

*Full Length Research Paper*

# The role, potential and constraints to development of rural financial markets in Zimbabwe

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Accepted 18 April, 2013

**This paper discusses the role, potential and constraints to development of rural financial markets in Zimbabwe. Zimbabwe has witnessed an increase in activity by rural microfinance players as a reaction to the steady decline in the country's economic fortunes dating as far back as 1997. Rural finance comprises credit, savings and insurance (or insurance substitutes) in rural areas, whether provided through formal or informal mechanisms. Zimbabwean rural households and businesses save money for a variety of reasons including life-cycle demands such as births, children's education, lobola (bride-price), establishing a home, smoothing out consumption, emergencies, and to finance investment opportunities. Poor rural folks borrow primarily from micro-finance institutions, from family and friends, and to a lesser extent commercial banks with rural outlets (for example, Agribank). The potential for the development of rural financial markets is constrained by weak or non-existent linkages between rural financial service providers and established rural institutions, particularly those that facilitate market access. Other constraints include vulnerability constraints such as systemic, market and credit risks; operational constraints due to low returns to investment, low asset levels, low investment levels; and geographic dispersion of potential users of rural financial services. Capacity constraints include low infrastructural capacity, technical capacity and training, social exclusion, and institutional capacity. Political and regulatory constraints also inhibit or limit development potential of rural financial markets and these include political and social interference in the rural microfinance sector and the legal and regulatory framework. The absence of financial and other incentives for formal financial institutions to operate in remote rural areas also results in limited development potential. In addition, rural economies have more volatile cash flows, and are home to economic agents with low risk-bearing ability, and are highly vulnerable to economic and natural shocks due to higher incidence and depth of poverty.**

**Key words:** Potential, household, constraint, finance.

## INTRODUCTION

Zimbabwe is home to a population of 13.2 million people, of which 70% live in rural areas and at least 72% live in poverty (Klinkhamer, 2009). The country witnessed an increase in activity by rural microfinance players as a reaction to a steady decline of the country's economic fortunes since 1997. This is because microfinance tends to thrive in developing countries where there is an increase in unemployment and poverty (Klinkhamer, 2009). As people seek to engage in informal sector activities (small, household-based, unregistered economic entities) to survive, there is a growing demand

for small loans for business, education, agricultural inputs, micro-leasing and also for micro-insurance.

Rural finance comprises credit, savings and insurance (or insurance substitutes) in rural areas, whether provided through formal or informal mechanisms

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(Macheka and Malaba, 2009). The word “credit” tends to be associated with enterprise development, whereas rural finance also includes savings and insurance mechanisms used by the poor to protect and to stabilize their families and livelihoods (not just their businesses). An understanding of rural finance helps explain the livelihood strategies and priorities of the rural poor.

Microfinance is the response to market failure in “conventional” banking services for the rural poor. It responds to the needs of low-income households. Sound schemes tend to be characterized by small, short-term loans, and savings mechanisms; simplified loan appraisal procedures; innovative approaches to collateral; rapid approval/ disbursement of repeat loans after repayment; high transaction costs; high repayment rates; and savings and loan services provided at a location and time convenient to the poor (Macheka and Malaba, 2009).

In partnership with the Government of Zimbabwe, organizations such as the UNDP have already begun to support microfinance institutions offering assistance to small enterprises and poor households in both urban and rural areas (Pearson and Hungwe, 1997). UNDP has achieved this by providing technical assistance to the Social Development Fund which, among other mandates, has a Microenterprise Development Program of on-lending to microfinance institutions. However, despite the high demand and the initial surge in microfinance service providers, the supply of rural finance has been drying up since 2004 and more so since 2007, with the closure of many providers and the complete halting of operations of most others (Klinkhamer, 2009). The economic meltdown which hit Zimbabwe left only a handful of financial institutions lending by the end of 2008.

## METHODOLOGY

This paper is based on information obtained from a survey of secondary sources of data. These included journal articles, published research reports, institutional publications, books, and the internet.

