Policy Brief
ELLA Area: Economic Development
ELLA Theme: Microfinance

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Evidence and lessons from Latin America

Rural finance has the potential to help poor people out of poverty, and Latin America has met that challenge in some unique ways.

EXPANDING MICROFINANCE IN LATIN AMERICA'S RURAL AREAS

SUMMARY

The inclusion of rural people in financial markets has long been a social objective pursued in developing countries around the world. Indeed, microfinance's pioneering work was first targeted at rural areas. This Brief begins by discussing microfinance's impacts in rural areas, presenting evidence on rural poverty as well as on microfinance's positive effects on consumption and investment in education. We then describe the evolution of rural microfinance in Latin America, before presenting some key Latin American experiences that aim to increase rural peoples' access, not only to credit, but to a range of financial services and products. We provide a view on adaptations to credit technology used in urban areas for application in rural finance, and emphasise the importance of risk management in order to expand outreach. The Brief concludes with lessons learned from the region.

THE COMMON CHALLENGE OF RURAL ACCESS TO FINANCE

About one fifth of the population in Latin America and the Caribbean live in rural areas, a relatively low proportion when compared with other developing country regions (see Table 1), though still significant. As Figure 1 shows, poverty tends to be disproportionately concentrated in rural areas, although in Latin America, like in the Middle East and East Asia, the proportion has declined significantly over the past two decades. It is worth noting, however, that this percentage is driven by the largest countries, Brazil and Argentina. In other countries, such as Guatemala, Mexico and Peru, the rural poor represent at least 80% of the total poor.

Financial inclusion of rural people holds much promise as a solution, but access to formal credit in the region is still very limited. For instance, Wenner and Proenza (2002) show that, in Latin America, between 4% (Peru) and 40% (Costa Rica) of people living in rural areas have access to credit from formal sources.[1] Trivelli and Venero (2007) show that this situation has not changed substantially after the 2000s.[2] That being said, there are interesting and successful examples coming from the region that are worth sharing.

[1] Wenner, M., Proenza, F. 2002. Financiamiento Rural en América Latina y el Caribe: Desafíos y Oportunidades (Rural Finance in Latin America and the Caribbean: Challenges and Opportunities). In: Wenner, D., Alvarado, J., Galarza, F. (eds.) *Prácticas Prometedoras en Finanzas Rurales: Experiencias en América Latina y el Caribe (Promising Practices in Rural Finance: Experiences in Latin America and the Carribean)*. CEPES, Lima.
[2] Trivelli, C., Venero, H. 2007. *Banca de Desarrollo para el Agro: Experiencias en Curso en América Latina (Agro Development Bank: Experiences Underway in Latin America)*. Instituto de Estudios Peruanos (IEP), Lima.

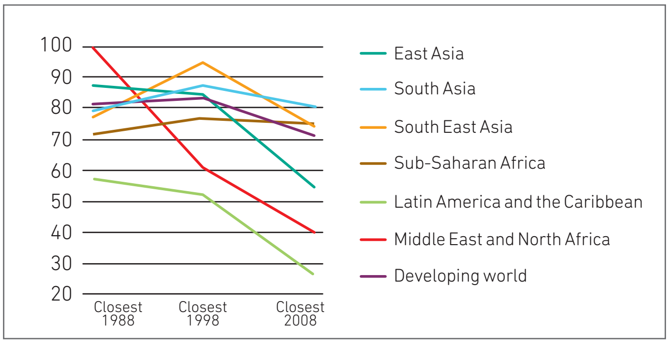
Table 1: Rural Inhabitants as Percentage of Total Population

South Asia	70%
Sub-Saharan Africa	63%
East Asia & Pacific	55%
Middle East & North Africa	42%
Latin America & Caribbean	21%

Own elaboration.
Source: World Bank. 2011. World Development Indicators 2010. World Bank, Washington, DC.

