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With a background in small-scale agriculture and forestry from the north of Sweden, and after several years of working in the Swedish Banking Sector, Åke Olofsson joined FAO in 1987 as an Associate Professional Officer. He holds since 1991 the position of Rural Finance Officer in the Agricultural Support Systems Division of the organisation. In this capacity, he works mainly towards the French-speaking countries in Africa and has travelled extensively to the region throughout the years. In recent years, he has also started working towards the Central European and Asian countries. In addition to covering in a broad manner the topic of agricultural and rural finance, he is also the technical officer for Crop and Agricultural Insurance issues in FAO. Åke also is the current manager of the Rural Finance Learning Centre (RFLC), a website that provides materials for capacity building in the field of rural finance.

Financial services and rural development

Money matters to all. It makes exchanging goods easier and it is a convenient means of storing up wealth for future use. Throughout the world, as people engage in commercial transactions, their need to manage money increases. Sometimes they have surpluses, sometimes they do not have enough and sometimes they need large amounts all at once. They may also need help from outside to manage their money. This is what we normally would call need for a financial service. The most common financial services are savings and deposits, loans, credits and money transfer facilities. Providers of such services may range from village moneylenders to multinational banks. Very few people who run a business – farmers, blacksmiths, hairdressers, merchants – can do so without access to financial services.

Rural finance

Many countries today have a variety of financial service providers also in rural areas, including public and privately owned banks, cooperatives and credit unions, village savings and loan associations, village banks and other types of self help groups, NGOs and microfinance organisations. Although they may on paper offer a wide range of products, in reality the availability and quality of the services as well as the requirements to access them vary largely from area to area and between the different service providers.

Despite the increasing presence of financial institutions in rural areas, many people still have, as a matter of fact, problems to find a bank or any other financial institution nearby and, if they do, they have difficulties in accessing them. Perceptions of high costs and high risk, but also the general inability of rural populations to offer real guarantees for loans, divert financial institutions from operating at a large scale in rural areas and particularly from lending to small-scale farmers and other rural entrepreneurs. Women, having on average lower levels of literacy and education than men and fewer formal property rights, usually experience larger problems in accessing financial services.

Rural finance, as a field of work, is concerned with redressing this imbalance and ensuring that people living in rural areas do have gender equal access to financial services that are tailored to their needs.

Financial services

A variety of financial service providers that are able to serve efficiently a wide range of clients, most of whom without prior access to financial services, are among those institutions that are essential for the development of rural areas. However, one needs to bear in mind that financial services, and in particular credits and loans, are not to be considered poverty reduction tools in the first instance. Financial services are, by their nature, unable to alone trigger development. In order to improve their living conditions, poor people need to be able to generate additional income and build up assets. Loans cannot directly multiply the net assets of poor people, but they can multiply their working assets. Access to financial services, in particular loans, can thus provide access to the production means and investments that are required to increase, for example, the production levels and agricultural productivity that, in turn, lead to higher incomes and assets.

Equally, if not more, important are deposit facilities. They are vehicles for people to invest excess liquidity capital and reserves into savings in order to earn additional income from the interest paid and to build up reserves for future needs, including risk reserves to better cope with risks and shocks. The saver must however first perceive that this is both a safe and remunerative way of depositing the surplus. Numerous are the cases around the world where people's deposits have not generated income or, worse even, been put at risk due to poor management of the deposit taking institution and sometimes also due to outright fraud.

Generating income

In addition to working assets, income generation also requires opportunities, skills and access to resources. The majority of people in rural areas of most developing countries depend on agriculture for their living. Their opportunities therefore primarily lie in the areas of increasing the agricultural production and/or processing the produce in order to add value, and secondly in diversifying into other, non-agricultural activities.

In all cases, a market for what is being produced must exist and people need to have access to that market. Understanding the market and market mechanisms are fundamental for any income generating activity. In agriculture, understanding and using market information is crucial to enable farmers and traders to make decisions about what to grow, when to harvest, to which markets produce should be sent and whether or not to store it.

For a farmer, skills include good agricultural practices and the use of improved technologies, tools and inputs, mainly quality seeds and fertilizers. Good practices could mean the use of resistant varieties, the application of correct crop sequences, practices that maximize biological prevention of pests and diseases, reducing erosion by wind and water through hedging and ditching, application of fertilizers at appropriate moments and in adequate doses, etc. The application of good agricultural practices depends mainly on farmers' knowledge of such practices, their access to and capacity to pay for the means, and the government's ability to offer quality services in a timely manner.

