

ADDRESSING RURAL POVERTY THROUGH RURAL AND AGRICULTURE FINANCE

CSD- LEARNING CENTER
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Prof. Puneetha Palakurthi
School of Community Economic Development
Southern New Hampshire University

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THE MATERIALS PRESENTED ARE BASED ON USAID
TRAINING ON RAF & FAO COURSE ON RURAL
FINANCE.

INTRODUCTION ACTIVITY

(15 minutes)

- How would you categorize your level of knowledge in RAF?
(beginner/intermediate/advanced)
- What activity are you working on that is related to RAF?
- To your knowledge, what is the state of RAF in the country/region where you work?
- Is there any knowledge or experience relating to RAF that you want to/could share with others?

WHAT IS RURAL & AGRICULTURE FINANCE?

Discussion – 5 minutes

Glossary

Agricultural finance: A field of work in which people aim to improve the access of the agriculture industry, including farmers and all related enterprises, to efficient, sustainable financial services.

Rural finance: A field of work in which people aim to improve the access of rural communities to efficient, sustainable financial services.

Microfinance: Financial services for lower-income households and micro and small enterprises; a diverse range of financial institutions offers microfinance services, including specialized microfinance institutions (MFIs), commercial banks, and NGOs.

Value chain: The series of transactions necessary to bring a product from inputs to the final market, involving a process of adding value at every stage.

Financial institution: An entity – regulated or not – that *specializes* in the provision of financial services

Financial intermediary: A financial institution that *collects, deposits, and lends* these deposits.

History of Agricultural Lending Programs

1950s and 1960s...

- Governments wanted to stimulate the adoption of new agricultural technologies
- Donor-driven and government-sponsored credit programs were designed that included:
 - Specified beneficiaries
 - Specified agricultural commodities
 - Subsidized interest rates

Brainstorm Activity

10 -15 minutes

What have been the historic problems with directed agricultural loan programs?

What lessons were learnt?

History of Agricultural Lending Programs

Results

- Primarily large farmers served
- Credit funds diverted
- Loan repayment indiscipline
- Alternative funding crowded-out
- Technology expansion not supported
- Non-farm financial needs not addressed
- Financial institutions not operating sustainably
- Vigorous rural financial markets blocked

History of Agricultural Lending Programs

Lessons Learned:

- Farmers have broader financial service needs than just credit for agricultural inputs
- For financial institutions to be sustainable, they need to have diversified portfolios not dependent upon a single sector
- Transaction costs, especially for smaller farmers, were high
- Publicly-owned institutions undermined by political interventions
- Liberal supply of liquidity, even if not subsidized, from donors and governments discourages banks from developing own resources (mobilizing deposits).

WHY RURAL AND AGRICULTURE FINANCE?

- **Reason #1** . There is a decline in formal rural and agricultural credit supply
- **Reason #2** . Rural finance is important for agricultural and economic growth, food security, and poverty reduction
- **Reason #3** - We have learned from the past!

Designing RAF

- Understand Rural Markets – both supply & demand side
- RAF Market Assessment
- RAF Project Design

Understanding Rural Markets

- **Demand for rural and agricultural finance: Who are the clients?**
- **Supply of finance and financial services: Who are the providers?**
- **Enabling Environment: What is it?**

Demand for RAF: Brainstorming Activity – 15 minutes

Rural and Agricultural Finance:

Who are the demanders or clients of financial
services or financial products?

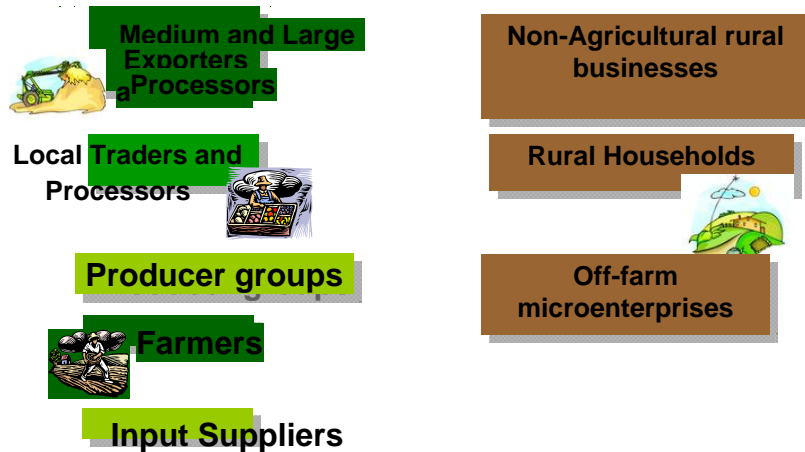
What are their financial needs?

What kind of financial products could fulfill those
needs?

