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## **RURAL FINANCE AND CREDIT ACCESS IN SOUTH-EASTERN BOSNIA AND HERZEGOVINA**

### **SUMMARY**

Many surveys carried out in last years in Bosnia and Herzegovina (BiH) showed that one of the most important problems faced by farmers and rural entrepreneurs is the lack of and/or difficult access to financial resources. The paper aims at analyzing rural finance and access to credit in south-eastern BiH. An exploratory survey was performed in March 2013 with 147 rural households from Vlasenica, Han Pijesak, Milici, Zvornik, Rogatica, Pale, Bratunac, Sokolac and Foca municipalities. About a half of the interviewees used loans for different purposes such as the purchase of agricultural equipment and machines, agricultural input, livestock and transport equipment and renovation of buildings but also for covering children education expenses or even for repayment of other debts. The interviewed rural households prefer borrowing from the formal sector (banks), followed by the informal sector (friends, relatives, private moneylender, supplier credits) then the semiformal sector (micro-finance institutions). Most rural people lack access to the range of financial services they need and those available to them are relatively costly or rigid. The interest rate is quite high and it is up to 12% yearly. The percentage of loan applications rejected is rather high. An important loan rejection reason is the lack of collaterals. Improving rural financial market in Bosnia has enormous potential to contribute to economic growth, poverty reduction and rural economy diversification. Therefore, public action and support is highly needed to make easier access to credits from formal institutions and to better structure and organize the semiformal financial sector.

**Keywords:** Rural finance, credit access, Bosnia and Herzegovina.

### **INTRODUCTION**

One cause of poverty is the lack of access to credit especially among rural households (Coleman and Wynne-Williams, 2006). Well-developed and inclusive financial systems are associated with more rapid growth. Finance helps extend the range of individuals, households, and firms that can get a foothold in the modern economy. Largely thanks to microfinance, there is now a growing appreciation of the “empowerment” dimension of finance (Basu, 2006).

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Paper presented at the 5<sup>th</sup> International Scientific Agricultural Symposium "AGROSYM 2014".

Notes: The authors declare that they have no conflicts of interest. Authorship Form signed online.

Most of rural people lack access to the range of financial services they need. Financial services available to them are relatively costly or rigid. Moreover, the main products of many microfinance institutions are not well-suited to seasonal or longer-term agricultural activities (CGAP, 2003). Traditionally, formal financial institutions (e.g. rural or agricultural development banks) have avoided or failed to offer sustainable services in rural areas. Thus, informal or semi-formal financial institutions as well as alternative providers like traders or input suppliers have become major providers of financial services (Richter, 2011). Financing of agriculture and agribusiness has always been difficult. Traditional forms of collateral are often not available, thus limiting access to needed funding for the sector (Winn et al., 2009).

Rural finance is the provision of financial services in rural areas that support a wide range of economic activities and households of various income levels. Rural communities could make use of a wide range of financial services (e.g. savings, insurance, loans) (Richter, 2011).

The lack of effective rural credit schemes hampers the efforts to increase the productivity and competitiveness of agricultural sector in Bosnia (EC, 2012). Access to credit by farmers in Bosnia and Herzegovina (BiH) is limited because of low coverage of financial institutions in poor municipalities, higher risks of service provision and limited availability of medium and long-term financing. Therefore, access to finance has been identified as an area of key vulnerability for the economic future of BiH (IFAD, 2011). The lack of favourable credit lines that are tailored to the specific characteristics and needs of agriculture is among the most often mentioned obstacles to the development of the sector. In Bosnia, rural population and entrepreneurs mostly face credit conditions and credit lines no different to any other business or person (Arcotrass et al., 2006).

Surveys carried out during the last years to get an insight into the diversification of rural livelihoods and economy in south-eastern Bosnia showed that one of the most important problems faced by farmers and rural entrepreneurs in their livelihood diversification endeavours is the lack of and/or difficult access to financial resources (e.g. FAO-ROECA, 2012; Berjan et al., 2010, 2013). According to FAO-ROECA (2012), the barriers to starting additional income generating activities in Bosnia are mostly economic. The lack of funding and access to credit is the barrier most frequently mentioned by Bosnian farmers. Rural dwellers and enterprises are not seen as attractive customers and banks do not have enough experience of the risks surrounding diversification activities and so are unable to evaluate business plans and credit requests. This makes interest rates very high. The conditions are better for microloans; that is, the interest rates are lower.

