Study of African and international innovations and best practices in increasing access to rural and agricultural finance

September 2012

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Abbreviations

AFRACA	African Rural and Agricultural Credit Association
AGFiMS	Agricultural Finance Markets Scoping
ANED	Ecumenical National Association of Desarrollo
APRACA	Asia–Pacific Rural and Agricultural Credit Association
ASCA	Accumulating Savings and Credit Association
ATM	Automated Teller Machine
BDS	Business Development Services
BRI	Bank Rakyat Indonesia
CBK	Central Bank of Kenya
CEDA	Citizen Entrepreneurial Development Agency
CGAP	Consultative Group to Assist the Poor
CGF	Credit Guarantee Fund
CIBA	Centre for Inclusive Banking in Africa
CRC	Credit Reference Centre
DBP	Development Bank of the Philippines
DDWI	Dry Day Weather Insurance
DFI	Development Finance Institution
EFA	Equity for Africa
FAO	Food and Agriculture Organisation
FAST	Finance Alliance for Sustainable Trade
GDP	Gross Domestic Product
GoB	Government of Botswana
GoM	Government of Malawi
GoT	Government of Tanzania
ICT	Information and Communications Technologies
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation

ILO	International Labour Organisation
ILRI	International Livestock Research Institute
KYC	Know-Your-Customer
LAC	Loan Approval Committee
LBP	Landbank of the Philippines
LSP	Livelihood Services Provider
M4P	Making Markets Work for the Poor
MABS	Microenterprise Access to Banking Services
MAMN	Malawi Microfinance Network
MENA	Middle East and North Africa
MFI	Microfinance Institution
MFW4A	Making Finance Work for Africa
MNO	Mobile Network Operator
MSMEs	Micro, Small and Medium Enterprises
MVC	Micro-Venture Capital
NBFI	Non-Bank Financial Institution
NDB	National Development Bank (Botswana)
NGO	Non-Governmental Organisation
NLCL	Network Leasing Corporation Limited
NPL	Non-Performing Loan
OECD	Organisation for Economic Cooperation and Development
OIBM	Opportunity International Bank Malawi Limited
OPM	Oxford Policy Management Ltd
PASS	Private Agricultural Sector Support
PBOC	People's Bank of China
RACA	Regional Agricultural Credit Association
RBM	Reserve Bank of Malawi
ROSCA	Rotating Credit and Savings Associations
SACCO	Savings and Credit Cooperative

SADC	Southern African Development Community
SCG	Savings and Credit Group
SECO	State Secretariat for Economic Affairs of the Government of Switzerland
SFSA	Syngenta Foundation for Sustainable Agriculture
SHG	Self-Help Group
SMEs	Small and Medium Enterprises
TA	Technical Assistance
USAID	United States Agency for International Development
VCF	Value Chain Finance
VSLA	Village Savings and Loan Associations
WBII	Weather-Based Index Insurance

Executive summary

Oxford Policy Management (OPM), in association with Kadale Consultants (Malawi) Ltd., has been engaged by FinMark Trust to undertake a study of African and international innovations and best practices at the policy level, industry level, supplier level and client level to improve access to agricultural and rural financial services in southern African countries.

The study is the second phase of a three-year programme to increase access to and the uptake of rural and agricultural financial services in southern Africa: the first phase documented the current state of rural and agricultural financial services in six Southern African Development Community (SADC) countries (Botswana, Malawi, Mozambique, South Africa, Zambia and Zimbabwe), and the third phase will use the findings of the first two phases to help create policy frameworks, strategic approaches, and country and regional programmes to address the rural and agricultural financial services challenges identified.

The overall objective of this second phase is to address and provide comprehensive answers to the following questions:

- What categories of public and private sector intervention are needed at the macro, meso, micro and client levels in order to address the rural and agricultural finance challenges in the region?
- What are the best African and international current practices and recent innovations in respect of each of these categories of intervention?
- What are the circumstances and main drivers that have enabled these practices to develop and bear fruit?
- What is needed to enable such practices to be applied with success in the six study countries and in SADC as a regional economic community?

'Rural and agricultural finance' can mean different things to different people, as can many of the terms relating to this subject area. As a result, Chapter 2 of this report sets out the working definitions used in the course of this study, including the definition of terms such as 'rural', 'rural finance', 'household', small-scale producer', 'agribusiness' and 'innovation'.

The first output of the study was a longlist of case studies of international best practice to address the key challenges in extending financial services to rural-based households, farmers and agribusinesses. These interventions were classified at the micro, meso and macro levels as follows:

Level	Range of constraints	Examples of interventions/ initiatives
Macro level	• Issues related to the legal, regulatory and supervisory framework for financial services • Problematic policies and incentive structures for both public and private players in agricultural markets, which result in market distortions (e.g. in commodity pricing) • Constraints that inhibit economic activity, for example lack of access to cellular platforms	• Development of regulations to support the design and implementation of financial solutions, e.g. warehouse receipts • Creating space for new types of financial service providers, e.g. rural banks or micro-leasing • Rationalising the direct provision of agricultural credit and other support packages extended by public sector agencies and government-owned financial institutions
Meso level	• Absence of needed	• Establishing or strengthening

Level	Range of constraints	Examples of interventions/ initiatives
	coordinating capacity • Lack of or inadequate information on market segments, sectors, etc. • Limited supply of support services (e.g. to support capacity building of financial institutions or to provide extension services to farmers) • Limited provision of financial sector infrastructure (e.g. interoperable switch facilities, credit information) • Low levels of trust (non-transparent relationships) between different levels within the value chain, typically resulting in competing, rather than mutually supporting, behaviours	support institutions such as associations, federations and other network-level entities as well as training institutions • Engagement of private sector willing to provide services such as capacity- building, extension services, credit bureaus etc. • Developing mechanisms for accreditation of or establishing market-driven standards for delivering support services (e.g. for skills development) • Conducting relevant market research and effectively disseminating information to market players
Micro level – supplier	• High set-up and operating costs in rural areas, which may result from: ➢ Poorly developed infrastructure; ➢ High risk profile of certain market segments, whether real or as perceived by financial institutions; ➢ Inadequate institutional and human resource capacity in product development and delivery of services; ➢ Regulatory constraints that inhibit innovation and outreach; ➢ Lack of understanding of rural and agricultural issues: both agricultural activities *per se* and agribusiness activities;	• Developing new products that respond to specific rural market conditions • Developing alternative mechanisms to deliver services to specific target groups, e.g. through linkage-banking schemes, use of technology, etc. • Improving institutional capacity to appraise, monitor and manage risks, etc. • Linking financial services with other services, such as cash transfers, through shared platforms • Promoting the development of linkages between formal and informal financial services

Level	Range of constraints	Examples of interventions/ initiatives
Micro level – client	• Production and productivity constraints, which result in low and irregular income patterns • High level of vulnerability to a range of personal, production, business and market risks • Relative isolation from input, service and output markets • Low level of financial capability/literacy	• Increasing access to productivity-enhancing inputs and technical support through private outgrowing and contract farming schemes • Supporting the establishment and strengthening of community-based institutions, e.g. village-based associations, cooperatives, etc. • Promoting broad-based social protection schemes, e.g. national insurance schemes • Delivering technical assistance (TA), e.g. business development services (BDS), agro-technical support and market access, financial education packages, etc. • Promotion of financial capability

The **longlist**, set out in Annex C, consists of 36 potential case studies from developing countries across Asia, Latin America, the Middle East and North Africa (MENA) region and Africa. The key considerations taken into account in developing the longlist included: the objective of deriving insights, lessons learned and analyses directly relevant to stakeholders; a primary focus on the impact on small, rural-based users of financial services; and the benefits of innovations involving work across both the financial and the non-financial dimensions of agriculture and agribusiness. Innovations were considered in relation to products and services, delivery, excluded target groups, providers, partnerships, promotion, financial education and the enabling environment/infrastructure.

The team agreed with the Technical Committee a **shortlist** of 12 studies that have been worked up into full case studies taking account of: (i) the nature of rural and agricultural financial services in the southern African context; (ii) the main challenges for increasing access to and the uptake of these services (as identified in previous studies); (iii) the client reality in the region; (iv) the binding constraints in the development of rural financial services in the southern African region at the macro, meso, micro and client levels; and (v) the gaps in public and private sector policy relating to those constraints.

To put the case studies in context, a situational analysis of rural financial services in southern Africa is set out in Chapter 4, including an analysis of each of the six study countries. The common issues identified in the six countries are summarised as follows:

Thematic area	Common issues
Role of government and development policy	• Unstable macroeconomic performance • Some financial policies cause market distortions, e.g. mandatory interest rate ceilings • Some governments are directly involved in financial services, e.g. through ownership/management of development finance institutions (DFIs), implementation of SME and guarantee funds • Agricultural policies that do not facilitate (crowd-out) private sector participation, e.g. some subsidies, export bans, price fixing, etc.

Supply-side constraints	• Limited incentives for financial institutions to offer/increase agricultural/rural finance • Finance often available for commercial agriculture but less so for small-scale farming • Suitable products also not available for emerging farmers (those moving from small scale to more commercial agriculture) • Weak value chain finance (VCF): lack of linkages, poor level of trust among players • Lack of capacity (both in management information system (MIS) and human terms) in financial institutions (especially among non-banks and informal providers)
Demand-side barriers to financial access	• Low population density: highly dispersed (limited aggregation among many smallholders) • High level of poverty in rural areas • Lack of access to markets by many smallholders • Exposure to risks: highly erratic income flow and vulnerable to loss of livelihood (e.g. crop and livestock failure); health (HIV/Aids) • Land issues: difficulty of using land for collateral • Lack of financial capacity/literacy

The 12 case studies that address these issues are listed below, classified on the basis of *what services* are provided *by whom*, through *which channels*, and *to whom*.

	Services	**Providers**	**Channels**	**Users**
A. Clustering small-scale producers		☑	☑	☑
B. Micro-leasing	☑	☑		
C. Facilitating MSME investment	☑			☑
D. Production insurance	☑			☑
E. Making Markets Work for the Poor (M4P) interventions	☑	☑	☑	☑
F. VCF	☑	☑	☑	☑
G. Lowering transaction costs for providers		☑	☑	
H. Reform of development banks	☑	☑		
I. Mobile financial services			☑	
J. Alternative collateral	☑		☑	☑
K. Working with savings and credit groups (SCGs)			☑	☑
L. Regional networks			☑	

On the basis of the thematic areas under which the common issues are grouped above, the case studies fall into five categories:

1. **Role of government**
   - Case Study H: Reform of development banks
2. **Addressing suppliers/providers' constraints**
   - Case Study A: Clustering small-scale producers
   - Case Study D: Production insurance
   - Case Study E: Making Markets Work for the Poor
   - Case Study F: VCF
   - Case Study G: Lowering transaction costs for providers
   - Case Study I: Mobile financial services
3. **Developing demand-driven financial products and instruments**
   - Case Study C: Facilitating SME Investment
   - Case Study D: Production insurance
   - Case Study E: Making Markets Work for the Poor
   - Case Study G: Lowering transaction costs for providers
   - Case Study K: Working with SCGs
4. **Overcoming demand-side barriers to financial access**
   - Case Study B Micro-leasing
   - Case Study D: Production insurance
   - Case Study E: Making Markets Work for the Poor
5. **Developing market infrastructure**
   - Case Study F: VCF
   - Case Study J: Registry for alternative collateral
   - Case Study L: Regional networks

Within each of these clusters we address, while elaborating the case studies in Chapter 5, the third and fourth of the four questions with which we started: the circumstances and main drivers that have enabled these practices to develop and bear fruit within each category; and what is needed to enable such practices to be applied with success in the six study countries and in SADC as a regional economic community

1 Introduction

OPM, in association with Kadale, has been engaged by FinMark Trust to undertake a study of African and international innovations and best practices at the policy level, industry level, supplier level and client level to improve access to agricultural and rural financial services in southern African countries.

This study is the second phase of a three-year programme to increase access to and the uptake of rural and agricultural financial services in southern Africa. The first phase was a study examining and documenting the current state of rural and agricultural financial services in six SADC countries (Botswana, Malawi, Mozambique, South Africa, Zambia and Zimbabwe). The current study identifies best current practices and innovations from across the African and international spectrum that are amenable to application and adaptation in the SADC region. The final phase will use the findings of the first two phases to work with policymaking and strategy-formulating bodies in the public and private sectors in the six countries to create policy frameworks, strategic approaches, and country and regional programmes to address the rural and agricultural financial services challenges identified.

The overall objective of this phase is to address and provide comprehensive answers to the following questions:

- What categories of public and private sector intervention are needed at the macro, meso, micro and client levels in order to address the rural and agricultural finance challenges in the region?
- What are the best African and international current practices and recent innovations in respect of each of these categories of intervention?
- What are the circumstances and main drivers that have enabled these practices to develop and bear fruit?
- What is needed to enable such practices to be applied with success in the six study countries and in SADC as a regional economic community?

The Terms of Reference for the assignment are reproduced in Annex A.

Following this introduction, we provide in Chapter 2 a set of working definitions and in Chapter 3 an explanation of the methodology adopted to produce this study. In Chapter 4, we outline the current status of rural and agricultural finance in the southern African context, in particular identifying the main challenges to increasing access to and uptake of these services and the major gaps in public and private sector policy at the macro, meso, micro and client levels. We provide a detailed analysis of the situation in each of the six study countries, followed by an overview of the common issues. Chapter 5 contains the 12 selected case studies profiling international best practice in addressing the gaps identified.

2 Set of working definitions

'Rural and agricultural finance' can mean different things to different people, as can many of the terms relating to this subject area. We therefore feel it is important to outline at the outset what we mean by some of the key terms used in the course of this study.

First, we would like to clarify the interpretation of **rural**. In many countries, such as Malawi, 'urban' is defined as any designated municipality. Anything not fitting this category is classified as 'rural', which means that the term covers a wide range of contexts, from peri-urban areas to secondary towns, villages and hamlets. 'Rural' can therefore be a rather broad definition and may officially cover quite large and densely populated secondary centres as well as the villages/hamlets that might more generally be thought of as 'rural'. Any study of rural finance, including this one, needs to take account of this diversity.

It would also, of course, be wrong to characterise 'rural' as synonymous with 'agricultural'. In rural areas, agriculture and related agribusinesses are important – indeed, in most places dominant – economic activities, but there are other sources of livelihood and economic activity in rural areas, including public services (teachers, nurses, etc.) and private sector activities (ranging from single-proprietor businesses through to large commercial firms). These may be directly involved in agriculture or related areas such as livestock, fishing and forestry, but they can also be involved, for example, in retail and wholesale trading, transport, farm and non-farm services (crop spraying, vehicle mechanics, etc.), hospitality and entertainment services, warehousing, small-scale manufacturing and even financial services. Finally, in most countries rural areas are also served by services and enterprises that are urban based (and may even be primarily urban in their activities), such as road haulage, telecommunications, etc. The diversity of activity is wider than generally perceived, and this therefore needs to be taken account of in the design and delivery of rural financial services. The particular needs and access challenges of each group vary and in several cases are quite distinct.

On this basis, for the purposes of this study, **rural finance** can be split into four main categories:[1]

1. **Agricultural finance** along the value chains ('farm'[2] 'off-farm'[3])
2. **Non-agricultural rural** '**enterprise' finance** ('non-farm'[4])
3. Non-farm and non-enterprise related **'household' finance** (medical, education, consumption, household assets, housing, etc.)
4. Financing of **urban or urban-based services** delivered to rural areas.

There are other areas of rural finance, such as the financing of rural infrastructure, but these are beyond the scope of this study.

[1] This draws on a study recently completed by Jason Agar, Kadale, for the USAID AMAP series: 2011 Rural and Agricultural Finance, Taking Stock of Five Years of Innovations, Micro-Report 181.

[2] In this study, the term refers to the broad range of 'agricultural' production – farming of crops, livestock and fish/fishing.

[3] In this study, the term refers to a business activity related to farming (excluding farming itself), such as trading and part/full processing of agricultural produce.

[4] In this study, the term refers to a business activity that is neither farming ('farm') nor trading/processing of agricultural produce ('off-farm'); includes forestry, fishing.

For the purpose of this study, the following definitions are used:

According to the International Labour Organization (ILO), a **household** as a production unit is 'a household producing goods for its own final use (e.g. subsistence farmers and households engaged in do-it-yourself construction of their own dwellings), and those employing paid domestic workers (maids, laundresses, watchmen, gardeners, drivers, and others)' (ILO, 2009).[5] In general, for this study, we think of a small group of people working in a close manner on economic activities.

A **small-scale producer** is a producer 'operating at a small scale, which is distinguished from industrial or commercial-scale producers. The line separating small- and large- scale producers differs across many environments. What is considered small-scale in one country or region may be considered large-scale in another' (OECD, 2001).[6] While there are indeed no clear definitions provided for small-scale production in many countries, many (market development/agricultural development) programmes define small-scale farming as those involving up to two hectares of land only, which is the definition we adopt for the purposes of this study.

An **agribusiness** is any form of enterprise (for profit) that provides services relevant to pre- and post-production activities. This includes supplying of various inputs, the consolidation of outputs, transportation, processing/treatment and the marketing of produce, whether in agriculture (including livestock), forestry and/or fisheries. For some purposes, the activities of farmers (crop and livestock producers), fishers and foresters can be defined as 'agribusinesses', but for this study these primary activities are treated as agricultural production activities and referred to as such throughout to distinguish them from the agribusinesses as defined above.

It is important to differentiate between these groups as each of them faces different challenges when it comes to accessing financial services. For example, while micro-leasing or risk-sharing investment may be a good solution for agribusinesses, they would be inappropriate for households. However, the focus of this study will be on agricultural finance, in the context of rural finance. We explore the differing needs of the different groups in more detail in section 4.1.

Innovation is a term that usually has positive connotations, so promoters of initiatives, products and organisations like to have 'innovative' attached to what they are promoting. As a result, the term 'innovative' has been overly (and often wrongly) applied and claimed.[7]

In the Collins English Dictionary, **'innovation'** is defined as: 'Something newly introduced, such as a new method or device'. The verb to '**innovate'** is defined as: 'to invent or begin to apply (methods, ideas etc.)'. For the purposes of this study we therefore define 'innovation' as:

- Something that is **new** (invented) and/or being **newly applied**; and
- Something related to **things**, **ideas**, **methods** and **systems** that have been introduced in order to respond to challenges (in expanding the delivery of services, etc.) and to overcome certain limitations and barriers faced by market players. From this, we mean

[5] ILO, 2009: Gender, Employment and the Informal Economy: Glossary of Terms

[6] OECD, 2001: Glossary of Statistical Terms

[7] J Agar, USAID, op. cit.

that innovation is not just about 'products' and is a response to challenges and opportunities faced: this tends to drive the search for a solution rather than a new technology being introduced and people then wondering what to do with it.

We explore the application of the term 'innovation' in this study in more detail in Chapter 3.

3 Methodology

Following a team brainstorming session, our first activity was to review documentation of particular relevance to this study. A list of documentation reviewed during the course of this study is provided in Annex B. The starting point for all team members[8] was an in-depth review of the full Phase 1 report documenting the status of agricultural and rural financial services in southern Africa, including regional and country reports. Beyond these, each team member self-selected particular documentation to bring themselves up to speed with relevant areas of rural and agricultural finance.

The literature on agricultural and rural finance is vast and growing. Many studies (general, regional and country-specific) describe the key challenges in extending financial services to rural-based households, farmers and agribusinesses in particular. Some of these challenges refer to the specific capacity constraints of institutions delivering financial services (e.g. the lack of capacity to develop more appropriate products for the rural and agricultural sector), while others involve broader, high-level issues such as how rural areas remain isolated from basic services and how local markets remain underdeveloped due to the lack of infrastructure. A number of interventions in agricultural and rural finance have, however, been introduced in recent years that exemplify practical ways of overcoming some of the key challenges in delivering financial services to the rural and agricultural sector.

Following our initial literature review, and drawing particularly on our analysis of the Phase 1 country reports, the team then researched and prepared a longlist of 36 case studies of international best practice to address the gaps identified. The longlist of case studies is summarised in Annex C. Our first step was to develop a first-level classification of interventions at the macro, meso and micro level. This involved conducting further desk-based research on rural and agricultural finance, with the goal of identifying case studies for each of the levels as described in the table below:

Table 3.1 First-level classification of interventions

Level	Range of constraints	Examples of interventions/ initiatives
Macro level	• Issues related to the legal, regulatory and supervisory framework for financial services • Problematic policies and incentive structures for both public and private players in agricultural markets, which result in market distortions (e.g. in commodity pricing) • Constraints that inhibit economic activity, for example lack of access to cellular platforms	• Development of regulations to support the design and implementation of financial solutions, e.g. warehouse receipts • Creating space for new types of financial service providers, e.g. rural banks or micro-leasing • Rationalising the direct provision of agricultural credit and other support packages extended by public sector agencies and government-owned financial institutions

[8] The core team for this study comprised Janet Hayes (Project Manager), Jason Agar, Abigail Carpio and Mateo Cabello. The team was supported by Robert Stone (Project Director), who provided quality assurance of all outputs and expert advice and guidance to the core team.

Level	Range of constraints	Examples of interventions/ initiatives
Meso level	• Absence of needed coordinating capacity • Lack of or inadequate information on market segments, sectors, etc. • Limited supply of support services (e.g. to support capacity building of financial institutions, or to provide extension services to farmers) • Limited provision of financial sector infrastructure (e.g. interoperable switch facilities, credit information) • Low levels of trust (non-transparent relationships) between different levels within the value chain, typically resulting in competing, rather than mutually supporting, behaviours	• Establishing or strengthening support institutions such as associations, federations and other network-level entities as well as training institutions • Engagement of private sector willing to provide services such as capacity building, extension services, credit bureaus etc. • Developing mechanisms for accreditation of or establishing market driven standards for delivering support services (e.g. for skills development) • Conducting relevant market research and effectively disseminating information to market players
Micro level – supplier	• High set-up and operating costs in rural areas, which may result from: ➢ Poorly developed infrastructure; ➢ High risk profile of certain market segments, whether real or as perceived by financial institutions; ➢ Inadequate institutional and human resource capacity in product development and delivery of services; ➢ Regulatory constraints that inhibit innovation and outreach; ➢ Lack of understanding of rural and agricultural issues: both agricultural activities *per se* and agribusiness activities;	• Developing new products that respond to specific rural market conditions • Developing alternative mechanisms to deliver services to specific target groups e.g. through linkage-banking schemes, use of technology, etc. • Improving institutional capacity to appraise, monitor and manage risks, etc. • Linking financial services with other services, such as cash transfers, through shared platforms • Promoting the development of linkages between formal and informal financial services

Level	Range of constraints	Examples of interventions/ initiatives
Micro level – client	• Production and productivity constraints, which result in low and irregular income patterns • High level of vulnerability to a range of personal, production, business and market risks • Relative isolation from input, service and output markets • Low level of financial capability/literacy	• Increasing access to productivity-enhancing inputs and technical support through private outgrowing and contract farming schemes • Supporting the establishment and strengthening of community-based institutions, e.g. village-based associations, cooperatives, etc. • Promoting broad-based social protection schemes, e.g. national insurance schemes • Delivering TA, e.g. BDS, agro-technical support and market access, financial education packages, etc. • Promotion of financial capability

In order to ensure we found the most innovative cases relevant to the southern African context, we carried out a full search, reviewing various data sources, including those of the key players involved in rural and agricultural finance, such as the International Fund for Agricultural Development (IFAD), Consultative Group to Assist the Poor (CGAP), the Food and Agriculture Organisation (FAO), USAID, MFW4A, and the Rural Finance Learning Centre.[9] We also consulted with other rural finance specialists in Africa and in other regions to access information on some of the most promising initiatives.

During the research into the longlist case studies, it became apparent that many of the initiatives cut across the macro, meso and micro levels, as necessarily integrated approaches. Moreover, at this stage, several of the initiatives included on the longlist cannot yet be declared as unmitigated success stories – methodological, financial, practical, political and/or other challenges remain in some cases. In the process of building the longlist, however, the team was guided by the objective of deriving insights, lessons learned and analyses that may be considered directly relevant and useful to governments and development partners, investors, financial institutions and others engaged in promoting more accessible financial services in the rural economy. Whilst we were mindful of the fact that many agribusinesses, larger agricultural producers, and urban-based suppliers to rural areas also have a need for improved access to finance, we deliberately considered case studies that address how their particular needs are addressed only if the cases also illustrate how this has an impact on the much larger proportion of rural-based users of financial services. This is in recognition of the fact that the case studies need to reflect the reality of the majority of people in the region, who are engaged in subsistence farming and confronted with food security issues.

Many of the innovations and examples of best practice considered by the team tackle both financial and non-financial issues and constraints. While the team focused on identifying cases that show innovation and best practice in rural/agri-financial service provision, we found that many of the innovative and successful agrifinance interventions, such as the Private Agricultural Sector Support (PASS) Trust in Tanzania, involve work across the

[9] A list of documentation collected is provided in Annex B.

financial and non-financial dimensions (including, for example, addressing farmer productivity issues through simultaneous offering of BDS and agro-technical advice, or reforming broader agricultural development policies consistent with national priorities to expand financial access in rural areas, etc.). This is especially relevant when we consider the needs of the large population of small-scale producers in rural areas, who face a range of constraints (not just financial access constraints) that keep them from effectively participating in markets.

In the process of identifying which cases to consider in that context, we naturally prioritised those cases that highlight solutions related to the provision of financial services. Having said that, we have also brought out and discussed certain non-financial aspects of the studies where relevant, though these are not the main focus of the case studies.