## RESULTS

### **The importance of rural financial markets in development**

Rural financial sector development promotes economic growth and can also reduce poverty (DFID, 2004). Rural finance is important to the poor. The poorest rural groups spend the highest proportion of their income on food (typically more than 60% and sometimes as much as 90%). Under these circumstances, any drop in earnings, or any additional expenditure (for example, health or funeral costs) has immediate consequences for family welfare, unless savings or loans can be accessed. Financial transactions are therefore an integral part of the livelihood system of the poor (Macheka and Malaba,

2009).

There is a strong correlation between the level of financial savings and national economic growth. Savings are important as they allow households to maintain precautionary balance against shocks. Households can also build cash collateral and a track record of savings will allow them easier access to credit (Mar and Onumah, 2004). Most rural communities lack secure and accessible deposit facilities and, consequently, savings are held as cash or assets (for example, livestock and building materials). Such savings are harder to mobilize and do not increase the availability of loanable funds. Rural entrepreneurs therefore find it difficult to access funds and have to rely largely on self-financing if they want to invest (Mar and Onumah, 2004).

The need for credit to support development of agriculture-based livelihoods has long been stressed, particularly as a justification for the state and donor supported subsidized credit programmes (World Bank, 2004). However, the rural economy is financially very fragile. Lack of credit is a significant and sometimes binding constraint, limiting investment in productivity-enhancing technology and inputs. Finance is also required for commodity marketing, sometimes through inventory-backed financing, which offers rural producers, traders and processors of the opportunity to improve household income through adopting better produce marketing and raw material procurement strategies (Coulter and Onumah, 2002).

Access to payment systems offered by financial institutions allows rural producers and traders to participate in modern, efficient commodity trading systems that offer better prices. Financial institutions should ideally provide low-cost and accessible channels for transfer of remittances (for example, migrant wages), which are crucial to the coping strategies of many rural households (Orozco, 2003).

Rural finance plays a critical role in household strategies to reduce vulnerability. It assists the poor to smooth consumption and to build up assets greater than the value of the liability (Gonzalez-Vega, 2003). This is particularly important for the rural poor, since agricultural incomes and rural health fluctuate widely and could destabilize consumption if households have no savings or credit to fall back on (IFAD, 2003; World Bank, 2004). Furthermore, rural households lack sufficient access to formal insurance, relying instead primarily on informal safety nets. Improved access to insurance could reduce enterprise and household risks, and make investment in the rural economy more attractive, contributing to growth and poverty reduction (Skees, 2003; Von Pischke, 2003).

The majority of the poorest households in Zimbabwe are directly or indirectly linked to agriculture for their food security and livelihoods. In addition, rural populations are also expected to feed urban populations and contribute to the nation’s food reserves and provide raw materials for urban industries. Therefore, agriculture must be placed at

the top of the nation's development agenda. Zimbabwe critically needs great investments in agriculture, not only in public finance investments but also in commercial ones. Agriculture and the environment upon which its activities are carried out are however dynamic. Therefore, technological advancements and innovations within agriculture also require major financial flows in terms of both development finance and commercial loans.

### **Lending policy of MFIs and client borrowing criteria for microfinance**

Reducing arrears is crucial for microfinance institutions (MFIs) to achieve self-sufficiency. MFIs must understand the causes of arrears. These could include an assessment by clients of the MFI determination to administer loan repayments; crises in clients' lives; issuing loans that are too large and therefore beyond the capacity of the clients to repay; or loans given on the basis of favouritism (Norell, 2004). Prevailing approaches to reduce arrears among Zimbabwean MFIs include following up late loans quickly, forming strong solidarity groups, updating and enforcing credit policies, focusing credit officers' services on specific geographic scope, not lending to start-up businesses, and providing financial incentives for credit officers. In critical arrears situations, MFIs often stop lending to new clients until portfolio quality improves, as well as ascertain or critically appraise clients' ability to repay loans (Norell, 2004).