In Latin America, as elsewhere, lack of access to finance often limits people's chances to escape and stay out of poverty, reducing investment in the human capital of their children, thus perpetuating the cycle of poverty. Lack of access to financial resources may also increase vulnerability due to external shocks, limiting the development of economic activities with positive returns as families become more risk averse.[3] Constraints to the expansion of financial services in rural areas include population dispersion and lack of basic infrastructure, which increase the costs of making financial services available to rural areas and discourage private investment. These are in turn linked to another constraint, which is the lack of adequately trained people to operate microfinance services in remote areas. Other constraints are related to circumstances specific to rural areas, like seasonality, price fluctuations and climatic risks. Finally, there is a policy-created constraint: the availability of subsidised or targeted credit from state-owned banks or donor projects, which inhibits the growth of a sustainable private microfinance market.

Figure 1: Rural Share of Total Poverty (Rural people as percentage of those living on less than US$ 1.25/day)



Source: IFAD. 2011. Poverty Report 2011. International Fund for Agricultural Development (IFAD), Rome.

IMPACTS OF RURAL MICROFINANCE: WHAT IS THE EVIDENCE?

A recent systematic review of studies of microfinance concludes that "almost all impact evaluations of microfinance suffer from weak methodologies and inadequate data".[4] This conclusion underlines the methodological and practical difficulties of implementing rigorous evaluations. In spite of its importance in the world of development, evidence of microfinance's effectiveness is limited. The study is a call for more and better research. However, as the authors acknowledge, clearly there is a demand for credit and other financial services, one that a dynamic and flexible microfinance industry that is adapted to local rural realities may make accessible to poor households.

For instance, in Latin America there is evidence of microfinance having a positive impact on such variables as firm revenue, employment and fixed assets.[5] There is also evidence that microcredit may have a positive impact on children's education. In effect, all studies explored in a recent survey of microfinance impacts in Latin America find positive and significant impacts of microcredit on education. For example, Maldonado and Gonzalez-Vega (2008) compared clients who have been engaged in microfinance for some time to new clients in rural Bolivia and found that children of these longer-term clients have about half to a quarter of a year less of a schooling gap than children from new client households.[6]

McIntosh *et al.* (2008) examined data from 1,672 rural households accessing microfinance in Guatemala, India, and Ghana.[7] Using econometric models, they found that after credit provision in the village, the probability of investing in housing improvements and making business investments increases two and three-fold, respectively.

EVOLVING PARADIGMS OF RURAL FINANCE

Before turning to Latin America's efforts to extend access to finance to rural areas, we first present a brief description of how rural microfinance approaches have shifted over time.

[3] Ibid.
[4] Duvendack, M. *et al.* 2011. What is the Evidence of the Impact of Microfinance on the Well-being of Poor People? EPPI Centre, Social Science Research Unit, Institute of Education, University of London, London.
[5] Gutierrez, C., Soarez, F. 2011. What is the Evidence on Microfinance Impact? A Review of Microfinance Impact Evaluations in Latin America and the Caribbean. Working paper. Multilateral Investment Fund Member of the IDB Group (FOMIN), Washington, DC. The study analyses published evidence of impact evaluations of microcredit and microcredit plus additional services, and impacts related to savings and new technologies in Latin America, covering 20 impact assessment studies over the past 13 years.
[6] Maldonado, J., González-Vega, C. 2008. Impact of Microfinance on Schooling: Evidence from Poor Rural Households in Bolivia. *World Development* 36(11) 2440-2455.
[7] McIntosh, C., Villaran, G., Wydick, B. 2008. Microfinance and Home Improvement: Using Retrospective Panel Data to Measure Program Effects on Fundamental Events. University of California, San Diego.

The concern with making credit accessible to rural households is not new. Drawing on the framework of Nagarajan and Meyer (2005), attempts to boost rural finance development policies have gone through three distinct phases: the old rural finance paradigm, a transition phase embodied in 'the microfinance revolution', and a new emerging paradigm incorporating lessons from the previous efforts.[8] Though the evolution was broadly international, we focus on how these phases played out in the Latin America region.