For the purposes of this report, we have taken the view that innovation needs to be more than just new to the organisation and/or the country. It also needs to be more than the application of relatively well-established approaches (such as using tried-and-tested VCF techniques) to new crops. These can be worthy and indeed innovative at the organisational and national levels, but not necessarily of note beyond these boundaries.[10] Part of the power of innovative ideas is that they spread rapidly and are imitated, expanded, adapted or applied in a new context. This study therefore includes both entirely fresh innovations (e.g. an online receivables registry in China) and variants and adaptations of existing innovations (e.g. Kilimo Salama, an adaptation of index-based weather insurance). We have not, however, attempted to define where innovations were *first* introduced or which organisation could stake a claim to be the first to use them. When selecting the longlist case studies, we also kept in mind how successful interventions have helped to make their services more affordable to the target market.

As shown in Annex C, the longlist consists of 36 potential case studies from developing countries across Asia, Latin America, the MENA region and Africa. Even at the longlisting stage, we kept in mind the need to find examples that could be applicable to southern Africa, regardless of the region in which they have been used. In order to ensure relevance to the southern African context, we assigned one or two particular countries to each member of the team.[11] Each expert documented and shared their learning about their focus country/ies with the rest of the team so all team members had a clear understanding of the issues in each country, and those common to the six countries. This learning is summarised in Chapter 4 and the detailed findings are provided in Annex D.

In drawing up the longlist, we used a template describing each example and including information on:

- The country where the initiative was introduced and implemented;
- The target population or group addressed;
- The gaps addressed by the intervention;
- A brief description of the pre-existing situation when the intervention was introduced, and essential features of the design of the intervention (highlighting what is innovative about the intervention);
- A brief description of key *relevant* features of the macro- and meso-level environment;

[10] Jason Agar, Op cit.

[11] For example, Jason Agar was the expert for Malawi as he worked there for many years and Abigail Carpio was the expert for Zambia as she is involved in two projects relating to rural and agricultural finance there.

- The key actors;
- An indication of the costs incurred by the implementers;[12]
- An indication of the end cost to the client;
- The time required to design and roll out the intervention;
- Sources of information and any key links (webpages, references, etc.);
- Any evidence/assessment of the success of the intervention (i.e. impact on access and uptake, and implications for sustainability); and
- Where possible, an indication of any prevailing challenges that are directly relevant to the intervention.

After this process of developing the longlist of potential case studies, the team conducted a brainstorming meeting during which we identified the case studies that were then proposed to the Technical Committee for working up into full case studies. This process of shortlisting took account of: (i) the nature of rural and agricultural financial services in the southern African context; (ii) the main challenges for increasing access to and the uptake of these services (as identified in previous studies); (iii) the client reality in the region; (iv) the binding constraints in the development of rural financial services in the southern African region at the macro, meso, micro and client levels; and (v) the gaps in public and private sector policy required to deal with those constraints.

More specific parameters were also considered in the process of selecting case studies to be included in the shortlist, given our knowledge of the gaps and most pressing issues confronting agricultural/rural finance in southern Africa. These parameters are described in Table 3.2:

Table 3.2 Parameters for shortlisting case studies

Specific issues to consider	Parameters for shortlisting case studies: guide questions
Low levels of productivity among a widely dispersed population of small-scale (often subsistence) farmers	Which interventions/initiatives have: • Proven effective in bridging gaps within sectors and value chains that are especially significant in the economies of the study countries? • Proven to be successful in stimulating greater productivity or development of local markets, etc.?
	• While it will be meaningful to consider interventions involving what are already considered *strong value chains*, are there initiatives that have proven successful even in the context of relatively weak value chains?[13]

[12] Where possible, we tried to get estimates of the investment and operating costs by the implementers. However, the goal here was primarily to identify the types of expenses, i.e. the range of activities that needed to have been implemented, necessary capital expense items, important investments in infrastructure, etc.

[13] A strong value chain is characterised by transparent and mutually profitable links between participants, and may involve single-crop farmers.

Specific issues to consider	Parameters for shortlisting case studies: guide questions
High risk profile of specific market segments in rural areas and the need for better ways to manage risk	• Are there initiatives that have proven successful even in the face of less favourable production (growing) and price conditions?[14] • What interventions demonstrate effective ways by which the risks associated with agricultural production can be mitigated?[15] • Have these interventions resulted in improved access (i.e. higher product uptake) and better-quality financial services (e.g. more affordable/appropriate)?
	• Are there interventions that demonstrate how improved information has successfully led to lower operating costs for financial service providers and other (sector) entities providing support services in the rural sector?
Importance of building partnerships, especially between actors in the private and public sectors, and increasing the level of trust along value chains	• In some countries some of the necessary intermediaries do not exist. Consider, for example, the importance of warehouse management systems/managers, traders/buyers, etc. Which cases provide useful insights regarding the rules (laws and regulations) that underpin relationships between the different actors involved?
The need for appropriate financial solutions in response to the situation and application	• Which initiatives demonstrate the successful use of financing tools such as factoring (discounting of receivables), collateral management agreements, etc.? • Which interventions/initiatives have demonstrated success in the implementation of financial products that are now starting to be tested or have been tested in some countries in southern Africa (e.g. warehouse receipts, leasing, etc.)?
The need for innovative delivery channels	• Which initiatives demonstrate the effectiveness of utilising information and communications technologies (ICT) to reach more remote areas?[16]
	• Which initiatives (other than the use of ICT) have proven successful in reducing the cost of transactions for providers?[17]

[14] Volatile market prices expose farmers to the risk of loss from unforeseen input or output price changes. This includes unexpected increases in expenses incurred for feeds, fuel, and fertiliser, or dramatic reductions in the prices due to record-high output. Farmers mitigate the risk of losses from price fluctuations through a number of methods, including, for example, diversifying their crop and livestock activities, hedging commodities under production, and contracting (pre-selling) production.

[15] Consider, for example, crop insurance that is available to cover moderate and catastrophic losses of production caused by weather-related (floods, droughts) and other events.

[16] This might include mobile phone-based transactions, automated weather data collection systems, centralised multi-institution administration systems, branchless banking operations through retail chains and other non-financial agents (e.g. petrol stations, local merchants, etc.).

[17] Some of the strategies used by financial service providers to reduce transaction costs include aggregation (i.e. lending to groups or associations) and flexible delivery mechanisms. In many cases, it is often necessary to invest in product design and in developing/improving management information systems, which underpin the performance and utility of technology, before developing more sophisticated technological solutions.

Specific issues to consider	Parameters for shortlisting case studies: guide questions
Institution-specific factors to consider	Which interventions/initiatives (at the micro-level supplier) demonstrate or suggest: • Medium-term sustainability (and, where possible, the institutional ability to survive even difficult years caused by weather, price movements, regulatory constraints or unfavourable government policies)? • Potential for replication or scale? and/or • Ability to overcome poor lending precedents and improve repayment culture?

Our proposed shortlist of case studies, as presented in our interim report, was then discussed with the Technical Committee and a final list of 12 case studies was agreed upon. Each team member was assigned a number of case studies to write.[18] In order to ensure consistency of content and quality across the case studies each author worked to an agreed template, and the case studies were then peer reviewed by the Project Director and Project Manager. The case studies are presented in Chapter 5.

[18] Case studies were assigned to the team member best placed to write each one, depending on their particular expertise on and knowledge of the best practice example in question.

4 Situation analysis: rural financial services in southern Africa

As explained in Chapter 3, the team undertook an analysis of the current status of agricultural and rural financial services in the six study countries, based on a combination of the Phase 1 country reports and their own knowledge of those countries. As can be expected of any group of countries, each has a different set of constraints and gaps in terms of increasing access to rural and agricultural finance. These constraints, along with potential solutions to them, are explored for each country below, and the detailed analysis for each country is provided in Annex E. The team also identified certain common issues emerging from the separate country analyses, which are summarised in section 4.4 below. Before outlining the specific constraints in each country, we first consider the client reality in the region and a segmentation of the market.

4.1 Client reality and market segmentation in southern Africa

As explored in Chapter 2, rural finance can be split into four main categories: agricultural finance along the value chains; non-agricultural 'enterprise' finance; non-farm and non-enterprise-related 'household' finance; and finance for urban-based services to rural areas. Within this classification, firms[19] play a vital, if sometimes obscured, role in the rural economy. In this context, firms can range from large internationally owned agricultural conglomerates operating estates/farms to a micro agri-input retailer with a small shop. Within this range there is considerable diversity based around combinations of the following:[20]

1. Locus of ownership – domestic/international;
2. Nature of ownership – owner managed (including family), separated (remote) ownership and (employed) management, state owned, member owned (cooperatives), and hybrid ownership;
3. Level of ownership – main entity or subsidiary;
4. Stage of development – start-up through various growth phases through to mature and declining;
5. Sector of operation – agricultural, livestock and fishing (broken down into agri-production, agri-processing, agri-trading (trading, wholesaling and retailing), agri-inputs, agri-services, agrifinance, agri-transport), mining (extraction, processing and transport), transport (service to business/personal users, repair, consumable supply), household products (manufacture and trading), food and beverages (processing and retailing), and services (entertainment, telecoms);[21]
6. Scale of operation – multi/single site, micro/small/medium/large;
7. Market focus – local, sub-national, national and international markets;
8. Import/export focus – bringing things to rural areas or taking them out; and
9. Capital intensity – capital and labour intensity.

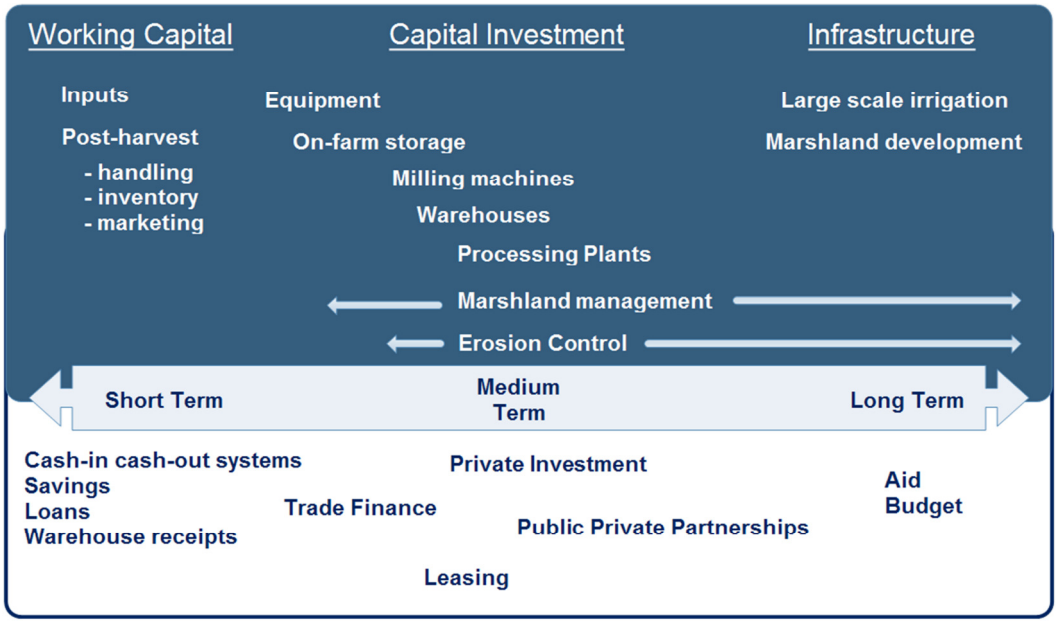
[19] Defined here as any formally registered legally constituted body engaged in business activity, i.e. sole traders, partnerships, limited by shares, limited by guarantee, co-operatives etc. These are predominantly privately owned, but can include firms that have all or partial public ownership, or member-ownership (e.g. cooperatives). They are distinguished from household/individual informally operating businesses.

[20] Jason Agar, Op cit.

[21] Clearly this is not a comprehensive listing, but aims to highlight the diversity of activity.

All of these dimensions have an impact on the firm's financial needs and potential sources of finance. International farming companies usually have a wide range of needs, but also access to both national and international finance options, perhaps through their parent firm. At the other extreme are small-scale family-owned firms, which also have a wider range of needs but much lower access to finance. The nature of the financial requirements of the agricultural sector, and particularly of their maturity profile, also varies widely depending on the type of activity, as illustrated in Figure 4.1.

Figure 4.1 Maturity profile of agricultural finance



Source: OPM

Although rural areas tend to be characterised by relatively high rates of unemployment and under-employment, this is also seasonal, which means that firms may invest in labour productivity, including improving **fixed assets**, even if there are times in the year when labour is relatively cheap and abundant. The need for competitiveness, driven by increasing globalisation of markets, is a major factor behind capital investment to reduce unit costs. Increased competitiveness also leads to a need for higher quality standards, particularly as end-user markets upgrade their requirements and seek greater traceability. Financing for fixed assets has to take account of the diversity of the assets required, from tools and equipment for farming, land and irrigation systems, through to transportation and processing equipment. The rural mix of assets is often more extensive than for urban firms.

Rural areas usually have lower labour costs, but other costs – **'transactional' costs** such as transport and access to utilities – are often higher because of poor infrastructure. Poorer availability of services, such as telecoms/internet, can impose additional costs through operating inefficiencies. Firms may be required to fill gaps in the expected public infrastructure, such as repairing/maintaining key roads and providing education and health facilities for workers and communities. This may also stimulate financing requirements.

On the positive side, limited competition in rural areas can increase **returns**, as there is less demand for rural raw material inputs, labour and business services. However, as a counterweight to this advantage, returns in value chains tend to favour those that control the ultimate distribution to end users/customers, so agricultural enterprises that predominate in rural areas often face lower returns than processors and retailers.

Rural firms are also vulnerable to **exogenous factors** related to agricultural production. Weather (drought, flooding, hail, etc.), disease, pests and global commodity price volatility are considerable risks affecting firm and value chain returns. Moreover, in some countries, volatility and uncertainty are exacerbated by arbitrary interventions by governments in agricultural markets (subsidies, price controls, export bans, etc.). Often, the greatest risk is carried directly by firms involved in agricultural production, but as these firms are interconnected with other rural firms then the impact spreads to all agri-related firms and even those non-agri-related firms that depend on agri-firms and farmers for their custom.

Financial institutions have tended to take two approaches to simplifying **rural firm finance:** either defining it simplistically as being farming and lending to farmers, or purposefully isolating and focusing on the non-farm activities out of reluctance to lend for what is viewed as high-risk production lending. Many financial institutions have experienced losses from forays into agricultural production lending and have therefore tended to write off rural finance as too difficult and risky. Financial institutions tend to group all forms of agricultural production finance as equally risky, even though much depends on the risk profile of the produce concerned. For example, crops such as tea are harvested on multiple occasions over a long period, therefore being less vulnerable to catastrophic loss than an annual staple crop such as maize. Some crops are more commonly irrigated, which makes a significant difference to the risk of major production losses. Some crops are grown within reliable outgrowing arrangements, such as sugar cane, with long-term contracts from reliable export customers. Some producers produce crops for particular niches and are therefore not as vulnerable to price swings for the general commodity. Indeed, the world prices of some commodities are more volatile than others, or at least have periods of lesser volatility.

As highlighted in *'Rural and Agricultural Finance: Taking Stock of Five Years of Innovations'* (USAID, 2011), there has been an encouraging trend for financial institutions and development partners to focus on particular value chains and to think about finance in the context of that value chain, rather than generically as finance for agriculture. This value chain focus addresses the differences between agricultural products; equally importantly, it has also broadened the view of lending beyond finance for agricultural production to include other agri- and non-agri-related firms in the value chain or working across value chains. Case study F explores best practices in VCF. This approach, along with other types of financing mechanism for agriculture, is explained in Box 4.1. We build further on these definitions, as well as providing a definition of value chain financing in Box 5.5.

Box 4.1 Types of financing mechanism for agriculture

Chain liquidity. This involves financial transactions *between chain actors*. An example is where a buyer or trader issues a short-term loan to a producer and is repaid when the latter sells the produce to the former. This type of finance improves the efficiency of a value chain. It is low-cost finance, often having no direct interest charges to the producer. It also entails relatively low levels of risks because of the almost perfect information existing between the lender and the borrower. However, this mechanism relies heavily on trust, it handles only small sizes of loans and critics argue that it creates dependency and may get farmers into a trap: a vicious cycle of indebtedness.

Agricultural finance. The most common *financial service, provided by financial institutions*, including banks, microfinance institutions (MFIs) and SACCOS. Examples include a loan issued by a bank to a trader for buying a crop, or a loan to a famer for buying inputs. This mechanism suffers from all the well-known problems of small-scale rural finance – asymmetry of information, a requirement for collateral, etc.

VCF. These are financial services established and anchored on the *cooperation between agents along value chains and between them and a financial institution*. For example, a loan might be given to a trader who banks with a financial institution in an area for the purpose of paying farmers for their produce. This is then sanctioned against crop sales to a processor, preferably one who also banks with the same financial institution. On delivering the crop to the processor, the latter pays the trader through the bank, which automatically deducts what is due for the loan repayment. It is not a solution for the many other technical, governance and managerial capacity issues along value chains, but it works well if augmented with a diverse range of capacity-building initiatives.

Source: OPM

In addition to lending, looking more carefully at rural firms and the value chains they operate in highlights that there are also considerable opportunities for non-lending-based financial services. This is a trend seen in other areas of finance, moving beyond lending to think more about opportunities for **savings** from periods of relative cash surpluses, **insurance** for meeting a range of production and market risks and **transmission** for payments to farmers, workers, urban–rural transfers, etc. These are products that have historically not been sufficiently addressed. Also, many small producers/traders of agricultural produce living near to borders also have a need for **foreign exchange services** to finance/facilitate informal cross-border trade. The opportunities are greater and more diverse than often assumed by the finance sector.

In terms of **sources of finance** for firms, there is considerable variation in how firms meet their need for capital. Large national and international firms are likely to have access to the same national sources of finance as other urban-based firms. Their scale means they are sufficiently attractive to financial institutions to have their financing needs met. Although this has tended to focus in the past on lending, it is clear from the case studies that more diverse needs are now being met by financial institutions, including insurance (for example, production risk insurance as outlined in Case Study D) and transmission/payment needs (for example, mobile money in Case Study I).

At the other extreme, small and micro owner-managed firms have regularly been neglected as too small and too difficult to deal with. Even if formally registered, they may be operating more like a family and household enterprise. They are at the cross-over point between a household enterprise and what might be recognised by many as a formal firm. Their capital base may be weak and the owners may move in and out of engagement with an enterprise or change its focus and activities unpredictably (e.g. from transport to retail). Formal systems and record keeping are probably very weak, and the owners not well equipped to articulate

their needs to financial institutions in a way that the institution can respond to. Their main source of finance is likely to be the owner(s) and their family, with few formal sources available to them. At the lower end of this group, traditional MFIs have targeted micro-entrepreneurs with individual loans that help them maintain steady streams of working capital, build stocks, etc. This has been shown to be effective for non-farm enterprises for which seasonality is not a major issue. In rural areas, however, these firms often coexist with either on-farm or off-farm activities that are seasonal in nature, reinforcing the need for a more holistic approach to all the needs of the household.

Financial institutions – in particular, banks that do not come from a microfinance tradition – struggle to bridge the gap between their formal orderly world and the more chaotic ways of operating for these firms. The clash of operating methods makes it hard to connect, with financial institutions generally assuming that the firm must formalise its operations to fit what it needs, rather than the financial institution adopting a more realistic and flexible approach to working with such firms.

In between the large firms that are well catered for and the micro and small firms that are mainly excluded[22] there is a range of firms with differing levels of access to financial services: the so-called 'missing middle'. Some of these rely more heavily on the owner's resources, while others are in well-established relationships with financial institutions. Within this broad group, lending tends to be insufficiently tailored to firm needs in timing, collateral, terms and payment periods. Beyond lending, there are insufficient services to address savings, risk and payment needs.

Overall, the lack of attention to the nature of rural firms, their diversity and range of needs has been a considerable oversight by financial institutions in the past. Development partners have also often focused too closely on very small-scale producers, failing to recognise the interconnected nature of firms and also the importance of the role of functioning firms as suppliers and customers of the producers. The value chain approach has helped address that lacuna, but over and above this is a need to respond in innovative ways to the diversity of rural firms and their needs. In this study, we have identified where there remain stubborn problems and how financial institutions are responding innovatively to that. Three of the case studies identified (B, C and J) address the particular issues facing micro, small and medium enterprises (MSMEs) in southern Africa.

4.2 Country analysis

As explained in Chapter 2, the team has undertaken an initial analysis of the current status of agricultural and rural financial services in the six study countries. As can be expected of any group of countries, each has a different set of constraints/gaps in terms of increasing access to rural and agricultural finance. These constraints, along with potential solutions to them, are explored for each country below, and the detailed analysis for each country is provided in Annex D. However, the team has also identified certain common issues emerging from the separate country analysis, which are summarised in section 4.3 below.

[22] Except for the smaller ones that are served by rural MFIs.

4.2.1 Botswana

Box 4.2 Botswana main financial headlines (FinScope 2009)

- In 2009, 67% of adults were financially included, with 41% formally banked, 18% using formal other products, 8% using informal products and 33% financially excluded.
- Compared to the previous survey in 2004, the level of the banked population was similar, although there had been a slight improvement in financial inclusion due largely to an increase in the use of 'other formal' products, mostly insurance products.
- Approximately 330,000 adults (33% of the total) used some kind of informal financial product; 236,000 adults (25%) used informal savings products; 141,000 adults (14%) borrowed from informal sources; and 254,000 adults (25%) used informal insurance products.
- The most common loans for rural respondents are from *motshelo*/savings clubs (56.5%) and from friends/family (53.3%).
- The most common type of insurance is a funeral policy, held by 26% of adults, followed by long-term investment products, medical aid and short-term insurance (e.g. motor).
- Overall, 48% of the population live in settlements not immediately served by banks, but the majority of the unserved (37% of the population) live in rural areas, with none of the settlements classified as rural having bank branches. A further 8% of the population live in urban villages without bank branches.
- According to FinScope (2009), 41% of adults are banked (rural 26%), 18% access formal other services (rural 22%), 8% have access to informal sources (rural 11%) and 33% are financially excluded (rural 42%).
- The landscape of access shows that only 8% of the adult population relies solely on informal finance – a smaller proportion than in many other African countries.
- 29% of adults used mobile phone banking, though such services in 2009 were limited to account balance queries and airtime purchases only. According to CGAP, 81% of the population had mobile phones in 2010.

Botswana is a middle-income country with the best sovereign credit rating[23] in Africa, as at 2009. Overall, it has a small population[24] and a very low population density (3.5 persons/km^2), of which 60% is urbanised. Population density is higher along the southern border with South Africa, as the sparsely populated Kalahari Desert and the Okavango Delta cover much of the centre and north of the country, resulting in pressure on land in certain areas. Infrastructure is focused in these populated areas, and is very limited in most of the rest of the country.

Botswana has been relatively well governed with the Government of Botswana (GoB) using resources generated from its diamonds to invest in infrastructure and welfare. The economy has been highly dependent on mining, particularly diamonds, and to a lesser extent on tourism (16% of non-mining gross domestic product (GDP)). Botswana has developed a relatively large public sector using its substantial revenues from mining.

[23] A sovereign credit rating is the credit rating of a sovereign entity, i.e. a national government.

[24] Circa 2 million: Census 2011.

Although of greater importance in the past, by 2011 agriculture accounted for only 2.4% of GDP compared to 25% in the mid-1970s and 37% at independence (1966). Between 1974 and 2011, average real agricultural growth was only 0.5% a year, making it the slowest growing sector of the economy and resulting in a generally weak rural economy. Only 4.6% of adults made their living from farming (FinScope Botswana 2009), with the main sources of rural income being cattle rearing, tourism, small-scale retail and sector employment. Historically, cattle rearing has been the mainstay of the rural economy, representing two-thirds of agricultural GDP. However, it has been in decline for many years due largely to inappropriate policies and the negative impact of the parastatal monopoly exporter, the Botswana Meat Corporation. In 2010, Botswana lost access to the European beef market as it could not meet the sanitary and phyto-sanitary requirements. This was compounded by a failure of compliance certification by the Department of Veterinary Services. Measures have subsequently been implemented to reinstate compliance and restore credibility; access should be restored by mid-2012, but this has been a significant blow to the rural economy.

The GoB's Annual Agricultural Survey (AAS) (2006) found that 96% of Botswana's 115,000 farmers operated mixed traditional/communal farming system on tribal land, with the remainder engaged in commercial farming in freehold and leasehold areas. According to Sigwele (2010), farmers in the low-input traditional sector were not able to adopt most technologies to increase livestock and crop productivity because of lack of finance and/or the high cost of inputs. Most smallholders cannot meet commercial banks' borrowing requirements due to irregular/seasonal incomes and lack of collateral.

One outcome of this economic profile has been high income inequality, with the fifth highest Gini coefficient in the world (over 0.6).[25] According to the 2009/10 Botswana Core Welfare Indicators Survey, mean household monthly incomes were five times higher in urban than rural areas. Consequently, the headcount poverty rate in rural areas was almost double that of the cities. Another problematic indicator is that Botswana has the second highest HIV infection rate in the world.

The GoB's tenth National Development Plan promotes financial sector development, in particular improving access to financial services for the poor. The aim is to remove barriers to wider formal sector provision, e.g. the high cost of operating banking services in rural areas, and to create incentives for financial institutions to improve access in rural areas. GoB's stated approach is to establish regulatory structures that promote competition and innovation, improve consumer education and infrastructure, and facilitate entry and exit to the market. GoB plans to use its own position to leverage change, e.g. by moving to smartcard-based payments systems.

The financial sector comprises the central bank (Bank of Botswana), commercial and investment banks, insurance companies, leasing finance institutions, a development bank, a savings bank, a building society, a development corporation and a number of non-bank financial intermediaries like micro-lenders and asset managers. In the past, the Bank of Botswana required that banks develop a branch network or representation covering stipulated rural areas, but this requirement was removed. Commercial banks and other financial intermediaries are subject to various lending restrictions and face mandatory interest rate ceilings on loanable funds at levels below market-clearing rates. This has discouraged lending to smaller businesses, particularly in rural areas, as it is more expensive than making large loans to a few major borrowers. Banks were the largest source

[25] It is unclear if many developing countries have reliable Gini data, and are therefore excluded from this comparison, but clearly Botswana has relatively high inequality based on this measure.

of loans across all settlement types. After banks, rural respondents made greatest use of loans from *motshelo*/savings clubs.