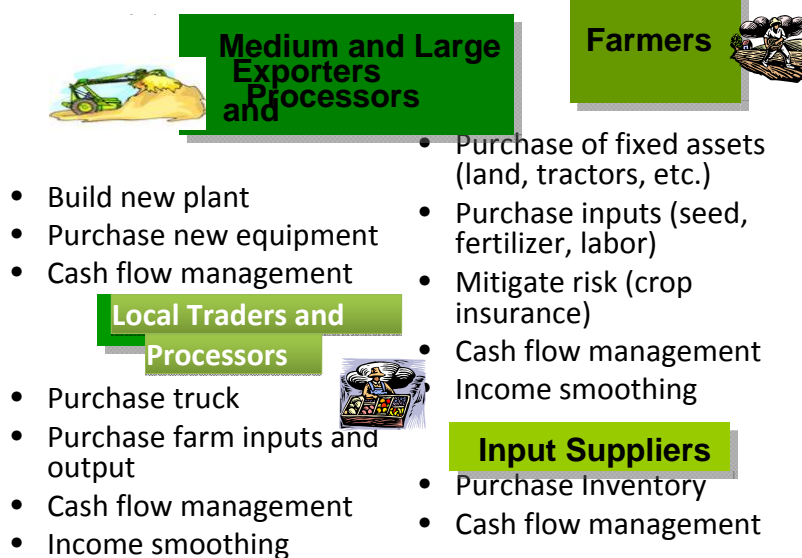
Some Hints.....



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)

Financial Service Needs

Overarching Categories

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



What Do We Want in Rural Financial Services?

We want diverse rural financial service providers, who:

- 1.Are viable and sustainable**
- 2.Service all segments of the rural population**
- 3.Collectively provide a full range of financial services**
- 4.Have costs of service compatible with the returns to capital of the population**

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

Key Challenges and Constraints to Demand

Constraints to Lenders:

- Covariant risk
- Policy and regulatory constraints
- Political meddling and crowding out through subsidized credit programs
- Underdeveloped human capital (illiteracy, health, etc.)
- Low levels of economic activity, low ag productivity and profitability
- Poor physical infrastructure (roads, etc.)

The impact of the key challenges and constraints on demand is...

High *transaction costs* for the borrower

- Problems producing *adequate collateral*
- Low productivity and profitability* leading to low incomes and opportunities for growth

Also....

- Higher *real and perceived risk* to lender, which affects the borrower

Key Challenges and Constraints – Supply side

- Lack of defined property rights and contract enforcement mechanisms in rural areas
- Geographic dispersion of clients
- Seasonality of agriculture
- Covariant risk
- Lack of registered credit history
- Other policy and regulatory constraints
- Political meddling and crowding out through subsidized credit programs
- Underdeveloped human capital (illiteracy, health, etc.) and low agril productivity and profitability
- Poor physical infrastructure (roads, etc.)

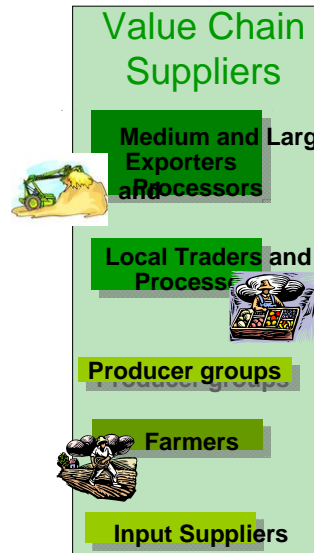
Key Challenges and Constraints

The impact of these constraints on supply is...

- *High operating costs* for the lender
- *High information costs* for the lender
- *Higher real and perceived risk* for the lender

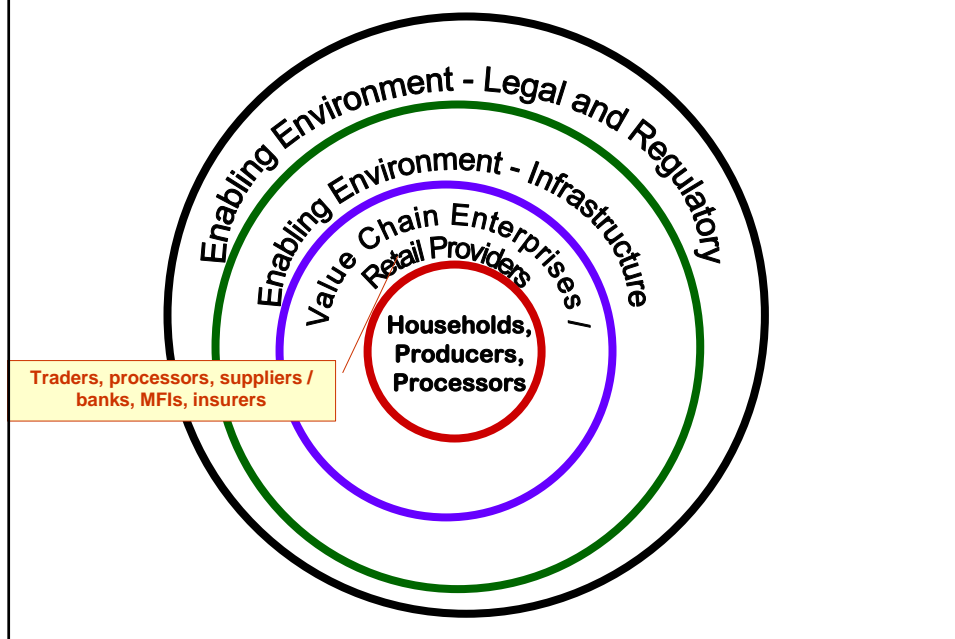
Could this be why many financial institutions do not lend in rural areas or to agriculture-related activities?