### **Structure of demand for rural financial services in Zimbabwe**

Determining the demand for the various types of financial services among low-income households is one of the most important aspects of developing a financial sector strategy. Low income households in Zimbabwe are located predominantly in the rural sector. The most commonly known financial service for low income households in Zimbabwe is microcredit (Klinkhamer, 2009). It refers to small loans that are accessible to people who have traditionally been excluded from formal financial services. Microcredit does not refer to a specific methodology, but rather the provision of credit services to low-income people. This may range from group and individual business loans to consumption loans for low-income employed populations. Microcredit clients typically have limited collateral (Klinkhamer, 2009), and thus its techniques depend on alternative guarantees such as social collateral or moveable assets.

The National Microfinance Survey and Proposed Legal and Regulatory Framework, commissioned by the Reserve Bank of Zimbabwe in 2005, found demand for business, education, food and shelter loans to be in high demand (Ernst and Young, 2006). Most of the available information on demand for loans concerns enterprise loans. Only 10% of manufacturing, commercial and

services (MSEs) in Zimbabwe had access to loans in 1998, of which 4.2% is from family/friends, 1.4% is from formal credit sources (12,000 MSEs), 1.1% is from so-called microloan programs (9,400 MSEs), and the rest from other sources (McPherson, 1998). It was found that formal credit seldom went to women. The microloan program, on the other hand, primarily served women. The percentage of MSEs with access to credit was roughly the same among agriculture and mining MSEs (10.8%), but varied widely per activity. Among cotton growers, 35.7% had received some form of credit, while 16% of maize and multiple crop growers had also received credit. However, those working in cattle, poultry-raising and mining were less likely to have access to credit (McPherson, 1998).

The survey by the National Task Force on Microfinance indicated that the formal financial system provides services to only about 30% of the economically active population. The remaining 70% are excluded from access to formal financial services. This 70% is often served by the informal financial sector, through microfinance institutions, moneylenders, friends, relatives, and credit unions (RBZ, 2008).

Besides demand for business loans, low-income households in Zimbabwe also seek loans to pay school fees for their children. Payment of school fees is normally due in January, right after the festive season and at a time when people are generally short of cash. With the dollarization of the economy, and school fees now being paid in hard currency, it has become even harder for low-income households to send their children to school without education loans (Klinkhamer, 2009).

There is also a high demand for housing loans among low-income households in Zimbabwe. The demand exists in the form of housing improvement loans (for example, windows, doors, plastering or roofing) to assist in finishing houses that have already been built. Demand also exists for the acquisition of sites and services, and loans for complete house construction or for the cost of purchasing a house (Klinkhamer, 2009). What people really want are more cost-effective housing options, to enable them to meet other needs such as education for their children, and other important household demands. Linkages between technical NGOs such as Housing People of Zimbabwe and existing housing cooperatives in Zimbabwe provide useful synergies. The NGOs provide technical expertise and training to housing groups (these need not necessarily be registered as cooperatives), while microfinance service providers can process the funding.

The rapid growth of microfinance services in the form of moneylenders during the early 2000s evidences the interest in consumer finance in Zimbabwe. However, because of the economic malaise, the demand has decreased dramatically, and many moneylenders have shifted their product offerings to loans for businesses.

The main constraint faced by agriculture and mining

enterprises in a nationwide survey conducted in Zimbabwe in 1998 was lack of inputs (26.4%), followed by the constraints of finance problems (19.1%) (DAI/PWC/ USAID, 1998). This translates into 84,422 enterprises. These data were captured before the major land reforms since 2000, which dramatically changed the country's farming situation. There are currently an estimated 1.1 million smallholder farmers. Smallholders are in need of both short-term and medium-term finance.

Micro-savings are deposit services that allow low-income savers to keep small amounts of money for future use. Often with very low or no minimum balance requirements, savings accounts allow households to save in order to meet unexpected expenses and plan for future investments. They may be offered by formal, regulated institutions such as commercial banks, or by informal, member-owned and managed institutions, such as Rotating Savings and Credit Associations. For those Zimbabweans who do save, they do so for a variety of reasons including life-cycle demands such as births, children's education, lobola (bride-price), establishing a home, consumption smoothing, emergencies, and to finance investment opportunities. This broad range implies that savings accounts are important for emergency savers, while structured savings products (for example, regular, small deposits) are appropriate to assist savers to build assets to invest in a business or for education. The savings for death seem to supersede every other emergency. This is evidenced in the high incidence of funeral and burial insurance or savings schemes among the poor in Zimbabwe. Low income households in Zimbabwe want to save with formal, semi-formal as well as informal institutions. The informal mechanisms that were identified during a 2001 Microsave study on savings behavior, when inflation was still somewhat contained, are burial societies, savings clubs and Rotating Savings and Credit Associations (ROSCAs), savings at home and in kind, reciprocal lending, and savings with employers (Microsave, 2001).

