



## **Rural Livelihood Diversification in South-Eastern Bosnia: Influence of Household Financial Management**

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**Abstract** A growing body of evidence shows that agriculture is no more sufficient to ensure sustainable rural development in Bosnia and Herzegovina (BiH) therefore rural livelihoods diversification is crucial. Farm activity diversification issue can be considered in terms of resources (land, labor or capital), location (on-farm or off-farm) and output (farm or non-farm). Well-developed financial systems are associated with more rapid and inclusive rural development and foster rural economy diversification. The paper aims at analyzing rural livelihoods diversification in south-eastern BiH with a particular focus on the influence of household financial management. The paper is based on an extended literature review and a questionnaire survey performed in March 2013 with 147 randomly selected rural households from nine municipalities in south-eastern BiH. The majority of the surveyed rural households (68.7%) have mixed (farm and non-farm) livelihoods. Household sources of income are quite diversified and many rural households have different non-farm income sources. More than two-fifths of the surveyed households had an activity on development or started new non-farm businesses in the last five years. However, about a half of these gave up because of many problems such as the lack of financial resources and time. Weak business skills are also a limiting factor. Financial literacy is often lower in rural areas. Moreover, it is positively associated to education level and negatively correlated to age. It comes no surprise that well educated and young rural people are those who started more new diversification businesses during the last five years. They find it less difficult to deal with paperwork, bureaucratic procedures and administrative documentation needed to make request for loans. Effective household financial management, depending mainly on household head financial skills, plays a significant role in determining livelihoods strategies and diversification endeavors success.

**Keywords** rural finance, household financial management, livelihood diversification, Bosnia

## **INTRODUCTION**

Agriculture is no more sufficient to ensure the sustainable development of rural areas that's why rural economy should be diversified (Antonelli et al., 2009; Haggblade et al., 2007; OECD, 2006). The framework provided by OECD (2009) considers the issue of farm household diversification by differentiating between activities in terms of resources (factors of production: land, labor or capital), location (on-farm or off-farm) and output (agricultural or non-agricultural). The major differentiation between activities is made on the basis of the location of the activities, either on-farm or off-farm. Within each location, diversification activities are further differentiated as to the type of output, whether agricultural production or continuation (e.g. processing of food or providing contracting services).

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 European Union's standards); investment in marketing (e.g. marketing materials, websites and marketing strategies). Therefore, they use often loans and have different needs in terms of financial services.

One cause of poverty is the lack of access to credit, especially among rural households (Coleman and Wynne-Williams, 2006). A growing evidence body shows that well-developed and inclusive financial systems are associated with more rapid growth and better income distribution. Finance helps extend the range of individuals, households, and firms that can get a foothold in the modern economy (Basu, 2006). According to Richter (2011), 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 like savings, money transfer services, insurance products, loans, leasing, factoring, loan guarantees, venture capital, and investment funds.

Budgets for agriculture and rural development of the Bosnian Entities - Republika Srpska (RS) and Federation of Bosnia and Herzegovina (FBiH) - remain low. Subsidies to farmers are mainly product-based. The lack of an efficient administration and effective rural credit schemes hamper the efforts to increase the productivity and competitiveness of the sector (EC, 2012).

The paper aims at analyzing the influence of household financial management on rural livelihoods diversification in south-eastern Bosnia and Herzegovina (BiH).

## **METHODOLOGY**

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

The questionnaire dealt with different issues including:

- 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; age structure; level of education of household members.
- Household livelihood diversification: household sources of income; main occupations of household members; sources of household primary income; significance of income from agriculture (main income, additional income, no income from agriculture); attempts to start new non-agricultural businesses to improve household financial situation; kinds of businesses tried out; main problems and constraints faced.
- Financial management of rural households: household financial manager's age, gender, educational level and occupation; membership in saving/credit groups.

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% of household members are illiterate while the rest have different education levels (primary school: 26.9%, secondary school: 17.7%, high school: 37.6%, and high education diploma: 13.1%).

## RESULTS AND DISCUSSION

### Livelihood Diversification Strategies

The majority of the 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.

Household livelihood strategies are quite diversified and many rural households have different farm and non-farm income sources. Nevertheless, the most important sources of income are crop production and animal husbandry, pensions, salaried work and wage labor (Table 1).