From First Efforts at Rural Finance to the 'Microfinance Revolution'

In the 1960s and 1970s, rural credit projects began to appear around the world, especially in Asia and Latin America. Confronted with the need to address the special costs and risks related to rural finance so that formal institutions could enter the market, governments and donors decided to take action. Proponents advocated for five main types of interventions: lending requirements and quotas on banks and other financial institutions; refinancing schemes; loans at preferential interest rates; credit guarantees; and finally, targeted lending by development finance institutions (DFIs).

A key feature of these programmes is that they were expected to promote agricultural development. Subsidised interest rates, loan waivers and forgiveness programmes were also used to reduce the debt burden under special circumstances. Some examples from Latin America include *BancoAgrario* in Peru, *Bandesa* in Guatemala[9] and *Banrural* in Mexico. Results, however, were far from those expected by policymakers. Policies implemented in some cases actually increased inequality in rural areas. Even if banks reached many new rural clients, they tended to offer the most resources to clients better-linked to the government, without much concern for costs. Credits were subsidised and used as a political instrument.

Regrettably, one of the consequences of this paradigm was loan write-offs, that is, debt remission. For example, in Ecuador between 1988 and 1998, eight laws were passed sanctioning loan write-offs in *Banco Nacional Fomento*, an entity which even today seems to be operating under this paradigm.[10] Colombia and Brazil offer other examples; between 1966 and 1983, Brazil's subsidies had grown to be the same amount as its export taxation,[11] and in Colombia – the next largest subsidiser – credit subsidies represented a third of taxes raised from exports.[12]

Over time, the old paradigm came to be viewed as generating a number of inefficiencies, while exacerbating social inequalities. Some key lessons emerged, such as that rural credit should move beyond just agriculture, weaknesses in financial institutions should be addressed, interest rate subsidies should be eliminated, and other financial services, such as savings and insurance, are also important. Although these lessons can be generalised to other regions that followed this paradigm, Latin America's poor record has brought out lessons that had been internalised over time.

Emerging from these lessons came 'the microfinance revolution'. In the late 1970s, previous failures caused a paradigm shift, leading to the appearance of NGOs and credit unions. The new approach was based upon small, short-term loans with a gradually expanding credit line, depending on the compliance of borrowers. In time, some MFIs proved to be sustainable and helped promote innovations in urban and rural areas. This paradigm mostly targeted the poor, and was different from the old paradigm in that getting to know the economic performance of customers, as well as their economic activities, even if informal, was given substantially greater weight. However, in Latin America the preferred targeted market was the unattended demand of small business entrepreneurs.

The New Rural Finance Paradigm

The new paradigm began in the late 1980s and was in full development by the mid-1990s.[13] This new way of thinking emphasises finance as a way to expand outreach to rural areas instead of treating it as a policy tool targeted to specific markets. Thus, financial services are valuable per se, because they allow efficient production and stable consumption, while at the same time lowering transaction costs. In Latin America, significant economic reforms were implemented between

[8] Nagarajan, G., Meyer, R. 2005. *Rural Finance: Recent Advances and Emerging Lessons, Debates, and Opportunities*. Reformatted version of Working Paper AEDE-WP-0041-05, Department of Agricultural, Environmental, and Development Economics, Ohio State University, Columbus.
[9] After later transforming into a bank of mixed capital, it changed its name to BANRURAL.
[10] Trivelli, C., Venero, H., 2007, above n 2.
[11] Anderson, K., Valdés, A. 2007. *Distortions to Agricultural Incentives in Latin America*. Agricultural Distortions Working Paper 60.World Bank, Washington, DC.
[12] Shiff, M., Valdés, A. 1992. *The Political Economy of Agricultural Pricing Policy: A World Bank Comparative Study*. World Bank, Washington, DC.
[13] Gonzales-Vega, C. 2003. *Deepening Rural Financial Markets: Macroeconomic, Policy and Political Dimensions*.Ohio State University, Columbus.

the late 1980s and the beginning of the 1990s,[14] so this new microfinance paradigm appeared later than in other regions, emerging after reforms were in place.

