selection and approval of loan applications and repayments.

Experience has shown that most revolving fund programmes established by NGOs are not sustainable. Most of them run into financial difficulties because of repayment problems and a high rate of default. Because their interest rates are low and administration is often inefficient, they are unable to cover programme costs.

Some of the programmes succeed, however, in transforming themselves into sustainable microfinance programmes. Changes include the introduction of appropriate loan and financial management procedures, the separation of microfinance administration and management activities from other parts of the programme and the adoption of procedures to strictly control repayments. These successful experiences can be a useful guide to those organizations wanting to professionalize their microfinance services. Some programmes hire in expertise for extra support.

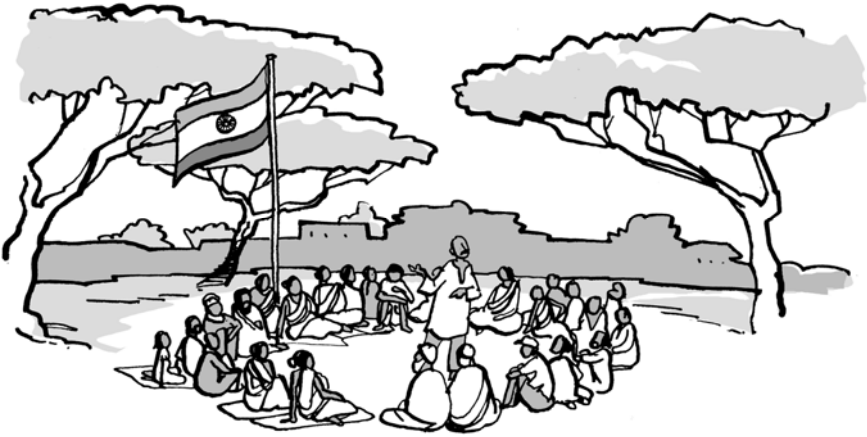
In general, however, the best way to ensure effective financial service is to rely on specialised financial service organizations if these are available. The successful administration of revolving fund programmes requires expertise in managing and operationalizing savings and credit programmes. Many NGOs do not have the expertise to successfully operate microfinance services and they need to employ experienced personnel. Developing reliable services costs time and there is always the risk that NGOs will not have enough capacity to set up a microfinance programme and maintain its other key activities.

### **Linkage model**

Self-help groups, community-based savings and lending groups and revolving fund programmes managed by development-orientated NGOs can be linked to microfinance programmes or banks. NGOs can play an important role in taking the initiative and starting the process. They can take the first step towards organising a target group and introduce members to savings and credit practices that – if managed properly - can help increase their economic and financial strength. After they have gained experience group members will be in a position to become clients either of banks or microfinance institutions. The *self-help group banking* model in India is a good example of how this strategy works.

### **Self-help groups in India**

The self-help group banking model has been very successful in India. It is said to be the largest and fastest growing microfinance programme in the developing world. According to a report published in 2005 by H.D.Seibel there are now some 1.4 million active self-help groups and together they have about 21 million members. Ninety percent of members are very poor rural women. There are about 36,000 bank branches and primary cooperatives that provide savings and credit services to these self-help groups. At the same time some 3100 governmental and non-governmental agencies experienced in group development act as facilitators. They strengthen existing self-help groups and help establish new ones. The Government of India actively promotes and supports this programme.



*Figure 11: The government of India actively supports the development self-help group banking.*

Before a bank participating in this microfinance programme can extend credit services to a self-help group, it must be satisfied that the group is stable and has the ability to function well. The group must have been in operation for at least six months, have members who consistently save and repay their loans and there must also be an efficient internal financial system for administering savings and outstanding loans. If the bank is satisfied with the way the self-help group is organized it will make loans to the group. The group will manage these loans, make them available to members and ensure they are repaid. Banks find the self-help group banking model profitable because repayment rates are high and transaction costs low. The self-help group can be relied on to act as an intermediary between the bank and individual group members.

### **3.3 Formal sector**

All financial services regulated by legislation fall within the formal sector. While most countries have banking legislation, not all have developed comprehensive laws and regulation to cover the field of microfinance. Sometimes organizations with small loan portfolios are

excluded from regulation and fall within the semi-formal sector discussed above. Cooperative societies, savings and credit associations and credit unions are generally covered by legislation designed specifically for cooperatives and fall under the jurisdiction of the Ministry of Cooperatives.

The formal sector consists of banks, registered microfinance institutions and registered saving and credit associations and unions. Within the formal microfinance sector there are many different approaches to lending and the structure and organizations of registered organizations and agencies vary considerable depending on location and type of client.