The poor in Zimbabwe also borrow from family and friends (Macheka and Malaba, 2009). This is an extremely important source of finance, but is inadequate in situations where everyone's need arises at the same time (for example, purchasing seasonal inputs, or replanting late because the rains have failed).

### **Rural initiatives of financial institutions**

The list of commercial banks offering financial services in Zimbabwe includes the CBZ Bank, Barclays Bank, Standard Chartered Bank, Kingdom Bank, Stanbic, ZABG, Trust Bank, People's Own Savings Bank (POSB), FBC Bank, TN Bank, ZB Bank, and Agribank. Commercial banks generally find that opening branches in rural areas does not make much business sense, general concerns for banks in Zimbabwe are high information, transaction and monitoring costs;

inaccessibility due to poor infrastructure networks; dispersed and intermittent demand for financial services; seasonality in deposits; and lack of acceptable collateral in the absence of legal title to land (RBZ, 2007).

A prime concern in Zimbabwe is the security of property rights. Lack of clarity in land titles is also a concern for using land as collateral security against loans. Rural operations and in particular agricultural loans suffer from the covariant risk, meaning that in the case of a natural disaster, all farmers in an area could be affected. Credit risk is exacerbated by operational risk, as institutions have difficulty recruiting highly qualified and experienced staff who opt to reside and work in rural areas (Klinkhamer, 2009). As a result, the bulk (90%) of the number of commercial bank retail branch network in Zimbabwe is located in urban centres to serve a clientele constituting as little as 30% of the national population. The opposite is true for rural areas, where only 10% (in terms of numbers) of the branches serve the bulk (70%) of the national population who reside there (RBZ, 2006). In terms of agricultural finance, Kingdom Financial Holdings and MicroKing, Standard Chartered, Stanbic, FSB, ZABG and Agribank are all involved in financing agriculture. However, commercial banks do not generally finance individual small-scale farmers with landholdings of less than 5 ha (SNV, 2009).

In Zimbabwe, there are three categories of non-bank financial institutions and these are building societies, asset management companies and money-lending institutions. Money-lending institutions include moneylenders that are primarily offering consumption lending services, and microfinance institutions (MFIs) that are usually started as NGOs with enterprise lending products (ZAMFI, 2009).

Although moneylenders are operating primarily in urban areas, some of the development-oriented microfinance service providers used to have quite a bit of outreach into rural areas, with Zambuko Trust once having 30 rural branches (Klinkhamer, 2009). The Zimbabwe Self Help Development Foundation (SHDF) works primarily in rural areas, and its agro-traders are among the main clientele. Pundutso is active in financing goats, heifers and small livestock, and has some experience with drip irrigation. Moreover, they have started to give loans for grains, as well.

Pearson and Hungwe (1997) did an extensive study of organizations working in the microfinance sector for both rural and urban areas in Zimbabwe. They studied local NGOs working in the microfinance sector in Zimbabwe including the Collective Self-Financing Scheme (CSFS) (rural areas), Credit Against Poverty-Masvingo (CAP) (rural areas), Dondolo Mudonzvo (rural areas), Environment and Development Activities (ENDA) (rural areas), National Association of Cooperative Savings and Credit Unions of Zimbabwe (NASCUZ) (urban areas), Organization of Rural Associations for Progress (ORAP) (rural areas), Phakama Savings and Credit Cooperative

Society (rural and urban areas), Zambuko Trust (mainly rural areas), Zimbabwe Association of Microfinance Institutions (ZAMFI) (both rural and urban areas), Zimbabwe Ecumenical Church Loan Fund (ZECLOF) (both rural and urban areas), Zimbabwe Project Trust (ZPT) (rural areas), Zimbabwe Women's Bureau (ZWB) (rural and urban women's groups), and Zimbabwe Women's Finance Trust (ZWFT) (rural and urban women's groups) (Pearson and Hungwe, 1997).