Access to resources normally means access to natural resources such as land and water. It also means access to labour and financial resources for investments that will increase productivity and production. Financial resources can be either own resources or resources borrowed from somebody else. For many small-scale farmers and other rural entrepreneurs, self-finance is often insufficient to acquire optimal levels of inputs and, more importantly, to invest in their business.

Risk and risk management

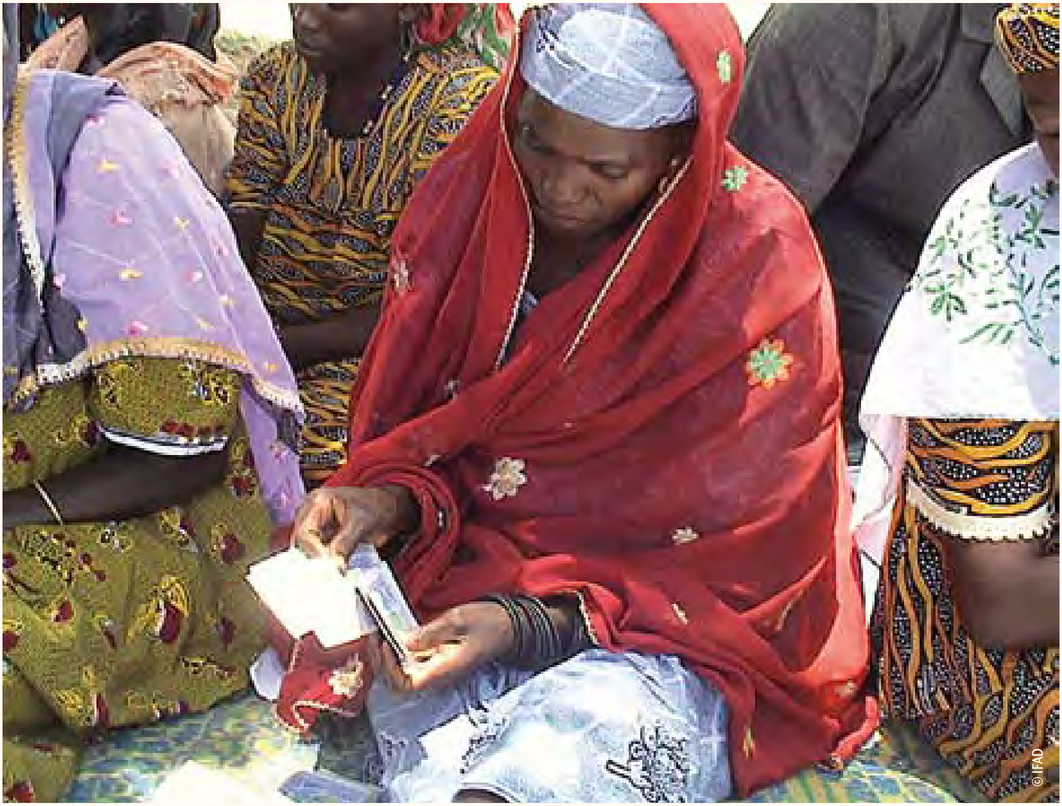
Despite the many efforts in the past, most financial institutions have not been successful in addressing the specific needs of small farm households. However, it is important to point out that provision of financial services is not necessarily a task for financial institutions only. Much of the finance in the agricultural production chain is actually taken care of by other actors such as traders, processors and input supply companies. It is essential though that whoever provides financial services understands and responds to the needs of the smallholders and focuses on a demand-driven approach that cultivates durable relations and pays special attention to the various specific risks associated with agriculture and lending to farmers. Systemic, market and credit risks and low and slow return on investments are among the most significant risks. To this we need to add geographical dispersion of the clients, which increases the cost for both accessing and delivering financial services

Initiatives to address the risks associated with agriculture and with lending to agriculture have to be directed at several levels simultaneously. For example, risks at the farm-level can be lowered by irrigation, improved farming practices, off-farm income and business skills development. Agribusiness firms, who depend on regular and good quality products, can provide technical guidance to smallholders and therefore also play an important role in reducing farmer level risks. Risks at the financial institution level can best be addressed by portfolio diversification and by servicing clients in different geographical areas. Financial institutions can also adapt their practices and simplify procedures as well as form partnerships with for instance specialised NGOs in order to support capacity building among small scale farmers. Constraints such as the low management and business development capacity of small scale farmers require long-term investment and commitment of governments, development agencies and others.