A further issue has been GoB's support for parastatal lenders that have performed poorly, such as the Citizen Entrepreneurial Development Agency (CEDA). CEDA provides subsidised loans to MSMEs and has a dedicated Young Farmers Fund. The National Development Bank (NDB), another parastatal, specialises in lending for agricultural purposes. Total bank lending for agricultural enterprises amounted to Pula 179.8 million (US$ 27.9 million) in March 2011, less than 1% of total lending and only 2% of bank lending to the business sector. Lending by NDB and CEDA significantly exceeds lending to agriculture by the commercial banks.

The Agricultural Credit Guarantee Scheme (ACGS) provides credit insurance for loans taken by dryland arable farmers through NDB and CEDA. The AGCS insures against inability to repay loans due to drought, flood or hail by levying a 5% premium on farmers on the value of eligible loans (for seeds, fertiliser, ploughing, fencing, farm machinery, etc.), which is matched by a 5% premium paid by GoB. In the event that 'drought' or 'flood' is formally declared by the GoB, the AGCS pays out 85% of the value of outstanding eligible loans. The AGCS is currently under review as it is recognised that the scheme is badly designed and vulnerable to abuse. One of the design problems is that the designation of 'drought' or 'flood' is done on a nationwide basis, rather than on a localised geographical basis where the problem actually occurs

It is notable that Botswana has few MFIs that provide credit for small and micro-enterprises.[26] However, **Savings and Credit Cooperatives (SACCOs) are well established** and provide members with facilities to save and access credit, mostly in rural and peri-urban areas. The Botswana Cooperative Association was formed out of 12 other cooperatives and registered in 1988.

The Botswana Savings Bank provides savings products with low minimum balances readily accessible to rural people through the post office network, with nearly 120 branches, including many in unbanked settlements. This network offers considerable potential for extending the provision of financial services in rural areas. **Several commercial banks in Botswana have started providing mobile phone based banking services**. These services include transferring funds between accounts and obtaining bank statements. Similarly, electronic banking has been introduced by some commercial banks, covering conventional banking services. The two major mobile network providers, Mascom and Orange, have introduced mobile money transfer services, MyZaka and Orange Money.

Conclusion

The key disabling factors identified were that:

- Farmers and MSMEs in the rural areas are dispersed;
- There are high information (poor communication) and transaction costs (poor quality roads/high transport costs);
- There is weak provision of basic public services in rural areas and poorly designed social safety net programmes;
- There are high farming risks resulting in adoption of a diversified income strategy;
- There are difficulties for MSMEs in providing collateral;
- Farming, especially rain-fed arable farming, is a marginal, risky and low return activity;

[26] MFIs are distinguished from payroll micro-lenders, providing consumption loans to employees.

- The smallholder agricultural sector is characterised by low productivity; in livestock, the traditional focus is on number, rather than quality, of animals and off-take rates are relatively low, resulting in an over mature, poor quality herd; and
- There is poor financial literacy and a fear of asset seizure.

The key potential enabling factors are:

- Widespread ownership and access to mobile phones, and improving communication infrastructure;
- A liberalised enabling environment; and
- Botswana Building Society's access to the post office network.

Given these and other issues, expanding rural/agricultural financial services in the country will require: (a) measures to reduce GoB/parastatal involvement in financial service provision; (b) development of agency banking and mobile money services for sparsely populated rural areas; (c) development and extension of rural risk reduction products (production and prices), particularly for livestock; (d) strengthening meso-level institutions to improve financial institutions' input into policy; and (e) policy-level reforms to promote SME lending.

4.2.2 Malawi

Box 4.3 Malawi main financial headlines (FinScope 2008 & MSME 2012)

- In 2008, 19% of Malawian adults were banked, 7% had other formal access, 19% had informal access and 55% were financially excluded.
- In rural areas, 14% were banked, 7% had other formal access, 21% had informal access and 58% were excluded.
- FinScope MSME 2012 found 59% of MSMEs are financially excluded, with the same issues of access and cost as with individuals.
- 24.3% of MSMEs had borrowed (FinScope MSME 2012), of which 11.4% borrowed from formal sources (mostly MFIs).
- 22.1% of rural adults borrowed money in the previous year.
- FinScope (2008) found that 74.5% of rural adults save for a mixture of investment, day-to-day needs and emergencies.
- Despite facing many risks that could be mitigated, only 3% of Malawians have insurance.
- Over 50% of adults walk to the nearest airtime agent, of which over 75% said it took under 30 minutes to get there.

Malawi is one of the poorest countries in the world, with 73.9% of the population living on less than US$ 1.25/day. 39% of the population lives below the national poverty line, and 15% are classed as ultra-poor. The country has one of the highest population densities in Africa with 139 people per km^2 and 84.6% live in rural areas. Agriculture dominates the economy, which regularly accounts for over 30% of GDP and represented 79% of exports by value in 2010.

Malawi has enjoyed relatively high growth rates since 2005, but in recent years the economy has been in crisis, most notable was the acute shortage of foreign exchange resulting from the Government of Malawi's (GoM) fixed exchange rate policy. The new president since April 2012 has addressed some major concerns resulting in resumed donor flows; however, in the short and medium terms Malawi will experience a painful period of adjustment while long-term prospects begin to improve.

Much of Malawi's population and its poverty is concentrated in rural areas. This potentially limits the demand for formal financial services. Most rural farming households depend on rain-fed subsistence or semi-subsistence agriculture. Maize is the dominant food crop. The result is high vulnerability to drought, so maize production is a central political theme in Malawi, resulting in many distortionary policies. Tobacco remains Malawi's dominant cash crop, but significant market changes for burley tobacco present a major threat to the economy and many rural livelihoods. Agriculture is central to rural life, but is not the only activity that creates financial needs.

In the last two years, many long-standing financial sector bills have been enacted, including the Microfinance Act, the Financial Cooperatives Act, the Financial Services Act, the Banking Act, the Insurance Act, the Credit Reference Bureau Act, the Reserve Bank of Malawi (RBM) Act and the Pensions Act. While these acts fill the regulatory gaps in the financial sector, it will take time for the regulator (RBM) and regulated institutions to adjust to the many changes that these acts require.

The demand for financial services stems from rural people's needs. Agriculture and related activities are predominant, but there are opportunities to serve business needs. The FinScope MSME 2012 survey found access to finance is the most significant obstacle to growth among business owners in the sector.

Evidence suggests rural people understand the importance of saving and value convenience and safety, but mainly save at home or in kind rather than in inaccessible formal finance institutions. Only 3% of adults had insurance; the reasons for not using insurance were information and understanding gaps, compounded by issues of affordability. Urban–rural money transfers are important to support family members. Most rely on traditional methods of personal cash delivery, but the potential for mobile money transfers and agency banking is substantial. 96% of MSMEs make payments in cash (FinScope MSME survey, 2012), suggesting there are substantial opportunities for bank and m-money transfers/payments.

The most important sources of loans were family, friends/neighbours and MFIs. Convenience, cost and reputation of the lender are the key criteria. Nearly four-fifths of adults try to avoid borrowing, as they fear the consequences of getting into debt. This may relate more to formal and informal interest-bearing borrowing than using informal non-interest-bearing sources. There is an understanding that borrowing is best used for investing in farming or a business. 24.3% of MSMEs had borrowed (FinScope MSME survey, 2012), of which 11.4% borrowed from formal sources (mostly MFIs). The most common reason for MSMEs to borrow was to pay other debts.

Policymakers and providers should encourage and promote the full range of financial services rather than focus on credit, facilitate development of mobile money services as convenient low-cost alternatives, facilitate development of micro-insurance relevant to rural areas, and support financial literacy for poor rural households.

On the supply side, the financial sector experienced significant legislative reform from 2009 to 2011. Time is needed for the new legislation to be absorbed by providers and

RBM, the regulator. RBM needs to manage its new powers appropriately to promote investment, outreach and innovation in rural Malawi.

Meso-level support institutions exist for all categories of formal providers. Of relevance are the Malawi Microfinance Network (MAMN) and the Malawi Union of Savings and Credit Cooperatives. These meso institutions facilitate exchanges of information, organise inputs and advocate for members with the regulator and GoM. From GoM's and RBM's perspectives, it is useful to have a single body through which to communicate to the member institutions.

At the micro level, financial providers are categorised into the banking sector, the non-bank formal sector, the microfinance sector and the informal sector. Banks currently have little rural presence, but several have taken more interest in the rural market through developing alternatives to the costly full branch, such as agents, banks-on-wheels, kiosks and point of sale devices. Other formal financial institutions also have little rural presence, but there has been innovation in weather index-based insurance, livestock/crop insurance, credit life and funeral benefit insurance.

MAMN's 19 registered microfinance members can be grouped into payroll lenders, state owned, non-governmental organisation (NGO) MFIs and the microfinance operations of banks. In 2010, the microfinance sector's outstanding loan portfolio stood at MK 11,965 million (US$ 80 million). Parastatal MFIs, notably Malawi Rural Finance Company, play a considerable role in microcredit supply and saving deposits. However, parastatal MFIs continue to perform poorly and distort the market. NGO-owned MFIs have experienced notable growth in recent years and can now potentially collect deposits under the new legislation. SACCOs have limited rural presence as they suffer from relatively poor repayment rates.

Informal sources are readily accessible at village level. Group-based providers include Village Savings and Loans Associations (VSLAs), Rotating Credit and Savings Associations (ROSCAs) and other community groups. CARE has increased its VSLAs from 174 in 2006 to 4,478 in June 2011, reaching 84,639 members. These groups and variants effectively mobilise community savings and on-lending, but have limited capital available. Money lenders (*katapila* operators) and retailers providing goods on credit are important individual sources. Although *katapila* operators charge high interest, the transaction costs are nil, as they are located in the community and lend immediately, thereby meeting a key need to access small amounts of credit instantly for emergency and consumption purposes.

Currently, mobile money services are offered by four banks and one mobile network operator. The current offerings are basic, but the range of transactions is widening as is the use of agents for cashing out and potentially cashing in. Policymakers and providers need to encourage appropriate regulation prioritising rural outreach and innovation, to support the promotion of group-based savings and credit approaches, and to address the role and practices of informal individual lenders.

The key financial access issue is that a large proportion of the population is too poor (or perceives that it is) to use formal services. There are also informational and understanding constraints that could be addressed by formal financial institutions and policymakers. Accessibility is a major advantage of informal sources: this suggests policymakers and the regulator should support more flexible forms of banking/formal financial institution outlets. The FinScope MSME survey (2012) found 59% of MSMEs are financially excluded, with the same issues of access and cost as with individuals.

Conclusion

Identified key **disabling** factors are:

- Economic instability;
- Agricultural volatility;
- Weak rural infrastructure;
- Difficulties with identity verification;
- Property rights that do not encourage investment;
- Limited regulatory experience of the new legislation;
- High levels of rural poverty;
- Fears of debt;
- Low financial literacy;
- Weak institutional capacity;
- High levels of GoM involvement as a provider; and
- Inappropriate product design.

Identified key **enabling** factors are:

- Enabling legislation is in place;
- High rural population density;
- Relatively good communication infrastructure;
- High latent need;
- Opportunities for contract farming;
- Opportunities to work with informal providers;
- Evidence of innovation; and
- Pressure on banks to move into the less competitive rural markets.

With limited incomes and their relative remoteness, rural farming households have not been very attractive to the financial sector. However, with a degree of saturation of the urban markets, there has been considerable interest over the last three years particularly in expanding the financial networks to rural towns and major trading centres through some branches, but mainly through use of banks-on-wheels and rural agents, such as agri-input dealers. The advent of cellular networks, coupled with relatively wide network coverage, is now creating opportunities for mobile money solutions, with some experimentations occurring on transfers and payments (including social cash transfers).

Given these and other issues, expanding rural/agricultural financial services in the country will require: (a) absorption of new legislative frameworks and adaptation by both the regulator and regulated; (b) development of agency banking and mobile money services; (c) development and extension of rural risk reduction products (production and prices); (d) financial education; (e) supporting mechanisms for farm inputs, including relevant savings mechanisms, contract farming schemes and agri-input credits.

4.2.3 Mozambique

Box 4.4 Mozambique main financial headlines (Finscope 2009)

- 78% of the Mozambican adult population are financially excluded and do not use either formal or informal financial products.
- Most Mozambican adults who are financially served use informal products.
- 12% of Mozambican adults use a commercial bank product.
- 4% of adults use financial products provided by formal financial institutions which are not commercial banks, such as insurance companies.
- 20% of the adult population claim they are saving or putting money aside for a specific purpose. Only 6% of adults use formal saving products – 11% use informal products such as xitique (savings clubs).
- 8% of adult Mozambicans say they borrowed money or took goods on credit during the 12 months prior to the FinScope survey. Reasons for borrowing are mainly short term, i.e. for emergencies such as medical attention and living expenses.
- 5% of adults have insurance – more than half the adult population (50.2%) claim never to have heard of insurance or insurance products.
- Almost half of the adult population (47%) would consult family or friends for financial advice rather than a financial institution. One in four would approach a bank and one in five would approach a community leader.

Despite high growth rates in recent years (GDP growth rate averaged 7.7% from 2002 to 2010) Mozambique remains one of the poorest countries in Africa – GDP per capita was US$ 804 in 2009.[27] Most of the population still live in rural areas (69% in 2007) and the agricultural sector accounts for 32% of the economy while employing over 75% of workers in the country.[28] For that reason, improving agriculture finance is one of the most pressing needs in the country: Mozambique has the lowest level of financial inclusion in Africa and 78% of the total population is financially excluded.[29]

This high level of financial exclusion can be explained by a combination of factors also affecting other African countries – highly dispersed populations, high levels of rural poverty and vulnerability, lack of infrastructure, etc. **Mozambique, though, presents a unique feature that makes the provision of financial services in rural areas even more difficult: all of the land in the country is owned by the state.** This situation has two direct effects on the provision of financial services: (i) people cannot use land as collateral; and (ii) the lack of ownership reduces small farmers' incentives to make long-term investments, including improvements in soil quality, development of irrigation systems, or planting trees and crops with long maturity. Although the lack of collateral has a direct effect on access to credit, it also works as a kind of mental deterrent – experience shows that clients without collateral tend to see themselves as unworthy of accessing financial services. On the positive side, some financial institutions in Mozambique are introducing innovations that

[27]World Bank, 2012, World Bank Data.

[28]National Statistics Institute (INE), 2007, National Census.

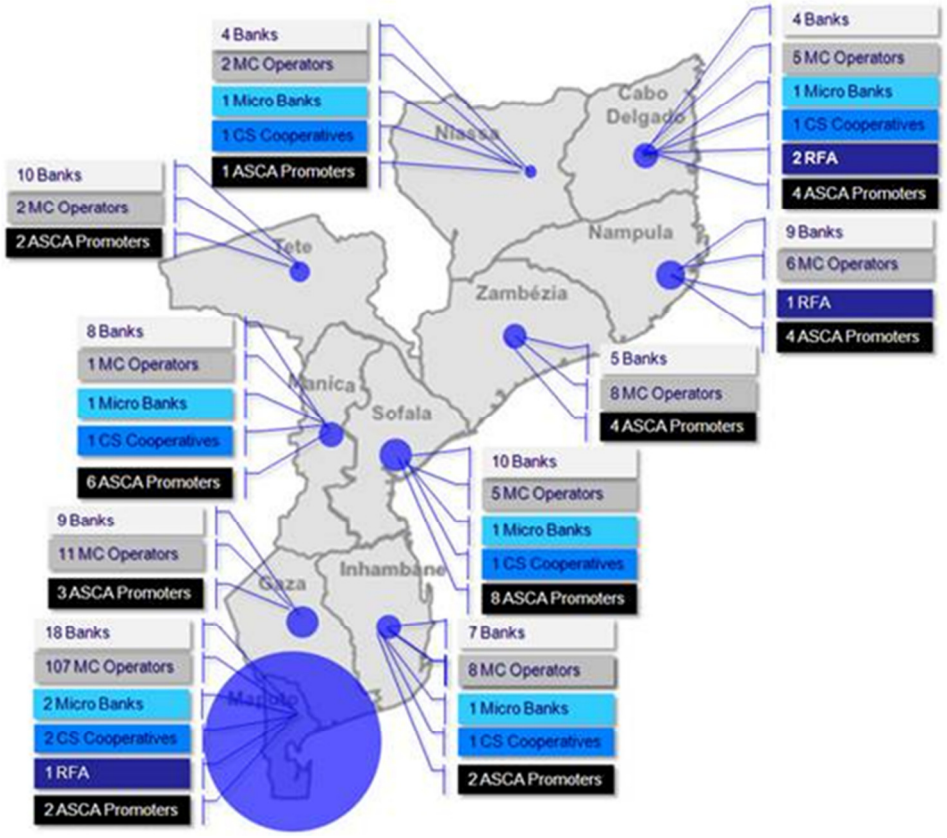
[29] FinScope Mozambique 2009.

make use of alternative forms of collateral. One of the key questions in this area is how to scale-up these innovations.

In recent years, there have been many initiatives to improve rural finance in Mozambique. One of these initiatives is the Rural Finance Strategy, which aims to achieve equal access to credit for rural individuals, groups and MSMEs, especially women and the poor. The Strategy puts a lot of emphasis on informal groups, mainly Accumulating Savings and Credit Associations (ASCAs) as well as on the organisation of value chain-focused associations. This initiative also aims to add strength and value to other policies aimed at improving rural productivity and the fight against poverty, namely the Strategic Plan for Agricultural Development 2010–2019 (PEDSA) and the Poverty Reduction Action Plan (PARP) 2011–2014.

Figure 4.2 shows the map of the distribution of financial services in Mozambique by province. At first glance it looks like financial services are evenly distributed across the country but the reality is that, despite the aforementioned policy, **the supply of financial services in Mozambique is still concentrated in large urban zones, mainly Maputo and Matola, but also Beira.**

Figure 4.2 Map of financial service providers by province[30]



In fact, most districts in the country (77 out of 128) do not have a single bank or automated teller machine (ATM). This situation also affects the financial services provided by cooperatives and MFIs, despite the changes in the regulatory framework, mainly Decree 47/98 regulating microcredit activities as well as subsequent regulations (revision of the Banking Law through the Law 9/2004 of June 21st and the Decree 57/2004) to increase the

[30] ICC (2012) 'The status of agricultural and rural financial services in Mozambique'

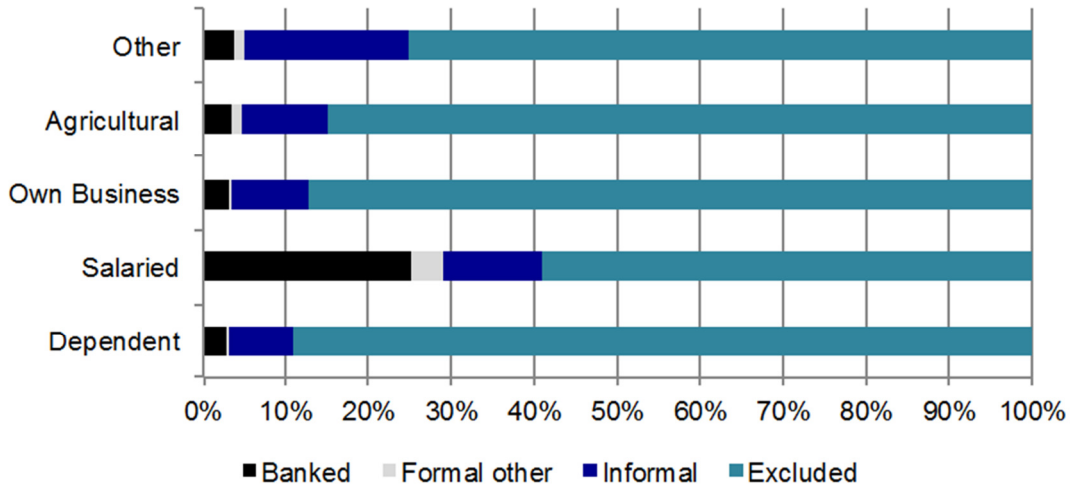
range of financial services provided by MFIs. The use of e-money services, which has to some extent helped to overcome the lack of formal financial services in rural areas in other African countries, has not yet been introduced in Mozambique. Even more importantly, financial institutions have shown no interest in offering agricultural finance.

From the perspective of the supply side, the main points to be highlighted are:

- Of the country's 462 commercial bank branches, 111 are in rural areas, with only a few banks offering special financial services for agriculture, including lines of credit;
- Mobile phone based financial services (or mobile money) are being developed and launched by multiple private sector companies – this is probably the most important innovation for expanding the coverage of formal financial services throughout the country;
- Credit cooperatives are active in rural and agricultural markets, though their outreach and information about their activities is limited;
- Most MFIs still offer strictly credit services, which greatly limits their potential outreach and impact on rural areas;
- Low management capacity and low repayment rates are the main constraints faced by government funds that supply credit;
- Despite the relative success of some ASCAs, the model is limited by its short savings and credit cycles, lack of professional management capacity and the informality of its organisation;
- Commercial advances and contract farming are increasingly popular forms of credit for farmers. The challenges related to the practice include weak contract enforcement mechanisms, risks associated with fixing prices before harvest, the delay of funds for initial payments and side selling by producers; and
- Financial sector infrastructure includes a developed national payment system and electronic network. A credit bureau exists for commercial banks, but one for microfinance operators is not yet in place.

In terms of demand for financial services, most inhabitants in rural areas reported being totally excluded, as Figure 4.3 shows. The only group with a relatively good level of access is salaried workers, with 25% of them being banked and another 12% accessing informal services.

Figure 4.3 Rural access strand by level of income



Source: FinScope 2009

From the perspective of the demand for financial services, the main factors constraining access are: (i) the lack of appropriate information about the availability, terms and conditions of credit and deposit services; (ii) high transaction costs incurred by potential depositors, which reduce the net return on their savings interest earnings; (iii) the elevated risks faced by farmers, who tend to be more vulnerable than other borrowers; and (iv) lack of financial literacy and technical skills.

Conclusion
Considering the above constraints and factors, expanding rural/agricultural financial services in Mozambique will require a combination of interventions that include: (i) a change in the structure of incentives for formal financial institutions, as a result of technological (particularly branchless banking) and product (particularly those designed for young customers) innovations or/and the arrival of new institutions into the industry that may change the structure of current market competition; (ii) the development of pilot schemes linking urban and rural financial institutions (including informal financial groups), so they can facilitate the understanding of the financial needs of rural farmers; and (iii) a holistic approach to improving VCF, focused on raising incomes in rural areas.

Investment in education, the development of financial literacy programmes, and offering more payments via branchless banking systems are other measures that will certainly help to reduce the level of financial exclusion in the country.

The upgrading of meso financial infrastructure, like a credit bureau for MFIs, and the improvement of rural infrastructure, mainly in the areas of transport, irrigation and communication, are other factors that could contribute to achieving the goal of expanding financial services in the country.

4.2.4 South Africa

Box 4.5 South Africa main financial headlines (FinScope 2011)

- The formally served rate of 63% remained stable from 2010, after increasing by 4% from 2009.
- Those served informally only stands at 5%: this has decreased by 4% since 2010; those served both formally and informally fell from 38% in 2010 to 28%.
- 27% are financially excluded: this has increased by 4% since 2010.
- Affordability, the lack of jobs and irregular income are the key barriers for entry into formal financial services for lower-income citizens.
- The number of Msanzi accounts continues to grow, with 15% of South African adults (approximately 5 million) claiming to have a Msanzi account.

Although South Africa's financial sector is the largest and most advanced in the region there is still a significant lack of access to financial services in rural areas. Over the past few years, there has been improvement in both access to, and depth of, financial services. There is now a wider range of financial services available to customers, such as mobile money transfer, short-term insurance products, lower cost transactional products, more ATMs and services delivered through retail service centres, taxi ranks etc. However, access to finance in rural areas, particularly where income is earned informally or irregularly, is still limited. Most banks focus on urban areas and middle to high-income households and formal enterprises. More than one third (37.7%) of rural households, half of

rural SMEs (50.4%), and 36.6% of small farmers are financially excluded (CIBA, 2012). The most prominent gaps in access to rural and agricultural finance are:

- Agricultural insurance;
- Non-life related micro-insurance;
- Enterprise loans or loans to self-employed individuals;
- Cost effective branchless banking solutions; and
- Effective micro-savings mechanisms.

The main constraints to access to finance in rural areas are found at the macro level. As in many other countries in Southern Africa, the lack of good roads, electricity and internet connections in rural areas discourages financial institutions from offering financial services, restricts rural residents' ability to access such services and pushes up transaction costs. South African fiscal policy and taxes on bank charges exacerbate the high cost of accessing financial services, which places them beyond the reach of many poorer South Africans in rural areas. Furthermore, while the National Credit Act aims to improve access to credit, it has only done so for salaried employees, thus not helping the unemployed, or those employed in the informal sector (the majority of whom live in rural areas) to access credit. The act has also caused banks to tighten their risk assessment procedures: this has further reduced access to finance for some (potential) customers. Finally, the communal land tenure system in operation in South Africa means land cannot be used as collateral for loans, leaving many small-scale farmers unable to use their most valuable asset as collateral.

There are also some constraints to access to rural and agricultural finance at the meso level in South Africa. Although parts of the meso level are well developed (associations, training, credit bureaus, information etc.) there are some weaknesses in the support infrastructure in general and in public sector financial service providers' delivery capacity and coordination[31] (CIBA, 2012). The result of these weaknesses is that most formal financial institutions have a blind spot when it comes to understanding the particular circumstances, needs and potential of small farmers. There is also a need for more effective coordination and capacity focused on rural and agricultural sectors. The Audit Bureau of Circulations (ABC) plays a role in organising the private sector in the agricultural industry and are trying to build the emerging farmer market: there is however a need to engage with government on the role of the private sector and the support and enabling environment needed to encourage this.

