

**SAVINGS & CREDIT FORUM
MONDAY, AUGUST 11, 2003**

***RURAL FINANCE and AGRICULTURAL CREDIT*
PAST EXPERIENCES, LESSONS LEARNT
and PRACTICAL EXAMPLES**

To the participants of the Savings & Credit Forum and other interested parties

September 4th, 2003

Dear colleagues, dear Madam, dear Sir,

DURING THE S+C FORUM OF MONDAY, AUGUST 11TH, THREE DEVELOPMENT FINANCE SPECIALISTS PROVIDED US WITH INTERESTING INSIGHTS INTO THE PARTICULARITIES OF RURAL FINANCE IN DEVELOPING COUNTRIES

- Dr. **Ruth Egger** from Intercooperation gave us a short introduction to the theme, by highlighting the differences between financial systems that operate in rural areas, as opposed to those in urban areas.
- Professor **Manfred Zeller** from the University of Göttingen provided us with an in-depth presentation into the world of rural finance. In particular he presented an overview of past practices in rural finance and the reasons why many experiences have failed. He then emphasized on the renewed interest for rural finance among donors, governments and practitioners, due to the overall recognition that rural finance is a key factor to foster economic growth, to increase the food security and reduce poverty. Finally, Prof. Zeller provided important policy implications for donors and governments who decide to support the development of rural financial institutions.
- Dr. **Sidy Modibo Diop** from the BNDA (National Bank of Agricultural Development) in Mali provided us with a practical example of how a private and state owned development bank contributes to the development of the rural financial sector in Mali. He first summarized the evolution of the bank since its creation in 1981, focusing on its ability to adapt its policies to the evolution of the sector it serves. Finally, he presented the BNDA's approach to offer services to a broad number of rural households, either directly or channelling funds through existing decentralized financial systems, and thus contributing at the same time to the strengthening and development of the economy and the financial system in remote rural areas.

All three presentations, as well as a list of references, can be downloaded at SDC's BSM finance website (www.intercooperation.ch/finance/download). The main questions and points of discussion from the plenum are summarized hereafter.

After the **presentation of Professor Zeller**, on rural finance and agricultural credit: past experiences, lessons learnt and practical examples, the present discussion points came up:

1. Transforming previously subsidized state banks into financially self-sufficient institutions, managed with business principles: how does this combine with reaching the poor?

Experience shows that these banks can be transformed to become more efficient and still keep their social purpose, although studies have provided evidence that the poorest people are not served by these institutions. Examples are the BRI, Bank Rakyat Indonesia, which has been transformed to become sustainable in the 80's but is still state owned. A public bank in Egypt, right hand of the ministry of agriculture, operates a broad network of branches in rural areas, not only to provide credit, but also to deliver inputs, technical assistance for production and marketing. The BAAC (Bank for Agriculture and Agricultural Cooperatives) in Thailand has a good outreach and a diversified service offer.

2. How can we combine solidarity groups, which need small and short-term loans, with rural development banks?

Solidarity groups are a good mean to reduce transaction costs and give small farms or poor people access to financial services. It is good for providing low income clients with short term consumption and production credits. Nevertheless, we have to consider that rural households do a lot of diverse activities, while solidarity group technologies hand out credits with the same amount and duration for all group members. These techniques are limited for investment credit. Moreover they only work in densely populated areas, because group members have to meet regularly (ex: Malawi, groups of about 45 people).

3. What types of institutions should donors support?
 - a. Credit unions or savings and credit cooperatives
 - b. Village banks (ex. : FINCA) and « caisses villageoises » (CIDR).
 - c. Microbanks

Village banks operate in remote rural areas. The community can decide on the interest rate that the village bank will charge to its member clients and the organizational setting and policies to the local conditions. Nevertheless, it needs a lot of investment in time and resources from the supporting NGO. The other types of institution (a and c) are more embedded in the financial system and driven by clients and competition.

Rural development projects with a credit component or revolving credit funds (RCF) should be something of the past! RCF are a vehicle to reach another goal of the project, to motivate people to participate in projects. In these funds, the ownership of the project is usually not clear; there is no control over the money and no policy standards are set. Thus, the money is not recovered properly and the gets lost after five years, on average. Finally, Professor Zeller argues that for very poor people, we should not use credit but give them, for example inputs for free!

4. In transition economies like Eastern Europe and Central Asia, FIDES has worked for ten years on institution building, legislation, regulation, etc. BUT it is very costly. It is also difficult to foster a spirit of entrepreneurship in such countries. People get a credit and are often confronted to the market for the first time.
5. How can we, as donors, foster innovation? How can we choose the right institution and the right innovation?

Donors and governments can play an active role in funding innovations. For example, DFID/CGAP has an innovation fund for microfinance institutions. The Grameen Bank has had donor support to develop the group lending technology in Bangladesh, which has then widely

spread to other institutions and countries. Innovations can be donor or state funded, but their spreading should not be subsidized; the market can do this.

Donors should choose the right institution to foster a technological innovation (e.g. smart card or mobile banking) and work with practitioners to develop the products (pilot project, contract, duration, risk sharing, what are you testing, how long are you testing it?). Donors can help create the environment for innovation (education, legal framework, infrastructure, etc.).

After the **presentation of Dr. Sidy Modibo Diop**, *Quel rôle pour une banque de développement "moderne"? Exemple de la BNDA*, the following points came up in the discussion:

1. Is it profitable to lend small amounts of money to rural clients?

For the BNDA, whose annual lending rate cannot exceed 18%, it is not profitable, reason why the bank channels those funds through the Decentralized Financial Systems (*Systèmes Financiers Décentralisés, SFD*). The BNDA charges 11% to the SFDs, which in turn lend to the final clients at 25%.

2. How do the three types of SFDs¹ split up the geographical space among them?

All three types of institutions have expanded over the whole territory of Mali. Through this rapid growth, some have lost the knowledge and the overview of their clientele and faced increasing problems of delinquency. A risk centre was created in order to fight delinquency in a more and more competitive environment.

3. Does the BNDA funding, and in general, donor funding to the SFDs have a negative impact on the promotion of saving?

It is important to mention that it is not easy to get a credit line from the BNDA, which has strict selection criterias.

The BNDA itself has difficulties to mobilize savings from the rural population. Small farmers do not save at the BNDA, but traders and NGOs do. Savings earn an annual interest rate of 3.5%, while peasants who buy a cow or a pig can double their capital in one year. In rural areas, clients need short-term savings possibilities, which are not profitable for the bank.

4. Where will the BNDA stand within 10 years time?

The BNDA will be associated to some SFDs to lend medium term loans to small farmers. Some SFDs will disappear. The BNDA will concentrate more on lending to rural small and medium enterprises.

5. What happens in times of crisis, for example in case of a drought?

The CVECAs², for example, were almost fully self-sufficient before the drought. They were strongly hit by the crisis and faced financial problems as well as migration of their human capital. They needed donor support to survive the crisis.

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¹ 1. *Institutions mutualistes* (cooperative type). 2. *caisses villageoises d'épargne et de crédit autogérées, CVECA* (savings and credit village banks). 3. Solidarity group credit systems and group lending.

² See footnote 1, type 2.