### **Agricultural and commercial banks**

State owned and semi-autonomous agricultural banks set up to stimulate economic activity in less developed rural areas in the immediate post-colonial period, frequently ran into problems. This was because they were obliged to undertake subsidised lending operations in sectors and regions where the return on investment was unpredictable. When loans to these areas failed to produce results and farmers and rural entrepreneurs were unable to repay them, the banks were often forced - for political reasons - to write-off these loans. Many agricultural banks were only able to operate if they had access to government subsidies or donor support. This situation changed in the 1990s with privatisations and a new wave of government reform. Government policy no longer included the provision of subsidies to agricultural banks and those agricultural banks that survived this policy shift cut back sharply on operations.

Commercial banks have never been particularly active amongst vulnerable groups or in the small-scale agricultural sector. Their contacts with rural communities have usually been indirect and restricted to providing traders with credit or extending loans to the wealthier class of farmer or shopkeeper. Sometimes, however, commercial banks do provide microfinance organizations with credit.

## **Rural microfinance programmes**

Microfinance programmes are the main providers of financial services to poor and marginal groups. They have developed a range of approaches, methods and models that include:

### *Village banks*

The international NGO *FINCA* has been the main promoter of the village banking approach. Village banks are found throughout South America. They are community run credit and savings associations managed at village level and supervised by the external NGO responsible for initiating the association.

Once a village bank concept has been explained to the community and accepted, the external NGO will start introducing members – usually between 30 and 50 people - to the principals behind village banking. A management committee is established and by-laws agreed. Once this has been done, the village bank is ready to receive an external loan from the NGO. This can then be used to provide loans to members.

Some village banks practice individual lending, while others extend loans to solidarity groups. Loans are usually granted for periods of between four and six months and repayments are required at regular weekly, bi-weekly or monthly intervals. Members are required to save and as their savings increase they become entitled to larger loans.

Members' loan repayments are kept by the village bank in an external account. Although this cash can be used for re-lending, the village bank must ensure that – at the end of the loan cycle - it has sufficient funds to repay the money it originally borrowed from the NGO. The village bank can apply for another loan from the NGO when the original loan has been fully repaid.

The village bank management committee keeps members' savings, the interest paid on loans and other income generated by members' activities in an internal account. The village bank is fully responsible for this account and - if it is managed well - the bank's capital will grow.

Members' savings, skilful loan fund management, interest paid on internal loans and other sources of income will increase the capacity of the village bank to build up its internal reserves. Unlike the *Grameen Bank*, for example, village banks are financial institutions that are fully community owned.

### *Solidarity groups*

The *Grameen* bank in Bangladesh is often taken as a model for solidarity groups. Its approach has been adopted in different forms by microfinance programmes all over the world. The *Grameen* bank's primary aim is to reach the poorest of the rural poor. Group membership is, therefore, restricted to impoverished and vulnerable women.

The poor do not have the collateral needed to guarantee loans. To solve this problem a solidarity group will agree to take responsibility for repaying a *Grameen* bank loan. Solidarity groups consist of five prospective borrowers and they are given special training. Once the group becomes active two members become eligible for a loan.

The *Grameen* bank observes the group for a month and monitors whether or not its members are able to meet the terms of their loan. The other members of the group will only become eligible for a loan if the first two borrowers pay back their loan - in instalments - over a period of six weeks. This means that - within the group - there will be considerable pressure to ensure that loans are repaid on time. The collective responsibility of the group serves as collateral for the loan.

The *Grameen* bank encourages its members to save but this is not obligatory. It provides small loans that have to be repaid in weekly instalments over the course of one year. Members meet weekly to save and repay their loans.

The *Grameen* bank has development objectives that extend beyond microfinance. It has a list of “*Sixteen Principles*” that cover problems ranging from sanitation to health, education, cooperation and family

planning. These issues are discussed regularly during weekly solidarity group meetings.

Unlike the village bank, the financial and administrative affairs of the *Grameen* bank at branch level are managed by professional staff. These branches usually serve between 15 and 20 villages. A number of centres will be organized at village level depending on the size of the village. These centres provide a basis for solidarity group activities.

Many microfinance organizations have drawn on the experiences of the *Grameen* bank and the solidarity group approach when developing rural microfinance services. The approach has often been modified:

- *Vulnerability.* Microfinance organizations target the poor but most of them do not apply strictly defined vulnerability criteria for membership groups in the same way as the *Grameen Bank*. It is often said that this is not necessary because within each group a process of self-selection takes place. Because the loans available within the solidarity groups are small, they are of little interest to wealthier participants.
- *Development goals.* Unlike the *Grameen* bank, many microfinance organizations do not actively pursue broader development goals. They restrict themselves to offering financial services to members. This is primarily because they want to keep programme costs low because high costs threaten sustainability.
- *Savings.* Many organizations require members to take part in a period of ‘obligatory’ saving before loans are disbursed. This can be seen as a training period during which members learn that they do have the capacity to save and that they can rely on their own resources. During the obligatory period it is sometimes possible for members to withdraw funds if emergencies arise or they need money for ‘non-productive’ purposes. But generally savings are kept by the organization as a guarantee that the loan will be repaid.
- *Group size:* The group size of microfinance organizations varies but on average it is somewhere between five and ten members.