**Table 1 Sources of income of rural households**

Source of income	%*	Source of income	%*
Crop and animal production	62.6	Non-farm self-employment or businesses	5.4
Pensions	36.7	Handicraft	4.8
Salaried work	34.7	Trade	2.7
Wage labor	26.5	Land and property renting	1.4
Services provision	16.3	Social aid and assistance	0.7
Forestry	8.8	Industry	0.7

\*Multiple answers were possible.

Source: Authors' elaboration based on the field survey results.

Despite the fact that about two-thirds of the surveyed rural households deal with agriculture (crop production and animal husbandry) the percentage of households whose primary income source is outside of agriculture is quite high. In fact, about a third of the target households (33.2%) declared that income from self-employment or business ownership is their primary income source. Other important primary income sources are salaried work (48.2%) and income from wage labor (18.6%). However, it should be highlighted that salaried work, and to a certain extent, also wage labor, includes also agriculture-related activities. In fact, income from agriculture is the main income for 24.5% of the surveyed households and additional income for 63.3% of them.

More than two-fifths of the surveyed households (40.8%) had an activity on development or started new non-farm and off-farm businesses and activities in the last five years to improve their financial situation and livelihoods. Of these, only about a half (51.7%) still deal with the non-farm activities that they have started up. The main off-farm and non-farm activities that the surveyed rural households tried out during the last years are handicraft (23.3%) and trade (23.3%). Other developed income-generating activities include: food processing, transport, rural tourism, timber and non-timber forest products collection, services provision (equipment and machines), teaching and wood processing.

### Effect of Access to Credit and Household Financial Management on Livelihood Diversification

About a half of the surveyed rural households in south-eastern Bosnia that invested in new diversification activities gave up because of many problems especially lack and/or difficult access

to funding and loans and lack of time to deal with new activities. 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 that 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.

One reason for which some loans requests were rejected was age of applicants. The age of the surveyed households' financial managers ranges from 22 to 71 (average: 48.1 years). Females represent just 8.8% of the household financial managers. According to FAO-ROECA (2012), 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.

Another important loans rejection reason is also the lack of collaterals. Many Bosnian mentioned lack of access to financing (including savings) as the main obstacle to livelihood diversification. Farmers mention mortgages and having to find guarantors as other obstacles (FAO-ROECA, 2012).

Nevertheless, many rural households' heads do not even apply for loans because the application procedure is too complicated for them. This is true not only regarding loans but also for other administrative procedures (e.g. for getting subsidies). Another rejection reason is the presentation of bad quality business plans. This also explains why many diversification endeavors are hampered by the lack of market since most rural people do not carry any feasibility study. All showed the importance of the human capital of the household financial manager.

Only 7.5% of the interviewed household financial managers have high education diploma, most of them have secondary school levels while 12.9% stopped their education at primary school. Only a very small percentage of the financial managers (2.1%) are illiterate. Regarding the occupation of household financial managers, 23.8% are government employees, 25.9% are retired, 15.6% are self-employed, and 11.6% are private company employees. Others are unemployed and housekeepers.

Many factors influence the diversification of farm households into non-farm activities, including government intervention (OECD, 2009). Prerequisites for encouraging private investments include improving the business climate, and providing business development and financial services suited to the needs of small rural entrepreneurs. Acquiring a labor force with appropriate skills is crucial. Strengthening the rural people's capabilities to take advantage of opportunities in the rural non-farm economy is essential. Education and skills are particularly important (IFAD, 2010).

According to the Working Group on Diversification of the British Department for Environment, Food and Rural Affairs (DEFRA, 2007), key barriers to farm diversification include validity of market research, capacity to develop a considered business case, quality of business skills and training, availability of appropriately skilled personnel and regulatory controls, and access to specialist business advice. Access to finance was also identified as a potential barrier.

According to Richter (2011), in general, levels of financial literacy are often low in rural areas so it is important to promote a finance culture among rural populations through awareness campaigns, financial education trainings or experience/testimony-sharing.

Diversification endeavors success is influenced by financial literacy. Control of financial resources can improve good management practices. By learning how to manage their enterprises better, women, as well as men, can become more capable of controlling their economic activities and thereby better able to evaluate their resources (Sudan, 2007).