The paper aims at analysing rural finance and access of rural households to credit from the formal, semiformal and informal financial sectors in south-eastern BiH.

## MATERIAL AND METHODS

The paper is based on secondary data from an extended literature review and primary data collected by an exploratory questionnaire survey carried out in March 2013 with 147 rural households in nine municipalities of south-eastern Bosnia: Vlasenica, Han Pijesak, Milici, Zvornik, Rogatica, Pale, Bratunac, Sokolac and Foca.

The questionnaire helped collecting different types of data:

- General information about the interviewees: age; gender; role in household (head or member).

- Household characteristics: type of household (agricultural, non-agricultural, mixed); number of male and female members; level of education of household members.

- Rural finance: use of loans and purposes for using them; households borrowing preferences (formal, semiformal or informal sector); important characteristics of selected borrowing source.

- Access to credit from formal, semiformal and informal financial sectors: knowledge about financial institutions in the area; if any loan was obtained in the five past years; if no, the main reasons; number of loan applications done by household in the five past years; number of rejected applications; main reasons for rejection.

- Characteristics of credits/loans obtained during the last three years: borrower; number of times of borrowing from this lender; amount of credit; loan collateral; amount of the loan with respect to the request; credit use; date for repaying the loan; loan interest rate.

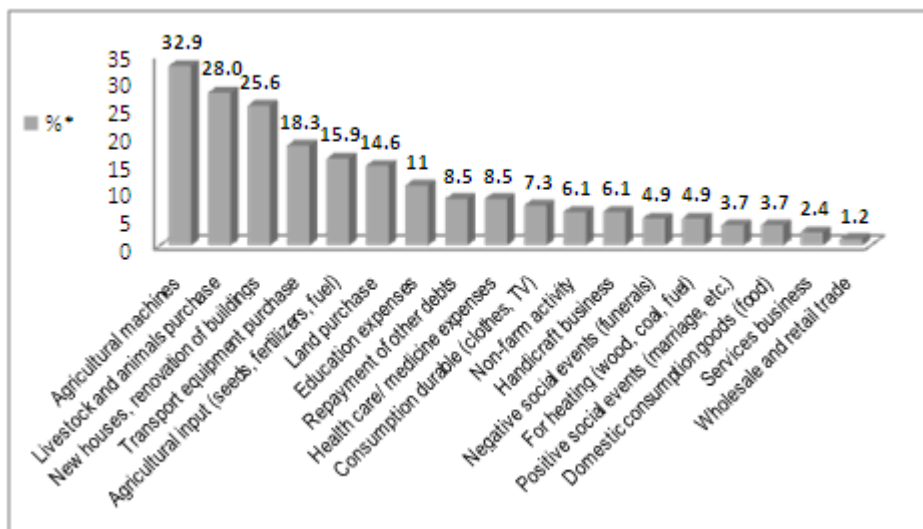
The formal financial sector refers to banks, savings and credit unions; in the semiformal sector are included micro-finance institutions, NGOs, associations, village savings and credit groups while the informal sector refers to friends, neighbours, family, relatives, private moneylenders, village revolving funds and supplier credits.

The average age of the interviewees was 47.4 (minimum: 19; maximum: 70). The majority of the respondents were males (91.2%). Almost all the interviewees were rural households' heads (89.2%). Nevertheless, 15 respondents were not but they deal with financial management in their households so they were entitled to answer the questions. Regarding household structure, the number of household members ranges from one to 14. As for education level, 4.7% are illiterate while the rest have different education levels (primary school: 26.9%, secondary school: 17.7%, high school: 37.6%, and university: 13.1%).

The majority of households considered in the present field survey (68.7%) were mixed households that's to say that their livelihoods are based on both farm and non-farm income-generating activities. Meanwhile, 6.8% of the target households consider themselves as non-agricultural.

## RESULTS AND DISCUSSION

About a half of the interviewees (44.2%) used loans for different purposes such as the purchase of agricultural equipment and machines, agricultural input, livestock and animals and transport vehicles, and renovation of buildings but also for covering children education expenses or even for repayment of other debts (Figure 1).



\*Multiple answers were possible. Source: Authors' survey

Figure 1. Purposes for using loans.

