

Empowering rural communities through financial inclusion

“The new rural finance paradigm is premised on the fact that **rural people are bankable.**”

(Nagarajan and Meyer, 2006)

While they need it the most, rural communities remain the largest unserved market for financial services. Ensuring their financial inclusion can unlock the considerable economic potential of rural areas.

Why action is needed

- Rural communities are highly underserved. Traditionally, formal financial institutions have avoided or failed to offer sustainable services in rural areas (e.g. rural or agricultural development banks). Thus, informal or semi-formal financial institutions as well as alternative providers like traders or input suppliers have become major providers of financial services. However, these informal providers often have weak institutional and managerial capacity; and operating in isolation from the financial system has let some of these providers charge steep interest rates.
- People living in rural areas may need access to financial services to purchase agriculture inputs; obtain veterinary



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services; maintain infrastructure; contract labour for planting/harvesting; transport goods to markets; make/receive payments; manage peak season incomes to cover expenses in low seasons; invest in education, shelter, health; or deal with emergencies.

Facts and figures

- About 70 percent of adults in the developing world have no access to financial services, a percentage far higher in rural areas. For example, rural Madagascar has one bank branch for 1.4 million people.¹
- Rural households can have relatively stable incomes. They often have diverse sources of income from a variety of farm and non-farm activities like trading, food production and processing, livestock rearing, day labour or seasonal employment on farms or in the city. Access to financial services that serve productive needs (investing in enterprises, building assets) and protective purposes (coping strategies for risk exposure), can provide further stability.²

Recent experience shows that...

- A number of microfinance institutions (MFIs) have increased their rural operations (e.g. ACLEDA Bank in

Cambodia³), while market pressures have driven others to terminate their rural operations.

- Member-owned financial institutions such as Self-Help Groups (SHGs), Village Saving and Loan Associations (VSLAs) and Savings and Credit Cooperatives (SACCOs) are increasing in numbers. Cooperatives can use cross-subsidisation, and federations of SACCOs offer economies of scale to members, as in the case of the Mixtlan SACCO and UNISAP Federation in Mexico.⁴
- Post Office Savings Banks are emerging as significant providers of deposit services in rural areas, for example in Kenya, South Africa and Tanzania.⁵
- Use of electronic technology is revolutionising the provision of rural financial services and is driving down costs of handling small transactions.⁶ Mobile phones or biometric smart cards are helping agents enrol clients, while clients use them for money transfers.



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- Climate change is impacting rural areas most severely. Rural communities cannot cope and adapt to growing incidences of drought, flooding or storms without access to insurance or emergency loans to deal with these sudden shocks, or to long-term finance for venturing into less risky businesses.
- Informal providers often offer only a narrow range of financial services. This makes enterprises dependent on self-finance and limits business investment and growth, while households lack instruments for stable consumption or reserves for emergencies.
- Little knowledge exists on the demand for specific financial services other than credit, like savings, payment services and remittance transfers, leasing or insurance, which makes it difficult for supply to meet demand.
- Transaction costs in rural areas, especially in remote areas, are high due to low population density, lack of infrastructure (communications, electricity, transportation) and small average loan amounts. This makes financial services expensive. Prohibitive transaction costs also discourage people to deposit savings, thereby depriving households of building financial assets.

Box 1

Some useful definitions

Not all rural finance is agricultural, and not all agricultural finance is rural...

Rural Finance

...is the provision of financial services in rural areas that support a wide range of economic activities and households of various income levels.

Agricultural Finance

...is the provision of financial services that support all agriculture-related activities, including those of processors, distributors and exporters who may be located in rural, urban or peri-urban areas.

Rural communities could make use of a wide range of financial services like...

