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

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**Discussant Reaction Paper**

**Comments on**

**“Innovative Products and Adaptations for Rural Finance”  
by Juan Buchenau**

**By Carlos Cuevas  
(World Bank)**

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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.

Juan Buchenau provides a comprehensive, up to date, insightful and well documented review of innovations and adaptations in rural finance. The author correctly inserts the word “adaptation” into the subject, as in many instances what are termed “innovations” are indeed the introduction of a product or practice that already exists elsewhere, slightly modified or not at all, into a new market.

As a general remark, an interesting exercise emerging from the paper would be to compare across innovations in terms of how they rate under two criteria. First, a measure of “unsatisfied demand” for specific innovations could be speculated on, as some innovations may be more critical than others, and others usually advocated for may be based on incorrect perceptions. An example of the latter could be the demand for long-term investments in agriculture, often assumed large and unsatisfied, even though in many developing economies they are constrained by macroeconomic and trade conditions long before they are by access to long-term finance. A second yardstick that will be interesting to debate is the likely effectiveness and impact of innovations *vis à vis* the costs of their development. Credit scoring, for example, seems to require many concurrent factors such as universal identification systems, and even then still be highly ineffective in helping lending decisions.

Given the richness of the paper’s contents and the page limit on our comments, I will confine mine to two areas: (a) the connection between the possibility of innovations and adaptations with the income cycles of rural farm households; and (b) the remaining relatively major unknowns of trade finance. The also relatively neglected areas of rural savings products and domestic money transfers are likely to be covered by Marguerite, hence I will stay away from them to avoid repetition.

### **Demand for new products and rural income sources and patterns**

It is tempting to submit that, in rural finance, most of what is needed are intelligent adaptations of financial products already available in urban markets. This, however, is highly contingent upon the nature and composition of the sources of income for the rural household. Several pieces of applied research suggest that agriculture – i.e., crop and livestock production – are only a fraction, and sometimes a small fraction of total household income, the remaining sources being wages earned off farm, remittances, and small rural non-agricultural business.

Such a diversified composition of revenues tends to smooth out the ups and downs of the (usually assumed “lumpy”) income pattern of farm households. Loan products that require frequent installment payments (as most micro-loan products do), or savings innovations that count on frequent though not necessarily regular transactions (such as the revolutionary methods of SafeSave), should then be adaptable to rural markets. Granted, the transaction costs of their use in rural settings are likely to be higher than in urban areas, but the basic “product design” would not be that different from the urban cousin. The examples given by Buchenau in the section on working capital loans would fall under this general category of products.

Things are far more complicated when it comes to financing agriculture *per se*. This is particularly relevant when agricultural production dominates income sources, and it is especially important for larger-than-small farmers who may still face access to finance constraints and who are likely to be important sources of wage employment for poorer households. Typical cash crops such as cotton, sugar cane or coffee are heavy users of seasonal labor, and others have a fairly steady demand for manual attention (e.g., tobacco, tea).

The author does a good job at reviewing the issues associated with financing agriculture, where collateral constraints and contract enforcement flaws become highly relevant. It is here where the importance of trade finance, while clearly acknowledged, seems to lack a commensurate degree of attention by “innovators”.

### **Trade finance**

Rural traders, as Buchenau indicates, are “the most important providers of credit in rural areas, with the possible exception of moneylenders in some countries” (page 19). In all surveys I have seen, traders are more important than moneylenders, not only in frequency of use but also in terms of relative amounts of financing. Their services are for the most part provided to known clients, for whom they are reliable and stable sources of finance. Rejection rates in this type of informal lending are minimal, and the amount of credit requested by farmers is typically fully granted by the provider.<sup>1</sup>

If trade finance is a reliable source, albeit more expensive perhaps than bank financing, why does it not receive more attention from researchers and eventually policy-makers? After all, microcredit is also recognized as reliable and relatively expensive while enjoying immense popularity among researchers and policy-makers.

Linking financing to farmers with their connections to suppliers or to processing plants, as described in the paper, are well established practices each with its own limitations and conditions. Little innovation or adaptation, to my knowledge, has been attempted to enhance the access to formal finance by the input suppliers or the product purchasers themselves. It is often the case, in my experience, that small suppliers are limited in how much business they can carry, and how much of a credit facility they can offer to clients, by their own inability to obtain bank financing. This, in turn, is traced back to the limited value of their “bankable” collateral, usually residential property and rarely moveable property such as their inventories of inputs.

Systems such as those described in the paper where banks take the portfolio of the dealers as collateral, and the dealers take diverse pledges the farmer may be able to offer to obtain financing hold substantial promise. Not only they are likely to be overall cost-effective, but also to attain extensive reach in relatively short time periods, with minimal or no need for subsidy compared to, say, establishing a microfinance institution.

Such systems, however, may require extensive legal and judicial reforms, as Buchenau points out (page 21), but also banking skills able to recognize and exploit these business opportunities. More generally speaking, in the end it appears as if for innovations to materialize it is necessary to rely upon the two other pillars of financial development namely: the legal and regulatory framework, including the judicial system, and the capacity of institutions to deliver services, identify opportunities and undertake innovation and adaptation.

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<sup>1</sup> A survey in Tanzania shows that 82 percent of the amount of financing requested from traders is actually received by farmers, in contrast with about 9 percent for the case of bank loans.