Focusing on market development, the goal of the new approach in rural microfinance is to create efficient financial markets that promote factor productivity, better resource allocation and improved management of risks. Within this approach, policies are orientated to establishing a suitable environment for the development of rural finance, including a favourable policy environment and macroeconomic stability, strengthened legal and regulatory frameworks, and institutional capacity-building to deliver demand-driven services that are self-sustaining.

LATIN AMERICA'S RURAL FINANCE EXPERIENCE

Under the new paradigm, MFIs adopted practices to reduce risks and costs so that rural finance could also be a profitable business of scale, as in urban areas. The following section introduces innovative practices from the region related to risk management, staff policies, products and services implemented in rural areas.

Risk Management

Like in the urban environment, evaluation of repayment capacity in rural areas is more important than collateral. Key questions when granting a loan in rural areas of Latin America are related to destination of capital lent, competitiveness of borrowers, business strategies, effectiveness of the management team and revenues forecast to service the newly acquired debt.[15]

A survey conducted by the Inter-American Development Bank (IDB) of 42 financial institutions in Latin America with rural portfolios documents some of the key strategies for reducing and coping with portfolio credit risk in rural areas of Latin America.[16] Among the most important risk management policies the study cites are: geographic, sector and crop diversification; loan size limits (rationing); business or farm size limits; joint liability loan contracts; graduated lending and termination incentives; activity or product exclusion lists; linkage of savings to credit approval; reliance on guarantee funds; reliance on Donor Trust Funds; portfolio securitisation; and, finally, credit insurance.

The survey highlights some of the advantages and disadvantages of these strategies. One key feature that emerges is the preference for portfolio diversification between agricultural and non-agricultural activities: less than 40% of the total loan portfolio was agricultural. Also, the analysis shows that when there is less diversification, meaning when agriculture portfolio shares are higher, delinquency rates are also higher.

BOX 3: SUSTAINABILITY THROUGH STRONG RISK MANAGEMENT: SPOTLIGHT ON AGRICULTURAL LENDING IN GUATEMALA AND PERU

The IDB study by Wennet *et al.* (2007) highlights the risk management strategies in use in four MFIs: Banrural S.A. and *Fundación para el Desarrollo Empresarial y Agrícola* (FUNDEA) in Guatemala; and CMAC Sullana and EDPYME Confianza in Peru. Both CMAC Sullana and EDPYME Confianza are non-bank MFIs, while Banrural S.A is a commercial bank and FUNDEA is an NGO. In each of these, the share of their agricultural portfolio has been rising steadily, which is often an indicator of the sustainability of operations. At the time of the study, the share of the agricultural portfolio was 11.4% in Banrural S.A (US$ 81.7 million), 15.2% in CMAC Sullana (US$ 11.6 million), 14% in EDPYME Confianza (US$ 3.1 million) and 39% in FUNDEA (US$ 3.0 million).

Institutions in the study tended to be well-diversified, profitable, and enjoy high asset quality in both their general and agricultural portfolios. Success was related to diversification strategies, achievement of scale, well-proven credit evaluation technology and retention of skilled and motivated staff. An interesting feature of all four institutions is the perception that price risk faced by actual and potential clients is a more serious concern than climatic risks. This may be because price hedging and insurance are not widely available in Latin America, and there is a persistent belief in the region that climate risks can be managed through a combination of portfolio diversification and limits on the size of the agricultural portfolio. The portfolio limits on agricultural portfolio for the four cases are as follows:

- Banrural S.A.: None
- CMAC Sullana: Maximum of 20%
- EDPYME Confianza: Maximum of 20%
- FUNDEA: Between 40 – 45%

Source: Wenner, M. et al. 2007. *Managing Credit Risk in Rural Financial Institutions in Latin America*. Inter-American Development Bank (IDB), Washington, DC.