One important characteristic of the *Grameen bank* and all solidarity group programmes is that they mainly - although not exclusively - target women. This is partly because rural women are often found in particularly vulnerability situations but it is also because experience has shown that women are easier to organise and are generally better at repaying their debts.



*Figure 12: Experience shows that women use their loans well and make their repayments on time*

#### *Individual lending.*

Individual lending schemes often exclude the poor but group lending is not always possible or acceptable. In some societies in Eastern Europe and Latin America group lending is not popular and it is often



difficult to get men and “wealthier” groups involved in this type of programme. For this reason many microfinance programmes opt for individual lending schemes rather than group lending projects.

Some programmes have adopted a dual approach which allows individual group members to take out individual loans as their economic activities grow and their need for cash increases.

### *Credit unions*

*Credit unions or Savings and Credit Cooperatives (SACCOs)* are institutionalized community-based, cooperative financial institutions. Credit unions are officially registered although this is not everywhere the case. However, where SACCOs function as semi-formal institutions, their organizational structure is similar to that of a credit-union. Membership is open to anyone in the community in return for the payment of a membership fee. This fee can be seen as a share.

Credit unions are owned and controlled by their members. Although paid managers may be responsible for day-to-day decisions, the ultimate control of the organization lies with a general assembly consisting of member owners. Each member has equal rights regardless of the number of shares he or she may possess or the amount of money they may have deposited. The principal one member one vote applies during general assemblies. Credit unions are led by an elected management committee. Within this committee there may be several sub-committees including, for example, a credit committee and a loan monitoring committee.

In the past many credit unions focused on credit delivery. They were less concerned with mobilising savings because loan capital was provided by external donors. In recent years, however, there has been a switch towards encouraging savings as a way of generating the start capital needed to run the union. Sometimes local credit unions are supported by so-called apex organizations. These umbrella organizations include, for example, national or regional federations of credit

unions that can supply additional funding if local credit unions wish to expand their loan capital.

Individual lending is the dominant strategy in credit unions. Loans are generally in proportion to members' savings and loan guarantees consist either of appropriate collateral or a personal guarantee – sometimes provided by a fellow member. But a growing number of credit unions now apply the principals of solidarity group loans.

The *World Council of Credit Unions (WOCCU)* is the umbrella organization of local credit unions and their regional and national federations. It has affiliates in almost 100 countries and provides long-term technical assistance to help develop, strengthen and modernise credit unions in all parts of the world.

### **Advantages and disadvantages of service providers in the formal sector**

Financial service organizations in the formal sector are officially registered and often have easier access to the external funds provided by (central) banks and donor agencies than organizations in the semi-formal sector. Also they are better able to meet the professional criteria donors use when assessing organizational performance and sustainability and the quality of financial and loan management.

Because they have easier access to external funds, service providers in the formal sector have more capital at their disposal, many more clients and a much broader outreach. However, their operations in rural areas – especially in Africa – continue to be marginal. Because they are generally more efficiently and professionally organised, formal sector organizations can guarantee higher levels of sustainability than organizations in the semi-formal or informal sector.

A main disadvantage of formal sector service providers – and especially non-member organizations – however, is the high cost of employing salaried staff to manage, execute and monitor programmes. This makes it difficult for them to deliver services at affordable rates

and creates particular problems for regions and groups that are only marginally involved in the cash economy. Farmers and rural producers in these areas are only able to save and borrow small amounts and often they require funds at short notice. Where population density is low, service delivery is very expensive and cannot be easily provided by organizations that have high staff costs.

Within the formal sector the products offered and the approach used often fails to meet the needs and specific circumstances of the target group. Formal sector organizations are not easily able to adapt their services and strategies because they lack flexibility. Many formal sector organizations focus on credit delivery even though savings services are often more important to the poor. Organizations may insist that loans are used for productive activities but clients may need them for consumption or emergency purposes. Organizations that require collateral or a co-guarantor tend to exclude poorer groups.

### **3.4 Non-financial actors**

#### **Leasing companies, traders and other local sources**

Some types of credit can be supplied by non-financial actors. Traders' credit, contract farming, warehouse receipt schemes and leasing fall under this heading. Leasing companies, traders, wholesalers or other crop buyers can provide credit services from their own capital funds or use the lump-sum loans they receive from banks and donors.

#### **Farmers/ Producer organizations**

Credit can also be supplied by farmers' organizations and production boards. This is especially the case in areas where cash crops such as coffee, cotton and tea are being grown. Here, production boards and farmer and producer organizations often offer such services as technical advice, credit, inputs and assistance with marketing. Credit can be supplied by special arrangement and can include traders' credit, contract farming, and warehouse receipt schemes. Funds can also be made available through more conventional loan arrangements. Banks too can make lump-sum loans available to farmer and producer organiza-

tions that offer loans to members who can provide acceptable repayment guarantees.