Currently, there are not enough linkages with different types of partners that could stimulate rural finance. Linkages enable service providers with institutions that are already trusted by the farmers, as well as those that facilitate market access, as trust and market access are two important constraints in rural markets.

The Government of Zimbabwe in 1980 set up various development finance institutions to service micro, small, and medium enterprises. The institutions include the Zimbabwe Development Bank (ZDB), which is now the Infrastructure Development Bank of Zimbabwe (IDBZ), the Small Enterprise Development Corporation (SEDCO), and the smallholder development facility at the Agricultural Finance Corporation (AFC), now Agribank. Currently, Agribank is facing a problem of capitalization, and given that it is owned by the Ministry of Finance and the Ministry of Agriculture, it is not likely that funds will be injected in the near future. However, Agribank has the country's largest branch network, with 54 branches country-wide.

Contract farming has been practiced since a long time ago in Zimbabwe and with the changed farming system, it is likely to increase. An inventory undertaken by SNV found that the highest number of smallholders reached through this type of scheme is in the cotton sub-sector (77,000 for Cottco and 70,000 for Cargill). Cairns spices reach some 5,000 and Delta some 4,500 smallholders. With the surge in the contract farming modality, corresponding finance options are also expected to become a major source of funds (Dawes et al., 2007).

Klinkhamer (2009) listed some examples of contract farming finance and they are as follows. Cotton Ginners Association (CGA) has 25 contractors, who generally provide input packages in-kind to smallholders (seeds, chemicals, fertilizers, fuel), though there can be a small cash portion to pay for weeding, picking bags and wool packs. An agreed number of kilograms is deducted at marketing. Cairns Foods (vegetables) is a processing company that has been working with smallholders for over ten years. It provides loans through financial institutions (not in-kind like most contract farming arrangements). Honeywood Enterprises Canned Food (vegetables) provides chemicals and fertilizer. Repayment from the clientele occurs by deducting the cost of inputs before the product is delivered to the contractor. Mitchell and Mitchell is currently the packhouse operating the largest horticultural out-grower scheme in the country, working with some 500

smallholders (ZAMFI, 2009).

Selby Enterprises provides some 390 farmers in 12 groups with seed, fertilizers, chemicals, transport, packaging materials and packhouse facilities and extension. Inputs and services supplied are debited on the individual growers' account and recovered at replacement cost plus a 3% handling fee. Zimbabwe Tobacco Association (ZTA) links smallholder tobacco growers with processing and marketing companies that provide working capital. Finally, the Zimbabwe Tea Growers Association (ZTGA) provides fertilizer loans (SNV, 2009).

Among the community-based initiatives, CARE has a large program in Zimbabwe supporting the creation of community savings and loan clubs, mostly in remote rural areas. The program is called Kupfuma Ishungu and the model is referred to as the Internal Savings and Lending model or as Village Savings and Loans Groups. Some microfinance programs including Farm Community Trust of Zimbabwe are based on this methodology. This methodology has increasingly become respected as a simple yet effective way to reach rural communities around the world, particularly in Africa. The model offers savings and loans services to self-selected groups based in a village. After saving for eight weeks, groups can start to give loans to members with the share capital contributed to by the group (SNV, 2009).

### **The legal and regulatory framework**

The Government of Zimbabwe regulates financial institutions through a range of statutory instruments whose provisions are monitored in part by the Registrar of Banks in the Ministry of Finance and by the Reserve Bank of Zimbabwe (Pearson and Hungwe, 1997). A variety of laws directly or indirectly affect the supply of financial services to low-income markets in Zimbabwe, inclusive of rural areas. There are associated constraints with the different pieces of legislation in the development of rural financial markets in Zimbabwe (SNV, 2009). These legal instruments include the Moneylending and Rates of Interest Act (Chapter 14:14), Cooperative Societies Act (Chapter 24:05), Banking Law (Chapter 24:20), Building Society Act, Post Office Savings Bank Act, and the Reserve Bank Act. The RBZ regulates discount houses, commercial banks, merchant banks, finance houses, building societies, the Post Office Savings Bank, and unit trusts (mutual funds).