[14] To learn more about these reforms and their impact on the microfinance sector, read the ELLA Brief: Latin America's Institutional Innovation for Microfinance Growth.
[15] Wenner, M. *et al.* 2007. *Managing Credit Risk in Rural Financial Institutions in Latin America*. Inter-American Development Bank (IDB), Washington, DC.
[16] Ibid.

Lending Technologies: Adapting from Urban Settings

In Latin America, the key institutional innovations have not come from technological equipment, but rather through the broader concept of technology, understood as the combination of well-trained staff with adequate operational processes to use technological equipment efficiently.[17] This rationale also applies to rural finance, where microfinance is even more labour-intensive, in Latin America's experience.

Staff and Operations Strategies

Preferred staff in rural MFIs have tertiary education and skills in accounting, finance and economics. Moreover, all institutions use performance incentives in the form of bonuses that can be equal to up to the base salary.

Table 2 highlights the strategies in use from the four case studies discussed earlier. Cash flows and sensitivity analysis, preference for households with diversified flows of income, repayment incentives and direct monitoring of clients are also used in the region.

Table 2: Staff and Incentive Characteristics - 4 Case Studies

	Banrural S.A (Guatemala)	**CMAC Sullana (Peru)**	**EDPYME Confianza (Peru)**	**FUNDEA (Guatemala)**
Education	Majority secondary education, some technical degrees	100% university trained agronomists	50% university trained agronomists and 50% university trained economists	Majority technical and university level in accounting, agronomy and business
Bonuses	Yes. Up to 100% of base salary	Yes	Yes. Up to 100% of base salary,average is 50%	10-20% of base salary

Own elaboration.
Source: Wenner, M. et al. 2007. *Managing Credit Risk in Rural Financial Institutions in Latin America*. Inter-American Development Bank (IDB), Washington, DC.

Financiera Calpiá in El Salvador is one MFI known in Latin America for its success with lending technologies. Its success is attributed to the ability of the institution to adapt its services from urban to rural areas. The adaptation process starts from the distinction in skills and tenure of loan officers: rural loan officers usually hold an undergraduate degree in agricultural sciences from the National School of Agriculture (*Escuela Nacional de Agricultura* - ENA), so that they have a strong understanding of rural economic activities. In terms of evaluating clients, *Calpiá* uses two steps: a talk with clients to inform them about activities of *Calpilá* and their strict standards, so that there is self-selection of clients, and then a process of gathering information on them if the clients are still interested after the talk.

The latter step includes information about the client, his or her reputation, both from their contacts and from credit bureaus, and on-site monitoring.[18]

Reducing Transaction Costs Through ITs

Advances in processes of rural microfinance in Latin America, Asia and Africa include: mobile banking, and electronic banking.[19] The World Bank is presently supporting some mobile banking initiatives in countries like Peru, Colombia, Ecuador, Guatemala, Dominican Republic, Bolivia, Haiti and Panama. These initiatives seek financial inclusion, specifically in rural areas, through the diffusion of mobile phones.

Credit bureaus are also important to mention as part of the rural experience since they are used for credit analysis of managerial ability, reputation, financial viability and clients' character. Ecuador's *Red Financiera Rural* (Rural Finance Network - RFR) offers a good example of the effective use of credit bureaus in the region. RFR is an association of small financial intermediaries that promotes microfinance market development and provides technical assistance to members. RFR encouraged MFIs to enhance coverage through credit bureaus by offering legal and software training and delivering free report services about shared clients. As a result, starting in 2005 with only 2 participating MFIs, by 2007, 113 MFIs were using the credit bureau to share information on 159,000 clients.[20]