- savings
- money transfer services
- insurance products
- loans
- leasing
- factoring
- loan guarantees
- venture capital
- investment funds

- Levels of financial literacy are often low in rural areas. This does not allow people to understand insurance, for example, and why they should pay a premium without timeline for payout.
- Legal systems that do not ensure marketable property rights and contribute to weak collateral and contract enforcement mechanisms, limit access to finance further. As a consequence, products such as long-term financing hardly reach rural areas. For example, leasing that increases the asset base of rural entrepreneurs and has potential to increase productivity and employment, is rarely offered in rural communities.
- Migration to urban or neighbouring rural areas increases remittance flows among family members, and thus also the demand for efficient money transfer services.

Policy options

Support knowledge and innovation in rural finance

- Support financial institutions to innovate and adopt delivery models that reduce transaction costs, e.g. deploy mobile banking units, introduce technology for mobile phone banking and internet payments, experiment with solar units to recharge notebooks of agents, introduce smart cards that function like debit cards.
- Better understand demand for financial services in rural areas, namely:
 - ◆ Identify gender-related demand specificities
 - ◆ Research demand specifications from remittance users as well as groups like youth, disabled persons, indigenous populations or people with HIV-AIDS
 - ◆ Research how climate change is shaping demand for financial services.
- Design innovative financial products that meet demand in rural and remote areas.
- Extend a range of financial services that are tailor-made for:
 - ◆ Agricultural production (e.g. crop and livestock insurance)
 - ◆ Agricultural-based industry (e.g. leasing)
 - ◆ Non-farm enterprises (e.g. a variety of loan products)
 - ◆ Household consumers (e.g. savings, health insurance, housing loan, consumption loan).
- Research the impact of financial service provision on rural household incomes and employment conditions, and implement new approaches on how financial institutions



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Box 2

Mainstreaming access to insurance services for rural communities - PWDS India

Since 2008 the ILO's *Microinsurance Innovation Facility* has supported the Palmyrah Workers' Development Society (PWDS) in Tamil Nadu. PWDS works with rural families in the informal economy lacking access to social and health security and whose income is often at risk by health shocks that force families towards emergency loans and debt. PWDS's beneficiaries are self-help groups comprising over 350,000 families.

The project pilots a business model for mainstreaming access to insurance services for rural communities. The model identifies, strengthens and leverages existing relationships and channels that build on trust. It tests the efficacy of existing self-help groups' federations as 'insurance service providers', by helping them build an insurance team to link between the communities and the insurers. Starting with health, the project is to develop an information and document flow within the federation-community system to provide low cost premium collection and claims servicing. The goal is to develop a self-sustaining retail distribution that provides relevant products to low-income communities.

Source: <http://www.microinsurancefacility.org/grantee/ig/palmyrah-workers-development-society-pwds>

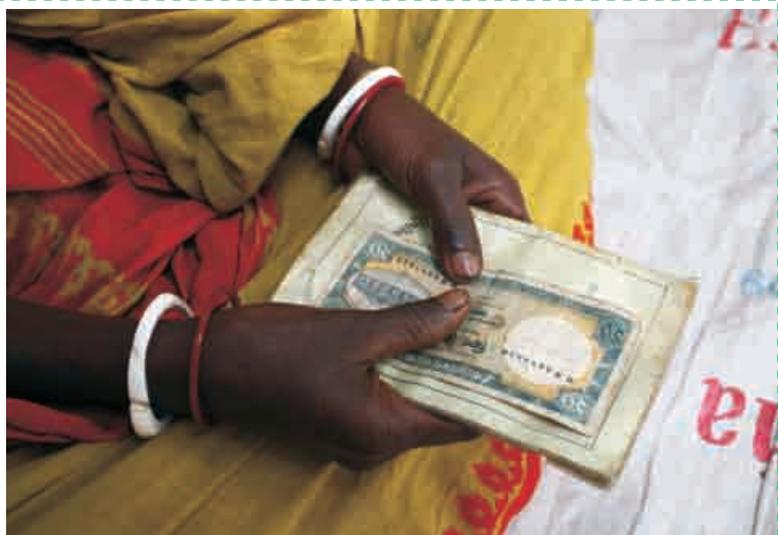
can contribute to improving decent work among rural households.

- Better understand agricultural value chains to identify the networks that value chain actors use to distribute inputs and collect produce from farmers, and use those networks to channel financial services.

