

# RURAL AND AGRICULTURE FINANCE

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## DRIVERS OF RURAL DEVELOPMENT

- High overall economic growth
- Effective land reform
- Rural infrastructure
- Effective institutions
- Rural financial services
- Dynamic agriculture sector
- Rural nonfarm enterprises
- Subsidies

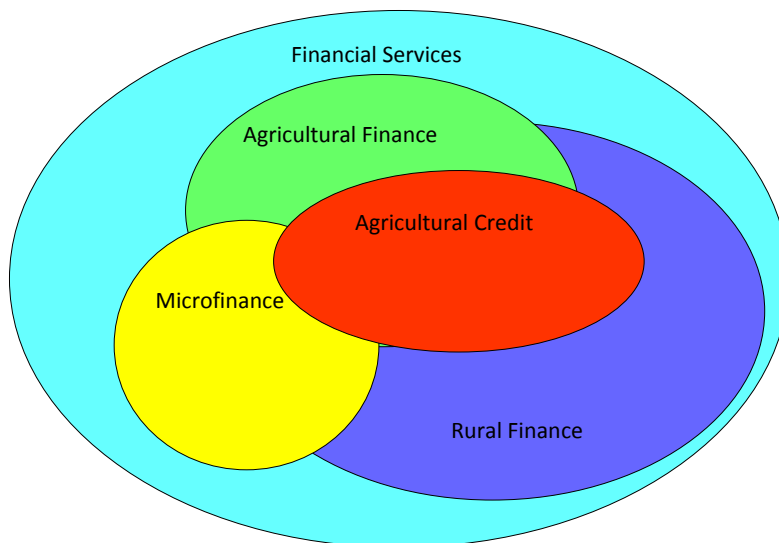
Adapted from "Rural Development - Outcomes and Drivers- An Overview and Some Lessons - Nimal Fernando (Asia Development Bank)

## Why Rural and Agricultural Finance are Important

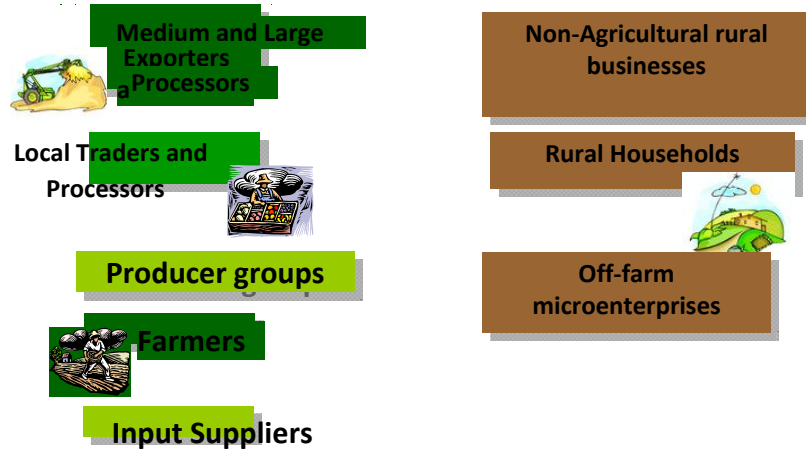


- Food security and MDGs are a priority
- Reduced government and donor support slowed rural investment and growth
- Finance is important for agricultural and economic growth
- Financial linkages are growing in importance and recognition

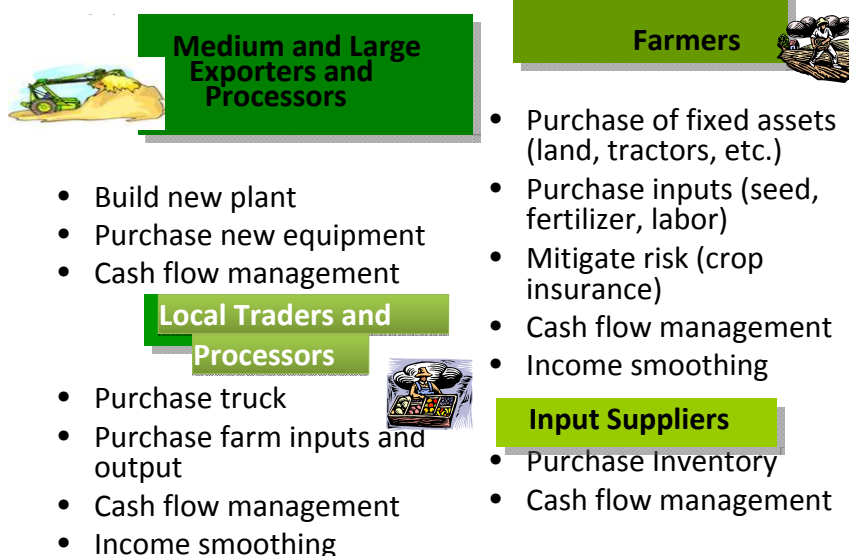
## RURAL FINANCE IN PERSPECTIVE



## Demanders of Rural and Agricultural financial services



## Financial Service Needs



## Financial Service Needs

Non-agricultural rural businesses



Rural Households

- Purchase inventory
- Purchase of fixed assets
- Cash flow management



Off-farm microenterprise

- Income smoothing and savings instruments
- Mitigate risk (health insurance)
- Access to remittances
- Life events
- Cash flow management
- Risk management (e.g. floods, fire)
- Fixed investments (e.g. sewing machine)