[17] This broader definition of technology is employed in the ELLA Brief: Latin American Innovations in Microfinance Technology, which includes much more detailed information about the range of technologies and innovative practices and processes implemented in the region.
[18] Navajas S., Gonzáles-Vega C. 2000. *Innovative Approaches to Rural Lending: Financiera Calpiá In El Salvador*. Ohio State University, Columbus.
[19] Nagarajan G., Meyer, R., 2005, above n 8. To learn more about mobile banking and electronic banking technologies, see the ELLA Brief: Latin American Innovations in Microfinance Technology.
[20] Bebczuk, R. 2008. Financial Inclusion in Latin America and the Caribbean: Review and Lessons. Working Paper No. 68. Centro de Estudios Distributivos, Laborales y Sociales (CEDLAS), La Plata. For more information about other technologies in rural as well as urban areas, see the ELLA Brief: Latin American Innovations in Microfinance Technology.

Products on Offer in Rural Areas

Financial products offered in rural areas also have particular characteristics when compared to those in urban areas. The most important features of rural microfinance products offered in Latin America are summarised as follows: [21]

1. Agricultural loans are larger and, due to seasonality, there are fewer repayments scheduled. Due to the volatile returns of agriculture projects, the debt capacity of farm-dependent households is more constrained.

2. Interest rates are lower due to suspected higher interest rate elasticities of demand that could lead to adverse selection.

3. Regulated entities offer larger loans than non-regulated entities, since their larger capital base means they can attract and mobilise deposits.

4. Most institutions tend to favour short-term working capital loans. Only 6.3% of regulated entities and 3.8% of non-regulated ones offered leasing, whereas 75%of regulated and 62% of non-regulated institutions offered fixed investment medium- and long-term loans.

5. The most common types of loans offered were individual. Group loans were a distant second; 91% of MFIs in rural areas offered individual loans, while 47% offered group loans. Village banking was even less common, being offered by only 34% of institutions.[22]

6. The most worrisome risks in the sector are political interference such as government debt forgiveness programmes, passage of usury laws, and mandatory refinancing of debt, meaning the macroeconomic environment plays an important role in the development of the sector.

It is well known that Latin American microfinance is not only about microcredit, but includes all types of products and services that can help customers enhance their economic performance, as well as providing valuable information about them and their economic activities. Here we outline some of the other common products offered in rural areas, focusing on savings, leasing, and other services such as micro-insurance and remittances.

Savings

Commercial banks offer deposits to poor clients, but not to the very poorest ones. Thus, the challenge is to provide these services to areas that are poor, remote and not highly populated. Savings offer an important risk management strategy in rural areas, providing security and liquidity, and may even be of more use to poor people than loans, as risk aversion to borrowing tends to be high. In addition, savings also benefit MFIs since their mobilisation can help expand outreach and thus contribute to sustainability and an increase in the public's confidence that may translate into more depositors.[23] *Banco Caja Social* (BCS) in Colombia is a case in point. BCS offers savings to 10% of the potential market and savers exceed borrowers four to one. Despite the market it serves, financial indicators such as ROA or ROE show high rates of return and high operational efficiency.

Despite the potential benefits of savings, institutions do not always have the proper incentives to develop adequate savings products, given the relatively high cost of supplying rural markets. Consequently, there is a lack of demand because of inflexible and inconvenient deposit products.[24] This is not uncommon in Latin America, as rural areas are characterised by lack of infrastructure, which diminishes institutions' incentives to operate. Coupled with rural peoples' distrust of new technologies, this tends to reduce demand, meaning the poor often use informal savings or other mechanisms to confront possible shocks.