There are a variety of constraints at the micro level. As in many other sub-Saharan countries, there is a general lack of appropriate, affordable products that meet the needs of low-income, rural residents, despite the success of the Mzansi account[32] and some mobile money applications, such as WIZZIT (see case study I). As mentioned above, formal financial institutions tend to be located in urban or peri-urban areas rather than in rural areas. There is also a widespread fear of losing assets due to failure to repay a loan which means that many people do not even attempt to access credit. This is linked to the low levels of financial literacy in rural areas of South Africa: a lack of understanding and awareness of the range of financial products available means that people do not generally access

[31] for example between CASP and MAFISA

[32]The Mzansi account is a low income transactional banking account that was developed in line with the commitments of the Financial Sector Charter, which requires banks to make banking more accessible to the nation and, specifically, to increase banking reach to all communities. The major South African banks worked collectively to provide a standard for new bank accounts, which is affordable, readily available and suits the specific needs of the previously unbanked communities.

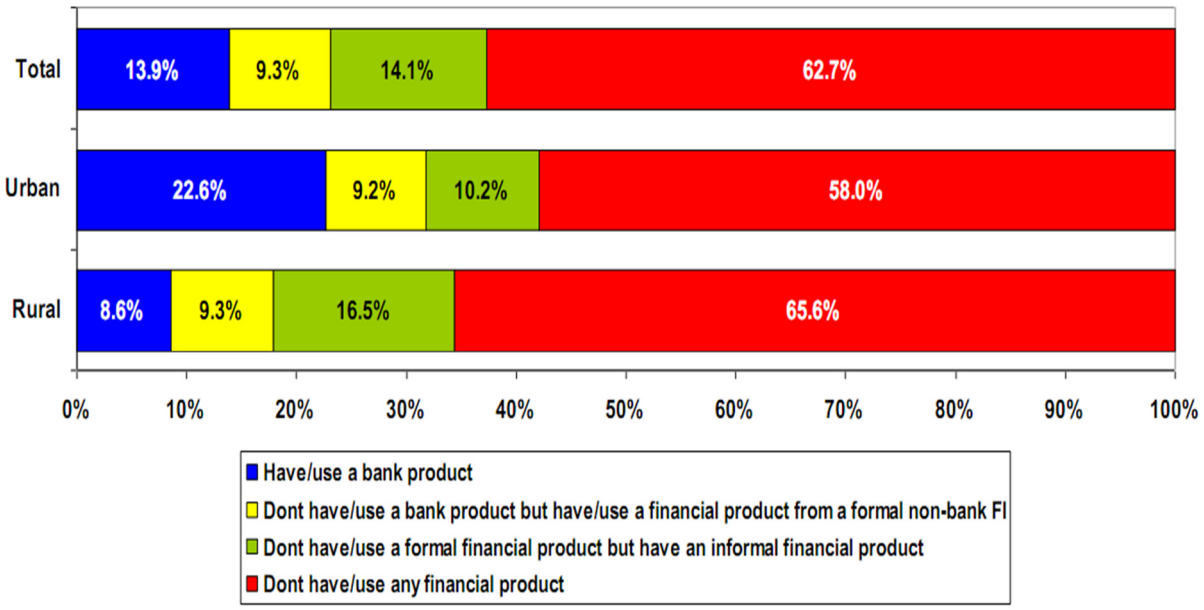
appropriate financial services. According to the National Credit Registry (NCR), more than half of the South African population has an impaired credit record. Further challenges to increasing access to finance in rural areas are the high cost of infrastructure and staff in South Africa and lack of capacity of management and staff in financial institutions.

Conclusion
Given these and other issues, expanding rural/agricultural financial services in the country will require a combination of interventions that include: (a) expanding branchless financial services to rural areas (for example through mobile money or agent banking); (b) finding alternative collateral mechanisms (for example the use of movable assets as collateral); and (c) supporting financial education programmes in rural areas.

4.2.5 Zambia

The results of FinScope (2009) in Zambia show that the overall level of financial inclusion increased by 3.6%, from 33.7% of adults in 2005 to 37.3% in 2009.33 The level of financial inclusion is 42% in urban areas and 34.4% in rural areas.

Figure 4.4 Zambia financial access strand, rural vs. urban (FinScope 2009)



Source: 2009 FinScope Zambia results.

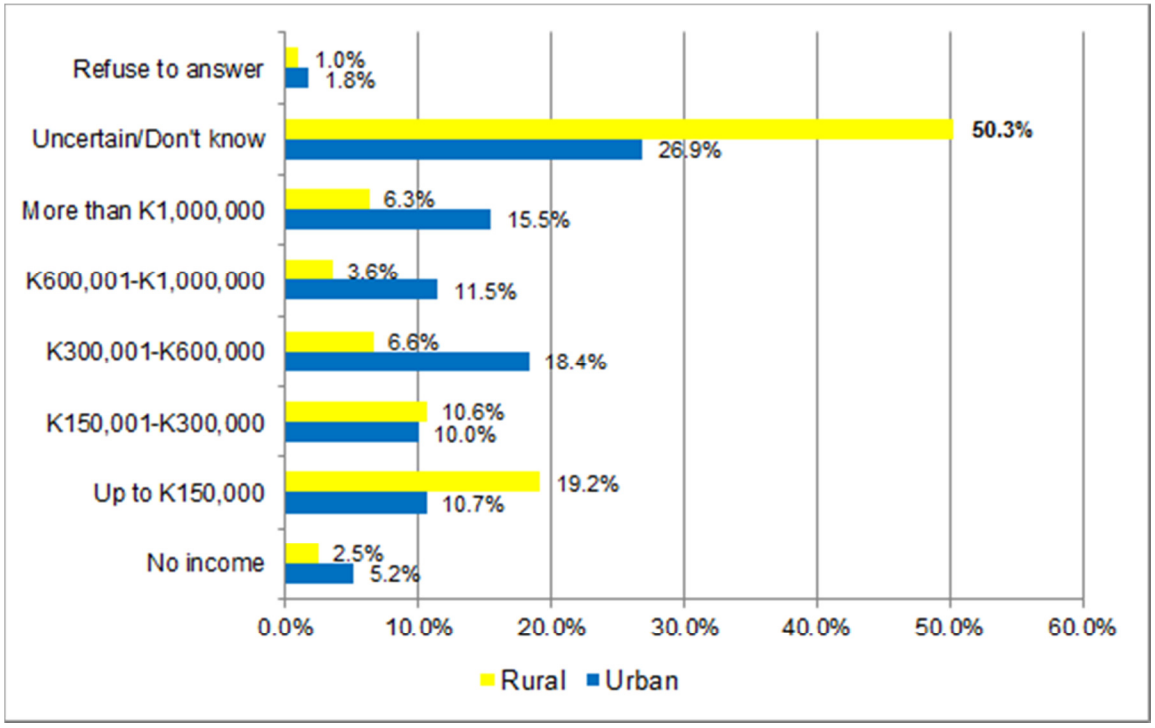
Despite the overall improvement in the situation of financial access in the country, majority of adults in Zambia continue to be financially excluded – in rural areas, it is estimated that this covers 65.6% of the adult population. The level of exclusion also extends to local enterprises: the Zambia Business Survey (2010) revealed that 85% of rural-based MSMEs are actually financially excluded, and only 5% of MSMEs are banked.

Zambia, like many countries in the region, faces significant constraints in the expansion of financial services in rural areas.

[33] The increase in the level of financial inclusion is driven by a growth in the take up of 'formal-other' products (in particular, formal money transfer mechanisms), and 'informal' products (mostly by a significant increase in the take up of informal credit in both rural and urban areas).

- The country has a **highly dispersed population**, where some of the poorest agricultural villages tend to be almost completely isolated at certain periods during the year;
- The **income of rural-based households and individuals is characterised as erratic and lumpy**, especially for those who rely on agriculture as their main source of income.[34] As explained in Wilkinson and Manje (2012), household income is variable and fluctuates with the farming season and main agricultural activities. It is estimated that only 8% of rural households have income throughout the year, and the majority (72%) have income only during specific months of the year. Very few farmers receive income on a regular basis, and this is true especially of small-scale farming that is entirely dependent on the rainy season.

Figure 4.5 Reported personal monthly income in Zambia (FinScope 2009)



Source: 2009 FinScope Zambia results.

- The vast majority of small-scale farmers face **specific bottlenecks that hinder their productivity** such as: (a) their isolation from markets and other basic services, given poor or limited public infrastructure (e.g. farm to market roads, electricity, cell phone coverage); (b) low yields, poor livestock production, and vulnerability to crop failures resulting from droughts and diseases; and (c) limited knowledge of/access to information regarding improved agricultural practices. These and many other constraints perpetuate low productivity and low incomes, and contribute to persistent rural poverty in the country.

[34] Most adults in Zambia, be they rural- or urban based, earn their income on an irregular, inconsistent basis. More than a third of Zambians earn their livelihoods in agriculture. This figure rises to more than 50% in rural areas. Most small-scale farmers rely on one crop – maize – which is harvested once a year and is susceptible to increasingly unpredictable climatic changes. Low yields and/or low prices (in the previous season) mean that many rural households are vulnerable to food production shortfalls and price increases in staple foods.

- Various studies also show that a high proportion of rural households have **limited understanding of financial services**. Formal financial services, in particular, are perceived negatively by rural households – e.g. misconceptions about financial products, particularly insurance products.[35]

On the supply side, many financial institutions, especially commercial banks, find the costs of setting up and operating branches in many rural areas of the country prohibitively high. As such, there is a dearth of financial institutions that are able to service the rural financial services market. There are many reasons for this, including: (a) certain regulatory requirements in the country imposing significant costs on running branches; (b) the high cost of personnel, given the limited capacity in the financial services sector; (c) high-risk perceptions regarding agricultural activities that dominate rural areas, which is partly explained by the lack of capacity in many institutions to understand this particular market, and to develop and deliver appropriate financial products; and (d) significant institutional capacity constraints, especially among non-bank financial institutions (MFIs and SACCOs).

The delivery of financial services to the rural areas in general, and to small-scale farmers in particular, is very limited. Commercial banks that used to operate in some rural areas, such as Lima Bank and Barclays Bank, have since closed their operations.

In recent years, there have been a number of promising market developments in the supply of agricultural and rural finance. Agricultural market facilitators such as Musika, Conservation Farming Unit (CFU), and iDE Zambia have all played a vital role in helping to stimulate new developments, but these are on a relatively small scale. Despite the introduction of new types of regulated financial institutions (e.g. microfinance institutions that are licensed to offer savings and loans), agricultural and rural outreach remains low. Whilst more market-led financing models are being tested and some are proving to work well, very few work at a scale that would facilitate a dramatic reduction among those who remain financially excluded. Some initiatives lack the means to support replication.

Some rural households (e.g. those in the cotton and tobacco sub-sectors) participate in outgrower schemes that allow them access to production loans. Input credit from agricultural buyers (some of them are large and well-established in Zambia) is estimated to be substantial – especially when compared to the volume of credit directly extended by financial institutions to small-scale farmers and farmer groups. Overall, however, small-scale farmers still emphasize that credit to support production and post-production activities are in scarce supply, expensive and heavily skewed towards the larger, corporate sector.

In terms of transactional services, particularly money transfers, rural households face severe constraints in receiving remittances (e.g. from relatives in urban areas). Recently, a number of mobile phone based money transactional facilities have emerged, which enable some rural households to send or receive cash in the rural areas. Celpay, Mobile Transactions Zambia and Bayport Financial Services are among the new entrants in the money transfer business space. While some of these initiatives are only at an early pilot phase, these service providers are contributing by providing alternatives to higher risk manual transfer mechanisms that are still dominantly used in rural areas.[36]

[35] It is meaningful to note that similar patterns can be observed even among MSMEs. The Zambia Business Survey (2010) reported that 52% of uninsured MSMEs do not understand what insurance is, 27% do not perceive the benefits of insurance, whilst 20% were unaware of the types of insurance products applicable to them.

[36] Money transfer and remittances are still largely carried out through personal delivery – e.g. delivery via public buses, friends or relatives.

Conclusion
Given these and other issues, expanding rural/agricultural financial services in the country will require a combination of interventions that include: (a) strengthening the non-bank sector; (b) introducing other tiers of financial institutions that are better placed to service more remote locations; (c) promoting an integrated financial system (e.g. through linkages/partnerships between current suppliers); (d) strengthening institutions that provide agro-technical support to farmers (e.g. to facilitate clustering/aggregation of small-scale producers, support crop diversification, and facilitate access to markets); and (e) supporting financial education.

4.2.6 Zimbabwe

Box 4.6 Zimbabwe main financial headlines (FinScope 2011)

- 40% of Zimbabwe's adult population are financially excluded and do not use either formal or informal financial products.
- Most Zimbabwean adults who are financially served use either formal (38%) or informal (41%) products.
- Only 5% of Zimbabweans in rural areas have access to a bank (within 30 minutes reach) compared to 49% in urban areas.
- Only 10% of Zimbabweans use an ATM/cash point card.
- 31% of Zimbabweans do not put money aside: of those who do, 27% do so at home, 12% are members of savings clubs and 11% have/use savings products/services from a commercial bank.
- 31% of Zimbabweans have/use some kind of financial product covering risk.
- 40% of Zimbabweans send or receive money: 17% have received money from within Zimbabwe and 14% received money from outside.

Zimbabwe has a rural population of about 8.3 million people, equating to about 65% of its total population (FinScope Zimbabwe, 2011), and agriculture is central to the rural economy. The economy and the agricultural sector have been through difficult times over the last decade following political volatility, government policies and the agricultural land reform programme, which saw the government take over almost all large-scale commercial farmland. These changes have caused agricultural production to fall to about 50% of 2000 levels and poverty levels to increase dramatically. The land reform programme has benefited a relatively small number of mostly rural farmers (150,000–300,000) through access to more and better agricultural land. The economy and the agricultural sector started recovering, albeit slowly, in 2010.

There are severe constraints to accessing finance in rural areas in Zimbabwe. More than half of Zimbabwe's rural adult population (51%) is financially excluded and only 12% are formally banked, compared to 47% in urban areas (FinScope Zimbabwe, 2011). The demand for insurance is limited as it is expensive and also because many small-scale farmers and rural enterprises have not been exposed to the service. Several contract-farming companies and input suppliers use some form of credit insurance to protect against the risk of farmer repayment default on input credit. Demand for transaction services has recently grown dramatically with the introduction of mobile banking services. With 85% of the population having access to a mobile phone (FinScope Zimbabwe, 2011) and some signal

coverage in most rural areas the potential of mobile banking is huge. There is also significant demand for foreign exchange services from cross-border traders in agricultural produce.

On the supply side, Zimbabwe's banking sector comprises 26 operational banking institutions, 16 licensed asset management companies and 157 operating MFIs. These are regulated by the Reserve Bank of Zimbabwe. Suppliers or facilitators of financial services include commercial banks, insurance companies, building societies, leasing companies, MFIs, contract-farming companies, transaction service providers, informal suppliers, public sector institutions, and donors. Contract-farming companies are a significant source of funding for the small-scale farming sector and have a positive knock-on effect on rural economies. Funds are often sourced offshore, especially by the large tobacco and cotton companies. Insurance and guarantee services show potential for reducing the risk of farmer default on input credit and are currently being offered on a limited basis. Government involvement as a supplier of finance to the agricultural and rural sectors remains limited due to a lack of allocation of resources. Donors continue to be an important source of finance for rural development and for the development of the agricultural sector, and there are several programmes to support these sectors.

Many of the constraints affecting access to rural and agricultural finance in Zimbabwe are at the macro level as they are related to the poor state of the economy. There is a lack of liquidity in Zimbabwe's economy: as a result of the country's recent economic history, domestic savings and inflows of foreign investment have shrunk. Financial institutions are therefore severely constrained in making loans and as a result tend to charge high interest rates and lend on 30-day terms only. This has created an acute shortage of finance available to the financial sector, which has pushed up interest rates and limited credit and other financial services to all but a few customers who can afford the services. Financial services to the agricultural sector and the rural economy have been particularly marginalised in this process as they are perceived to be high risk. Most formal and informal micro-lenders collapsed either as a result of the loss of financial assets due to the hyperinflation in 2007–2009 that lead up to dollarisation, or due to their inability to compete with government subsidies for agricultural inputs. Many service providers are struggling to recover from this in terms of products and outreach: there are now around 150 MFIs in Zimbabwe compared to more than 300 before the crisis. However, the financial sector is now starting to recover as the wider economy also does so. Financial institutions are also subject to lending restrictions and have mandatory interest rate ceilings on loanable funds at levels below market-clearing rates. Furthermore, the government's land reform policy has adversely affected access to finance, particularly in rural areas. The policy caused international isolation, significantly reducing foreign exchange and foreign investment. Financial institutions do not accept the 99-year leases given to new land occupants by the government as collateral, as these are not secure and the government has made the lease non-transferable. Finally, as in many other countries in southern Africa, the lack of good roads, electricity and internet connections in rural areas discourages financial institutions from offering financial services, restricts rural residents' ability to access such services and pushes up transaction costs.

There are two main meso-level constraints to increasing access to financial services in the rural areas of Zimbabwe. The first is the lack of capacity in many financial institutions, including in terms of infrastructure (for example, MIS), technical ability, training, staff skills and institutional capacity. There is also a lack of capital for banks to provide wholesale finance to MFIs as a result of the general lack of liquidity in the economy.

There are several constraints at the micro level. Most credit tends to be offered on a short-term basis and there is little financing available for medium- and long-term productive investment of the type farmers really need to purchase equipment and grow their business. The cost of finance is high and credit is generally out of reach for small-scale farmers and mostly confined to large commercial agro-enterprises. As in other southern African countries,

financial institutions tend to be concentrated in urban and peri-urban areas. However, this has not always been the case in Zimbabwe: Agribank and the Post Office Savings Bank (POSB) both had large networks (including in rural areas) but are currently struggling to re-capitalise and are making huge losses. Some other banks have closed their rural branches as they have lost their client base (partly as a result of the land reforms mentioned above) and many are downsizing due to the unstable economic environment. As in South Africa, there is also a widespread fear of losing assets due to failure to repay a loan, which means many people do not even attempt to access credit. This is linked to the low levels of financial literacy in rural areas of Zimbabwe: a lack of understanding and awareness of the range of financial products available means that people do not therefore access appropriate financial services.

Having identified these constraints, it is important to consider some key factors enabling access to rural and agricultural finance in Zimbabwe. The economy is now starting to recover, with economic growth moving from 6% in 2009 to 9% in 2010 and 9.3% in 2011:[37] this has brought about recovery in the financial sector, with an increasing number of banks and resultant increasing competition and new product design. The government also gives high policy priority to the rural and agricultural sectors. There is an increasing focus on rural development and small-scale farmers in the government's policy priorities and resource allocation. For example, agricultural financing for smallholder farmers has been provided through state-subsidised input schemes. Such prioritisation and related resource allocation will hopefully lead to increased financial inclusion in rural areas.

Conclusion

Given the above analysis, expanding rural/agricultural financial services in Zimbabwe will require a combination of interventions that include: (a) expanding branchless financial services to rural areas (for example, through mobile money or agent banking); (b) finding alternative collateral mechanisms (for example, the use of movable assets as collateral); and (c) supporting financial education programmes in rural areas. This could in turn increase demand for financial services by creating greater awareness and understanding of financial services. The supply of financial services could be improved through addressing key national issues affecting the financial sector, the economy and law enforcement and thereby creating a conducive environment for investment. Exploring various insurance and guarantee services could also enhance supply by some providers by reducing risk. Access could be further enhanced through ensuring that the policies for rural and agricultural sector development include access to finance and by extending the financial services currently offered through mobile banking.

4.3 Summary of common issues

As indicated at the beginning of this chapter, in conducting the country analysis, the team identified certain common issues. These issues fall into three broad groups relating to: 1) the role of government and development policy; 2) supply-side constraints; and 3) demand-side barriers to financial access. They are listed under those categories in Table 4.3.

Table 4.3 Common issues for agricultural and rural finance in Southern Africa

Thematic area	Common issues

[37] World Bank Development Indicators [http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG/countries/1W-ZW?display=default] Accessed 16 July 2012.

Role of government and development policy	• Unstable macroeconomic performance • Some financial policies cause market distortions (e.g. mandatory interest rate ceilings) • Some governments are directly involved in financial services (e.g. through ownership/management of DFIs, implementation of SME and guarantee funds) • Agricultural policies that do not facilitate (crowd-out) private sector participation (e.g. some subsidies, export bans, price fixing)
Supply-side constraints	• Limited incentives for financial institutions to offer/increase agricultural/rural finance • Finance often available for commercial agriculture but less so for small-scale farming • Suitable products also not available for emerging farmers (those moving from small-scale to more commercial agriculture) • Weak VCF: lack of linkages, poor level of trust among players • Lack of capacity (MIS and human) in financial institutions (especially among non-banks and informal providers)
Demand-side barriers to financial access	• Low population density: highly dispersed (limited aggregation among many smallholders) • High level of poverty in rural areas • Lack of access to markets by many smallholders • Exposure to risks: highly erratic income flow and vulnerable to loss of livelihood (e.g. crop and livestock failure); health (e.g. HIV/Aids) • Land issues: difficulty of using land for collateral • Lack of financial capacity/literacy

We kept these issues in mind throughout this study, both in selecting the case studies for the shortlist and when drafting the case studies, in order to ensure that the case studies are as applicable and relevant as possible to the six study countries.

5 Examples of innovation/best practice to address gaps identified

Following the longlisting and shortlisting process outlined in Chapter 3, the OPM/Kadale team, in consultation with the Technical Committee, arrived at a shortlist of 12 case studies. Table 5.1 summarises the main elements of each case study and is followed by the full case studies themselves.

Each case study includes the following information:

- The rationale for the proposal: why is the case study potentially suitable to the southern African context?
- One or more examples of where it is in operation and what the impact on access and uptake has been;
- Outline of the essential features of the design and operating procedures;
- Detailed description to enable replication in southern Africa (including enabling environment prerequisites, capitalisation requirements, sources of finance, degree of self-sustainability, delivery channels, timeframe for operationalisation, TA needed, expected costs and benefits and leverage potential); and
- Any other aspects of relevance.

Table 5.1 Summary of proposed case studies

	Case study title	Lead case[38]	Variant(s)[39]	Level of intervention	Category[40]
A	Clustering farming in Peru – a comprehensive approach to agricultural finance	Critecnia (29)	NorminVeggies (30)	Micro (client and supplier)	Addressing suppliers'/providers' constraints
B	Micro-leasing in Bolivia: how to facilitate access to capital for productive investments	ANED (2)	Network Leasing Corporation Limited (NLCL) (28)	Micro (supplier) (and macro: links with regulation)	Overcoming demand-side barriers to financial access
C	Facilitating MSME Investment: Sharing the risk and bringing partnership expertise to bear	InVenture (11)	EFA (35), Funding Circle, Kiva	Micro (client and supplier)	Developing demand-driven financial products and instruments
D	Production risk insurance: partnerships for promoting lower-cost production risk reduction	Kilimo Salama (20)	Livestock Insurance (18), MicroEnsure (23), Opportunity International Bank Malawi Limited (OIBM) (22)	Micro (supplier)	Addressing suppliers'/providers' constraints; Developing demand-driven financial products and instruments; Overcoming demand-side barriers to financial access
E	Market system change/M4P	PASS Trust (36)	Agricultural Finance	Micro, meso and macro	Addressing suppliers'/providers' constraints; Developing demand-driven financial products

[38] Numbers in brackets refer to longlist case study numbers in Annex C.

[39] Again, numbers in brackets refer to longlist case study numbers in Annex C.

[40] As explained in section 5.2, the categories of intervention established in this study are: (1) Role of government; (2) Addressing suppliers'/providers' constraints; (3) Developing demand-driven financial products and instruments; (4) Overcoming demand-side barriers to financial access; and (5) Developing market infrastructure.

			Markets Scoping (AGFiMS) (33)		and instruments; Overcoming demand-side barriers to financial access
F	VCF: adopting an integrated approach	Hortifruti (12)	BASIX (13)	Micro (client and supplier)	Addressing suppliers'/providers' constraints
G	Strategies adopted to lower the cost of supplying rural financial services	XacBank (24)	Rural banks in the Philippines (31)	Micro (supplier)	Addressing suppliers'/providers' constraints
H	Reform of development banks in Asia	Reform of Agricultural Development Banks in Asia(27)	N/A	Micro (supplier)	Role of government
I	Mobile money: scale or substance?	WIZZIT (32)	M-PESA (19/17)	Micro (supplier)	Addressing suppliers'/providers' constraints
J	Finding alternative collateral – China's online receivables registry	International Finance Corporation (IFC) China (7)	Replication in Malawi	Meso, micro (supplier and client)	Developing market infrastructure
K	SaveAct – doing more than enabling people to save in rural South Africa	N/A[41]	N/A	Micro (supplier)	Developing demand-driven financial products and instruments
L	Regional cooperation in agricultural and rural finance: what can AFRACA learn from APRACA?	APRACA (25)	AFRACA	Macro, meso	Developing market infrastructure

[41] This was suggested as a case study by the Technical Committee after the longlisting process had taken place.