### **Linking farmers or producer organizations to financial service providers**

Development-orientated NGOs often try to establish links between themselves and financial service providers. NGOs introduce new agricultural practices, provide agricultural training and monitor the progress of new technologies at farmer level. If all goes well agricultural productivity and farmers' revenues improve and the farmers concerned become more acceptable as clients to financial service providers. This type of cooperation involves the financial service provider committing itself to issue loans to all eligible farmers participating in the programme, while retaining control over the management of any savings and credit programme.

## 4 Good practices

The issue of sustainability is one that concerns all microfinance organizations. It is of utmost importance, yet the emphasis on sustainability has its drawbacks, especially when trying to extend the outreach of financial services in rural areas. Alternatives that increase outreach while guaranteeing sustainability, however, are being developed. Recently microfinance institutions have taken initiatives to ensure they fulfil the original mission of microfinance which is to serve the poor and the very poor through the better management of microfinance organizations and by monitoring their ‘social performance’.

### 4.1 Sustainability

#### Lesson learnt

In the past credit supply to farmers was considered to be part of agricultural development. Credit was provided to enable farmers to mechanise production, install irrigation, buy fertilisers and improved seeds and take advantage of other new agricultural technologies. Credit was frequently provided at rates that did not cover costs so farmers would not be burdened by heavy repayments. Credit was ‘cheap’. Often, when farmers had difficulty in repaying their loans or deliberately defaulted on their repayments, no measures were taken against them.

This led to poor discipline amongst borrowers and many ceased to take their repayment responsibilities seriously. As a result many loan funds suffered serious losses. Cheap credit meant that credit programmes became dependent on external resources and this undermined their sustainability. In addition, it was the wealthier farmer - who probably could have mobilized credit from other sources anyway - who tended to benefit most from these programmes. Experience shows that these types of cheap credit programmes were not very successful in reducing rural poverty.

A new approach to financial services emerged in the 1980s. Financial programmes started to emphasize the need for sustainability and programmes that could guarantee clients permanent access to financial services. Developing sustainable financial services became an objective in itself. Programmes extending credit had to ensure that they could raise enough income through interest payments to cover costs. These included the expense involved in raising external loans, the losses incurred when clients defaulted on repayments and the negative effects of inflation on the value of loan capital.

### **Sustainability**

New approaches were developed to enable financial organizations to extend their services to the poorer category of client. These included group lending, simpler client and loan assessment procedures and the delegation of administrative tasks to the members of a savings and lending group. These new methods were not only more client friendly, they also helped reduce the cost of microfinance operations.

Even so the interest rates that microfinance institutions have to charge to ensure sustainability remain relatively high. Unlike conventional banks, microfinance organizations deal with very large numbers of small loans and savings. Handling this type of business is more expensive than dealing with a small number of large loans. In addition, professional staff members are needed to assess clients' loan applications and ensure that effective loan monitoring and financial management systems are established.

Currently, good practice in microfinance is measured by the degree of sustainability achieved. This means that microfinance organizations have to make sure that - when they select clients - they choose those who are able to repay their loans. The emphasis on sustainability can contribute to the "health" of microfinance organizations. But there are also drawbacks. The interest rates charged by microfinance institutions to cover their costs are often in the region of 25 – 30% per year - higher than the market rates of commercial banks. Potential clients often find this excessive.

It is a considerable challenge to keep the cost of providing financial services to remote areas and vulnerable clients within realistic margins. To do this effectively microfinance organizations must continually try to improve the efficiency of their operations. If market conditions in marginal and impoverished areas are such that it is not possible to provide financial services at a reasonable rate – then alternatives are needed.

### **Social performance management**

Microfinance institutions are aware of the criticism that the emphasis on financial sustainability has led to a decrease in outreach to poor and very poor clients. It has also been questioned whether microfinance in reality creates a dependence on credit rather than helping the poor to improve their position economically. For example, the possibility that clients fall into spiralling indebtedness by borrowing money to pay back other debts. In response some 150 microfinance institutions and donor agencies have joined the ‘*Social Performance*’ initiative. Social performance assessments are being made of microfinance institutions with the aim of developing better management practices to enhance their social performance.

Questions raised during such assessments include:

- What is the mission of the institution? Does it have clear social objectives?
- What activities will the institution undertake to achieve its social mission? Are systems designed and in place to achieve those objectives?
- Does the institution serve the poor and the very poor? Are the products designed to meet their needs?
- Have clients experienced social and economic improvements?

### **Other alternatives**

Other alternatives currently being explored include:

- **Seed capital:** Donors often provide young financial service organization with ‘seed capital’ – usually for a period of three to five years to cover start-up costs. Sometimes this seed capital is granted for a

longer period if the financial service organizations have to deal with very vulnerable and marginalised communities. This makes it possible for organizations to take more time to build up their income to the point where it covers costs. In this way they avoid having to pass start-up costs on to their clients in the form of high interest rates.