Peru offers an interesting example of a successful effort to increase deposit and loan services in rural areas, through the Puno-Cuzco Corridor Project, launched in 2000 and funded by IFAD (International Fund for Agricultural Development). One specific successful output of the project was to promote savings among rural women. As of 31 December 2005, 3477 accounts had been opened by the same number of women in 185 savings groups. This led to an increase in their savings rate, enhancing their information on, and knowledge of, the

[21] Own elaboration by author, based on Wenner, M. et al. 2007. *Managing Credit Risk in Rural Financial Institutions in Latin America*. Inter-American Development Bank (IDB), Washington, DC.
[22] Village Banking is a model of microcredit where neighbours in a poor community form a borrowing group and are asked to save a percentage of their loan. The only collateral is that the other people in the group who will have to repay in noncompliance. For more information, see: FINCA, IFAD. *Village Banks: The New Generation*. FINCA, IFAD, online publication.
[23] See this document from CGAP which includes a case study from Colombia. Consultative Group to Assist the Poor (CGAP). 1998. *Savings Mobilisation Strategies: Lessons from Four Experiences*. CGAP, online publication.
[24] This has also been documented in Africa. See, for example: Chao-Béroff, R. 2003. *Rural Savings Mobilization in West Africa: Guard Against Shocks or Build an Asset Base?* MicroBanking Bulletin 916-18.

financial system, such as the rules and regulations governing financial institutions, and expanded their access to other services provided by the formal financial system. They had more cash available for investment and consumption as a result of the higher incomes generated by their business plans and profiles, most of which were successful.

Another proven source of deposit services in rural areas are savings banks. The model is undergoing rapid expansion because of its potential to improve access to financial services for the poor and improve insights into their financial behaviour. In El Salvador, a project recently started by the World Savings Banks Institute (WSBI) looks to establish offices with agents in at least half of the unbanked municipalities of the country, almost all of which have high levels of poverty. [25] Their goal is to double the number of savings accounts held by poor people.

Leasing

Leasing is an interesting option for facilitating access to credit. Though leasing is beginning to gain more popularity, it is still underutilised in Latin America. In leasing, the provider (lessor) owns the equipment and permits the client (lessee) to use it in exchange for periodic payments. One example comes from John Deer in Mexico, which operates only in rural areas and provides leasing contracts for more than $25 million with a portfolio at risk of 3.9% (30 days). Leased equipment includes tractors, power tillers, water pumps, rice hullers, dairy processing equipment and maize-milling equipment. The *Asociación Nacional Ecuménica de Desarrollo* (National Ecumenical Development Association - ANED) in Bolivia also offers leasing for agricultural-based enterprises in small towns adjacent to villages, although its leasing portfolio only represents 8% of its total loans.

Needless to say, leasing requires an enabling environment, including a clear legal basis and minimal regulation. Some necessary elements in the legal framework are "clear definitions of a lease contract, leased assets, and responsibilities and rights of parties to a lease contract; clarity in allocating responsibility for liability of third-party losses arising out of the operation of leased assets; priority of lessor's claim over leased asset; and a framework for easy and fast repossession of leased assets". [26]

Other Services: Microinsurance

In addition to products offered, there have also been some advances in terms of services offered in the region. In particular, different types of insurance are now available, such as crop insurance, livestock insurance, life and health insurance, and credit-guarantee funds.[27] However, coverage is still low and serious challenges have been faced in providing access to insurance in the region. For example, Costa Rica's crop insurance, established in 1969 and underwritten by the *Instituto Nacional de Seguros* (National Insurance Institute - INS) operated until the mid-1980s with numerous deficiencies such as poor coverage, high geographic concentration of crops like basic grains, and operational losses due to substantial subsidies. Later, consumer subsidies were abolished and price gaps closed. By 1996, the social objectives of the insurance, including coverage, crop diversification and backing small producers in credit operations, had yet to be achieved.[28]

On the other hand, *Mapfre Seguros*, a major Spanish insurer present in 45 countries and particularly active in Latin America, has shown that insurance may be profitable in rural areas. Their success comes from generating insurance prices based on special mortality tables; making their products are demand-driven, by being based on the risks of their target populations; and offering new distribution mechanisms, such as through retail stores, utility companies, consumer goods companies and faith-based institutions. In Brazil alone, *Mapfre Seguros* has now insured 50,000 rural households. [29]