5.1 Towards best practice policies, approaches and models: categories of intervention

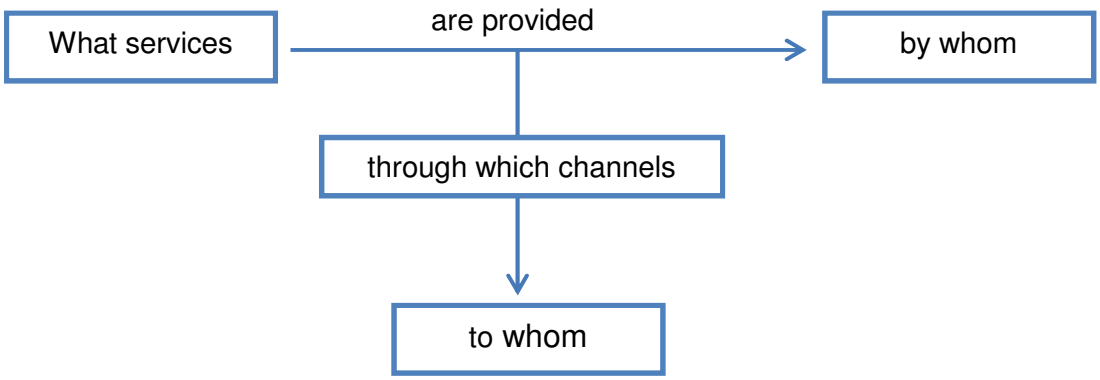
The selected case studies need to be set out in a way that facilitates a synthesis of best practice approaches and models. It is useful to begin the exercise by reverting to the four questions from the Terms of Reference with which we began:

- What categories of public and private sector intervention are needed at the macro, meso, micro and client levels in order to address the rural and agricultural finance challenges in the region?
- What are the best African and international current practices and recent innovations in respect of each of these categories of intervention?
- What are the circumstances and main drivers that have enabled these practices to develop and bear fruit?
- What is needed to enable such practices to be applied with success in the six study countries and in SADC as a regional economic community?

In this section, a first categorisation of interventions is proposed, within which the best current practices and recent innovations, as exemplified in the case studies, are classified. Categorising interventions in agricultural and rural finance is not an easy task. The micro/meso/micro model of M4P is very useful for analysing the approach to be taken in intervening to tackle a specific issue or class of issues, but it is less useful in categorising the interventions themselves. That is because interventions may be needed at several levels to tackle binding constraints that may also apply at more than one level. For example, reducing the time it takes for clients to get to a bank branch – a micro level issue that could also be described as a macro (infrastructure) level issue – might require: (a) changing the regulations for the physical structure of branches (macro level); (b) modifying the approach that supervisors take to inspecting branches (meso level); (c) improving the connectivity of the real-time gross settlement network (meso level); and (d) establishing linkage-banking initiatives or partnerships between banks, non-banks (SACCOs and MFIs) and other institutions – e.g. post offices, local retail outlets, etc. – using agent-banking models (micro level).

In order to be useful, however, all interventions ultimately need to have a positive impact on the services that are actually provided by financial service providers to people and businesses in the rural and agricultural sectors. For the purposes of this study, therefore, we propose to categorise interventions very simply on the basis of *what services* are provided *by whom*, through *which channels*, and *to whom*, as shown in Figure 5.1.

Figure 5.1 The simplified structure for categorisation



Obviously all interventions involve all four elements in Figure 5.1, but the virtues of each intervention and its innovative characteristics will tend to have a specific focus, and it is that focus on which the categorisation is based, as illustrated in Table 5.2.

Table 5.2 The structure for categorisation: key focus areas for interventions

	Services	Providers	Channels	Users
A. Clustering small-scale producers		☑	☑	☑
B. Micro-leasing	☑	☑		
C. Facilitating MSME investment	☑			☑
D. Production insurance	☑			☑
E. M4P interventions	☑	☑	☑	☑
F. VCF	☑	☑	☑	☑
G. Lowering transaction costs for providers		☑	☑	
H. Reform of development banks	☑	☑		
I. Mobile financial services			☑	
J. Alternative collateral	☑		☑	☑
K. Working with SCGs			☑	☑
L. Regional networks			☑	

We propose then to simplify the categorisation of the case studies on the basis of an extended version of the thematic areas under which the common issues are grouped in section 4.3, as listed below and summarised in Table 5.3.

1. **Role of government**
   - Case Study H: Reform of development banks
2. **Addressing suppliers/providers' constraints**
   - Case Study A: Clustering small-scale producers
   - Case Study D: Production insurance
   - Case Study E: Making Markets Work for the Poor
   - Case Study F: VCF
   - Case Study G: Lowering transaction costs for providers
   - Case Study I: Mobile financial services
3. **Developing demand-driven financial products and instruments**

- Case Study C: Facilitating SME Investment
- Case Study D: Production insurance
- Case Study E: Making Markets Work for the Poor
- Case Study G: Lowering transaction costs for providers
- Case Study K: Working with SCGs

4. Overcoming demand-side barriers to financial access

- Case Study B Micro-leasing
- Case Study D: Production insurance
- Case Study E: Making Markets Work for the Poor

5. Developing market infrastructure

- Case Study F: VCF
- Case Study J: Registry for alternative collateral
- Case Study L: Regional networks

Table 5.3 Clustering of case studies

Category	Case study
1. Role of government	H
2. Addressing suppliers/providers' constraints	A, D, E, F, G, I
3. Developing demand-driven financial products and instruments	C, D, E, G, K
4. Overcoming demand-side barriers to financial access	B, D, E
5. Developing market infrastructure	F, J, L

Within each of these clusters we, while elaborating the case studies, have addressed the third and fourth of the four questions with which we started, i.e. the circumstances and main drivers that have enabled these practices to develop and bear fruit within each category and what is needed to enable such practices to be applied with success in the six study countries and in SADC as a regional economic community.

5.2 CASE STUDY A: Clustering farming in Peru – a comprehensive approach to agricultural finance

5.2.1 The rationale for including the case study

A farming cluster is a concentration of interconnected businesses, suppliers, and associated institutions in a particular field. The main aim of clusters is to increase the productivity with which companies can compete, nationally and globally. The cluster usually includes the entire range of input–output linkages in production of and transactions in goods and services. A key factor in farming clustering is the presence of complementary economic activity – e.g. specialised suppliers, a large or advanced local customer base, producers of complementary products and services, specialised institutions, etc. – which increases the pool of available inputs in a location while giving rise to externalities of various sorts. This, in turn, enhances the incentives and resources available for entrepreneurship, innovation and growth.

Comparison with other regions indicates that the relative 'isolation' of farmers in Africa is one of the reasons why it is difficult for rural agriculture to take off. Clustering is a way to enable southern African farmers to participate more equitably in the opportunities to evolve dynamic markets. Through the clusters, farmers have better chances to proactively plan their production in cooperation with the big consolidators servicing these high-value markets, to manage quality and to consolidate significant product supply.

The experience of **Critecnia** in Peru is a useful case study in that context: it shows that clustering strategies increase the bargaining power of farmers, introducing new dynamics in the marketplace, and gradually ensure the replacement of adversarial relationship with some traders into collaborative arrangements with product consolidators and institutional buyers. This case study is presented in the hope that it may contribute to the creation of innovative supply chains in the SADC region that may give small farmers, through acting collectively, the benefits of more stable markets and/or higher returns.

This case study is particularly relevant because the challenges and obstacles that Critecnia had to overcome in Peru are very similar to those constraining rural and agricultural development in southern Africa. These **challenges** included:

- The resistance of farmers to working together – farmers' previous negative experiences with associative approaches to production and marketing had undermined their trust in collaborative methods. The most notorious cases were the financial and governance problems that triggered the collapse of many cooperatives in the past;
- The low level of contract compliance and repayment culture. The origin of this problem in Peru lies in the interventions of publicly owned DFIs that weakened the repayment culture during the 1970s and 1980s. Critecnia's approach to overcoming this obstacle was to focus on the creation of incentives for farmers to comply with their contracts;
- Limited education and technical skills of farmers. The model used by Critecnia relies heavily on using local village leaders as the linkage between the company and the cluster of farmers; and
- The narrow and limited vision that commercial banks had of rural activities, which are often perceived as highly risky.

5.2.2 Description of the innovative model proposed by Critecnia

Critecnia is a private company providing services to farmers in rural areas in the provinces of Cañete and Chincha, around 150 km to the south of Lima. It is a family business originally

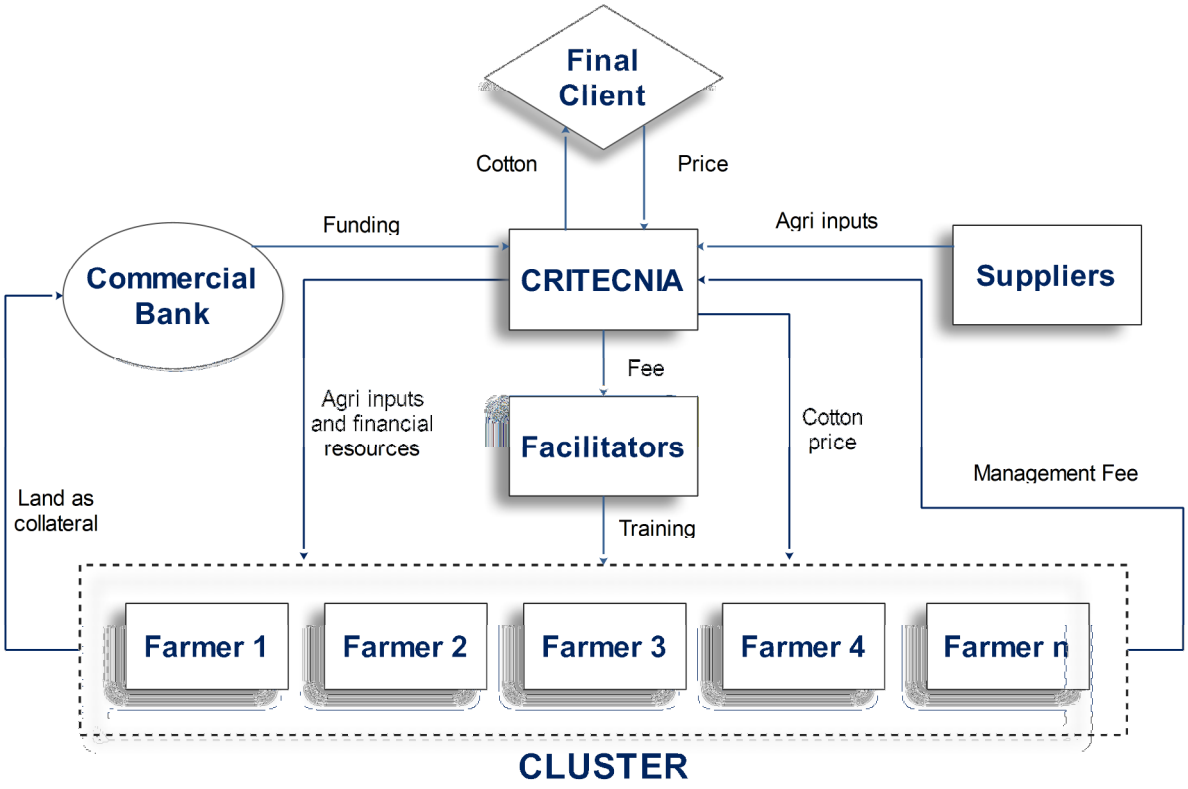
created to provide support to cotton farmers. Most of the farmers in these provinces are former members of cooperatives formed during land reform in the 1960s. After the financial and administrative collapse of these cooperatives in the early 1980s, these farmers received titles to the property of their lands.

The model, which was entirely developed by Critecnia (without any support from any external agent or donor), involves the creation of a company whose principal activity is to offer integrated management services for the agrarian sector. Critecnia selected a group of small-scale farmers in order to create a company composed only of farmers. The farmers' company signed contracts with Critecnia to receive their management services. Critecnia's functions include: (a) seeking financing resources, using farmers' land as collateral along with the likely future harvest; (b) the management of all activities in the agricultural production process; and (c) the commercialisation of production. For these services, Critecnia receives a fixed amount of money and a percentage of the produced income as payment for its successful management. The contract also requires Critecnia to provide services such as product marketing studies, marketing, advice and financing, and assistance with loan applications and dealing with the bank.

Understanding the idiosyncrasies of micro and small farmers in the two provinces was critical to Critecnia's success. Critecnia found that farmers' deep mistrust of new projects, combined with their own lack of skills, was an important factor in their lack of progress. Even when new projects started successfully they often failed after a short time because farmers decided to give up their obligations and return to the original position where the government would support them without any obligations on their part. Incorporating the farmers' own ideas and experiences as part of the project was one of Critecnia's main goals. This increased the farmers' sense of ownership, which was extremely important in guaranteeing the sustainability of the project. Critecnia uses facilitators as a linkage between the company and the farmers' company and their role is critical. The criteria used to choose facilitators are: (a) high level of knowledge that permits them to understand the specifics of the model (academic studies and relevant practical experience); (b) high level of credibility among the farmers; (c) belief in the benefits of the model; and (d) advanced skills in communication and leadership. Facilitators manage the relationships with the farmers from the beginning, explaining the benefits and obligations of the model and taking charge of communications between Critecnia and the farmers. The role includes the following functions: (a) training the farmers in the basic principles of the business model; (b) receiving and dealing with complaints from farmers; and (c) opening a channel of communication between the company's directors and the farmers. In this sense, an important part of the success of the model can be attributed to the efficient work of the facilitators.

Figure 5.2 below shows in more detail the structure of the relationship between Critecnia and the farmers' firm (the cluster).

Figure 5.2 Structure of the Critecnia model



Source: OPM

The main features of the relationship include:

1. Critecnia identifies farmers who could be seen as leaders by their peers. These farmers act as facilitators – they have a good reputation and know the sector quite well. They become full-time staff of Critecnia for the whole length of the contract (one year).
2. Facilitators contact other farmers in the region and hold informative meetings with them. A key part of the process is explaining the requirements to become part of the structure. These are:
   (i) To own at least four hectares of land with property titles and no mortgage;
   (ii) To get a group to form a limited liability company controlling at least 100 hectares;
   (iii) To sign a management contract with Critecnia; and
   (iv) To produce a good cotton harvest.
3. Farmers included in clusters sign a management contract with Critecnia lasting one year. This contract includes obliging farmers to give a fixed part of their production to Critecnia, while retaining the option of choosing between a price determined at contract signature or the market price at the moment of the sale.
4. Critecnia then applies for a working capital loan with each farmer's separate land as collateral. The bank issues a loan with which Critecnia buys agricultural supplies in bulk (thus benefiting from reduced prices) and delivers these inputs to the farmers. The rest of the loan is used for other expenses such as labour. Critecnia retains a fixed amount and a percentage of any income generated.
5. Facilitators act as agents in loan monitoring and recovery while Critecnia delivers technical services. Facilitators receive an additional commission based on the yield and

delivery of the harvest. After the harvest, Critecnia distributes the net profits to each farmer after deducting loan principal, interest, and a commission for management and technical advice.

6. In the case of non-repayment, the bank can execute individual pledges. In cases in which non-repayments are the result of exogenous circumstances, Critecnia renegotiates the debt with the bank.

The benefits for the farmer include: (a) accessing discounted production inputs, thanks to the economies of scale resulting from Critecnia buying supplies in bulk; (b) obtaining better prices for the sale of products; (c) capitalising on the experience and reputation of Critecnia's management and gaining enhanced skills through the training provided; and (d) benefiting from reduced risk, which in turn helps to reduce the interest rates at which farmers receive their loans: having individual responsibility for loan payment means that the entire company does not have its credit rating degraded.

In a nutshell, the whole model is sustained by two cornerstones:

- The generation of trust between Critecnia and the farmers, thanks to the presence of facilitators; and
- The generation of economies of scale in a way that ensures that all farmers share the increased benefits, while losses are assumed individually rather than collectively.

5.2.3 Other examples of 'clustering'

In the Philippines, **NorminVeggies** (Northern Mindanao Vegetable Producers' Association, Inc.) is an association of vegetable farmers and stakeholders in Northern Mindanao who have organised themselves to undertake and implement strategies to access new market opportunities within the vegetable industry by innovating and increasing their value-added activities. The association formed marketing clusters based on farmers' capability, interest and level of capitalisation. Access to capital is facilitated by the Kaanib Foundation Inc., the NGO member of NorminVeggies. The Foundation makes available a production fund that finances the farmers in a way similar to financiers/traders: this means that it is perceived as a business transaction and not a dole out. To repay the loan, the farmers give 30% of the net sale proceeds, i.e. after deducting the farm inputs and other costs. This 30% is deposited in the local cooperative, which together with a grant fund provided by Lutheran World Relief Services will constitute in the future a loan fund.

However, getting access to credit is not the only benefit for small farmers – there are other important synergies because of the collaborative effort. The co-sponsorship of the government results in important benefits for the association. For example, farmers were able to get an interest free, five-year loan from the Department of Agriculture to the association for the acquisition of a reefer truck and two chillers. This kind of deal would have been impossible if the farmers had not decided to work together.

In addition to these financial advantages, farmers receive technical support to improve the quality of their production. Thus, they follow a quality assurance plan for each product, have training in good agricultural practices, and designate lead farmers to act as quality managers and coaches. Small farmers are clustered with independent farmers who help jumpstart quality production. Benefits and accountability for quality are shared between all the cluster members. Products are traceable to the farm and farmer who supplied each pack or crate of produce. Farmers maintain ownership of their own products up to the institutional market and therefore have a greater participation in the value chain.

These two examples illustrate the old adage 'unity makes strength'. Chapter 4, in its summary of the southern African situational analysis, shows how difficult it is for individual

farmers to get access to financial services. Replacing individuals with larger groups, as was done in Peru and the Philippines, may be an effective way not only to increase access to financial services for southern African farmers but also to improve the quality of production, to get better access to markets (for selling products or buying inputs) and/or to reinforce the position of farmers within the value chain.

5.2.4 Conditions to develop clustering in southern Africa

As mentioned above, the main obstacles to the development of clustering in Peru, which can also be found in southern Africa, were:

- The resistance of farmers to working together;
- The low level of contract compliance and repayment culture;
- Limited education and technical skills; and
- Narrow and limited vision that commercial banks have of rural activities, which are perceived as highly risky.

From the perspective of a value chain, these bottlenecks can be divided into the following categories:

- **VCF bottlenecks**: mainly (a) insufficient trust between the actors across the value chain; (b) poor incentives for repayment of loans; and (c) poor incentives for using other financial services such as insurance, savings etc.;

- **Agricultural finance bottlenecks**: mainly (a) lack of products to serve rural smallholders; (b) insufficient skills for risk assessment and management in the financial sector; and (c) inadequate rural banking infrastructure (branches/service points/agents/mobile network infrastructure to enable mobile banking); and

- **Bottlenecks with sector-wide impacts**: asymmetries of information and power among different actors across the value chain.

These bottlenecks do not operate in isolation. For that reason, any intervention to improve cluster farming in southern Africa needs to take account of the links between bottlenecks. The key factor in Peru in overcoming these obstacles was the existence of a private company at the heart of the value chain, Critecnia, with the knowledge, skills and links to act as a focal point, creating trust between the actors, who are mainly farmers but also financial institutions and input suppliers.

The story of **Snacks** in Box 5.1, also in Peru, provides an interesting example of how a clustering initiative can evolve into autonomy and sustainability.

Box 5.1 Bringing actors together along the value chain

Snacks America Latina Perú SRL, which was founded in 1995 and forms part of the PepsiCo multinational, supplies 85% of the Peruvian crisp market. In 2001 they needed to diversify their sources of potatoes to the coastal lowlands, to bridge the seasonal gap in their traditional sources high in the Andes.

They did not have the capacity to train and organise farmers to grow the crop. Snacks was willing to pay extra for a reliable supply, and to agree on prices beforehand. But it would be too cumbersome to sign contracts with numerous individual farmers. The answer was to team up with Fovida, an NGO that promotes the development of small-scale farmers. Fovida agreed to help develop potato production in the coastal lowlands to help fill the seasonal gap, working with farmers in the Chillón River area, near Lima. The NGO helped farmers organise into a producers' group, called the Asociación de Productores.

Thus, Snacks signed a contract with Fovida to supply the potatoes to the Snacks factory. This contract specified quantities, prices, delivery times, and so on. Fovida was also obliged to provide post-harvest services such as selection, loading and transport of the potatoes, and handle all the documentation. It also had to ensure that the farmers did not sell the potatoes to other buyers. If the quality was below specification, the company would not accept delivery. This contract gave Fovida a lot of responsibility and a lot of risk: it became a major actor in the value chain.

Credit for the potato farmers was provided by Credivida, a separate Fovida credit programme that had hitherto worked mainly in urban areas but which agreed to tailor-make a financial product to suit the needs of the potato growers. It was willing to do this because in Snacks the farmers had a firm buyer with a guaranteed price and because Fovida managed the chain, provided technical support to the farmers and handled all the payments.

The structure of the arrangement evolved in three stages:

- Fovida had been providing its services free to the Asociación, funded by Novib, a Dutch donor agency, but after the Novid project ended in 2004 the Asociación paid a service fee that covered most of Fovida's costs.
- In 2008, Snacks agreed to include the Asociación as a formal partner in the agreement. Instead of a supply contract between Fovida and Snacks, there was now a tripartite contract between the company, the NGO and the farmers' group. In the new agreement, Fovida stopped being a direct actor in the chain. The farmers took over full responsibility for producing and delivering the potatoes to Snacks in accordance with the quality standards agreed upon. Fovida was now responsible only for providing technical and business support to the farmers, in return for its service fee.
- In 2009, the agreement with the buyer was revised again: the Asociación contracted directly with Snacks, without Fovida being involved. The tripartite arrangement has been replaced by a bilateral contract between the farmers and Snacks. The farmers may choose to contract separately with Fovida to supply technical and business support services (they have to pay the full cost of these) or they are free to make arrangements with other service providers if they wish. This means that Fovida has moved from being a major chain supporter with triangular relationships with Snacks and Credivida, to a mere supplier to the chain.

Source: Royal Tropical Institute and IIRR (2010)

Needless to say, a company like Critecnia cannot be created out of nothing: this is a lengthy, organic process. But in the southern African context there are companies that are not far away from where Critecnia was when they started promoting cluster farming. What the Snacks case study shows is that the involvement of other actors – in this case, an NGO initially supported by a Dutch donor agency – may accelerate the process, bringing different actors closer along the value chain. So, in order to develop successful clustering experiences in southern Africa, the following steps are necessary:

1. Identify private companies, whether they are processors, traders or wholesale assemblers, potentially interested in working with clusters of farmers.

2. Analyse the role of these companies within the value chain, with special emphasis on the weakness of their relationships with other actors.

3. Promote pilot projects to overcome barriers and create trust along the value chain, involving other actors like NGOs or development institutions that may facilitate the reduction of asymmetries of information and power.

5.3 CASE STUDY B: Micro-leasing in Bolivia: how to facilitate access to capital for productive investments

5.3.1 The rationale for including the case study

Micro-leasing is a collateralised lending product that can be described as long-term rental to a single client. Its attractiveness as a financial product stems from the separation of ownership and use over the full useful life of an asset. By converting an initial large capital outlay to a stream of smaller payments over time, leasing enables micro and small business to overcome capital impediments. Not having the resources to buy an asset is therefore no longer a barrier to acquiring the asset.

There are two types of equipment leasing arrangements: the financial lease and the operating lease. In a financial lease, the client (lessee) pays the full price of the equipment, plus interest, through the lease period. At the end of the lease period, the client may purchase the equipment outright for a nominal amount (usually the depreciated asset value). In an operating lease, the client rents the equipment for a specified period, at the end of which the client returns the equipment, buys it outright, or renews the agreement. In the case of an operating lease, the client may cancel the agreement and return the equipment before the end of the lease period.

This case study is highly relevant to the southern African context as long-term financing is rarely available to farmers and micro and small rural businesses. Micro-leasing could therefore provide an effective alternative to taking on more debt. In short, the advantages that micro-leasing may bring to southern African rural areas are the following:

- **Absence of collateral requirement:** the country analyses reveal that the absence of collateral is one of the main barriers to accessing credit in rural southern Africa. The main advantage of micro-leasing is the absence of external collateral requirements. The equipment itself serves as security because the lessor retains ownership. If the lessee is unable to make the payments, the lessor can repossess the asset. In most countries, this is a relatively straightforward procedure;
- **Simpler evaluation:** the lack of relevant skills and understanding in financial institutions on what is happening in rural areas is one of the reasons most commonly cited to explain lack of access to and use of financial services. A micro-lease can be arranged more quickly and simply than a bank loan. Rather than looking into the credit history and asset structure of the client, the leasing company has only to make sure that the client has the ability to generate sufficient cash through the leased equipment. Less detailed documentation is necessary and the appraisal can be processed relatively quickly;
- **100% finance:** the low level of formal savings in the SADC region is another factor explaining lack of access to long-term finance, since banks usually require clients to cover part of the investment from their own resources. Down payments are often as high

as 40% of the investment. In a lease, 100% of the equipment value is financed and up-front security payments seldom exceed 10%. This enables lessees to retain more of their scarce resources as working capital;

- **Tax incentives:** international experience shows that in many countries the tax system is conducive to leasing (ILO, 2003), providing an important incentive to banks and other financiers, such as equipment suppliers, to lend beyond the short-term. The lessor, as the owner of the equipment, registers the full lease payment as income but deducts the depreciation of the asset for tax purposes, usually on an accelerated schedule.

This case study relates to the micro-leasing activities carried out in Bolivia by the **Ecumenical National Association of Desarrollo (ANED).** Information is also provided on another interesting initiative, mainly operational in Pakistan, by the **NLCL**. The risks are identified and recommendations are made for launching a micro-leasing programme in the context of the southern African region.

5.3.2 Description of ANED's micro-leasing product

ANED was founded in 1978 for the exclusive purpose of providing credit to low-income people who were traditionally ignored by the banking sector, in both urban and rural areas. It was the first institution of its kind in Bolivia, offering specialised financial services to the poorest segments of the population.

