



**Paving the Way Forward for Rural Finance
An International Conference on Best Practices**

Discussant Reaction Paper

Comments on
“Models of Rural Financial Institutions”
by Manfred Zeller

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All views, interpretations, recommendations, and conclusions expressed in this paper are those of the author (s) and not necessarily those of the supporting or collaborating institutions.

General Comments

“Models of Rural Financial Institutions” by Manfred Zeller is an informative and comprehensive document on a complex subject. It objectively covers many models of rural finance and while the title signifies institutional models, I was glad to see that Mr. Zeller did touch on non-institutional ones and recognize that there is a need for a diverse set of models. Even more importantly it goes beyond the models to discuss the deeper issues of rural development. The case is made that improvement in rural finance is not only development and learning of new approaches but also by interventions that enable economic growth in rural areas.

The complexity and the challenges of rural finance that must be addressed to be effective in reducing poverty are well laid out. The high levels of rural poverty and the importance of agriculture and food security in many countries are noted along with the recognition of the role rural finance can have in accelerating rural growth. While directed credit schemes were generally not successful, ending many of them has resulted in a noted reduction in rural and agriculture finance, and hence an increased need to re-direct attention to rural finance. Rather than “quick-fix” solutions to increase rural financial services, the case is made for both adaptations and expansion of models to fit the reality of their contexts and to address the underlying causes of rural poverty through policy changes and improvement in other factors including knowledge, markets, public services and technology. Regardless, the conclusion is the public investment in pro-poor and pro-rural financial innovation is required.

Specific Comments

- The triangle of microfinance is discussed in the context of rural finance noting the trade-offs between the objectives of financial sustainability, outreach and impact. A challenge that arises is to really understand the role and limitations of finance. It is only a tool in development, namely the services of financial intermediation, yet it has often been expected to also be a welfare tool, thus creating tension and compromising its ability to achieve its business goals.
- Rural finance is compared with microfinance. The document correctly notes the many lessons to be learned from the advances in microfinance and to recognize that the significant differences in the rural context require much caution as to their applicability in rural finance. For example, the microfinance notion that the poor can afford high interest rates cannot be assumed in rural finance where the turnover of capital is normally much slower. Systemic risk, climatic risk and seasonality are very different as well as costs of operation. The main lessons to be copied include the advances in standardization, efficiency, service and the effective use of non-collateral guarantees.
- CARE strongly coincides with the document’s strong recognition of savings and savings-led models, including the role and value of Credit Unions and informal systems such as ROSCAs. In this regard, I would like to point out that there are improved and significantly modified models of ROSCAs. CARE has found that these can be adapted and replicated very successfully in many low-income, rural communities. These modifications, for example, allow any member to rapidly grow their savings and to have flexibility in borrowing when they desire, thus eliminating the traditional weaknesses of these informal systems.

- The document and accompanying chart provide a useful to a typology of models and characteristics. However, “non-bank financial institutions” (Financieras, EDPYME, Cajas, Building Societies, etc.) have been overlooked in the discussion. These are important in many countries and even though they may share many of the same characteristics, they are distinct from microbanks.
- There is recognition of the value of agribusiness and trader. It is noted that many government and donor finance guidelines have effectively “screened out” this method of outreach to farmers who may otherwise not be reached. However, it must be added that trade finance is not only funded through bank finance, as described, but also through other mechanisms including inventory schemes and equity investors. CARE has developed successful, non-bank, trader finance models that we have been able to grow to significant scale and replicate in other countries.
- The mention of the value of non-financial business development services should be especially highlighted with regards to the poor. Many of the poor suffer from insufficient land and other resources to be competitive and in order for them to move out of poverty, they and their children must be trained and equipped to transition into alternative livelihoods. For many households, these changes in livelihoods are needed in order for financial leverage to be effectively utilized.

Recommendations and Agenda for Donor Activities

1. **Finance is only a tool** – the donor and development community must address the overarching rural finance impediment of very low levels of productive growth stemming from a lack of investment and unfavorable economic environments in rural communities.
2. **There is no blueprint** – donor support of a wide range of approaches, each with its inherent strengths, lessons and outreach, enhances both impact and learning. For reaching the poorest, the importance of building reserves through savings and insurance must be recognized and supported.
3. **Learning and information exchange** – donors’ support can play a key role in rural finance networking, similar to the way it has through the SEEP network and the many country-level networks that have enriched the microfinance field. Investment in this area decrease the recurring mistakes that waste precious resources.
4. **CABFIN** – active donor involvement in and funding for a joint effort initiative for “*Capacity building in rural finance*” (CABFIN) to implement a knowledge information system on learning, best practices of approaches and training materials for rural finance is needed to promote a global learning agenda.
5. **Enabling environment** – donor influence for reversing restrictive or counterproductive finance practices through rural policy changes is needed to improve the operating environment for not only rural finance but also more importantly rural economies.

6. **Risk reduction and analysis** – an emphasize on both reducing risks in rural finance and in systematic incorporation of risk assessment management is needed to assist the banking and investment communities in increasing their participation in rural finance.