The Moneylending and Rates of Interest Act dates back to 1930, and its content is not attuned to the current times (Klinkhamer, 2009). This Act controls the largest number of registered microfinance service providers, all the moneylenders, and recently also the development-oriented microfinance service providers. Examples of concerns raised in connection with this Act include the following: First, the license is not really a license, as it has to be renewed every year. No investor will invest in

an entity that has such a short guaranteed lifespan as an ongoing concern. In addition, renewal requirements are excessive. Secondly, the Act stipulates “No lender shall stipulate for, demand or receive from the borrower interest that is greater than the prescribed rate of interest”. Interest rate controls have not proven to be an effective instrument for consumer protection and leads to a more limited and less responsive supply of financial services for low-income households. Competition is the best driver to ensure affordable interest rates, while offering services clients need.

In some countries, lower-income households, especially the poor, highly value savings, and Zimbabwe is no exception. However, this is not possible under this law, under which the largest number of microfinance service providers is now registered. Furthermore, although the Moneylending Act is a step in the right direction, with a graduated interest rate regime (yielding higher rates for smaller loans, and lower rates for larger loans), government controlled ceilings for the smaller loans may really not be high enough to encourage achievement of operational or financial sustainability in an average MFI in a reasonable amount of time.

The Banking Act is restrictive in that it contains a clause which states that no banking institutions shall engage in any business or activity other than the approved banking business. The country’s tax laws are also prohibitive to the development of an efficient rural finance sector.

Taxation is high in Zimbabwe; the income tax rate is 35% of profits. In terms of the country’s tax laws, it will be important to consider how to use taxes to encourage access to finance. Examples could include tax incentives for banks operating in remote areas, tax incentives for wholesale lending to microfinance service providers, or retail lending to the MSE sector.

### **Financial sector reform and rural financial markets**

The liberalization of the financial sector in Zimbabwe was an integral part of the Economic Structural Adjustment Programme (ESAP), a programme which was introduced by the government in 1991 and implemented until 1995. It was aimed at restructuring the economy from a predominantly state-interventionist type of economic management towards a more market-driven system. The adoption of ESAP and its successor programme, the Zimbabwe Programme for Economic and Social Transformation (1996-2000), was a notable trend in most African countries where the failure of “socialist” experiments and other models of state management of the economy, led to situations where countries had to resort to the World Bank and the International Monetary Fund (IMF) for financial support. The Structural Adjustment Programme (SAP) is typically the prerequisite for assistance from these two multilateral bodies (Moyo, 2001).

Prior to the introduction of the reforms, the financial sector was heavily controlled by the state. Interest rates were fixed by government (for example, lending rates to be charged by banks and deposit rates to savers); there were credit ceilings which channeled resources to specified sectors; and there were restrictions as to who could carry out banking business (Moyo, 2001). The sector was heavily segmented, with categories of institutions being confined to specified types of banking businesses (for example, that building societies could only engage in mortgage finance, commercial banks to provide short term funding for working capital, merchant banks for wholesale banking, etc).

In a paper analyzing the impact of financial sector liberalization on the poor in Zimbabwe, Moyo (1997) notes that contrary to expectations, liberalization of financial markets has not improved access to credit by the poor and other marginalized groups in both rural and urban areas.

Indeed, there were a number of new entrants and players in response to the market signals of liberalized markets. However, competition was not total, as the regulatory environment perpetuated segmentation and also made it particularly difficult for small players to enter the market and thus enhance their capacity to service the lower end of the market, particularly the rural poor and marginalized groups.

Fundamentally in fact, financial sector liberalization was not designed with poverty reduction as its thrust. The design and implementation of the programme made it quite evident that in fact, under circumstances prevailing in Zimbabwe, they were unlikely to reach the poor and marginalized.