ANED's micro-leasing programme emerged in 1997 as a response to the needs of many rural producers to have fixed assets to enable them to significantly increase their productivity and income. ANED had already attempted to satisfy that demand through classic associative credit but this had failed, demonstrating that incentives to repay remain weak when there are no real guarantees involved. Furthermore, ANED's solidarity loan programmes could not satisfy demand because the loans were small and short-term. The challenge was therefore to design a financial product that would facilitate the acquisition of fixed assets and, at the same time, incorporate guarantees that would motivate a sector of small farmers and businesses without real collateral to pay back their loans.

In the beginning, the programme encountered the following challenges:

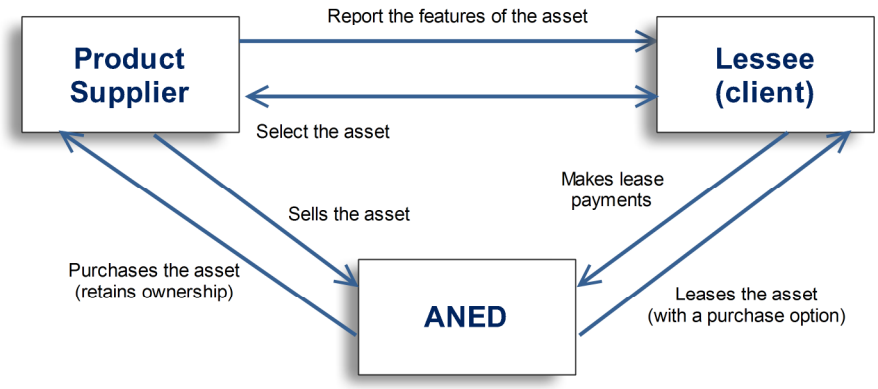
- To develop a methodology through which the programmes could be explained in a simple manner to the users, considering that most of them had only basic education levels;
- At an operational level, ANED had to rearrange their software, as the one that they were using did not take into account the taxes relating to leasing operations in Bolivia; and
- ANED had to identify suppliers who could provide appropriate machinery to meet the needs of the target clientele, as well as to train clients in handling the machines and equipment.

ANED established that the highest demand was for motorised pumps for irrigation purposes, as most of the farmers grow garden vegetables. ANED therefore developed relationships with suppliers of these products. These relationships are extremely important because they ensure that a large part of the promotion, including instruction and training, is taken on by suppliers, which considerably lowers costs. This relationship also ensures that the price paid for the pumps is below what a buyer would be charged individually.

The ANED system is based on operating leases, as illustrated in Figure 5.3 below. Upon completion of the agreed term, the client has the option to purchase the asset, after paying an amount called the 'surrender value'. The key feature of the operation is that the legal property of the asset is separate from its economic use. As mentioned before, this operation

does not require any type of guarantee as the equipment itself constitutes collateral for the operation.

Figure 5.3 The ANED micro-leasing operation



Source: OPM

The contract between ANED and the lessee must contain the following points:

- A first payment ranging from 15% to 25% of the value of the equipment: this provides an incentive for the appropriate use and maintenance of it;
- A contract term not exceeding two-thirds of the economic value of the equipment or five years, to prevent clients from losing interest in purchasing the equipment when faced with obsolete or depreciated items; and
- A relatively low residual value or final lease payment to motivate producers to become owners of the equipment.

ANED's typical clients have a very basic level of education: 55% have completed elementary school and only 5% have finished high school. In the case of complex equipment, such as farm tractors, clients must prove that they have at least two years' experience with similar items. Finally, those who use motorised pumps for irrigation purposes, which as mentioned above are the most frequently leased items, are small farmers who grow from 0.2 to two hectares of vegetables.

5.3.3 Outline of the essential features of the design and operating procedures

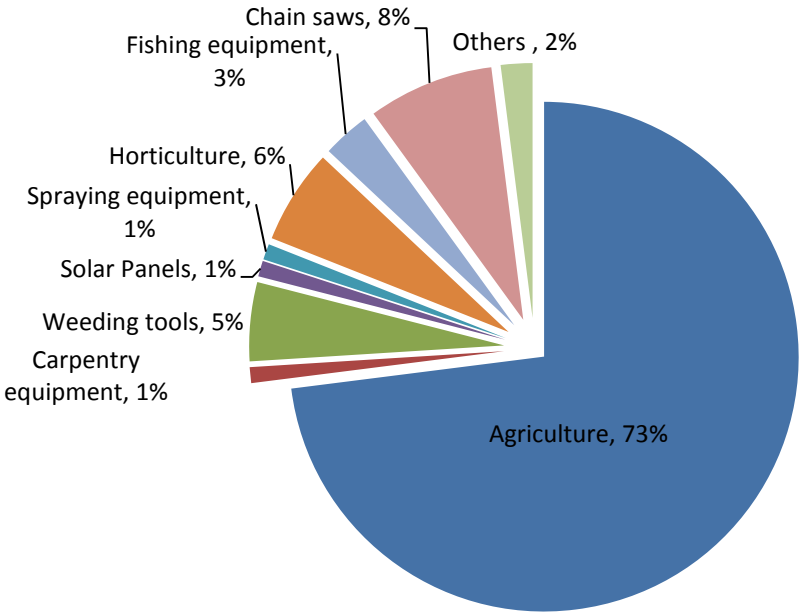
Requirements for clients seeking financial leasing with ANED include not having outstanding debts with the institution and demonstrating experience in the activity for which the piece of machinery is going to be used, as mentioned before. The steps in any micro-leasing operation are the following:

1. Clients express their interest in acquiring a specific type of equipment;
2. Assisted by loan officers, clients obtain the cost estimate on the equipment and attach it to the leasing application form;
3. An ANED loan officer visits the client and sets up a cash flow outline taking the household as the unit of analysis, based on the income expected from the acquisition of the new piece of equipment, minus the lease payments and other expenses resulting from its use;
4. The probable impact of the equipment on the community environment and the risks associated with its operation and maintenance are examined;

5. If the result of the analysis is positive, the loan officer recommends approval of the application;
6. The application is passed on to the Lease Committee to be approved or rejected;
7. If the application is approved, ANED purchases the item; and
8. ANED and the supplier deliver the equipment.

Figure 5.4 below show the main destination for micro-leasing since the programme started in 1997. Farmers in rural areas were by far the main beneficiaries of the project, with tractors and irrigation pumps as the most leased equipment. In total, since its creation, more than US$ 3 million has been invested in Bolivia by ANED.

Figure 5.4 Uses of micro-leasing facilities (1997 – 2012)

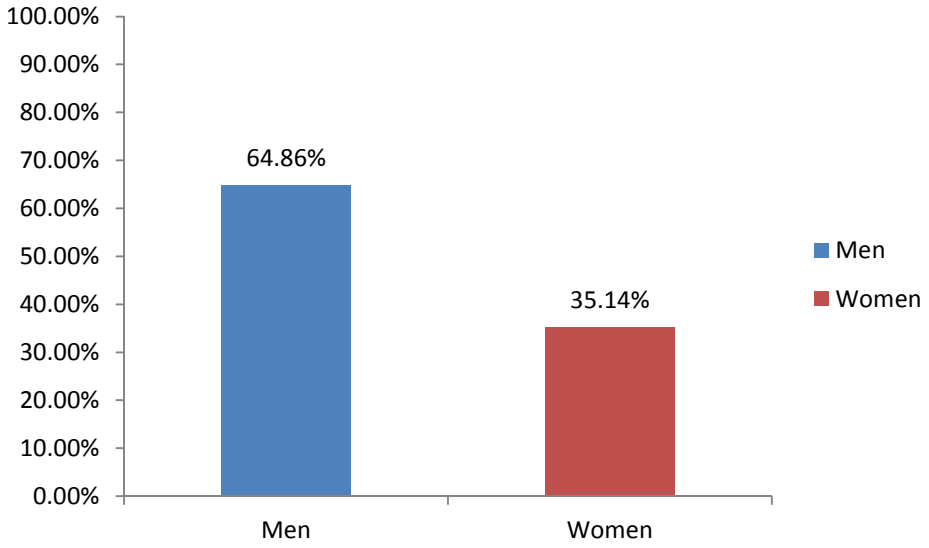


Source: ANED

Among the information provided by ANED, one point in particular stands out – in these 15 years, the average size of a micro-lease was US$ 1,500, which shows that the beneficiaries of the project were mostly micro and small producers in rural areas. This should be reassuring for those who have the unfounded belief that micro-leasing is not a suitable product for small farmers in southern Africa.

Last, but not least, as Figure 5.5 below illustrates, more than one-third of the total beneficiaries of the programme between 1997 and 2012 were women. This proportion is especially significant considering that most women in rural areas in Bolivia have no access to credit because they lack any kind of collateral at all – goods are usually registered in the husband's name. That means that micro-leasing is an effective tool to improve financial inclusion among excluded, collateral-less women.

Figure 5.5 Beneficiaries of ANED micro-leasing programme, 1997–2002



5.3.4 Other relevant micro-leasing experiences

NLCL in Pakistan provides finance leases for both new and used assets of values between US$ 17 and US$ 1,760, with rural leases available in the areas surrounding major urban locations. Examples of products that have been lease purchased include donkey-pull carts and livestock, as outlined in Box 5.2. By 2004, 21% of NLCL's lease portfolio by value and 43% of its leases were in rural areas.

The main features of NLCL operations are:

1. **Security:** the primary security is the asset. Additionally, lessees have to make a security deposit – typically equivalent to 20% of the asset cost for micro leases and 10% for small leases. Lease applicants have to deposit both this amount and the first month's lease rental for NLCL to issue the purchase order for the asset. NLCL does not take additional collateral as security;
2. **Insurance:** two types of insurance coverage are included in all leases provided by NLCL. An all-risk policy protects against general risks such as fire, theft, flood, etc. A group life policy covers all outstanding lease payments if a lessee dies, thereby allowing the leased asset to be transferred to the lessee's family. For all leases except livestock, the insurance is purchased from a commercial provider and the costs are included in the lease rental. Because of the high cost of livestock insurance from commercial providers, the company maintains an internal risk fund that serves the same purpose. The leased animals are stamped for identification;
3. **Lease term:** lease terms range from three to five years. In Pakistan, leases are legally required to last for at least three years. However, many rural clients demand a shorter-term lease, particularly for assets such as buffalo.[42] For such clients, leases are structured such that the lessees complete payments within a period of 18 to 24 months, but the company carries the lease on its books for three years. The last payment made

[42] The demand for a shorter-term lease on an asset such as a buffalo whose life extends over a much longer period may seem strange, but almost all of the producers end up buying the buffalo. Therefore, transactions involving livestock such as buffaloes can be seen as a way of purchasing an asset in instalments.

by the lessee is treated as an advance and is amortised over the remaining lease period in the company's books;[43]

4. **Lease cost:** the costs range between 8 and 17% of gross lease value (all leases are in PKR), including insurance costs. This includes the cost of funds for NLCL, operating costs, loss provision, insurance costs, and profits. The insurance costs 1.5% of the gross lease amount; and
5. **Lease payment schedule:** most leases have a monthly payment schedule. For rural leases, recovery officers visit the lessees on a fixed date every month and collect the lease payments.

Box 5.2 Examples of leasing by NLCL

Siddique in Sharif Pura Daroghewala has leased a donkey-pulled cart worth PKR 10,000 (US$ 168). He uses the cart to transport materials and earns PKR 100 (US$ 1.68) to 400 (US$ 6.72) per rental. Before getting the cart, he used his bicycle for transporting. The donkey cart has increased his productivity because it allows him to transport larger quantities with the same effort. Siddique's lease payment is PKR 765 (US$ 13) per month. When Siddique does not have the lease payment ready on the usual date, the recovery officer comes a second time.

Naziran in Sharif Pura Daroghewala leased a buffalo. She previously leased another buffalo, completed the lease, and now owns it. The new lease is for 18 months and the value of the lease is PKR 25,000 (US$ 420), of which Naziran paid a 20% deposit. Naziran's monthly lease payment is PKR 1,372 (US$ 23). She would like NLCL to increase the maximum lease amount permitted for buffalo leases because the price for a good buffalo that gives 12–15 kilograms of milk a day is more than PKR 40,000 (US$ 671).

Source: Nair and Kloeppinger-Todd, 2004

5.3.5 Conditions to develop micro-leasing in southern Africa

In order to develop a micro-leasing scheme in any of the SADC countries, the following internal and external conditions will need to be addressed:

Internal conditions

- Matching of **financial resources**. An institution offering leasing needs to attract matched resources to finance the leasing scheme. A lessor offering leases with two to three year lease terms needs medium-term financial resources on the liability side of its balance sheet. Leasing companies that do not collect deposits from the public will have to rely on capital markets for equity and/or debt. Some of the larger leasing companies may also be able to use their internal capital resources, particularly if their micro-lease book is only a small part of the firm's overall loan book. Another possible provider of leases might be large equipment manufacturers, but they are not usually interested in providing these kinds of services and also may not have the capacity to successfully engage with farmers. Considering the weak structure of capital markets in most SADC countries, the most likely option is that micro-leasing services are/would be provided by deposit-taking institutions;

[43] This is just a way of managing the accounts – the leases are legally required to last at least three years so when the last payment is made, and this is beyond the three-year period, it is treated as an advance and amortised during the last year. This does not imply that a further lease is signed.

- In terms of **human resources**, any institution offering leasing needs to have the necessary staff skills in-house. Some of the skills required for leasing are different from those required for lending. Lease officers need to be able to assess the value of the equipment, its potential residual value, its usefulness for the farmer or the rural MSME, the extra cash it will yield, and the business environment it operates in. Having said that, the ANED case illustrates how, very often, lease operations are simpler than loan operations, which may fit more easily with the structure of skills in the SADC financial sector;
- **Operational systems**: the lessor needs to have good operational, internal control and accounting systems. As well as an information system for financial monitoring, the lessor has to keep track of the status and value of all leased equipment. This means physical proximity to clients in rural areas, which is one of the main challenges in expanding access to and use of financial services in the region.

External conditions

An **enabling regulatory system** is vital for the development of micro-leasing. Lessors will survive and make a profit only if an enabling regulatory framework for micro-leasing is in place. This means that: (a) procedures for obtaining a leasing license have to be transparent; (b) requirements regarding the capitalisation of the scheme should be less stringent than for deposit-taking financial institutions; (c) procedures for lessors to repossess equipment in case of default have to be straightforward; and (d) the tax treatment of lessors and lessees has to be consistent and favourable to leasing.

In terms of rights, the particular legal hazards of leasing derive from the fact that the ownership of an asset is separated from its possession and use. In every lease transaction there is a potential for conflict between the lessee (who has possession and use), the lessor (who has ownership), and the equipment vendor (who sells to the owner, but extends warranties to the user). The parties involved may have different perceptions of their rights over the asset and the obligations of the other parties. The lease contract gives the lessee the right to possess and use the asset. The lessor must allow the lessee unhindered possession of and use of the asset. The contract should enjoin the lessor in such a way that hindrances will modify the lessee's obligation to make periodic payments. The lessee for his/her part has to be enjoined to use the equipment only for the purposes for which it was leased. The law concerning the supplier will be spelled out in a country's Sale of Goods Act, or equivalent legislation. Such a statute usually holds the seller responsible for the saleability of the goods and their suitability for the purpose.

Box 5.3 The rights of the lessee in Uzbekistan

In Uzbekistan, the lessee is allowed to terminate the lease agreement if the lessor either fails to make the leased equipment available to the lessee or impedes its use as laid out in the lease agreement. The lessee has the right to make demands directly on the vendor of the leased equipment in cases where either the quality or quantity of the equipment supplied does not meet the specified requirements.

Source: ILO, 2003

As mentioned above, one of the main attractions of leasing is that the lessor uses the leased equipment as principal security without the need for any additional collateral. This aspect of leasing is especially important in countries where weak collateral laws and dysfunctional judicial systems prevent or discourage lenders from lending to small enterprises. The legal framework for leasing should assure the lessor's right, in the event of default, to repossess and dispose of the leased asset without hindrance or delay. If this right is not clearly stated

in the legal framework, a lessor might find the lessee claiming that his or her instalments have purchased equity in the equipment. Such claims can lead to long and costly judicial procedures.

Box 5.4 Repossession and residual value in Ghana

The Ghana Finance Lease Law states that in case of repossession:

(1) the lessee shall, unless otherwise stipulated between the parties, be responsible for the immediate payment of all rents due for the remaining term of the lease agreement.

(2) the parties may, under a lease agreement, stipulate that the amount of future rents at the time of repossession shall be decreased by the fair value of the asset repossessed less any administrative costs of the lessor, including but not limited to legal and transportation costs.

(3) The lessor shall not be entitled to recover damages to the extent that it has failed to take reasonable steps to mitigate its loss.

Source: ILO, 2003

One of the big 'ifs' of this case study is what happens if there is no specific leasing legislation in place, as is the case in many SADC countries. If a country has no laws relating to leasing, this does not mean that leasing is impossible or illegal; however, it does mean more uncertainty for the lessor and lessee. The absence of a leasing statute means that there is more scope for misunderstanding and less scope for litigation. In the absence of specific legislation on leasing, the courts may try to deliver justice but may have to resort to persuasion based on indicators of ownership. If there is no specific leasing legislation, the lease contract can be written as an agreement between lessor and lessee on whatever terms they decide between them. The lessor should consider the existing legislation governing credit relationships, especially those which govern the handling of securities in the form of movable assets.

In the absence of an appropriate legal framework for leasing, the costs of leases are likely to be higher. The cost of legal hazards will become one of the risks associated with leasing, and should be realistically estimated. A legal assessment will shed light on potential legal hazards and their likely cost. The assessment will also point to the best institutional structure in which to conduct the leasing business.

As a rule of thumb, micro-lease contracts should be designed with a view to minimising disputes. Disputes can never be eliminated, but it is worth properly evaluating the options for resolving them when they do arise. The cost and speed with which lease disputes are resolved is a factor in the profitable and competitive provision of micro-leasing services. If dispute mechanisms are predicted and accurately factored into micro-leasing costs, leasing programmes become more competitive.

There also needs to be a **sufficient market for leasing**. This requires a critical mass of entrepreneurs in need of medium-term finance. A market of micro and small rural enterprises, all needing different types of equipment, does not in itself constitute an adequate market for micro-leasing. As illustrated by the ANED example, the fact that most of its clients needed more or less the same kind of equipment (irrigation pumps) was critical for the success of the scheme.

The existence of **equipment markets** is also important. Leasing needs reliable equipment suppliers who value the alliance with the lessor as part of their own marketing strategy. In a distorted or uncompetitive environment, lessors will have difficulties in negotiating favourable

prices and conditions with suppliers. Micro-leasing also needs a second-hand market, because lessors need to be sure that they can sell repossessed equipment. Again, the case of Bolivia is very encouraging as transportation costs are among the highest in the world and second-hand markets were until recently virtually non-existent (these two factors being related to the land-locked nature of the country and the low level of development of second-hand markets). However, second-hand markets are now growing in Bolivia as a result of the recent economic growth in the country. In the SADC region, however, transportation costs are more affordable, which will facilitate the development of the product, and second-hand markets are generally already larger than has been the case in Bolivia.

There also need to be **sufficient technical support and after-sales services**. One of the major challenges for lessors is the maintenance of equipment. The availability of efficient workshops and access to spare parts is essential. Technical analysis is very important in the choice of appropriate technology and suitable equipment. Most financial institutions do not have this capacity in-house, so it is important for the lessor to establish links with institutions that can provide TA and recommendations. The selection of irrigation pumps by ANED was a wise decision as this kind of equipment does not require a huge amount of maintenance and repairs and, when it does, it is usually quite simple and straightforward. Any institution aiming to develop a micro-leasing scheme in southern Africa should have this precept in mind.

5.4 CASE STUDY C: Facilitating MSME investment: Sharing the risk and bringing partnership expertise to bear

5.4.1 The rationale for including the case study

This case study is based around a relatively new category of financing small enterprises that some providers have termed Micro-Venture Capital (MVC).[44] Essentially, MVC is capital invested in enterprises that are too small for traditional venture capital, but that do not need the same degree of management and technical oversight as typically accompanies venture capital investment. MVC is also used as an alternative to a loan from a commercial bank, which may find the enterprise and/or its project too risky or beyond its lending criteria, such as for collateral. It is also an alternative to microfinance because the loan required is too large or beyond the scope of the MFI. In practice, MVC sits between venture capital 'equity' (finance for early-stage, high-potential, high-risk, growth start-up companies) and 'debt capital' (borrowing from traditional lenders), adopting elements of both that vary between the different MVC providers. In some cases, what is billed as MVC may in reality be more like a term loan with a profit-related return for the 'investor'.

The drive for MVC appears to come from private and quasi-private institutions and private individual 'investors' looking for new ways to finance MSMEs for profit or for sustainable philanthropic reasons. This private drive makes this a particularly interesting approach, with the capital and the risk being borne privately. It has also spurred innovation in delivery and in due course there may be competition for resources and further improvements in efficiencies and models to stay ahead of the competition.

InVenture is a for-profit entity that facilitates not-for-profit[45] 'investments' by private individuals into MSMEs. InVenture blurs the line between investing and lending through its use of fixed-term 'investments' that look more like term loans and 'profit-sharing/dividends' that look like a form of variable profit-related interest. This is an interesting half-way house between venture capital investment and debt-based lending. However, perhaps what is most interesting about this case is the mechanism to link remote[46] 'investors' from developed countries with MSMEs needing capital in developing countries. This opens up channels to relatively small (and often non-professional) private individual investors who do not have the time or expertise to assess the business they are investing in and are not able or willing to provide technical/business input.

The case study briefly reviews the need for new ways to bring capital to MSMEs, illustrates this facilitative approach using InVenture as the lead example, explains the essential features of the model of operation, and considers how the model can be replicated in southern Africa.

InVenture and other MSME investment facilitators such as Invest Africa, Equity for Africa (EFA), Kiva and Finance Alliance for Sustainable Trade (FAST) tap into private individuals' motivations to assist people in developing countries, but through investing rather than giving. However, in the course of the research, an interesting developed country commercial variant

[44] No standardised definition for MVC was found, so we have used statements from various providers and commentators. These are often context specific, so the scale of investment and attitude to involvement in the enterprise differ. InVenture is used to illustrate this category. Alternative related approaches are also explored to bring additional insight.

[45] As is discussed, the InVenture model facilitates quasi-philanthropic investing, where the investor's principal can be recovered from the MSME and ultimately withdrawn, but any profit on the investment has to be reinvested in MSMEs. InVenture appears to be structured as a for-profit organisation.

[46] This includes investors from anywhere in the world, but typically developed countries, with MSMEs in developing countries, across Asia, Africa and Central and South America.

on linking private individual's capital to MSMEs came to light, namely 'Funding Circle' from the United Kingdom. Funding Circle calls itself an online marketplace for loans to smaller firms.

MSMEs are widely recognised as a significant potential driver of growth and employment in developing countries. In Zambia, for example, MSMEs account for 91% of employment in rural areas.[47] However, in much of southern Africa MSMEs are excluded from access to formal financial services, particularly credit.

From the perspective of formal financial institutions, MSMEs are more expensive to serve than large firms relative to income yielded per loan or transaction. This is particularly so for rural and agricultural MSMEs, due to their smaller scale, physical dispersion and higher business risk. The 2009 Zambia Business Survey (ZBS, 2009) found that the minimum turnover firms needed to qualify for the main banks' lowest priced credit products would exclude 90% of Zambia's MSMEs. Moreover, the 'informal' nature of their business practices, such as record keeping and accounting practices, represent a major barrier to staff in formal financial institutions who are less comfortable and able to deal with informal business practices. Finally, many MSMEs lack legal status, formal registration, credit history or the collateral that formal financial institutions require.

The ZBS 2009 reported that only 2.3% of MSMEs use credit products, compared to over 45% of large businesses. Furthermore, just under 60% of Zambian MSME owners said that access to finance was '*a serious constraint to their operations*'. This constraint was reported most frequently by microenterprises and farm owners. Consistent with MSMEs' perceptions, the study's 'productivity analysis' also found that access to financial services and bank credit in particular is a serious constraint on MSME performance in Zambia. In Malawi, 34% of MSME owners identified access to finance as the biggest constraint to their businesses,[48] making it the most commonly stated constraint.

The position of agribusinesses was even worse than MSMEs in general: for example, in Tanzania 54% of the largest 25% of agribusinesses were financially excluded, compared to 13.9% of the largest 25% of MSMEs. In addition, 50.2% of agribusiness owners identified lack of access to finance as their main obstacle for growth.[49] A similar picture was found in the FinScope Malawi MSME 2012 survey.

The additional challenge for agricultural MSMEs is that mainstream commercial banks are generally reluctant to lend to agribusinesses due to the cyclical nature of agriculture, the risks from climate and volatile demand and prices in world produce markets. For example, in Malawi only 4.8% of lending was to agricultural enterprises, even though agriculture constituted 33% of GDP in 2010.[50]

Therefore, although credit is what MSMEs are often seeking, traditional forms of credit are often unavailable to meet this need. This case study explores one innovative method to improve access to finance from non-traditional sources using new platforms to link remote sources of finance with remote users of finance.

[47] Zambia Business Survey, 2009, FinMark Trust

[48] FinScope Malawi MSME Survey, 2012, FinMark Trust.

[49] Agricultural Finance Markets Scoping (AgFiMS), Tanzania, 2011, headline results.

[50] Source: Reserve Bank of Malawi (RBM), 2010, Economic and Financial Statement. There are dangers in making direct comparisons between agricultural lending as a proportion of total lending and agriculture as a percentage of GDP, because agriculture may not necessarily require the same level of credit as all other activities (especially trade), but a 4.8%:33% ratio is clearly significant.