- **Technical assistance:** Ensure that adequate and appropriate technical assistance is available to vulnerable groups and those living in marginal regions so they can develop profitable economic activities and repay their loans.
- **Start-up grants:** Provide very vulnerable clients with start-up grants instead of loans. This makes it possible for them to begin investing in their farm or enterprise without the additional burden of having to repay a loan. Once their business has become sustainable or has the potential to expand and they can comply with credit conditions, they become eligible for a loan.
- **Savings:** Relying on the client's own savings rather than loans especially when the money is being used for non-productive purposes prevents clients falling into debt.
- **Community run:** Setting up financial service structures such as community-based savings and lending groups that do not require expensive professional management because they are run by the members themselves.
- **Communication technology:** Applying recent technical innovations in the communication industry to the financial sector such as the use of mobile phones and internet in locations where this is technically possible. The mobile banking approach where bank staff visit villages on fixed (market) days has also proved successful because clients no longer have to travel long distances and the banks avoid the cost of having to set up local agencies.



## 4.2 Integrated approach

Rural microfinance is often linked to programmes of livelihood improvement and poverty alleviation. Access to credit plays an essential role in economic development but other factors are equally important. Rural people need training in technical and business skills to enable them to plan and manage their activities; they need access to appropriate agricultural and pastoral technologies to improve production and they need roads and other communication networks so they can keep in touch with market opportunities.

Many financial service organizations only offer services that are directly related to their core activities such as the provision of loans, savings facilities, assessing the financial and repayment capacity of borrowers and monitoring repayments. This is known as the *minimalist approach*. These organizations have chosen to specialise in what they can do best. By adopting this approach organizations avoid having to pass on the cost of additional services to their clients. However, other services including marketing support, training and input-supply are also needed for economic development. The shortcomings of the minimalist approach can be compensated if financial service organizations cooperate with NGOs, producers' organizations, the private sector and government and development-orientated agencies.



*Figure 13: Mobile phones can facilitate the work of both farmers and microfinance organisations*

Vulnerable groups - including rural women - may lack the self confidence to take up new economic activities or change their way of doing things. Working together in solidarity or self-help groups organized by microfinance organizations can help them strengthen their skills and capacities and makes it easier for them to exchange experiences and work together to solve their livelihood problems.

### 4.3 Role of different actors

Many development programmes and NGOs have tried to create their own micro credit services but experience has shown that success is difficult to achieve. The most common problems are the large number of clients who do not repay their loans and the high cost of providing programme services.

Running a microfinance programmes requires expertise and a business-oriented attitude. Those running development programmes or NGO activities often do not have these skills. Organizations planning to launch credit services should ensure that their staff can:

- **Assess:** Assess borrowers financial and repayment capacities. They should be able to analyse the profitability of the proposed economic activity and the cash flow that this business - together with other household livelihood activities - will generate.
- **Enforce:** Enforce strict obedience to the conditions attached to the loan. NGO staff are often too lenient where defaulters are concerned. This does not encourage borrowers to develop good repayment habits and can eventually lead to the failure of an entire credit programme.
- **Management:** Managing financial affairs efficiently. The financial management of the loan and savings programme should be kept apart from other programme activities and all costs related to it should be administered separately. This makes it possible to realistically assess costs and take them into account in developing savings and loan policy.
- **Monitor:** Understand and initiate monitoring systems capable of tracking repayment, the status of the loan portfolio and the balance

between “good” loans - where repayments have been paid in regularly - and “bad” loans that mean a loss of loan capital and profit. Monitoring makes it possible to assess operational soundness and financial sustainability.



*Figure 14: With advice and support equipment bought with a loan can be used more productively and better maintained.*

An organization should only consider setting up financial services if there are no other microfinance organizations able to meet the needs of its client group. If an organization does decide to establish a financial service programme the following should be taken into account:

- Does the proposed programme fit in with the culture, identity and other activities of the organization?
- Should microfinance activities be organised as separate activities or can they be combined with existing programmes? In general it is better to keep financial service activities separate from other activities;

- Will specialised staff be needed to run the proposed programmes or will existing staff need specialised training?

Development programmes and NGOs play an important intermediary role in linking clients to financial service providers. Vulnerable groups need more than just credit to enable them to establish economically viable livelihoods.

The best approach, therefore, is for development programmes and NGOs to provide additional services aimed at improving the technical skills and confidence of their client group and leave the provision of microfinance services to specialised financial service providers. If vulnerable clients are well prepared before they start out on their planned economic activity, they present a lower risk to financial service providers and these in turn will be more prepared to accept them as clients.

## 5 Main conclusions

The characteristics of the rural economy of a region or group will determine the choice of financial services and service institution. (see Table 2). Any decision on the provision of financial services should start by analyzing these characteristics and the type of demand.

