



## Economic development and employment

# Rural finance systems; financing agriculture and SMEs

### The challenge

Access to financial services in urban regions has steadily improved in recent years, even for poorer population groups and small and medium-sized enterprises (SMEs). In rural areas on the other hand, access to professional, needs-driven financial services continues to pose a challenge. The majority of the population of many of the partner nations in which The Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH is active on behalf of the German Federal Ministry for Economic Cooperation and Development (BMZ) lives in rural areas. As agriculture accounts for more than half the gross national product of many countries, it follows that innovative, sustainable solutions for rural development must also embrace the improvement of financial systems.

Problems of low population density, long distances and covariant risks such as extreme weather events further restrict access to financial services in rural areas. Agricultural financing and the provision of services suited to farms and SMEs pose additional unique challenges. The financing of agricultural production and downstream value-creating processes require banks to understand – and adapt to – the particular features of seasonal production cycles. The availability of risk reduction tools such as savings, guarantees, insurance products and leasing is often a critical factor in credit-granting decisions.

An additional challenge for SMEs is that their loans are often larger than traditional microfinance loans. As SMEs are unable to offer adequate security, special methods such as cash flow-based lending are called for. However, the knowledge of such methods is usually lacking in conventional security-based lending.

### Our approach

GIZ is involved in the search for and implementation of sustainable solutions aimed at providing households and businesses in rural areas or in the agricultural sector with financial services. Particular focus directed towards providing advice on the granting of loans, money transfers, building up savings, and insurance.

Our projects endeavour to provide financial institutions such as savings and credit cooperatives, microfinance institutions, commercial banks and specialised public-sector agricultural or development banks with specific financial knowledge. This enables them to reliably deliver efficient services and products, and to implement professional portfolio and risk management systems. We also provide advice on the introduction of innovative and consumer-driven products or product mixes. In addition, the regulatory conditions and supervisory framework of the financial institutions involved need to be adapted, and the structures of associations and cooperatives need to be strengthened.

New technology-based approaches open up prospects, in particular for remote regions. GIZ is working towards making money transfers possible where banks do not have a physical presence – by using networks of agents or mobile banking, for instance. Protective regulation, training and consumer protection are particularly challenging issues in this respect.

Projects aimed at developing the financial system are often embedded in programmes for sustainable economic development, poverty reduction and strengthening the role of women.



## Our services

The approach adopted depends on the economic structure of the particular rural region, the banking industry conditions, and the policy and regulatory framework.

GIZ assists in the development of lending and deposit departments in savings banks, agricultural banks, commercial banks, cooperative banks and microfinance banks. We provide advice to selected financial institutions regarding the introduction of needs-based financial products for rural households, agricultural production operations and small family businesses. We are particularly committed to improving the financial literacy of the rural population and to ensuring the sustainable use of migrant remittances.

We strengthen regional and national associations and service institutions. We support credit cooperatives or bank branches in rural areas by offering our expertise on such matters as cost control, standardisation and software-supported reporting systems, training and deposit protection.

Cooperation with academies and universities boosts the transfer of knowledge. In this respect GIZ works together with the German Savings Bank Foundation for International Cooperation and the German Cooperative and Raiffeisen Confederation (DGRV). Business models and financing models are developed jointly with the stakeholders and financial institutions and introduced along value chains.

We build capacity at central banks by providing advice on aspects of regulation and supervision for specialised financial institutions such as microfinance or cooperative banks.

## The benefits

Effective and economically robust financial institutions are indispensable to sustainable, broad-based economic development in rural regions, and in the agricultural sector in particular.

The introduction of appropriate financial products can enable rural enterprises, for example, to expand their productive capacity by investing in machinery, factory premises or livestock housing. Family operations can purchase seed and fertiliser. The rural economy overall receives a boost.

## A practical example

Uganda's agricultural sector, the country's largest source of employment, lacks access to suitable financial services. Financial institutions are conservative in their dealings with customers in rural areas. Their appraisal of the costs and risks of agricultural lending and, in particular, financing for production purposes is excessively high. A lack of knowledge about the agricultural sector and its value chains is one of the main reasons for this situation. In view of these constraints, GIZ offers support at several levels. We support inter-ministerial and private-sector discussions of policy issues through an interdisciplinary panel comprised of representatives from the general public and from private finance and agriculture. Together with the Bank of Uganda and the Plan for the Modernization of Agriculture, GIZ developed the Uganda Agricultural Finance Yearbook, a centralised knowledge project which it now produces independently. This publication showcases current issues, campaigns, successes and failures arising from cooperation between the financial sector and agriculture. The compilation and analysis of data, together with practical examples of support for agricultural investment, is steadily improving links between the financial and agricultural sector in Uganda.

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