Increase capacity of financial institutions to serve rural and remote areas

- Strengthen management capacity and governance of informal and semi-formal financial service providers, like Savings and Credit Cooperatives (SACCOs), village banks or informal savings groups, for instance through community training on how to set up and manage member-owned institutions.
- Link informal providers to formal financial institutions. Local member-owned institutions have the flexibility and accountability (entailing trust) needed to penetrate remote areas, but their potential is limited due to their isolation. When linked to the financial system, they can expand the range of services offered.
- Develop alliances among various types of institutions, for instance channel life or health insurance through local hospitals or provide credit along the agricultural value chain (e.g. via rural trader shops, or agricultural processing firms).⁷
- Facilitate portfolio diversification of financial institutions to mitigate risk stemming from concentrated agricultural portfolios. Consider the risk in financial portfolios resulting from climate change.
- Regularly assess if supply for financial services meets demand.

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Provide an enabling environment

- Abolish or do not reinstate interest rate ceilings that do not allow full cost recovery for financial service providers, especially those who service rural and remote populations. Private providers may be forced out of operation in the rural market or grow more slowly, thus leaving clients with limited choice.
- Abstain from direct credit schemes or subsidised first-tier government lending programmes. It is common that governments and project management units lack the technical skills and political independence needed to manage these schemes, which are often associated with low recovery rates. Also, they may offer below-market interest rates that crowd-out private providers and when the programme discontinues, clients remain with a limited choice.⁸
- Increase financial literacy of rural communities through financial education in school and training curricula so they are empowered to take informed financial decisions in their households and in their businesses.

Box 3

Building alternative livelihoods through entrepreneurship training to microfinance clients- NWTF Philippines

In the framework of the ILO's *Microfinance for Decent Work Action Research Programme*, NWTF has been experimenting with entrepreneurship training for clients since 2009. The project aims at reducing vulnerability of poor households by expanding their asset base and income sources on the Philippine island Negros Occidental. The Negros Women for Tomorrow Foundation (NWTF) uses ILO's GYB/SIYB materials that are adapted to microfinance and the Philippines. Trainings are conducted by trained loan officers. After the GYB training the client prepares a business plan, and based on its viability receives a business loan (USD 22 - 3,200). Business loans have been used, among others, to expand the stock of merchandise in clients' stores and set up loading stations for mobile phones. Once the business is running, the client receives the SIYB training in weekly sessions. For instance, new knowledge on marketing practices has led a food vendor to launch a marketing campaign that has increased sales.

Source: Generate Your Business / Start and Improve Your Business.
See: www.nwtf.ph

RURAL DEVELOPMENT through DECENT WORK

FOR GROWTH, PRODUCTIVE JOBS, INCOME, FOOD SECURITY, GOOD WORKING CONDITIONS, EQUAL OPPORTUNITIES, RIGHTS, VOICE, SUSTAINABLE DEVELOPMENT, CRISIS RESILIENCE

- Promote a savings and insurance culture among rural populations through awareness campaigns, financial education trainings or experience/testimony-sharing among insured and uninsured people.
- Support savings mobilization by prudential regulation of deposit-taking financial intermediaries. Do not crowd-out savings mobilization by supply of public and donor resources.⁹
- Avoid pressuring informal or semi-formal institutions to become regulated large formal institutions. Informal institutions have unique advantages that can be leveraged by linking them to formal finance.
- Integrate rural finance into the broader financial system development agenda. For example, the Ministry of Finance in Uganda, under the participation of industry stakeholders, created a "Microfinance Outreach Plan" to motivate financial institutions to expand their services in rural areas.
- Support index-based insurance products like weather-based crop insurance by providing accurate statistical data (e.g. on regional rainfall) and infrastructure (e.g. weather stations) to collect data and make it available to insurers¹⁰
- Integrate financial components in interventions like entrepreneurship development or local economic development.
- Improve infrastructure to lower transaction costs (e.g. in communications, electricity, transportation).
- ◆ Promoting innovation through action-oriented research and knowledge management
- The ILO has developed training materials on financial education for a number of countries like Cambodia, Mongolia, Nepal, Indonesia and Moldova; and materials for Senegal are in preparation. In Cambodia alone, over 200 local trainers have been trained with those materials, and over 13,000 people in poverty have received financial education training.
- Through the *Microfinance For Decent Work Action Research Programme* (MF4DW), launched in 2008, the ILO is studying the impact of innovations in microfinance on poor households and their businesses. MF4DW is working with 16 microfinance institutions across the world on reducing child labour, improving working conditions and risk management strategies, encouraging formalisation, or increasing job creation.
- Through the *Microinsurance Innovation Facility*, launched in 2008, the ILO seeks to increase the availability of quality insurance for the developing world's low-income families, the majority of whom live in rural areas, to help them guard against risk and overcome poverty. It provides grants to support organizations develop innovations in the microinsurance sector, and offers a range of customized services to support microinsurance consultants and providers deliver value to the poor.