5.4.2 Examples of facilitated investment in operation, its access and uptake

The main case study is **InVenture**, a US-based Certified B Corporation[51] founded in 2009 that facilitates socially oriented investment by private individuals into developing country MSMEs. InVenture works through NGO and MFI partners in developing countries who screen MSMEs and manage the disbursement and collections. InVenture promotes these investments to potential 'InVestors'[52] via its website[53] as a social investment. InVenture has piloted a programme through partners in four countries:

1. **KeyCredit, Ghana,** January 2010
2. **Project Muso, Mali,** March 2010
3. **Association for Sustainable Community Development, India,** April 2010
4. **APROS, Mexico,** June 2010

InVenture has not disclosed the size of its current portfolio or the total number of MSMEs receiving investments and there was no response when it was contacted. According to one media article on its website, InVenture funded 47 businesses as of October 2011, claiming a 100% repayment rate. Looking at the MSMEs on the InVenture website that are shown as fully financed, payments do not appear to be to schedule, possibly due to late updating.

From the website, the scale of capital that MSMEs can raise ranged from US$ 1,000 to US$ 10,000, over terms of one to three years. InVestors invest a minimum of US$ 25 and can choose one or several MSMEs to 'invest' in. The terms offered to InVestors differ between the profiled MSME and subscribers choose which MSMEs to invest in and how much they want to invest based on those terms.[54] When the 'subscription' is complete, the investment is made. InVenture appears to be in a development phase and it is unclear whether it will be able to scale-up its pilot work.

Founded in 2003, **EFA** is a not-for-profit fund manager, based in Tanzania, managing for-profit 'double bottom line' funds for institutional investors and certified individuals.[55] EFA describes its activity as 'lending' and provides capital of between US$ 2,000 and US$ 50,000 in machinery for Tanzanian entrepreneurs with 'viable expansion plans' who are currently excluded from formal sources of finance. The interesting parallel feature with InVenture is the linking of remote private individuals with capital from developed countries and enterprises[56] in need of capital in developing countries.

The most recently available data are from December 2010, when EFA reported a portfolio of 73 loans totalling US$ 435,000. EFA's average loan size is US$ 6,000, but the organisation claims that this has been restricted by the capital available to it, not demand from MSMEs. EFA targets this figure to increase to around US$ 25,000.

Another example of this type of model is **Kiva**,[57] which also uses an online platform to connect remote private individuals to microenterprises for loans.[58] Kiva claims a more

[51] A new category of company with a social and/or environmental mandate.

[52] This is the InVenture term for those who provide capital to MSMEs through its platform.

[53] www.inventure.org

[54] Since there is a philanthropic element to the investment, the profile of the entrepreneur and his/her status and business need are more likely to influence the choice than the variability of terms and profit potential.

[55] www.equityforafrica.org

[56] Based on the average loan size, these are SMEs not micro-enterprises.

[57] www.kiva.org

[58] Similar to InVenture in practice, except it is explicitly a loan to the micro-enterprise.

impressive 781,123 lenders and US$ 326 million in loans, across 63 countries with a 97.8% repayment rate. However, it should be noted that the cases featured by Kiva appear to be only illustrative and that the investment is done in collaboration with locally based partners. It is not clear how strong these relationships are.

Invest Africa appears to offer a similar package to InVenture, with pilots in Ghana and Benin.[59] There is also the **FAST**, which has an online financial marketplace to connect SMEs with providers of trade finance.[60]

A commercial example of linking private individuals with capital to enterprises that wish to borrow is the aforementioned **Funding Circle** from the United Kingdom.[61] Opened in August 2010, Funding Circle is clear in presenting its services as facilitating loans between remote individuals and small businesses, but it shares some features with InVenture. Funding Circle currently has 845 businesses that have received loans, to a value of £37.5 million (US$ 58.1 million) and appears to be a well-functioning model seeking full commercial viability. Funding Circle gives a clearer idea of a how a model to facilitate private capital for southern Africa could operate. The size of Funding Circle loans is in the range of £50,000–100,000 (US$ 78,000–156,000). Although this may be too large for southern Africa, the mechanism and principles could be utilised.

The above examples suggest there are a range of models that facilitate access to capital from remote private individuals for MSMEs. These models are still in their early stages but differ from traditional venture capital models because the capital is repayable in a relatively short period and there is no direct involvement by the investor, with that role taken by the facilitating party and its associates. They differ from traditional debt in that the interest is set by the bid and offer arrangements, and can have a profit-related element. There does appear to be an interesting hybrid that utilises the power of the internet to mobilise private capital from small investors.

5.4.3 Outline of the essential features of the design and operating procedures

Some of the key features of **InVenture's model** are:

1. Use of national partners who independently screen clients, monitor performance and disburse funds/collect payments;
2. An internet platform to showcase MSMEs and enable individual, often very small, investments/loans to be made at low transaction costs;
3. Financial record keeping and real-time business monitoring via an SMS platform;
4. Business input in the form of money management tools via SMS and TA from InVenture's voluntary 'Fellows'; and
5. A profit share allocated to InVenture, partners and the InVestor, though the InVestor cannot withdraw any profit but must reinvest it.

[59] http://invest-africa.org

[60] www.fastinternational.org/en/node/492

[61] www.fundingcircle.com

Figure 5.6 Overview of InVenture's model

Source: www.inventure.org/using/how-inventure-works

InVenture mobilises private individual InVestors to provide capital to MSMEs in four pilot countries. InVenture's local NGO/MFI partner organisations screen MSMEs, who have to show some track record of paying loans successfully to qualify.[62] The partner organisations disburse funds and manage the collection and payment to InVenture. The original 'investment' is repaid by the MSME in an agreed term along with a variable profit share according to performance.

InVestors are linked to MSMEs that are showcased through an online platform. The MSME indicates the amount it wants, the term and what it commits to pay as a percentage of its profits. The InVestor stipulates which MSME(s) to invest in based on the terms offered by the MSME.

InVenture says its InVestors are making an investment in the business but, unlike venture capital, the InVestor does not actually take any equity or active part in running the business.[63] The responsibility for providing business advice is taken by InVenture, which provides business guidance to borrowers through its 'fellows'.[64] It also uses a number of SMS tools ('InSight') for the enterprise to submit data and return weekly summary sheets with calculated profits etc. InVenture places volunteer associates with partners to provide technical advice, but it is unclear if this is functioning and effective. The aim of the SMS platform is to provide the business owner with 'self-help' information by processing the data sent into basic spreadsheet templates for profit and for the owner to identify trends. This is supported by initial training for new business owners that enter the programme. Otherwise, the data do not appear to be audited.

Screening clients is important to ensure that the investments have a reasonable risk profile. To this end, InVenture targets MSMEs that are borrowers who have already been through microfinance cycles, as determined by its local partners. Thus, the initiative does not invest in MSMEs that have not previously accessed finance and might be termed financially excluded, but rather those who are already financially included to some extent. This suggests InVenture is targeting the 'missing middle' of enterprises that have successfully accessed MFI loans and want to take their businesses to the next level but cannot access bank loans.[65]

[62] Must have a track record of positive cash flows for 2–3 years or successful micro-loan clients with 100% repayment rates. Additionally, each MSME needs to demonstrate a funding need that will result in increased profit and they must have the potential to hire more employees within the investment term. Lastly, they must be willing to commit a percentage of their profit to local community initiatives.

[63] There is no apparent passing of partial legal ownership, so it appears to be a misuse of the term 'investment'.

[64] Fellows are people with expertise who volunteer to assist. It is not clear how this works in practice.

[65] Invest Africa explicitly states this – http://invest-africa.org

At any point during the investment term, the business owner can pay the original principal and exit the InVenture programme. If the MSME does not pay back the principal within the specified investment term, the MSME has to continue paying monthly dividends at a 5% increased rate for another two years. InVenture makes no guarantee that any capital will be repaid to the InVestor, or that they will be able to honour the InVestor's investment preference in all cases.

MSMEs repay the principal plus an agreed portion of their profits, usually about 27–30%. This is split between partner organisations (3%), InVenture (10%),[66] InVestors (12%) and community social projects (5%). InVenture requires InVestors to reinvest their share of profits (12%) via a Social Enterprise Expansion Dollars account to be reinvested in other MSMEs. The InVestor can withdraw only the original principal amount, but not any profit. InVenture's daily reporting SMS platform allows InVestors to follow the progress of the business they have lent to online.

Figure 5.7 Tracking page for investments in MSMEs

Source: www.inventure.org/entrepreneur

A more commercially oriented model is exemplified by **Funding Circle**, a 'peer-to-peer company' that facilitates loans to UK SMEs by linking them to remote online investors. Businesses can borrow between £5,000 (US$ 7,750) and £250,000 (US$ 387,500) over one, three or five years. The website acts as an online market place where SMEs that have been screened can advertise their investment opportunities to potential investors, who compete with each other to provide finance for the loan. A key feature of this model is that investors 'bid' against each other to finance the investment by offering different interest rates in an online auction. The borrower is able to choose which bids they wish to accept. Investors do not in practice finance 100% of the requested amount for any one business to spread their risk. Borrowers can borrow from as many investors as they wish, accepting the best rates they are offered.

This is a form of disintermediation that cuts out the banks as intermediaries between borrowers and those with funds to lend. For the investors, the online marketplace allows them to lend varied amounts to multiple borrowers, thereby spreading their risk. They also get an average annual gross yield (return) of 8.3–8.5%, which is significantly higher than

[66] InVenture is a for-profit organisation.

from UK bank deposit accounts.[67] Further, there is provision for investors to withdraw their money, should they need to, by selling their loans to other lenders or at the maturity date, for which a fee may be charged (0.25% of the loan).

Funding Circle also has its own credit assessment team that screens every application, which is available to investors and uses similar criteria to the commercial banks. Investors also have access to full financial data on all businesses for transparency.

Kiva is a not-for-profit organisation based in the US with "a mission to connect people through lending to alleviate poverty."[68] The model has some similarities to InVenture's, but it is longer established and operates on a much wider scale with 154 field partners through whom borrowers can access capital in 63 countries worldwide, including southern Africa. It has clearly achieved a degree of scale that InVenture appears not yet to have.

Importantly, Kiva is explicitly lending (not 'investing'), whereas InVenture claims it is as a MVC investment, not a loan. Another key difference is in the size of the loans offered. InVenture provides finance to fill the gap between microfinance and banks, whereas Kiva's average loan size is US$ 396, which means it serves the same market as many MFIs.

It is not clear how effective Kiva's field partners are at identifying and screening potential borrowers.

FAST enables producers to connect with many potential sources of finance through the online financial marketplace platform. The aim is to help potential borrowers learn about the financing options best suited to their business and give lenders access to and contact with underserved businesses and find the areas where their investments will have the greatest impact. FAST has over 100 financial service providers and other organisations dedicated to bringing sustainable financial products to market.

Unlike InVenture, **EFA** does not provide an online platform for investors to select entrepreneurs in which to invest. Its investments are selected by its own assessors 'on the ground'. Its capital base comes from institutional investors looking for social returns and 'certified' individuals, and so the linkage is made directly by EFA.

The key questions that influence the actual design of a model are:

1. How are potential borrowers identified and screened?
2. By what mechanisms are remote investors linked to businesses in need of capital?
3. What role does the investor or facilitator play in the business?
4. How is the investment structured for repayment and profit-sharing?
5. What is the role of the intermediary organisation, what return does it receive and in what form?

5.4.4 Detailed description to enable replication in Southern Africa

This case study has identified two main variations. Both link remote private capital to MSMEs through an online platform. The InVenture (investment) and Kiva (loans) models use partner organisations in developing countries and provide technical support to the MSME, with no financial return accessible to the investor – they are based on philanthropic motives and are international in focus. The Funding Circle model is explicitly a lending model with financial returns to the lender, but no technical input. It is national in focus and is explicitly for commercial purposes.

[67] From this gross interest, bad debts and Funding Circle's fees are taken.

[68] www.kiva.org/about

Replication needs to consider the following:

Enabling environment prerequisites
There appear to be no legislative or regulatory constraints on investors/lenders in broad terms, particularly if working through national partner organisations that would be registered locally. There may be a need for the online facilitator to register in some countries depending on the particular regulatory requirements, e.g. compliance with consumer credit rules. Any organisation that operates like InVenture would probably have to register in its home country of operation, but since this is an internet-based model there is scope to choose a country where the rules are suitable for such models. It is, however, important for the facilitator to be based in a country with credible rules so as to give confidence to potential investors.

Capitalisation requirements/sources of finance

The great strength of this model is that it does not need loan/investment capital funds, but draws on private capital. Potential replicas would require some initial capital to develop an internet platform, establish a network of partner organisations, advertising to attract lenders and so on.

Degree of self-sustainability

InVenture's costs are met from a service charge of 10% that is taken out of the 27–30% 'dividend'[69] paid by MSMEs. To be sustainable, a replica organisation would need a sufficient volume of viable micro-entrepreneurs demanding loans and enough online lenders to supply funds at acceptable terms. One cost advantage of this model is that there is no cost of capital to be factored in, only operating costs and a profit, if commercial.

The InVenture model depends on MSMEs making a profit in order to pay the monthly dividend and being sufficiently transparent to share genuine viability information rather than hide its profits. It is not apparent that firms are being 'audited' to determine what profit they have – this, in any case, would be a costly activity to undertake. A lending model avoids the issue of checking to see if profits have really been made, though ultimately unsustainable enterprises will not be able to repay loans. The viability of the MSMEs is necessary.

Delivery channels

As noted, InVenture uses partner organisations to screen MSMEs for its InVestors to choose from: the range of MFIs and NGOs operating in the southern Africa region provide a ready-made 'local agent' base that could be utilised.

Timeframe for operationalisation
Both Kiva and Funding Circle have built considerable portfolios in relatively short periods. InVenture and EFA have taken longer to build smaller portfolios, potentially indicating issues concerning either the model or the effectiveness of implementation.

We estimate that an operation based on this model could be designed, developed, piloted and be operational in a period of 18–24 months.

TA needed
It might be possible to approach one of the existing operators to develop a model that is tailored to southern Africa, probably with help for the selected operator to find good partners in each of the six countries. The technology involved does not appear to be proprietary or necessarily leading edge, but rather uses a relatively straightforward web platform. A key technical requirement is to develop a sufficient, credible and low-cost system for screening, but that can utilise existing credit risk assessment techniques.

[69] In reality, the InVestor is not an owner and therefore the term 'dividend' is potentially misleading, though it is the term that InVenture chooses to use. The payment is more like a profit share/bonus.

Expected costs, benefits and leverage potential

The main benefits would flow from access to finance for MSMEs that are ready to take their business to the next level. As noted, MSMEs are important for employment creation and poverty reduction. However, it has not been possible to identify what that cost would be or to quantify the benefits in this exercise.

The greatest leverage flows from the use of private capital, which would be substantial, compared to the likely operating costs of the respective models.

5.4.5 Other aspects of relevance

To be profiled on the InVenture website and attract potential 'investors', MSMEs must meet certain criteria, including having been successful MFI clients. So, as was stated above, this model focuses on the included, or at least partially included, MSMEs with some credit track record. Kiva targets lower-level MSMEs than InVenture, and the facilitating investment model is probably capable of targeting a range of MSMEs. However, lack of a track record does make it higher risk for the investor, meaning MSMEs without a track record might be of interest only for philanthropic 'investment'.

Many MSMEs operate on a more 'informal' level in southern Africa. The InVenture model relies on its businesses sharing a proportion of their profits. Without proper records and auditing, a business may disguise the profits it makes to avoid paying dividends to the capital provider. The Mozambique Association for Rural Development encountered this problem for its programme of joint-venture seasonal investments.[70] It is probably wise to avoid profit-sharing arrangements and focus instead on interest-based arrangements, with some flexible or variable elements.

[70] Kadale 2008, Programme Review, Malonda Foundation, Unpublished.

5.5 CASE STUDY D: Production risk insurance: partnerships for promoting lower-cost production risk reduction

5.5.1 The rationale for including the case study

This case study focuses on addressing the production risks for crops and livestock. It explores different models for insuring against risks and innovation in delivery channels.

The lead case is **Kilimo Salama** ('safe agriculture' in Kiswahili) of Kenya, an index-based weather insurance product that incorporates a partnership approach and uses technology to reduce costs and improve responsiveness.

This case study shows innovative ways of addressing the high level of exposure to risks identified as a common issue across the six study countries in section 4.3. In particular, it addresses farmers' acute vulnerability to loss of livelihood deriving from crop and livestock failure. This case study looks at innovative ways in which insurance can reduce production risk.

The drive for this initiative has been from the Syngenta Foundation for Sustainable Agriculture (SFSA), a charitable trust. SFSA is a separate legal entity from Syngenta, a major Swiss agri-chemicals firm. Having a model led by a trust has advantages, as it is not driven by the limitations of a development donor. However, there may be a partial motivation by SFSA to promote crop-protection products, of which Syngenta is a leading supplier. There is therefore a quasi-commercial motive, combined with a quasi-commercial approach.

Agricultural production is an inherently risky activity for farmers because of the range of uncontrollable production and market risks. Crops and livestock ('produce') may be destroyed by weather conditions (drought, flood, hail, etc.), by disease and/or by pests. There are also risks with fluctuating input prices and lack of availability at critical points of production, as well as risks resulting from fluctuating market demand and prices, usually linked to world commodity supply and demand trends. As well as the uncertainty, when risks become actual 'events', farmers can lose a significant part or even all of their produce for a particular season, which can leave them destitute if they have limited accumulated assets. As farm inputs are often financed out of previous seasons' income, the loss of produce and income in one year can also have knock-on effects for production in subsequent seasons. This in turn directly affects the viability of financiers of production, input suppliers and produce buyers.

Historically, insurers have found it difficult to insure crops and livestock for several reasons. Firstly, 'moral hazard' is a constant insurance issue, due to the very nature of insurance, i.e. providing cover for an insured event can lead to the insured not taking due care or failing to take action to mitigate risks, knowing that s/he is covered in the event of loss. This can be addressed partly by restricting the cover, but if the cover is so limited through exceptions, it is of little or no value to the insured.

A second issue is the insurer's ability to calculate risk where information is poor, resulting in incorrect pricing that either results in unsustainable claim costs or a product that is unattractive to potential clients.

A third issue is the usually high cost of verifying that an event has occurred and the extent of the loss, particularly if the insured are dispersed rural claimants with relatively small policy values. As well as practical challenges, such as tracking down insured rural claimants, there is the ever-present risk of dubious and fraudulent claims. When this cost, and the cost of meeting (hidden) fraudulent claims is included, the cost to the potential client becomes high relative to the value of the insured item/event. MicroEnsure estimates that in India at least

50% of claims for loss of cows were fraudulent, with farmers often insuring only one or two cows out of the herd, but claiming that, whichever cow died, it was the one that was insured.[71]

Fourth, the concept of insurance is often poorly understood by farmers. OIBM, with World Bank support, pioneered an early version of weather index insurance, but found that farmers did not understand why they did not get a payout in the first year having paid for the insurance, even though the insured event (drought) had not occurred. To the farmers, it appeared they had wasted their money, which significantly affected renewal rates. OIBM dealt with this by bundling the insurance into its loans, so that purchase was automatic.

Fifth, in addition to these challenges, the relatively high frequency of adverse weather events and the covariate nature of agricultural production risks exposes insurers to large payouts. For example, drought in southern Africa is a high frequency risk, particularly due to the unimodal rain system in many places and lack of extensive irrigation outside the commercial sector. Many farmers in the same locality grow the same crops/livestock due to the agro-economic conditions, but also for good marketing reasons, as buyers want to come to areas where production is concentrated. However, in a season where there is drought, an insurer may have difficulty in paying out all the claims, further undermining the farmers' very low trust in insurers.

The net result of the above factors has been that premium rates for insurance against weather risks have often been too high for many farmers, and insurers have found it too difficult and too risky to manage agricultural risks. Insurance take-up rates in many southern African countries are extremely low: the 2008 FinScope in Malawi, for example, found less than 3% of adults with some form of insurance, the most common category being compulsory motor insurance, and no single category reaching 1.8% of adults. The 2009 FinAccess study in Kenya found that 91.1% of Kenyan adults had never used an insurance product, and that 81.4% of non-users of insurance thought it was expensive.

In the absence of private insurance, some governments have stepped in to provide agricultural insurance. For example, the Chinese government introduced state agricultural insurance in 1982. Government interventions, however, are vulnerable to the same problems as those identified above. Although these national insurance schemes are able to use historical data, once it has been built up, their ability to correctly interpret data is not a given; even large national schemes can be overwhelmed by the levels of claims, resulting in government insurance schemes limiting the value of payouts or delaying payments through administrative measures to keep costs down.

There have been attempts to improve verification as a way to bring down premiums and make insurance more affordable for smallholder farmers and the insurer. The problem noted above with livestock claims in India undermined the provision of livestock insurance, so the Centre for Insurance and Risk Management in collaboration with IFFCO–TOKIO General Insurance Company implanted radio frequency identification micro-chips in the insured cow to improve verification.[72]

An alternative, and potentially more fruitful, approach has been the development of index insurance, commonly used for agriculture in developed countries, but much less so in developing countries. The key is to find an index with reliable data that is highly correlated to crop yields or livestock losses and thus can be a reliable proxy for the actual assessment of loss. Index insurance determines the average losses incurred by the group that is insured. This has the major advantage of not having to send assessors out to find farmers and verify each claim, with all its related practical difficulties, costs and delays.

[71] Interview with Richard Leftley, CEO, Micro-Ensure, 2011 (conducted by Jason Agar).

[72] www.cirm.in/projects/livestock

There needs to be a reliable basis for turning the selected index data into a calculation of loss, so that the process of indemnifying the insured is independently and objectively calculated, rather than based on information from a claims assessor who is then required to visit each insured person. This requires as direct a link as possible between the index and the event; in this respect, rainfall and, to a lesser extent, other weather measurements form an obvious index for crop production. Rainfall is also directly related to livestock pasture availability, and so is (slightly less) directly related to livestock mortality rates.

This has resulted in a focus on weather-based index insurance (WBII) and particularly rainfall indices. Initiatives around WBII have been facilitated by the availability of long-term rainfall and other weather data assiduously collected by governmental meteorological offices in many countries, including in southern Africa. There are legitimate questions about the quality of these data, but there is no obvious reason why it would have been tampered with in the past, though poor methods and incorrect implementation may have affected data reliability to some extent. In general terms, the data provide a long-term picture of weather in a range of locations that can be related to production data.[73] Moreover, as well as reducing verification costs for insurers, WBII opens up the potential for re-insurance, as re-insurers can be sure the insurer has not tampered with the index.

An alternative to weather station data collection is the use of satellite imagery. The International Livestock Research Institute (ILRI) in Kenya addressed the verification issue by using pasture as a proxy for livestock losses. The Index-based Livestock Insurance pilot in arid north-eastern Kenya monitored pasture availability through satellite imagery and calculated the risk that animals will die, based on past pasture and meteorological data. Payment for insured animals was linked to pasture measurement. The ILRI pilot claims to mitigate around 25 to 40% of the livestock loss risks for pastoralists, although the expansion of the scheme seems to have stalled.

Dry Day Weather Insurance (DDWI), as offered by **MicroEnsure** and its partners in Tanzania, Rwanda, India and the Philippines, illustrates another approach that more clearly targets the risk and so enables a more focused insurance, at lower cost. For DDWI, drought is more specifically defined by how many days a crop has not been replenished by rain. This significantly refines the determination of the risk event, recognising that certain stages of plant growth are more critical to crop survival and productivity.

DDWI identifies two key risk periods for a crop. For the first post-planting period, where farmers have to risk planting when the rains may not have fully commenced, the farmer is paid the cost of inputs used if there are a specified number of consecutive dry days. This enables the farmer to replant. For the second defined 'risk' period, the farmer is paid a percentage of the crop value if the specified number of dry days occurs in the maturing phase. This payment increases as the number of dry days continues from the trigger number (say 22) to the maximum number (say 30), at which point the whole crop is deemed to have been lost. This is an interesting refinement that seeks to more accurately insure the event through a better understanding of the nature of the link with the index and how it is related to the event. The result is a more targeted risk and a product that can be offered at a lower price. The availability of funds for re-planting also helps ensure the farmer does not just lose the value of the inputs, but still has a chance to get a crop that season.

However, despite a considerable amount of attention and innovation to date, weather insurance has yet to gain significant penetration of the rural agricultural market.[74] The main

[73] Production data is less reliable than weather data, as it is harder to measure and there are reasons to manipulate it, as occurred in Malawi to justify the input subsidy programme.

[74] In India there have been larger-scale initiatives than in Africa, such as BASIX, IFFCO-TOKIO and Agriculture Insurance Company of India. The latter had over one million insured farmers, but has subsequently reduced its coverage, due to issues of widespread fraud.

issues have been: (a) availability of verifiable data due to the absence of reliable weather stations/data at local levels; (b) the high cost of weather insurance related to targeting the risks and relatively low uptake; (c) poor distribution/availability of insurance products in rural areas; (d) limited understanding of insurance by farmers; and (e) low trust of insurers even where insurance is understood and available.

5.5.2 Example of where it is in operation and what the impact on access and uptake has been

Kilimo Salama is a partnership between UAP Insurance and the SFSA for an Agricultural Index Insurance Initiative that commenced in 2009. Kilimo Salama offers farmers the opportunity to buy insurance for their farm inputs (seeds, fertiliser and/or crop protection) at the point of input purchase through approved local stockists. It is termed 'pay as you plant'.

In the first (pilot) season of 2009, 200 farmers bought insurance and all received the maximum payout of 80% of the cost of the inputs due to a severe drought that year. The average insured amount was US$ 19 and the average cost to the farmer was US$ 0.95. Although these are small amounts, qualitative research by SFSA identified that farmers had such low trust in insurers that they were trying out the product to see if they would get paid. In that small sense, the drought that triggered a payment for all 200 farmers was fortuitous as it encouraged uptake in subsequent years.

In year two (2010), 12,000 farmers bought the insurance, with 10% of them receiving partial payouts ranging from 10% to 50% of the input value. By the third year (2011), the uptake increased to 23,000, with 1,400 farmers getting a payout. As at April 2012, over 50,000 farmers purchased insurance for the 2012 season. Kilimo Salama is operating in a limited number of areas, so there is further potential for scaling up.