The number of microfinance institutions and clients has increased rapidly in recent years, but rural areas and marginal groups have not benefited equally from this growth. Therefore, new approaches are being developed to serve modern agriculture as well as marginal rural areas and groups.

The financial sustainability of microfinance institution has been of strategic importance in recent decades. However, this has often been achieved at the expense of their social performance. Alternatives have to be sought to ensure that marginal groups and regions also have access to appropriate financial services.

### **Different target groups**

In Chapter One, two types of target group were identified. Each type requires a different strategy:

- **Type One:** Type One is characterised by groups who are only marginally involved in the market economy. They live in areas that are geographically isolated, have poor soils and rainfall and few marketing opportunities. As a result they avoid taking risks and produce mainly for their own subsistence. Extreme poverty or the lack of land, capital and labour can also make it extremely difficult for groups living in more prosperous regions to participate successfully in the market economy.
- **Type Two:** Type Two includes producers who have sufficient assets and who live and work in regions where there are enough resources to enable them to participate (fully) in the market economy.

## **Demand for financial services**

### *Savings or credit*

Saving is the most important entry point for those planning to provide financial services for farm households in the Type One category. Income smoothing is a well-known part of household management in rural economies. Savings and lending programmes can build on this practice to help rural producers manage their incomes more effectively and build up their financial reserves. Savings can be used to finance investments. This enables individuals and households to avoid having to borrow money and possibly falling into debt if they cannot repay their loans on time.

Farmers, shopkeepers, traders and entrepreneurs in the Type Two category are usually involved in income generating activities that offer good economic prospects. However, they need credit because they often lack the capital to develop their activities. Because they have resources they are less vulnerable to falling into debt than the resource poor.

### *Agricultural credit*

Most microfinance programmes do not provide mid-term or long-term credit. Microfinance programmes that supply short-term credit and require repayment in weekly or monthly instalments that start shortly after loans have been disbursed are most suitable for producers and traders. This is because their economic activities are characterised by short business cycles and many of them will probably be able to repay their loans from other sources of income. Short-term credit facilities are less appropriate for agricultural production and investment, however. Plants and animals need time to mature before their products become available, and investments in machinery and buildings often take several years to produce returns.

### *Insurance*

Insurance services can help people as well as financial service providers cope with risks. Health and life insurance programmes are being

developed. There are microfinance programmes that are now experimenting with insurance systems that cover such risks as the non-repayment of outstanding debts when animals become sick, harvests are spoiled or a client dies. Most of these programmes are still at the experimental stage and it remains to be seen whether it is possible to create micro-insurance programmes for the poor in such a cost-effective way that clients can afford the premiums. In the agricultural sector calamities such as droughts, floods, and low prices often affect a very large number of clients at the same time. It is difficult to insure such ‘co-variant’ risks, since the financial claims in such cases can be enormous.

*Table 2: Characteristics of the rural economy and the demand for financial services*

<b>Rural Economy</b>	
<b>Marginal regions / groups</b>	<b>Regions / groups well integrated in market-economy</b>
<p><i>Characteristics:</i></p> <ul style="list-style-type: none"> <li>➤ Poor road and communications infrastructure</li> <li>➤ Low population density</li> <li>➤ Weak and undiversified local economy</li> <li>➤ Mainly crops for own consumption</li> <li>➤ Few opportunities for off-farm activities</li> <li>➤ Financial services for household cash management</li> <li>➤ Large number of small savings and loans.</li> </ul>	<p><i>Characteristics:</i></p> <ul style="list-style-type: none"> <li>➤ Good road and communications infrastructure</li> <li>➤ High population density</li> <li>➤ Strong local economy</li> <li>➤ Market for diverse cash crops</li> <li>➤ Many opportunities for off-farm activities</li> <li>➤ Financial services for investment in economic activities</li> <li>➤ Small number of larger money transactions</li> </ul>
<p><i>Leading to ....</i></p> <ul style="list-style-type: none"> <li>➤ Higher transaction costs</li> <li>➤ Profitability for low-cost organizations</li> </ul>	<p><i>Leading to ...</i></p> <ul style="list-style-type: none"> <li>➤ Lower transaction costs</li> <li>➤ Profitable for high-cost organizations</li> </ul>
<p>Source: <i>Community-based Financial Organizations: A Solution to Access in Remote Rural Areas?</i> Anne Ritchie. World Bank. Agriculture and Rural Development Discussion Paper 34. (based on similar diagram in this publication, but with modifications)</p>	

## **Different financial service providers**

### *Informal sector*

Most poor rural households particularly in marginal areas rely on informal sector’ providers like friends, relatives, shopkeepers and money lenders when they need loans. Savings are often kept in kind

and traditional saving and lending groups are common in such communities.



*Figure 15: Repayment schedules cannot always be met*

People resort to informal sources of lending because they have no alternative. Formal or semi-formal financial services providers often avoid the rural areas especially those that are marginal or thinly populated. This is because of the high cost of providing services when transport, communication and other infrastructures are poor and clients save or borrow very small amounts of money.

