

Rural finance:

Small amounts making a big difference



Enabling poor rural people
to overcome poverty



A women's group meets in Mombasa, Kenya. Members know that if they repay their small loans on time, they should be able to take out bigger loans. This gives them an opportunity to plan ahead for the development of their small businesses.

Most of the world's 1.4 billion very poor people live in precarious conditions, without the security of reliable income, shelter or food. Being able to save or borrow small amounts of money can make a big difference to their lives. Yet only about 10 per cent of poor people living in the rural areas of developing countries have access to even the most basic financial services.

Small, informal savings and credit groups have operated in different forms around the world for centuries, but the field of microfinance (financial services for poor people) took off in the late 1970s when experimental development programmes in Bangladesh began lending tiny amounts of money to groups of poor women. The women invested the money in small income-generating activities, and reliably repaid their loans. News of their repayment rates, and the difference microfinance had made to their lives, spread and the field quickly grew, reaching more and more people around the world.

It soon became clear that providing loans was not enough. Poor rural people, like everyone else, needed access to a wide range of financial services. Today, the rural finance sector has moved beyond credit to include savings, money transfers and a variety of insurance products that cover life, health and agriculture.

Access to financial services in rural areas allows poor people to manage their household cash flows, start new agricultural activities and set up small businesses. When poor rural people have higher earnings and safe ways to save their money, they can pay for healthcare and education, and plan and invest in the future of their farms or businesses.

Microfinance is particularly important for poor women and children. Women are

often at the lowest levels of rural societies. The status of women, in their homes and in their communities, improves when they are responsible for loans and manage their household's savings. Credit extended to women has a greater positive impact on household food consumption and on the quality of life for children than similar loans to men.

In countries as diverse as Bangladesh, Kenya and Bolivia, poor people consistently repay their loans more reliably than conventional borrowers. This has driven the rapid expansion of microfinance since the 1970s. But given that fewer than 10 per cent of poor rural households have access to the most basic financial services, there is still a long way to go.

Beyond lending and saving: new directions in microfinance

Microinsurance. Unexpected events and income shocks can have a devastating impact on any household anywhere in the world. Insurance is a means of cushioning the blow, but it is not widely available to poor people in developing countries. The Microfinance Centre for Central and Eastern Europe is a network of over 90 microfinance institutions from the region. The MicroInsurance Centre is an international microinsurance consulting firm that promotes partnerships between regulated insurers and rural finance providers. With support from IFAD, these organizations are working to develop microinsurance products specifically for low-income individuals and families, particularly in rural areas.

Index-based weather insurance. Extreme weather events and natural disasters such as droughts or floods can destroy crops, trap rural households in poverty, impede development and drain a country's financial resources. Smallholder farmers in developing countries are particularly vulnerable to the harsh effects of these weather risks. Affordable insurance can help improve their financial security and protect their livelihoods in the event of a crisis. IFAD has joined forces with the World Food Programme (WFP) and other partners to promote index-based weather insurance to mitigate these risks.

Remittances. The money that migrant workers send home – remittances – is a lifeline for poor people. These funds, which add up to more than US\$300 billion worldwide, generally surpass foreign direct investment and development assistance combined. IFAD is working to unlock the development potential of remittances by linking them to other financial services, such as savings, insurance and loans. The Financing Facility for Remittances, based at IFAD, seeks to improve access to cost-effective and easily accessible money transfer services in remote rural areas. The Facility is funded by the European Commission, the Governments of Luxembourg and Spain, the United Nations Capital Development Fund, the Consultative Group to Assist the Poor (CGAP) and the Inter-American Development Bank/Multilateral Investment Fund.

IFAD's commitment to rural finance and innovation

IFAD's goal is to empower poor rural women and men in developing countries to improve their incomes and food security. To do this, IFAD is working to expand access to a range of financial services in rural areas.