The market by its nature benefits those who already have access to economic resources and information, and to those who are strategically located to take advantage of the opportunities offered by the market (that is those who are already gainfully employed, those residing in urban areas, or in the few rural communities well networked to benefit from national and international trade). It does not benefit the majority of the rural poor, who make up the bulk of the Zimbabwean population (Moyo, 2001).

A study by Chipika et al. (2000) established that financial reforms had a largely negative impact on agricultural credit in the rural districts of Zimbabwe. The results obtained from the study showed that quite clearly, financial sector reforms did not improve access to credit, they also increased the cost of credit, and individuals and households continued to rely to a large extent on own personal sources of finance.

The experience of Zimbabwe with financial sector liberalization points to the need to consciously establish financial institutions and markets designed to service the economically active poor. These should be an integral part of the formal financial system. It is worth noting that the emergence of the microfinance sector in Zimbabwe

coincides most closely with the introduction of reforms. Microfinance has emerged as a response to the failure of the formal sector to meet the needs of the MSEs and the informal sector. Unfortunately, until recently, the support of the microfinance sector has been minimal and this has therefore compounded the problem of lack of access to credit and other financial services (SAPRI, 2001).

### **Constraints to the development of rural financial markets**

Miller (2004) classifies the constraints faced in rural finance as: (i) vulnerability constraints, including systemic, market and credit risks; (ii) operational constraints due to low investment returns, low investment, low asset levels, and geographical dispersion; (iii) capacity constraints including infrastructural capacity, technical capacity and training, social exclusion and institutional capacity; and (iv) political and regulatory constraints, such as political and social interference and regulatory framework.

Clients for rural finance are more dispersed than urban clients due to lower population densities. They often demand relatively small loans and savings accounts, so per unit transaction costs are high for financial institutions. Information costs for providers and users of rural finance are higher because the rural transportation and communication infrastructure is usually less developed. Furthermore, rural incomes are subject to seasonality, and involve a slow turnover of economic activities that are risky. Agricultural loans are usually perceived as being less sound because of the production and marketing risks involved. Moreover, in rural areas, many non-farm and off-farm activities are invariably linked to farm activities. Therefore, non-farm and off-farm households are also subject to many risks that affect the agriculture sector, and this creates covariance in incomes (Macheka and Malaba, 2009).

Although rural households engage in a variety of enterprises, the concentration on similar, agriculturally related activities within restricted geographical locations results in high covariance of farm household incomes. Formal insurance mechanisms are generally absent to mitigate risks arising from covariant incomes (Conning and Kevane, 2004). As a result, local financial institutions are vulnerable to localized disasters.

In general, many rural clients have little acceptable loan collateral, either due to lack of assets or unclear property rights for the assets they do possess. Underdeveloped legal systems in rural areas are incapable of recognizing marketable property rights resulting in weak collateral and inadequate contract enforcement mechanisms. Inadequate regulation and supervision of financial intermediaries, limited lobbying power among the rural poor, weak governance, corruption, and other political factors also limit the provision of rural finance (Yaron et al., 1997). Opportunities still exist for expanding the

frontier of finance in rural areas, however, because of the high demand for financial services, the high level of social capital and collateral substitutes that are proxies for marketable physical collateral, and the informal mechanisms used to enforce contracts (Von Pischke, 2003).

In Zimbabwe and other Southern African countries, rural areas, as opposed to the urban areas, are characterized by higher transaction costs for both financial institutions and their clients. Such rural economies have higher systemic risks, more volatile cash flows, economic agents with lower risk-bearing ability and high vulnerability to economic and natural shocks due to higher incidence and depth of poverty (Macheka and Malaba, 2009).

### **DISCUSSION**

To rescue Zimbabwe's once growing microfinance sector, and rapidly build solid institutions well integrated into the financial sector with robust outreach into rural areas, various steps need to be taken by the various stakeholders.