### *Member- and community-based organizations*

Member-based organizations, such as village banks, savings and credit associations, community-based savings and lending groups as well as self-help groups can reduce the cost of service delivery by handing over management tasks to local members who are better able to offer low cost services in rural areas than other microfinance institutions.



In the community-based savings and lending groups approach, the management of the programme is handed over fully to the group. In this way operational and management costs can be reduced to almost nil. The community-based savings and lending group approach also focuses on the accumulations of savings. This approach is well adapted to the capacity of the poor(est) and their needs. One disadvantage, however, is that the loans available are limited to the capital the group can mobilise through members' savings. The self-help group-banking linkage approach as practiced in India is a good alternative. Through linkages with banks larger loans can be made available to individual clients whose capital needs are beyond those that can be met by the group.

### *Formal sector*

Banks or microfinance organizations that have a higher cost structure and higher operational costs can play a role for regions and groups that are well integrated into the market economy. Clients operating within the commercial sector may require special financial products not only for production, but also for trading, marketing and investment. Providing such services requires costly specialised skills – expertise which these types of organizations can afford. The average loan taken out by these clients is high enough and their communities accessible enough to reduce operational costs.

Even so the costs involved in accessing credit service in many cases remain high because farmers' profit margins and incomes are generally low. Therefore, alternatives have to be identified. These include trader's credit, contract farming and warehouse receipt schemes. Also technological innovations, such as electronic banking and mobile banking can contribute to cost reduction.

### **Good practices**

In the past agricultural banks were often dependent on constant injections of government or donor money to compensate for the financial losses they incurred when required – often for political reasons – to target sectors and regions where clients had few economic opportuni-

ties. Also strict obedience to the terms of loan repayments was often not enforced. NGOs and development programmes that based their financial service programmes on revolving funds were largely unsuccessful in establishing sustainable services.

In general, most NGOs are not well equipped to manage financial service programmes and the provision of these services should be left to specialised organizations. NGOs do not have the expertise or the business-like approach needed to ensure the sustainability of financial programmes. NGOs are most effective when providing support services such as agricultural or business training and ensuring that clients develop viable economic activities and take advantage of market opportunities. The provision of financial services can best be left to specialised organizations.

In recent years sustainability has become one of the main objectives of financial service providers and organizations. Although sustainability is important, if it is over-emphasized it can create problems for those concerned with rural development and the livelihoods of the poor. Initiatives are being taken to improve the social performance of microfinance institutions. In this context, alternatives are being developed that focus on the needs of marginal groups as well as the importance of ensuring sustainability. The provision of start-up grants to very vulnerable clients and increasing the length of time a new programme can be subsidised before sustainability can be expected are examples of this approach. Putting savings first, relying more on community-based structures and providing proper technical support to assist clients develop economic activities, can also ensure appropriate and sustainable financial services for the poor.

# Further reading

## Training materials

### RFLC (Rural Finance Learning Centre)

The website of the RFLC (Rural Finance Learning Centre) is dedicated to providing access to the best materials for capacity building in the field of rural finance. It aims to assist organisations in developing countries to build their capacity to deliver improved financial services which meet the needs of rural households and businesses. The website gives access to training materials (self study guides, training tools) and a reference library of documents and multimedia. After registration you can receive a monthly update listing new materials added to the RFLC. Self study guides can be downloaded from:

[www.ruralfinance.org/id/22362](http://www.ruralfinance.org/id/22362),

and online lessons from: [www.ruralfinance.org/id/5568](http://www.ruralfinance.org/id/5568).

### Village Savings and Loan Associates

VSL Associates is a consortium of practitioners dedicated to spreading the *Village Savings and Loan ASCA* methodology more widely worldwide and particularly in Africa. It offers training and services to programmes that want to promote the model. Excellent training manuals on ‘Village Saving & Lending Associations’ and ‘Management Information Systems’ can be downloaded from the website:

[www.vsla.net](http://www.vsla.net)

## Technical guides

*Agricultural Production Lending*. A Toolkit for Loan Officers and Loan Portfolio Managers. FAO and GTZ, Eschborn 2004.

[www.fao.org/ag/ags/subjects/en/ruralfinance/agfinance.html](http://www.fao.org/ag/ags/subjects/en/ruralfinance/agfinance.html)

or: [www.ruralfinance.org/id/22390](http://www.ruralfinance.org/id/22390)

*Handbook for the Analysis of the Governance of Microfinance Institutions*. IFAF, GTZ, Cerise, Iram. 2004.

[www.ruralfinance.org/id/34135](http://www.ruralfinance.org/id/34135)

***Rural Finance Course.*** Developed by FAO (Calvin Millar), IDEAS, Giordano dell' Amore Foundation, University of Bergamo.