[25] World Savings Banks Institute (WSBI). 2011. *Estudio Comparativo de los Obstáculos que Deben Salvar las Cajas de Ahorros para Mejorar el Acceso de las Personas de Escasos Recursos a los Servicios de Ahorro (Comparative Study of the Obstacles that Savings Groups Must Face In Order to Improve Access to Savings Services for People with Limited Resources)*.WSBI, Brussels.; Angelow, W. *et al.* 2012. *Mass Retail Banking: How Savings Banks In Africa, Asia and Latin America can Provide Usable Services to the Poor*. World Savings Banks Institute (WSBI), Brussels.
[26] Nair, A. 2004. *Leasing: An Underutilized Tool in Rural Finance*. Agriculture and Rural Development Discussion Paper 7. World Bank, Washington, DC.
[27] Nagarajan G., Meyer, R., 2005, above n 8, 19.
[28] Gonzáles-Vega, C. Larde de Palomo, A., Loría M., Jiménez R., Quiroz, R. Alvarado, J., Galarza, F. Cajavilca, J. 2003. The Economic, Legal and Regulatory Environment: Deepening Rural Financial Markets. In Wenner, D., Alvarado, J., Galarza, F. (eds.) *Promising Practices in Rural Finance: Experiences from Latin America and the Caribbean.* Centro Peruano de Estudios Sociales, Inter-American Development Bank, Academia de Centroamérica.
[29] Goldberg, M., Palladini, E. 2010. *Microfinance: Managing Risks and Creating Value with Microfinance*.World Bank, Washington, DC.

ENABLING FACTORS

UNDERPINNING THE SUCCESSFUL EXPANSION INTO RURAL AREAS

The shift in microfinance paradigms – in the region and internationally - has been an essential factor in increasing access to financial services in rural areas, although there is still much to do in order to expand outreach. In particular, the new paradigm has led to innovation in technologies that has prompted expansion of microfinance in rural areas.

The development of microfinance in Latin American urban areas and the sustainability it achieved also stimulated increased microfinance activity in rural areas. This itself was facilitated by an adequate environment: a stable macro-economy; appropriate operational policies; clear property rights; and an adequate regulatory framework. Access to skilled labour and strong human resources also played an influencing role.

The upgrading of institutional capacity that allowed NGOs to become regulated and banks to engage in microfinance also helped in the process. This was again associated with the microfinance revolution.

Diversification in products offered by Latin American MFIs has contributed to making rural microfinance a sustainable and profitable business. These services include savings, leasing, as well as microinsurance, and have contributed to increasing demand in the rural microfinance markets.

LESSONS LEARNED

1. Rural areas need financial services for all types of economic activities, and these services should encompass more than credit. Latin America has shown that this is possible with proper risk management and other important practices mentioned above.

2. Since reducing transaction costs benefits all actors, innovation is essential for expanding outreach and achieving sustainability in rural microfinance. Innovation needs to be understood as development in technologies, services and products.

3. Differences between urban and rural credit technology emphasise the role of loan officers who can establish the kinds of client relationships that help build confidence and generate operational efficiency. In rural areas, it is recommended that loan officers have knowledge on agronomy and other rural economic activities. Other differences to be expected are fewer repayments scheduled, larger loan sizes and lower interest rates to avoid adverse selection.

4. Latin American experience shows that, within a microfinance context where small institutions largely dominate, larger institutions are able to diversify risks, offer a wider range of products, obtain better efficiency ratios and charge lower lending interest rates. Economies of scale and scope achieved by these institutions allow for better diversification of risk so that agricultural lending can be amplified. This likely indicates that prioritising growth and the diversification of institutions should be an important task for governments and donors providing support for the sector.

CONTACT GRADE

To learn more about Latin America's experience with microfinance in rural areas, contact the author: Miguel Jaramillo, PhD, Principal Researcher, GRADE, at mjaramillo@grade.org.pe.

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