In 2008 IFAD-supported rural finance institutions reached over 4 million voluntary savers, with cumulative savings of over US\$1 billion. They also served 21 million active borrowers, 87 per cent of whom were women, and had total outstanding loans of approximately US\$4.6 billion. Approximately 18 per cent of IFAD's overall portfolio of loans and grants is focused on rural financial services, making it one of the top four microfinance funders in the world. Its Rural Finance Policy spells out the guiding principles of IFAD's rural finance operations.

There is no single microfinance model. IFAD works with a wide range of partners, tailoring its interventions to each particular context. Its partners in rural finance include grass-roots savings and credit associations, financial cooperatives, microfinance institutions, rural banks, specialized NGOs and agricultural development banks.

In many areas, self-help groups are central to rural finance. These village-based groups consist of approximately a dozen women who save money and make small loans to each other within their group. In Indonesia alone, IFAD has established over 58,000 self-help groups, 1,900 self-help group associations, 200 microfinance institutions, and 35 cooperatives, benefiting more than 800,000 households.

If microfinance is to make a lasting difference in peoples' lives, financial institutions must be sustainable, providing relevant financial services over the long term and continually increasing their outreach to poor people. IFAD always looks at the long term, working to build institutions that are able to allocate scarce resources efficiently, manage risk and reduce transaction costs.

Sustainable poverty reduction requires political will, good governance and sound policies. Governments have an important role to play, creating a conducive policy and regulatory environment in which microfinance institutions can thrive and be effectively supervised.





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IFAD is an international financial institution and a specialized United Nations agency dedicated to eradicating poverty and hunger in rural areas of developing countries.

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basis of some common factor (such as geography, religion, economic level or social group). The resulting mutual trust and support enabled them to work well together, gradually gaining confidence in mobilizing savings, building and managing group resources and gaining access to external credit. The women found that their improved economic power also enhanced their standing within their communities and families.

What started as a pilot programme has now become a movement for social empowerment – particularly for poor rural women. The number of self-help groups linked to banks has increased from about 500 in the early 1990s to more than 3 million in 2008.

Respecting cultural sensitivities: microfinance in Pakistan

The Dir district of Pakistan, a remote, mountainous and disadvantaged area, is culturally conservative. Women's roles are limited by religious customs and traditions. In addition, many communities observe strict Islamic prohibitions against interest-based lending, making activity in the region difficult for the formal banking sector.

The IFAD-funded Dir Area Support Project introduced a new system – Islamic Microfinance, known locally as Murabaha – using an approach compatible with Islamic principles and acceptable to local communities.

Introduced after consultation with religious scholars, the bank and customer enter into a sale and purchase agreement. The lender is an active, risk-sharing partner in the enterprise, providing training in relevant topics, such as basic accounting and marketing.

For women participating in the project, the benefits have been considerable. Bacha Khela, from the Shaikh Ahid women's organization, is supporting five children and a sick husband. With her first loan of US\$227, she was able to set up a grocery shop in her own home. Bacha was able to repay the loan within a year and now earns US\$38-45 a month.

"Before I joined the women's organization, I had no hope of having my own income," Bacha says. "Now I have my own business and my life has improved. I have bought a stove and a refrigerator. My goal now is to buy my own house and to pay for my other children's education."

LINKS

IFAD and rural finance
www.ifad.org/ruralfinance/

Rural finance innovations
www.ruralfinance.org/cds_upload/1122821975489_RFI_worldbank.pdf

Rural finance for the poor
www.ifad.org/pub/other/rural_e.pdf

Weather index insurance
www.ifad.org/ruralfinance/wrmf/index.htm

Weather index insurance brochure
www.ifad.org/ruralfinance/wrmf/brochure.pdf

Microfinance Centre for Central and Eastern Europe
www.mfc.org.pl/

MicroInsurance Centre
www.microinsurancecentre.org/UI/Home.aspx

United Nations Capital Development Fund
www.unctf.org/english/index.php

Centre Internationale de Développement et Recherche
www.cidr.org/

MicroSave
www.microsave.org/

Rural Finance Knowledge Management Partnership
www.ruralfinancenetwork.org/

World Food Programme
www.wfp.org

Consultative Group to Assist the Poor
www.cgap.org