Firstly, microfinance service providers will need to prepare bankable business plans, approach banks early to see what type of finance they would be prepared to offer, and also fundraise with the corporate world and donors. Merging is another strategy that could make it easier to overcome the current challenges faced. Products and delivery channels will need to change in the higher cost environment with a view to increasing efficiency. More efficient business models are also needed to reach a significantly larger customer base than was the case in the past, including hitherto underserved and unserved rural areas.

Secondly, the Zimbabwe Association of Micro Finance Institutions (ZAMFI) will need to revise their current work plan in view of the changed economic and political environment, set clear targets on how to build the industry, lobby for an enabling environment and industry infrastructure, restart information collection and dissemination through monthly updates on the ZAMFI website, including a mapping of the geographical coverage of the microfinance service providers. ZAMFI will also need to cooperate with Agribank and contract farming finance providers.

Thirdly, the Government of Zimbabwe should take immediate steps to halt microfinance service provider licensing renewal requirements and start working on removing other legal and regulatory obstacles preventing access to finance. This implies that advances need to be made to remove legal impediments in the area of savings and micro insurance, transactions and leasing instruments for MSEs, business loans including value chain finance as well as consumption finance and low income housing finance. Moreover, the single most important contribution that a government can make

towards building an inclusive financial sector is to create an enabling environment, at the enterprise and financial institution level.

Fourthly, donors need to make funding available for a short-term recovery package. This would save the remaining microfinance service providers from going down. It would also reduce donor dependency by enabling them to continue to reach the poor who can help themselves, before they become destitute and dependent on grants. For Zimbabwe, it is suggested that donors can pledge funds for different areas of interest such as rural/urban value chain finance, food security, micro-leasing, low income housing finance, supporting high HIV/AIDS incidence areas, empowerment of women, and support at the middle or macro-level.

Fifthly, measures should be taken to enhance agricultural value added by increasing access to financial services. Promoting appropriate financial services will require addressing many more challenges than in urban areas. This is the case because of the high cost of operating in less densely populated areas, lack of know-how, the need for medium and long term financing to mitigate risk, a new farming system without an industry infrastructure to support the new reality, and a complete lack of security due to land title issues and the disregard of property rights in Zimbabwe. To raise agricultural value added, the following are some of the potentially feasible measures that can be undertaken. A facility, or window of a facility that offers medium and long term funding for financial institutions expanding in rural areas should be established. Furthermore, tax incentives for banks and other financial institutions operating in rural areas should be provided. Information systems should also be established in preparation for weather-based insurance.

The experience of Zimbabwe with financial liberalization suggests that there is a need to develop strategies which cater for the development needs of some groups such as those poor and disadvantaged in rural areas and that the market by its nature, cannot be relied upon to perform such a role. People's financial markets, now embodied in the emerging and growing microfinance sector need to be supported by the national government, private sector and the donor community. These are markets which can grow and actually, their clients also tend to grow to a level where in fact, they become eligible for formal bank lending. This interrelatedness of formal and informal or developed and underdeveloped markets needs to be recognized and nurtured.

Government, through its information collection agency, Zimstat (formerly Central Statistical Office), can assist in collecting information on rural finance. Rural financial institutions have a difficult time gathering sufficient information about potential clients and managing that information efficiently. Improving the infrastructure for collecting, processing and sharing information will make smaller rural financial institutions more efficient and lower

lending costs. Improving information systems will help these institutions move along the path towards financial sustainability.

Of particular importance are the laws and institutions that either facilitate or inhibit secured lending by influencing the ease with which agricultural and other rural assets can be used as collateral. The legal environment for secured lending can be strengthened through collateral widening measures that codify land rights, promote legal reform for institutions, cooperatives, and NGOs, and expand borrowing laws to increase the participation of the poor. Improving the systems through which collateral can be provided and collected will open the door to a larger client base, while still protecting the interests of lenders.

Enhancing value-chain financing can also promote the development of rural financial markets. Input suppliers, processing firms, warehouses and other commercial actors in the agricultural and rural sectors provide critical financial services to small and medium rural producers. Enhancing existing, interlinked rural finance activities and facilitating new services by these actors can expand access to finance and ensure competitively priced rural financial services.

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