## Overarching Categories

- **Working Capital**
- **Fixed Asset Financing**
- **Income Smoothing**
- **Life Cycle Events**



## Characteristics of Financial Products that Clients Want

- Quick service
- Flexible loan amounts and terms
- Cost effective
- Not just working capital
- Choices of financial providers
- Diversity of products
- Serve household and business needs
- Not require traditional collateral

## Unique Features/Requirements of Rural and Agricultural Finance

- High financial transaction costs of serving dispersed and small farm households
- Heterogeneity, seasonality, and duration of farming and non-farming loan needs
- Lower profitability and higher risk of on-farm investments
- Lack of loan collateral
- Need for training/informational needs of bank staff and farmer clients
- Politically sensitive environment
- Low loan repayment discipline

### **Challenges in the Rural MF Sector**

- ✓ High cost of service, especially to poor
- ✓ Lack of coordination and standard reporting between MFIs
- ✓ Over-indebtedness of some clients
- ✓ High rate of agricultural finance default and default history in some countries
- ✓ Lack of “bankable” investments beyond trade

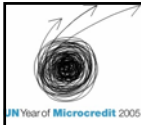


10<sup>th</sup> Year of Microcredit 2005

### **Lessons From Microfinance**

Microfinance has been successful in:

- high volume, low value, unsecured loans to the working poor
- sustainable operations in higher-density areas
- proving the poor will repay



## Lessons From Microfinance

Microfinance has not been effective in:

- providing agricultural and term lending
- cutting operating costs
- providing a multiple array of demand-driven products – is improving through linkages

### KEY CHALLENGES FOR RURAL FINANCIAL SERVICE PROVISION

#### Vulnerability Constraints

- Systemic Risk
- Market Risk
- Credit Risk



## KEY CHALLENGES ...

### Operational Constraints

- Investment Returns
- Low Investment and Assets
- Geographical Dispersion



## KEY CHALLENGES ...

### Capacity Constraints

- Infrastructural Capacity
- Technical Capacity and Training
- Social Exclusion
- Institutional Capacity





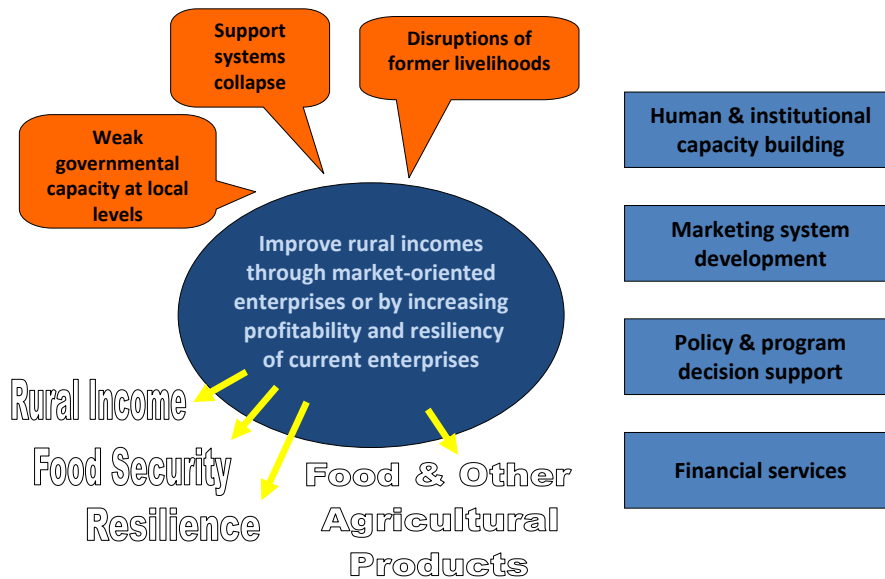
## KEY CHALLENGES ...

### Political and Regulatory Constraints

- Political and Social Interference
- Regulatory



## Enhancing Rural Livelihoods



## KEY ISSUES IN DESIGNING RURAL FINANCE

- Recognizing the combined firm-household as the client
- Understanding the heterogeneity of firm-households
- Risk perceptions and preferences
- Assets and sources of income (crops and enterprises)
- Patterns of cash flow
- Evaluating the importance of culture, social capital, gender, and rural infrastructure
- Estimating the demand for and use of financial services
- Choosing an appropriate lending technology with procedures for:
  - Screening clients and loan purposes
  - Monitoring borrowers
  - Contract enforcement and loan collection
- Establishing loan contract terms and conditions
- Diversifying the loan portfolio

(Klein, et al.; Yaron, et al.)

## Rural Finance Program Design Framework<sup>1</sup>

Participant Profile	Operating Environment & Context	Existing Operators and Services
Interventions	Methodology and Products	Delivery Mode: Direct or Partnership
Desired Impact	Program Efficiency	Sustainability and Scale

<sup>1</sup> Adapted from CARE

## Rural Finance Products

- Warehouse Receipt: document listing goods or commodities kept in safekeeping in a warehouse; the warehouse receipt can be used to transfer ownership of the commodity, *instead of physical delivery*
- Leasing: A method of financing the acquisition or use of fixed assets, predicated on the concept that the value of the asset is in its use in the business rather than through ownership.
- Insurance: Agriculture ( indexed weather based instruments), Health & Life.

## Contd....

### Credit Enhancement:

The process of reducing credit risk by requiring collateral, insurance, guarantees or other agreements to provide the lender with reassurance that it will be compensated if the borrower defaulted.

### Credit Guarantee:

A promise made by a third party to pay in the event of default by the borrower