



Refinancing Connects Banks to Rural Clients

In Armenia, Macedonia and Moldova, low-cost refinancing capital makes rural investments attractive and profitable for local banks, and reduces rural poverty by stimulating economic growth.

Refinancing is part of a new approach adopted by IFAD to support rural investment in Armenia, Macedonia and Moldova. Refinancing operations are similar across the three countries. A small, semi-independent refinancing unit is established in the relevant ministry and receives a government loan, funded by IFAD. The unit then selects those banks – called participating financial institutions – that will use the refinancing facilities and funds to on-lend to rural clients. In day-to-day operations, the process begins when the bank receives a loan request from a rural client. If the request is approved, the bank sends the loan documents with a refinancing application to the refinancing facility. If the decision is favourable, the facility transfers funds to the bank to finance the rural client's loan.

Countries:

Armenia, Macedonia, Moldova

Direct Beneficiaries:

Small farmers, small and medium enterprises, rural unemployed

Results:

- Refinancing has speeded up the entry of local banks into agriculture-related activities.
- Sales and employment of financed companies have increased substantially.
- Revenues in rural households have risen significantly as small farmers have sold their produce or leased their land to larger companies.

Main Lessons:

- Market-based criteria (to develop new rural financial markets) and government policies (to set up new institutions governing the overall refinancing procedure) are key factors of success.
- Refinancing has provided an immediate low-cost, low-risk opportunity for local banks to enter rural markets. In addition, once banks acquire the appropriate skills, they can serve rural clients with their own funds.



BASIC INFO

Sources:

Refinancing facilities: IFAD introduces an innovation in rural finance development (IFAD, 2008)

Project Names:

Rural Finance and Small Enterprise Development Project (Moldova)
Agricultural Financial Services Project (Macedonia)
Rural Areas Economic Development Programme (Armenia)

Project Starting Dates:

2001 (Moldova), 2003 (Macedonia) and 2006 (Armenia)

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WEB PAGES

IFAD operations in NENA and CEN:

<http://www.ifad.org/operations/projects/regions/pn/index.htm>

IFAD learning notes:

<http://www.ifad.org/rural/learningnotes/index.htm>

Refinancing facilities (IFAD publication):

<http://www.ifad.org/pub/pn/financing.htm>

IFAD case studies:

<http://rpr.ifad.org/node/248>
(username and password: "guest")

Background

Radical changes shook the political, social, economic and financial systems of the newly independent countries in Eastern Europe and the former Soviet Union following the collapse of socialism early in the 1990s. The transition from centrally controlled systems meant that emerging economies had to create completely new institutions and systems.

Initially, IFAD's interventions in financial markets in the newly independent countries followed established patterns based on lines of credit or support to microfinance. As the financial systems of these countries developed, the challenge was to find a better, more appropriate approach.

IFAD developed an innovative way to sustain rural investments, shifting support to national financial systems as a whole and injecting longer-term investment capital through highly concessional loans into these systems to speed up rural growth.

Refinancing operations started in Moldova, Macedonia and Armenia in 2001, 2003 and 2006, respectively. IFAD's loans and grants for these refinancing facilities form the core of the Fund's investments in these countries.

The Nuts and Bolts of Refinancing

The size of the refinancing loans ranges from US\$2,000 to US\$150,000 (€200,000 in Macedonia). This is in order to cater for all actors in rural supply chains – from the farmer to the processing company.

Policies on interest rates charged for refinancing and lending vary significantly across countries and are in line with market-based criteria and government policies at the time of intervention. Policies concerning credit risk and collateral are similar in all three countries. Banks bear the full credit risk and establish collateral

requirements. Refinancing facilities encourage banks to accept soft collateral (unregistered land, small business assets and household assets), particularly from farmers. As a result of the refinancing operations, banks in all three countries are moving towards more flexible, client-friendly collateral policies.

From Skepticism to Enthusiasm

The concept of refinancing was initially met with skepticism. However, it has delivered beyond expectations to quickly become the main financial tool supporting rural investments in all three countries. Since start-up, the cumulative refinancing amounts to US\$22.6 million in Moldova, €11.5 million in Macedonia, and US\$7.1 million in Armenia – and recovery rates are as high as 98.5 per cent, 96 per cent and 98 per cent, respectively.

The success of this new approach has recently attracted substantial co-financing. For instance, Macedonia's refinancing facility has been allocated €21.2 million by the World Bank, €20 million by the European Investment Bank, and US\$850,000 by the Swedish International Development Agency. Also, Armenia's refinancing facility has been allocated US\$6 million by the World Bank and US\$8.5 million by the Millennium Challenge Corporation.

Impact on Farmers

In Moldova, the completion report for the Rural Finance and Small Enterprise Development Project estimates that 8,500 farmers and 220 large farming enterprises have gained access to markets by selling produce to enterprises financed through the project's Small Enterprise Development Fund (SEDF). In addition, refinanced loans have had an indirect impact on low-income rural populations. SEDF activities have benefited an estimated 26,500 rural households by enabling them to lease

their land to larger-scale farmers financed under the facility.

In Macedonia, an impact evaluation for the first year after loan disbursement shows that for a sample of 934 farmer borrowers, the average family business income increased by 30 per cent. A smaller sample of 301 borrowers for the second year showed an average income increase of 60 per cent over the base year.

In Armenia, the 2007 impact survey shows good development impact on farms financed under the refinancing facility. Over the two-year survey period, revenues in small farm households rose by 168 per cent in the first year and by 17 per cent in the second. Small farms employed more labour as they expanded operations, from an average 31 days of seasonal labour per farm per year to 150 days per farm by 2007.

Replication and Scaling Up

The impact of the financed investments on farmers' incomes, companies and rural value chains has exceeded expectations. The market-based refinancing model in rural finance has various advantages that make it an interesting option for future interventions in the financial sector worldwide. While refinancing facilities have worked well in these three countries, their replication in other countries and regions would require IFAD to partner with a number of well-managed, regulated financial institutions that demonstrate a solid interest in expanding their operations in rural areas.

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