ILO's role

- Given the important effect of the financial market on the level and quality of employment, the ILO is mandated to work on financial inclusion. In particular, it is to "consider... financial policies and measures in the light of social justice", including those related to rural areas.¹¹
- The ILO works on financial inclusion in rural areas through:
 - ◆ Capacity building of constituents (governments, workers' and employers' organizations) as well as ILO staff
 - ◆ Functioning as a help desk for requests from constituents and ILO staff and quality monitoring of ILO interventions

¹ Consultative Group to Assist the Poor: *Financial Access* (Washington: 2009)

² ILO: "Rural Microfinance", in *Making Microfinance Work: Managing Product Diversification*, Vol. II (Geneva: 2011)

³ Nagarajan, G.; Meyer, R.: "Rural Finance Today," in *Finance for the Poor*, Vol. 7 No. 4 (2006)

⁴ Chao-Bérouff, R.: *Reaching the Hard to Reach* (Coady International Institute, Nova Scotia: 2008)

⁵ "Rural Finance Today," op. cit.

⁶ Ibid.

⁷ Miller, C.; Jones, L.: *Agricultural Value Chain Finance. Tools and Lessons* (FAO, Rome: 2010)

⁸ Consultative Group to Assist the Poor: *The Role of Governments in Microfinance* (CGAP, Washington: 2004)

⁹ FAO/IFAD/Ford Foundation: *Rural Finance Research Conference, Conference Proceedings*, International Conference on Rural Finance Research, 19th-21st March 2007 (Rome: 2007)

¹⁰ Ibid

¹¹ ILO: *Philadelphia Declaration*, 1944 (article 2), and *Declaration on Social Justice for a Fair Globalization* (Geneva: 2008)

Links

- ILO: Social Finance Programme: www.ilo.org/socialfinance
- ILO: Microinsurance Innovation Facility: www.ilo.org/microinsurance
- International Training Centre of the ILO in Turin, offering training course and certification on Making Microfinance Work materials: <http://mmw.itcilo.org/en/home/home-page>

Tools

- ◆ ILO: "Rural Microfinance," in *Making Microfinance Work: Managing Product Diversification* (Vol. 2) (Geneva: 2011). http://www.itcilo.org/en/flyers/2010/mmw/attachment_download/file
- ◆ ILO: *Budget Smart: Financial Education for Migrant Workers and their Families - Trainers' Manual and Smart Guide on Money and Migration: Thailand* (2011)

- ◆ ILO: *Financial Education for Youth: Trainers' Manual and Trainee's Guide: Nepal* (2011).
- ◆ ILO: *Financial Education: Trainer's Manual: Cambodia* (2008)
- ◆ ILO: *Building Financial Capability for the Vulnerable Households: A Manual for Individual Training / Counselling Session: Moldova* (2008)
- ◆ ILO: *Village Banking in Lao PDR Materials: Lao PDR* (2008)
- ◆ ILO: *Guarantee Funds for Small Enterprises: A Manual for Guarantee Fund Managers* (Geneva: 2004)

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