Rural dwellers involved in activities related to economic diversification have different investment needs. Generally speaking investment needs can be categorized as follows (FAO-ROECA, 2012): investment in new technologies (e.g. equipment, storage facilities); investment in new tourism facilities (e.g. restaurants and accommodation facilities in order to meet EU standards); investment in marketing (e.g. marketing materials, websites and marketing strategies). Farmers normally take out loans to buy machinery, supplies or raw materials, or to build greenhouses or buy perennial plants (FAO-ROECA, 2012).

About a half (49%) of the surveyed rural households prefer borrowing from the formal sector, followed by the informal sector (43.5%) while only 7.5% of the interviewees prefer borrowing from the semiformal sector.

Different important characteristics are valued by the interviewees when they decide borrowing and they determine the choice of a borrowing source or another. These are in decreasing order: interest rate (68.7%), low collateral requirements (27.9%), flexible repayment terms (24.5%), confidence a loan will be made (23.8%), short time for credit approval (22.4%), simple loan procedures (21.8%), long-term loan availability (15%), friendliness of the person making the loan (9.5%) and short time/distance to the loan provider (0.7%). It is clear that interest rate is the most important factor.

#### *Banking and micro-finance sectors in Bosnia*

For a small country with two separate entities, BiH has a multifaceted banking and microfinance sector. There are 20 banks in the Federation and 10 banks in operation in the RS. Furthermore, there are at least 25 Microcredit Organizations (MCOs) which are both for profit and non-profit (IFAD, 2011).

Bearing in mind that there are no agricultural or rural credit institutions that deal exclusively with agriculture and other rural businesses in BiH, there are two sources from which rural individuals, collectives and enterprises can get short-term credits under the same conditions as any other applicant. One of these sources is the commercial banking sector, and the other is the micro-finance institutions. One comforting fact is that the whole of BiH is well covered with banking institutions and micro-finance institutions and their branch offices, so at least rural areas have physical access to existing credit lines, and can be properly informed about them (Arcotrass et al., 2006). In both Republika Srpska (RS) and the Federation of Bosnia and Herzegovina (FBiH) the majority of the farmers gain financial support from banks. In FBiH microcredit organizations have gained more popularity than in RS (FAO-ROECA, 2012).

The Banks record of agricultural lending is poor and most rural dwellers find bank loans inaccessible. Some banks started lending in rural areas after international organizations (e.g. EU, KfW, EBRD, USAID, and IFAD) provided credit lines or grants for agricultural lending. While some banks (e.g. NLB Tuzlanska Banka, Nova Bank AD, BOR bank, Bobar Bank Bijeljina, Bosnia Bank International Sarajevo, ProCredit Bank) are able to provide short-term loans, the agriculture and rural sector also requires medium and long-term loans which the banking sector is unable to provide from its existing sources of finance which are typically short-term deposits (IFAD, 2011). Most commercial banks in Bosnia have gradually developed special credit lines for small and medium enterprises, which can be applied for agro-businesses, too. Interest rates for long-term credits are too high for both agricultural producers and other rural businesses (Arcotrass et al., 2006).

Microcredit organizations (foundations or companies) are a relatively recent development in BiH. All of the micro-credit organizations that there are now were established in the post war period, mainly due to help from international financial and humanitarian organizations. By the end of 2010 BiH had approximately 25 micro-credit organizations (FAO-ROECA, 2012). The main role of micro-financing institutions lies in the fact that they serve the clients who do not have collateral and have low income or no income whatsoever (Arcotrass et al., 2006). Micro-finance Institutions (MFI) in BiH rely mainly on funds from different international and local governmental and non-governmental organizations and institutions (e.g. WB, EU, USAID, GTZ, Federal Investment Bank) (IFAD, 2011; Arcotrass et al., 2006). The network of MFI covers the whole territory of BiH and they offer credits that amount 250 – 15,000 EURO for agricultural producers and cooperatives, rural groups and individuals and entrepreneurs (Arcotrass et al., 2006). It is estimated that micro-credit organizations make loans of between 200 and 300 million Bosnian Convertible Marks (BAM) per year (FAO-ROECA, 2012).

Loan characteristics and credit access conditions change a lot mainly depending on the selected financial sector: formal, semiformal or informal sector.

*Access to loans from the formal financial sector*

It is surprising that only 85% of the interviewees know at least one formal financial institution (bank). The percentage is even lower (46.9%) when it is matter about those that obtained a loan from a bank since 2007 (5 past years). The reasons for not applying for any loan are different and sometimes multiple: risk of not being able of paying back the loan (71.8%), enough own money (25.6%), interest rate too high (4.1%), not knowing how to invest borrowed money (5.1%), feeling that application would be rejected (health, age or other reasons) (2.6%), banks too far (0.7%) and application procedure too complicated (3.8%).