Rural people tend to operate not just with one but with several livelihood activities. They often switch from one to the other even within the same day and also by seasons. Diversification makes even more complicated financial management as households with mixed livelihoods should manage variable cash flows and match income and expenditure requirements by saving and borrowing from different sources (CARE India & FAO, 2007).

Lack of experience is another problem that was faced by many Bosnian rural households that tried to diversify their livelihoods. In fact, many rural Bosnian people were forced to start new

businesses for which they had no experience prior to the civil war, or were faced with high competition and were selling their products almost at a loss to the food processing factories. They would have needed skills to start something new that the market needed. Bosnian rural households are nowadays aware of the fact that also in agriculture it is especially important to follow technology and to obtain technical assistance so as to be able to develop a business plan, minimize risks and put aside profit from the business. Education on how to run such businesses is of utmost importance. Risk in agriculture is always high and one has to gain experience so as to minimize its impact once it occurs (Matul & Tsilikounas, 2004).

Difficult access to funding is aggravated by the fact that only 12.9% of the surveyed rural households are members in saving/credit groups such as “Mali akcionari” (small shareholders) and “Mali poljoprivrednik” (small farmers) organizations, microcredit foundation “EKI”, and Mikrofin. Micro-credit in BiH stimulated household reconstruction as it provided an efficient and long lasting coping mechanism for households after the war. For most clients micro-credit helped at least to sustain their household self-employment activities (Matul & Tsilikounas, 2004).

Membership in local financial groups helps developing financial management skills. As Sudan (2007) points out, regular micro-credit clients adopt good management practices more substantially, in particular with regard to calculating profits on the basis of records. In fact, the clients are more inclined to use costs and earnings records than are non-client group. The clients appear better able to estimate their sales, expenditure and profits than those in the non-client group. The main management practices in use are: capacity to keep enterprise money separate from money for personal expenses and ability to calculate profits based on records and to estimate profits.

Rural households got in touch with saving/credit organizations to get loans but also for saving purposes. The choice of these groups and organizations is based on many reasons including that they trust the members of the group or they are friends with some of them. The other rural households never applied for joining saving and credit groups or their applications were rejected. One of the reasons for not applying was that the application procedure is considered quite complicated especially for those that have low education levels. Moreover, apart from the lack of collaterals another reason for rejecting some applications was that they were badly prepared.

Evidence from India shows that credit groups must have sufficient knowledge and skills to deal with the organizational and technical issues related to various aspects of the economic activities, in addition to relevant management skills. Therefore, training meant for grassroots organizations must deal with formation and structure of credit groups, their roles and responsibilities, and account-keeping and financial management (Sudan, 2007).

## **CONCLUSION**

Most of the surveyed rural households in south-eastern BiH have mixed livelihoods as they rely on both farm and non-farm income-generating activities. More than two-fifths of the surveyed households started new non-farm businesses and activities such as services provision and on-farm processing in the last five years. However, they faced many problems and constraints such as the lack of financial resources. Weak business skills are also a limiting factor. Well educated and young rural people are those who started more new diversification businesses during the last years. They find it less difficult to deal with paperwork to get loans and subsidies. They are also better informed about availability, terms and conditions of specialized credit lines. Moreover, the financial management skills of the borrowers are taken into consideration by lending institutions when analyzing loan requests. Educated rural people are also more likely to perform some bookkeeping, which is positively valued by financial institutions.

Harnessing farm diversification, especially in the non-farm economic activities, requires improving the environment, thus strengthening incentives and reducing risks. Fully exploiting rural economy diversification potential in Bosnia requires also upgrading rural people’s human capital (including financial management skills), strengthening rural social capital and improving access of the rural population to finance. Access of rural households to financial services is crucial for creating an enabling environment for fostering Bosnian rural economies diversification. However,

that depends not only on the existence of a good institutional and political environment that harnesses diversification and makes easier access to loans but also on rural people's financial management skills. Therefore, future projects and initiatives dealing with livelihood diversification should also address this issue. This can be done by organizing training sessions about financial management and bookkeeping for rural people. Moreover, extension services should include training about soft financial management skills in their activities.

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