[www.ruralfinance.org/id/36775](http://www.ruralfinance.org/id/36775)

***A Technical Guide to Rural Finance. Exploring Products.*** WOCCU Technical Guides, December 2003.

[www.woccu.org/publications/techguides](http://www.woccu.org/publications/techguides)

***Village Savings and Loan Associations (VSLAs). Programme Guide.*** Field Operations Manual. Hugh Allen and Mark Staehle (VSL Associates) (2007). [www.vsla.net](http://www.vsla.net)

### **Recent developments**

***Rural Finance: Recent Advances and Emerging Lessons, Debates, and Opportunities.*** Nagarajan, Geetha and Richard L. Meyer. August 2005. AED Economics Working Paper Series. Ohio State University, USA. <http://aede.osu.edu/resources/docs/display2.php?cat=5>

***Innovations in microfinance.*** (Bamako 2000). Technical Note 1-6, USAID Micro-enterprise Best Practices (MBP) Project.

[www.microfinancegateway.com](http://www.microfinancegateway.com)

### **General background**

***The Poor and Their Money.*** An essay about financial services for poor people. Stuart Rutherford (1999). Institute for Development Policy and Management. University of Manchester.

[www.uncdf.org/mfdl/readings/PoorMoney.pdf](http://www.uncdf.org/mfdl/readings/PoorMoney.pdf)

***What Matters in Rural and Microfinance.*** Hans Dieter Seibel (2000). Development Research Center. University of Cologne.

[www.unikoeln.de/ew-fak/aef/working\\_papers.htm](http://www.unikoeln.de/ew-fak/aef/working_papers.htm)

# Useful addresses

## HIVOS

Hivos is a Dutch non-governmental organisation inspired by humanist values. Together with local organisations in developing countries, Hivos seeks to contribute to a free, fair and sustainable world in which citizens - women and men - have equal access to the resources and opportunities for their development. Hivos provides financial and political support for local NGOs. Hivos is also active in networking, lobbying and in exchanging knowledge and expertise, not only at international level, but also in the Netherlands. Contact:

P.O. box 85565, 2508 CG The Hague, Netherlands

T: +31 70 376 5500, F: +31 70 362 4600

E: [info@hivos.nl](mailto:info@hivos.nl), W: [www.hivos.nl](http://www.hivos.nl)



## ILEIA

Centre for Information on Low External Input and Sustainable Agriculture. Promotes exchange of information for small-scale farmers in the South through identifying promising technologies. Information about these technologies is exchanged mainly through the LEISA Magazine. All articles accessible on-line.

Contact: ILEIA, Zuidsingel 16, 3811 HA Amersfoort, The Netherlands

T: +31(0)33-4673870, F: +31(0)33-4632410

E: [ileia@ileia.nl](mailto:ileia@ileia.nl), W: [www.leisa.info](http://www.leisa.info)

## CGAP: [www.cgap.org](http://www.cgap.org)

CGAP (Consultative Group to Assist the Poor) is a leading agency in the field of microfinance, housed at the World Bank but operating as an independent entity. It is a consortium of bilateral and multilateral development agencies, private foundations, and international financial institutions. CGAP works with stakeholders to set standards and identify best practices for microfinance, and provides advisory services for governments and financial institutions. It also distributes information and research through a variety of free publications (occasional papers and guidelines).

### **FAO Rural Finance Group**

The FAO (Food and Agricultural Organisation of the United Nations) Rural Finance Group ([www.fao.org/ag/ags/subjects/en/ruralfinance](http://www.fao.org/ag/ags/subjects/en/ruralfinance)) is dedicated to promoting improvement in rural financial services in developing and transition countries. Details of their work and publications can be found here. A much greater range of information and resources relating to rural finance can be found in the Rural Finance Learning Centre (RFLC) which is managed by the FAO Rural Finance specialists ([www.ruralfinance.org](http://www.ruralfinance.org)).

### **Imp-Act Consortium: [www.ids.ac.uk/impact](http://www.ids.ac.uk/impact)**

The Imp-Act Consortium is a global group of non-profit organisations working to promote and support the management of social performance (SPM) by microfinance institutions. It provides training in SPM. Local trainers are being trained and certified. Lessons learnt and good practices are collated and shared through regular updates, the website and other publications.

### **Microfinance Gateway: [www.microfinancegateway.org](http://www.microfinancegateway.org)**

The Microfinance Gateway (the Gateway) is the most comprehensive online resource for the global microfinance community. It includes research and publications, discussion groups, featured articles, organization profiles, and the latest news and events in microfinance. The mission of the site is to advance knowledge and encourage innovation within the microfinance industry.

### **WOCCU: [www.woccu.org](http://www.woccu.org)**

World Council of Credit Unions (WOCCU) is the leading international trade association and development agency for credit unions worldwide. WOCCU promotes the sustainable development of credit unions to empower people around the world to grow through access to high quality, affordable financial services. Technical guides, research reports and credit union best practices can be downloaded from its website.