Impact

Several attempts have been made to measure the impact of access to credit, loans and other financial services on the income and living conditions of rural people. Although one can rightly argue that there is a strong positive correlation, it is nearly impossible to quantify this impact since there are many other factors, such as access to education, health services, infrastructure, etc. that would also need to be taken into consideration. The direct contribution of financial services to increasing incomes depends to a large extent on how well the delivery of a loan or a credit is adapted to the economic activities being financed, that is to say to the capacity of the borrower to repay the loan.

Studies have shown that especially rural women can be-



come economically empowered by greater access to financial services. Women can increase their understanding of and control over household finances and promote their own economic activities, create and protect assets, enter markets, and diversify their economic activities. By strengthening women's economic roles and enhancing respect for women's decision-making, access to financial services may also increase women's own share of the benefits from greater household well-being. The combination of women's increased economic activity and increased decision-making in the household can spur wider social and political empowerment. Even bank products that are gender inclusive may bring about change by developing women's confidence in negotiating with male staff and initiating wider impacts in their relations with men in other arenas.

Way forward

Building diversified rural financial institutions that are gender-sensitive and able to respond to local conditions, enhancing institutional sustainability with outreach to small and dispersed clients, and fostering a supporting policy and regulatory environment are all vital for the development of rural areas.

Being gender sensitive means that financial service providers need to pay attention to the individual client and to the extent possible adapt their products and services to the needs of this type or group of clients. For loans and credits, it means to adapt application procedures, eligibility and collateral requirements, repayment schedules and, if and when possible, interest rates, and size and terms of loans and credit. For savings and deposits, service providers would

have to pay attention to compulsory (often used as a condition for granting a loan) versus voluntary savings, minimum entry-levels of savings, flexibility with regard to saving and withdrawal of savings, confidentiality and attractive returns on savings.

Several problems continue nevertheless to exist. For example, higher interest rates may be needed in rural than in urban areas to cover costs and risks. Policy makers are sometimes tempted to reject market determined rates and rationalize interest subsidies and controls because of high degrees of rural poverty. Such policies may, however, have serious negative repercussions on the sustainability and viability of the financial institutions. Secondly, the rates of return on farm investments are perceived to be low and highly variable. The length of rural loans need therefore to be longer to fit rural production and cash flow patterns. Lastly, the heterogeneity of farming and the rural economy has increased as new opportunities have emerged and as farm-households have adopted complex survival strategies. This increases the complexity that financial institutions face in evaluating the credit worthiness of diverse potential clients and in analysing their capacity to repay loans.

Increased competition in the banking sector is prompting financial institutions to reconsider business opportunities also in the agricultural and rural economy. In order to be successful, rural finance service providers will need to invest in institution building. In addition to paying attention to client demand and to the design of their products and services, they will also have to carefully control costs, develop strong management and information systems, remunerate staff incentives, use professional management, and implement strong governance. It also calls for greater transparency in operations and more systematic accounting for costs, revenues, loan recovery, efficiency and productivity measures in order to facilitate the comparative analysis of performance between institutions and the establishment of best practices.

Rural Finance Learning Centre (RFLC)

"Capacity building" implies the existence of a stated goal, measurement in performance in relation to this goal and consequent identification of weaknesses, followed by "action" (the capacity building) to overcome these limitations and move closer to the goal.

Building capacity is essential to all development initiatives and also to the development of rural finance. The **Rural Finance Learning Centre, RFLC**, is a website (www.rural.finance.org) managed by FAO. The Centre hosts an evolving collection of quality resources suitable for capacity building in rural finance, targeted at practitioners, policy-makers, trainers and researchers working in this field. The goal of the site is to help people find materials which suit their purpose and enable them to improve their own knowledge and that of others. In doing so, the RFLC purposely searches for gender specific material.

The RFLC was established on the well-founded assumptions that i) financial services are important to facilitate livelihood development of the poor in rural communities and that ii) currently these services are not adequate, iii) that capacity building would help improve rural finance service provision and is needed at a number of levels, iv) that effective capacity building requires the delivery of suitable methods and materials as well as the motivation and desire of people or organisations to use them and, v) that an Internet-based resource, housing training materials and a library of documents and publications that are organised within a logical framework, would provide the target audience with an effective and efficient tool to access these methods and materials.