Supply of Financial Services: Two Lenses



Many rural enterprises are demanders AND suppliers of financial services!!

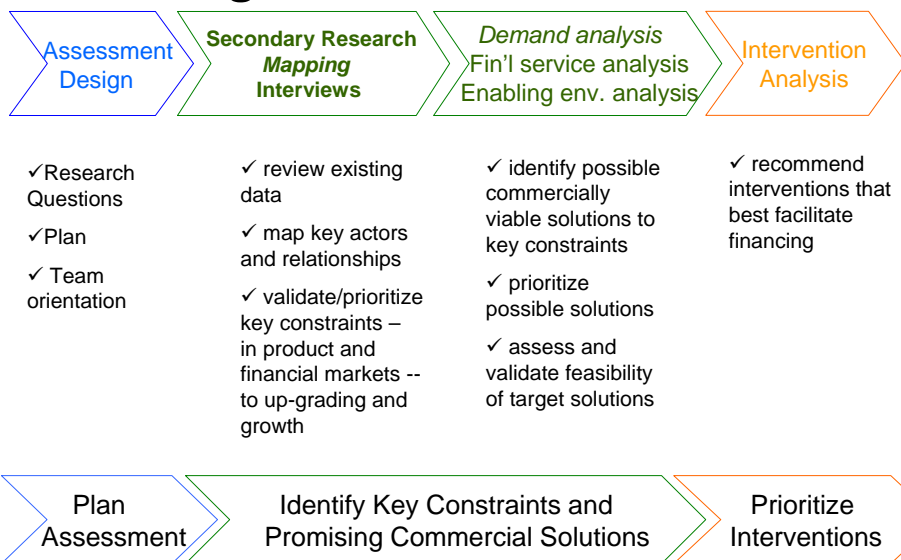
Financial System Actors and Institutions



RAF Market Assessment

- DEAMAND
- SUPPLY
- SUPPRTING ISTITUTIONS
- LEGAL & REGULATORY FAMEWORK
- POICY FRAME WORK

Framing a RAF Market Assessment



How to analyze the market – Demand Side



Formal financial institutions: financial institutions subject to prudential norms and regulation (e.g. banks)

Semi-formal financial institutions: subject to laws/regs but not prudential regs (e.g cooperatives, credit unions, other non-deposit taking entities)

Informal financial institutions: not subject to laws/regs (e.g. ROSCAs)

How to analyze the market- supply side



- : Loans
- Deposits
- Insurance
- Leasing
- Money transfers
- Payments

How to analyze the market – supply side

Secondary Research Interviews

Demand analysis *Fin'l service analysis*

- Industry analysis
 - Numbers and types of financial institutions, share of financial services market in terms of volume of business, client base and market coverage
 - Trends (SWOT analysis may be useful)
- Institutional analysis
 - Performance assessment in terms of outreach, profitability and efficiency
 - Qualitative and quantitative analysis of ownership, governance, capitalization, etc. based on various appraisal formats (CAMEL, PEARLS, GIRAFE, The Mix www.mbbmix.org, etc.)

CADE STUDY WORK

- WORK IN 4 GROUPS
 - Read the case given to you by your facilitator and then respond to following two questions
 - What constraints you find with regard to enabling environment?
 - What is the consequence of that constraint?

Actors	Constraint	Potential Solution
Input Supply	Need for higher-quality seed grown by smallholders, and provision of inputs on credit to producers	Increased inventory financing
Small-holder Production	Need for outgrower schemes through producer associations, and contract farming with technical assistance	Ease association registration and access to inputs
Commercial Production	Need for production of higher-value products	More access to credit for expansion of production
Processing	Need for processing of higher-value products, and oilcake processing	Access to equipment financing, leasing, and trade financing
Financial Institutions	Disincentives for banks to lend	Liberalize T-bill market, pilot product for lending, design effective training
Enabling Environment Institutions	Registration of associations very difficult, Weak judicial system undermines value of collateral	Revise requirements, brokers link small-holders to key services, legal/judicial reform

Rural Finance Program Design Framework¹

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

¹ Adapted from CARE

Impact & Indicators

Brainstorm activity – what are common indicators -

- For agricultural projects
- For financial projects