Many households presented more than one loan application for banks since 2007: twice (23.3%), three times (9.6%), four times (1.2%) and more times (1.2%). Unfortunately, out of the surveyed rural households that did loan applications since 2007 only for 81.2% no application was rejected while the remaining have seen their applications rejected once (10.1%), twice (5.8%) or even three times (2.9%) in the same period. The main reasons for rejection are: total lack of collateral (38.4%), no enough collateral (15.4%) and no investment possibilities and weak business plan (7.7%). According to FAO-ROECA (2012), an important loans rejection reason is the lack of collaterals. Farmers mention mortgages and having to find guarantors as other obstacles. Another issue that complicates access to funding relates to ownership. Women and young people in BiH face difficulties in getting loans since they are rarely the owners of the land or assets on which they want to make investments. Ownership is often a prerequisite for getting a loan.

*Access to loan from the semiformal and informal sectors*

Due to barriers to accessing bank loans, virtually the only source of loans that many farmers have are loans from micro credit organizations (FAO-ROECA, 2012). About two thirds (62.2%) of the interviewees obtained at least a loan from informal and semiformal lenders since 2007. The main reasons for not applying for any loan from the semiformal and informal financial sectors are in decreasing order: risk of not being able of paying back the loan (80.6%), interest rate too high (74.2%), enough own money (19.4%), no idea on how to invest borrowed money (16.1%), too complicated application procedure (12.9%), already having a credit from a bank (12.9%), feeling that application would be rejected (3.2%), semiformal institutions too far (3.2%). The rejection rate is little lower than in the case of the formal sector (9.7%). Among the interviewees that applied to loans only 49% applied just once since 2007 while the other applied twice or more times. It goes without saying that for many of them also applications have been rejected more than once. The reasons for which applications were rejected are similar to those listed for the formal sector and again the main reason is the lack of collaterals. However, in addition to these, especially in the case of some informal lenders, no justification of application rejection was provided.

Credits obtained from formal, semiformal and informal sectors in the last three years. More than two thirds (69.5%) of the surveyed rural households obtained at least one credit in the last three years mainly from different banks (Nova bank, NLB Development bank, Raiffeisen bank, Hipo Alpe Adria bank, Pavlović bank, Banjalučka bank, Poljoprivredna bank, Unicredit bank, Nova Banjalučka bank) and micro-credit organizations (Mikrokredit partner, Mikrofin, Mi-Bospo, EKI, Partner) as well as some informal lenders such as friends, neighbors, relatives, shopkeepers and private businessman.

The amount of borrowed money ranges from 800 to 60.000 BAM. In general the loan was the same amount asked for. The period for the payoff of the whole credit ranges from three months to more than ten years. They used as collaterals mainly wages, valuable goods, properties and estates. The interest rate is rather high and it is up to 12% yearly. For that borrowers have to pay too much money over credits to lenders. Given that interest rates in most formal credit markets are in the range of 10–24%, many potentially profitable projects are not undertaken in rural areas (Coleman and Wynne-Williams, 2006). The interest rates that micro-credit organizations charge to agricultural enterprises are relatively high and have increased in recent times. In the FBiH, the weighted average effective interest rate on long-term agricultural loans was 33 percent. It was 25 percent for short-term loans (FAO-ROECA, 2012).

## CONCLUSIONS

The formal sector (banks) and semiformal sector (microfinance institutions) are currently not meeting the demand for financial services of many Bosnian rural households. The lack of credit lines tailor-made for agriculture and other rural businesses is probably the most often mentioned obstacle and missing link in the development of Bosnian agriculture and rural economy. Access of rural households to financial services is a prerequisite for creating an enabling environment for fostering Bosnian rural economy diversification. Entities should continue to support rural finance initiatives through improvements in the policy, legal, and regulatory environment. They should also attract foreign investment in the microfinance sector. Microfinance donors and practitioners should ensure that their microfinance initiatives follow good practices and focus on sustainability from the outset. A greater variety of rural finance institutions will help meet the needs of a diverse rural population. Allowing market forces to meet this demand, under an enabling framework created by Entities, will be the most effective way of achieving this objective.

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