A further feature of the product that has a significant impact is its freephone (cellular) information service that insured farmers can call to get answers on farming matters. A reported 16,000 farmers used the service in 2011, though this may not have all been for advisory questions.

Although not necessarily directly attributable, CIC Insurance Group, another micro-insurer, has launched a crop insurance product with Rockefeller Foundation support that competes with Kilimo Salama Plus (see below).

5.2.3 Outline of the essential features of the design and operating procedures

Kilimo Salama works as follows:

1. A farmer is offered an insurance contract when purchasing inputs (for maize, wheat, beans and sorghum) supplied by participating companies[75] through one of 80 selected stockists. The policy covers up to 80% of the value of those purchased inputs should those inputs not produce a crop due to a shortfall or excess of rainfall;
2. An adapted mobile phone/scanner records the bar code on the inputs purchased and automatically generates an insurance contract offer sent by SMS;
3. The farmer pays 5% of the value of the inputs, which is registered to his/her mobile phone and receives a SMS confirmation. The price of the insurance is 10% of the cost of the inputs purchased by the farmer, of which the input companies pay the other 5%;
4. The farmer chooses a weather station that is either closest or, in some cases where there may be two options, the one that best reflects the farmer's local climatic conditions;

[75] SeedCo for seed, MEA for fertiliser and Syngenta for crop protection (pest and disease treatment).

5. Rainfall, temperature and wind data are collected at solar-powered, tamper-proof, automated weather stations. Data are sent through the cellular network every 15 minutes;
6. Data are automatically recorded and if the required conditions are met, such as defined by a standard model for relating rainfall to crop outcomes (Water Requirement Satisfaction Index), then the farmers that are affected and the extent to which they are affected is automatically determined;
7. An SMS is sent to the farmer that an insurance payment is due and the payment is made at that point via M-PESA as a credit, to be cashed or used for M-PESA payments; and
8. SMSs are sent to insured farmers concerning seasonal agronomic activity that should be undertaken and insured farmers can ring a helpline that has trained extension staff available to answer farming questions. The purpose is to increase the perceived value of Kilimo Salama's offer as more than insurance, so that in years where there is no or a low payout, a farmer has more value than just peace of mind.

For distribution and promotion, Kilimo Salama is available through a limited number of local small-scale agri-input stockists, presumably because not all the input companies are willing to supply all potential stockists, due to risks of non-payment, etc. Stockists and the location of weather stations need to be aligned. For the stockist, there appears to be no margin from selling the insurance, but the offer can attract more farmers to buy from them, especially as there are promotional activities for Kilimo Salama, through radio and public meetings.

A second emergent factor driving purchase is that some MFIs began to make purchasing Kilimo Salama a requirement for obtaining a loan. This was the case for 8,000 of the 12,000 purchasers in year two. Therefore, although the uptake in year two showed a large increase, it was partly due to compulsion. Data on the proportion of voluntary and compulsory purchases are not available for subsequent years, but it is likely that MFIs and other lenders may be one of the key drivers in take-up. This has pros and cons. It will likely result in reaching more farmers more quickly and achieving scale benefits. However, it does not on its own necessarily change farmers' understanding and appreciation of the benefits of insurance. Even so, the increase in voluntary purchase was substantial.

The focus of the insurance on inputs, and not crops, was based originally on what most farmers said they were willing to try. Subsequently, a second insurance product has been launched as Kilimo Salama Plus, which is a crop-based insurance. The mechanism is the same, but the farmer pays 10% of the value of the inputs instead of 5%. Data were not available on the extent of the crop value that is covered under this insurance.

The willingness of input suppliers to pay half the 10% premium is related to the opportunity for business, as they have a unique addition to their product offer that is not available from competing seed, fertiliser or crop protection suppliers. UAP is also seeking to build the size of its agricultural insurance portfolio, but indicates that it is not yet making a profit.

Kilimo Salama addresses several of the issues raised in the introductory section, such as:

1. Reducing the costs of verification, of distribution and of administration and so lowering the cost to the farmer;
2. Reaching dispersed rural people through distribution points they can easily access; and
3. Increasing trust in insurance, particularly that they will pay out fairly and swiftly.

5.5.3 Detailed description to enable replication in southern Africa

Enabling environment prerequisites
There are no specific regulatory implications, other than that such a partnership would need to have a fully registered insurance company within it, or working closely with it. The regulation of the insurer would then fall under the normal rules.

The levels of trust in insurers are likely to be low across most of southern Africa – trust would enable an initiative to progress more quickly but is not a necessary requirement at the outset. However, as with any insurance, any manipulation of the payout would undermine any trust that has been built. The automated calculation and communication of the payouts is an important trust-building feature.

Capitalisation requirements
The key capital costs are for establishing the fully automated weather stations and the software/hardware for automating the recording and analysis of weather data. Some of the equipment and systems are proprietary to SFSA.

Other than the capital items, there is no capitalisation required, presuming that an insurer is sufficiently capitalised/re-insured to meet a large number of claims in any one period.

Sources of finance
The initial pilot work was financed by SFSA out of its own funds, with contributions by partners to their own costs. However, in 2010 Kilimo Salama received a US$ 2.4 million award from IFC through its Global Index Insurance Facility to further develop and scale-up the initiative. The award is for expanding the network of weather stations, provision of equipment (phones and hardware) and scaling-up costs.

Degree of self-sustainability
The price of insurance has often been a barrier to uptake, and so it appears that the offer to the farmer at 5% of the input cost is reasonably attractive, noting that the input companies provided a further 5%, so that UAP receives 10% of the input cost as the premium. It appears that the insurer expected a catastrophic production year once in every ten years, when all insured farmers would receive a payment, as occurred in 2009.[76] With payouts to between 6–10% of farmers in 2010-11, this would suggest that the claim ratio is already much higher than the premium basis, even if the maximum payout is 80% of the input value. As noted, UAP has indicated that it is making a loss so far.

Interestingly, M-PESA reports that it is benefiting from the additional traffic and signing up new customers. M-PESA is an important feature and enabler for Kilimo Salama. Mobile money services are becoming increasingly available in southern Africa. Although Kenya is well ahead in this respect, it is unlikely that the slower development of these services would be a substantial constraint to replication.

As noted, the agri-input stockists are an important feature, providing a new point of access for the distribution of insurance. They do not apparently take a margin on the service, apart from the benefit of a small temporary cashflow gain into their M-PESA accounts, as they are not required to remit the premiums immediately. However, the opportunity for incremental business appears to be a strong enough attraction for them to participate, particularly due to the promotional efforts around Kilimo Salama from which they benefit through increased traffic. Replication of delivery channel should therefore be possible at low cost.

[76] For the model to be commercial, then the catastrophic loss would at least need to be less than one in 10 years. It could be that the insurer is just testing the approach on a not-for profit basis, or they are rounding up/overstating the catastrophic loss likelihood.

The development of automated weather stations has to move in step with the establishment of the delivery channel. This is likely to be a constraint due to the investment cost and issues over negotiating use of land, maintenance and relationships with national meteorological offices. It would be beneficial if there were sufficient national governmental interest to support the expansion of such weather stations or, in the absence of this, a development partner willing to resource it. Although the weather station supplies data used for a commercial transaction, the same data would be useful to many other stakeholders – it is probably better to regard weather stations as a public good, or perhaps set them up under a shared ownership model where other insurers/firms could opt in to share the cost and the data.

Timeframe for operationalisation

One remarkable feature of the Kilimo Salama case is the speed with which it has grown to 23,000 users in its third year of operation. The length of the planning and inception period is not clear, but the learning from Kilimo Salama and supporting issues of equipment and software should speed up replication, if it involves SFSA or if SFSA shares what is probably proprietary technology.

TA needed

It would seem likely that the elements of the model could be replicated by a partnership with technical knowledge of insurance, cellular equipment and information systems. However, there would probably be merit in working with SFSA given its coordinating role, likely proprietary hardware and software and inevitable learning from having gone through the process.

Expected costs and benefits

As noted in the sustainability section, the current pricing to farmers at 5% (input insurance) and 10% (crop insurance) of input costs seems to be unviable and there is currently a degree of subsidy, partly through losses incurred by the insurer.

The capital costs are also high if the initiative has to meet the costs of establishing automated weather stations.

More positively, Kilimo Salama has found a very low-cost distribution method for selling insurance through the agri-input dealers mentioned earlier. These are selected in an area, based on financial resources and stock range.[77] Kilimo Salama has very low administration costs, estimated at KSH 1 (US$ 0.015) per policy, based on having an automated system for the registration of policies by SMS and automated payouts if the insured event occurs. This is a significant cost breakthrough.

Leverage potential

The potential number of input and crop policies is very large, given that farmers typically grow more than one crop and/or have livestock.

In terms of leverage, there is also potential to sell other insurance policies to farming households to cover non-production-related risks. The way in which **TiGo** in Ghana, a cellular service provider, has used life insurance as a reward for buying airtime is interesting. When a user buys airtime, they get a related amount of life cover for the following month. The more they top up, the more cover they get, automatically as part of the top up. This is clearly intended to get users to switch from other networks to TiGo. It has been successful at stimulating demand for services, but it also highlights that there is interest and potential demand for other types of policies.

[77] Selected from the current stockists of the partners' products.

The TiGo and Kilimo Salama experiences also highlight that mobile phones provide a new method of promoting and delivering financial services, for which the potential is only just beginning to be realised.

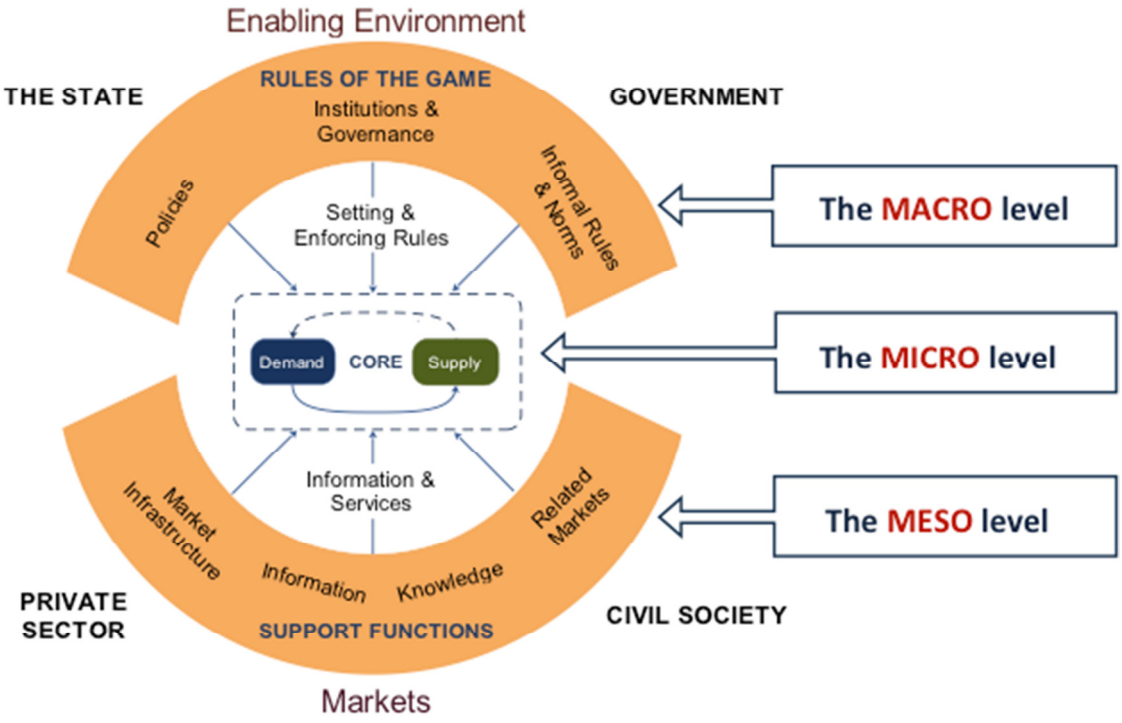
5.6 CASE STUDY E: Market system change/M4P

5.6.1 The rationale for including the case study

Market systems change is the focus for the M4P approach,[78] which starts with a characterisation of the market as illustrated in Figure 5.8. The **'core'** is where transactions take place between buyers and sellers seeking to match supply and demand ('**micro level**'). The core sits within an overall enabling environment that is characterised by policies, legislation, regulation and informal rules/norms. Governments largely determine these '**rules of the game**' ('**macro level**'). Finally, there are **'support functions'** that enable the efficient and effective operation of the core through information flows, capacity development, infrastructure and financial services **('meso level**').

As explained in the introduction to Case Study C, SMEs in Africa, and across the developing world, face significant constraints in accessing finance. An M4P approach can significantly help to alleviate these constraints.

Figure 5.8 M4P framework for analysing market failures



The lead case is **PASS Trust** in Tanzania, which aims to increase access to agricultural finance by supporting agribusinesses to develop credible business plans to present to commercial banks, as well as supporting commercial banks to lend through a credit guarantee fund (CGF) that reduces the risks of lending to agribusinesses. In this way, PASS has enabled lending transactions to take place that would otherwise not have happened,

[78] There are other approaches that seek systems change, like Inclusive Market Development, but M4P is the most comprehensive and well-developed approach conceptually.

addressing key supply and demand constraints within a broader market systems view. The success of this approach has encouraged more banks to lend to agribusiness clients.

The supporting case, **Agricultural Finance Markets Scoping**, is also from Tanzania, involving gathering reliable information on the demand for and supply of financial services to the agricultural sector and sharing it with policymakers and financial service providers. Its aim is to increase the supply of, and access to, agrifinance through stimulating market-leading innovation and supportive policy changes.

This case study shows how market systems thinking could tackle constraints to increasing access to financial services in rural areas of southern Africa. Change needs to be effected at key points, often across the macro, meso and micro levels of a market system, to ensure that markets will work better for the rural poor in southern Africa.

It has already been noted that agriculture in less-developed African economies is of great importance. For example, in Tanzania, which is the source of the two cases reviewed, agriculture and agribusiness accounted for 27.8% of GDP in 2011.[79] Furthermore, the generic challenge for agribusiness MSMEs to access investment and/or credit has also already been outlined under other cases, such as Case Study C.

In this current case, the focus is specifically on encouraging domestic commercial banks to lend to rural and typically agricultural businesses ('agribusinesses'). International agribusinesses generally have access to finance for investment and operations through their parent companies and/or from international or national banks. Large national agribusinesses may be part of a national group that can source finance or are probably significant enough in scale in their own right to raise finance from domestic commercial banks.

The situation for MSMEs is altogether different, as has been noted in the earlier cases. For the purposes of this section it is necessary to divide MSMEs into micro-enterprises and Small and Medium Enterprises (SMEs).[80] Again, the analysis in earlier sections showed that micro-enterprises typically borrow from informal sources rather than from formal financial institutions, as noted in many of the FinScope studies.[81] The size of loans, cost of servicing and challenges of working with relatively informal businesses with limited records and informal methods of working make this group unattractive to many commercial banks.

The situation of SMEs is different from that of micro-enterprises. Because of their larger size and relative visibility, SMEs are more likely to be registered and 'on the radar' of government bodies for tax and (partially) meeting legislative and regulatory requirements that apply to their sector(s) of operation. They have also probably moved to some, or a considerable, extent beyond a purely informal business model based on an owner's way of operating and idiosyncrasies, without yet being fully formalised. Due to their scale, SMEs may have reached a size that is of interest to commercial banks, because it becomes more viable to deal with them particularly in urban areas where access costs are lower. Many commercial banks now have a specialist section or department that focuses on SMEs as a distinct target group, with some product and service modifications to support this segment. Yet SMEs relatively informal manner of operation, compared to the larger businesses that bankers normally work with and compared to the formal operating nature of the banks themselves, presents 'cultural' challenges to the bankers in dealing with SMEs.

[79] https://www.cia.gov/library/publications/the-world-factbook/fields/2012.html

[80] The definitions of Micro, of Small and of Medium businesses/enterprises differ between countries and typically include a mix of employment, turnover and investment criteria, none of which is wholly satisfactory in distinguishing them into clearly defined categories.

[81] Tanzania has many informal organisations and community-based financial organisations, such as ROSCAs, ASCAs, VSLAs and Village Community Banks.

The issue of risk in the agricultural sector has also been discussed, including in Case Study D. All business sectors carry risk, but agriculture carries additional risks relating to climate impacts, disease and pests, as well as highly volatile agricultural commodity markets. Typically, there is a high degree of concentration on particular agricultural commodities that further increases vulnerability. In Malawi, for example, tobacco exports are typically over 50% of exports by value. In Tanzania, agricultural exports are diversifying through non-traditional crops, but 85% of revenues still come from the five main traditional crops: coffee, cashew nuts, cotton, tobacco and tea (World Bank, 2006). These risks are challenging for bankers to internalise, relative to their experience of less volatile sectors of the economy.

PASS's own analysis of the agricultural sector revealed deficiencies in the agribusiness finance market at the micro level, such as the weak financial capacity of farmers and rural SMEs and the lack of understanding by banks of agriculture and agribusiness. It also identified meso-level challenges such as information asymmetries between bankers and farmers that exacerbate the risks for both, lack of BDS, absence of capacity building mechanisms for farmers and rural SMEs, and the lack of a mechanism for promoting understanding of the sector among bank staff.

Looking at this from a market systems/M4P perspective, the number and size of transactions between firms wanting to borrow and banks wanting to lend has been constrained by a mix of factors. The firms are not able to meet the range of information, collateral and response requirements of banks ('norms') and do not know how to present their cases to the banks in terms that will enable the bank to assess the proposal and respond positively to it. On the supply side, banks are concerned about the extra risks presented by SMEs and agriculture and how to manage them. They also tend to generalise the risk to presume that in the absence of information to the contrary, all SME and agricultural lending is equally risky.

PASS addresses these 'business culture' factors through providing BDS to help SMEs to prepare and present their business proposal and through various CGFs to reduce the lending risk. Over time, the latter have the potential to give banks the confidence to lend to SMEs in the agricultural sector and to progressively change bankers' understanding and perceptions of the actual risk level to be less risky than they currently think it is.

In support of this, AgFiMS provides information and analysis to help banks better appreciate the risks, but also to identify unmet demand and guide them to develop or adapt products to meet these gaps.

Both PASS and AgFiMS are funded by development partners and initiated by public rather than private players. However, PASS was able to get private sector engagement and payment from the banks, once the concept was demonstrated. AgFiMS is more obviously a public good, and may find it more difficult to get private resources and leadership, even if they see it as a valuable source of information from which to shape their products and market development activities.

5.6.2 Examples of where it is in operation and what the impact on access and uptake has been

PASS Ltd has its origins in 1998 under Danida's Agricultural Sector Programme Support, becoming a legally registered trust in 2007. Its objectives are to increase the involvement of SMEs in commercial agriculture, to provide technical services and financial linkages to commercial agricultural SMEs and to encourage the formation of producer organisations to increase market linkages.[82]

[82] Presentation by Andrew Temu, October 2008.

PASS offers a range of products[83] but of particular interest is business planning for potential borrowing organisations and a range of CGFs for lenders, from which it earns fees that provide it with an income. According to the *Evaluation of Danish Support for Financial Services in Tanzania* (OPM, 2009), PASS's overall facilitation of the engagement between business and banker is an important factor. This involves support both to the banks and to the borrowers at each stage of the proposal development and appraisal. By having a full appreciation of both sides, PASS helps borrowers construct proposals that lenders can appraise positively, also helping banks to undertake informed appraisal of those proposals. This suggests that it is the three-way combination of the BDS to borrowers, the availability of the CGF to lenders and the facilitation support that links these that forms the package of services that has increased lending. PASS has been termed a 'bridge' between banker and borrower (OPM, 2009).

The outcome of PASS support has been more rational, better-informed credit decisions by the banks, with a high application success rate, reportedly at 82% in 2007, resulting in increased availability of credit to SME agribusinesses. On the demand side, there has been an increased understanding of how to manage their finances by agribusiness owners that have gone through the process of proposal development. By 2012, over 35,000 farmers had benefited through 600 organisations that have been able to access TSH 95 billion (US$ 61.1m)[84] of credit from nine banks. This included loans to SACCOs,[85] farmer cooperatives and farmer associations in addition to private agribusinesses.

Loans were for a range of crop production sectors (sugar cane, juice concentrates, livestock, tea, paddy rice, maize and sunflower), agro-processing and agro-trading. Credit supported crop production in the main, but also mechanisation and transport. PASS claims impacts on production, employment, income, bargaining power and access to market,[86] not all of which are readily measureable or have been measured. However, in relation to agricultural production, the estimate is that, as a result of access to credit, smallholder sugar cane increased from 10mT/ha in 2003 to 40–60 mT/ha in 2007; coffee from 2 kgs/tree to 6 kgs/tree (same period), and the proportion of hens laying from 50% to 75% (same period). This is in line with expectations that access to finance enables investment in productivity-enhancing inputs for agriculture (seed, fertiliser, tools, equipment, irrigation and so on). PASS has enabled those increases to be achieved. PASS indicates that it has been able to track increases in clients' profitability and productivity, though this type of data is not published. It also claims that most clients have increased production and sales volume.

The latest bad debt provision on its facilitated loans was not available but in September 2008 it stood at only 1.4%. By 2008, PASS was reported to have reached operational sustainability and was expected to attain full sustainability by 2012, though it could not be confirmed whether this has actually been achieved. PASS has reportedly been able to maintain the real value of its CGF in recent years.

PASS was originally launched in the Morogoro region. After an over-rapid expansion in the early years the operation retrenched, but is now successfully spreading to other regions in Tanzania. The PASS model is being replicated in Kenya, Uganda and Mozambique and it is hoped that it will be replicated further in Africa.

AgFiMS

AgFiMS is a diagnostic tool piloted in Tanzania in 2011. It provides research data about the demand for, and supply of, financial services in the agricultural sector. It aims to increase the

[83] Its products/services also include farmer organisation development and contract farming facilitation.

[84] US$ 1=TSH 1,555 – www.oanda.com/currency/convertor/ 4 July 2012.

[85] Tanzania has a particularly large number of SACCOs at over 5,000, but many are small and poorly capitalised. However, they form an important financial link with rural people.

[86] A. Temu (2009).

supply of and access to agricultural finance in Africa through market-leading innovation and policy change.

AgFiMS has its roots in FinMark Trust's FinScope survey, which gathers primarily demand-side data on adult financial knowledge, perceptions and practices. The overall purpose of AgFiMS is to address the lack of reliable information about the state of finance in/for the agricultural sector, which is seen as inhibiting investment in African agriculture. This has resulted in low penetration by financial institutions of the rural market, poor customising of financial products and the under-capitalisation of agribusinesses. Therefore, the AgFiMS diagnostic package combines demand- and supply-side research specifically into agricultural enterprises to produce reliable analysis. This analysis is targeted at policymakers to inform policy decision-making and at financial service providers to inform product design and identification of market opportunities.

The final findings from the first AgFiMS in Tanzania are becoming available at the time of writing, giving more depth of analysis on top of the draft findings that were published in the first quarter of 2012 – the headline findings are available at www.agfims.org.

AgFiMS is supported by the Gatsby Charitable Foundation, the Tanzania Financial Sector Deepening Trust and the Rockefeller Foundation, with technical support from FMT.

It is too early to discern the impacts of AgFiMS, particularly on policy, and no evaluation has yet been undertaken. However, according to one of the AgFiMS technical team, there has been follow-on work in Tanzania with two banks concerning product design and market opportunities based on further analysis of respondents.

There is interest in implementing AgFiMS in other countries, potentially in the same way in which FinScope spread following its initial implementation in South Africa. Benin is the most likely next country for implementation, possibly followed by Mozambique or Ethiopia, with possibilities in Zambia and Uganda. This roll-out is uncertain and not verified, but the range and quality of the data gathered in Tanzania strongly suggests that there is the potential to use this tool for policy analysis, design of development partner intervention and financial services development across Africa.

5.6.3 Outline of the essential features of the design and operating procedures

The essential features of the **PASS** model are:

1. Undertaking scoping work and research to focus activities by area or value chain – PASS has a restricted geographical focus and used a Vertical Integrated Commodity Systems Approach to focus on the weakest links in a value chain:
2. Developing relationships with one or more formal financial institutions to build trust and a willingness to engage in a supported process;
3. Determining and understanding the appraisal process of lender(s) and their requirements to enable the facilitator to assist applicants to understand and meet the requirements:
4. Designing a CGF that supports lending to target groups, seeking maximum leverage for the guarantee[87] and ideally simplified procedures and improved terms such as for collateral, which ought to be less important to the lender;
5. Supporting businesses, farmer cooperatives/associations and small rural financial institutions to develop a business plan/borrowing proposal and/or undertake feasibility studies through a (partially paid for) business planning service;

[87] PASS appears to have only a 1:1 leverage but over time is seeking to increase it as the risks become better known and quantified.

6. Facilitating engagement between business and banker at each stage in the process (facilitation which may sometimes blur into intermediation); and
7. Integrating with other approaches, such as market linkages/outgrower scheme links (optional).

The essential features of the **AgFiMS** model are:

1. Reviewing secondary sources and establishing a survey methodology;
2. Undertaking a nationally representative survey of agricultural enterprises that are of a sufficient scale to potentially access formal finance,[88] following determination of the minimum thresholds to qualify for the sample (such as land area and/or turnover);[89]
3. Undertaking a representative survey of informal financial service providers to generate quantitative and qualitative data;[90]
4. Interviewing formal financial institutions to generate quantitative and qualitative data;
5. Analysing data and presenting/publishing them for target stakeholder access using a range of analytical tools and foci – e.g. GIS maps for identifying density frequencies, analysis by distribution channels, identification of unserved market segments, comparing attitudes and practices, etc.; and
6. Following up with interested stakeholders to enable them to internalise and use the data.

5.6.4 Detailed description to enable replication in southern Africa

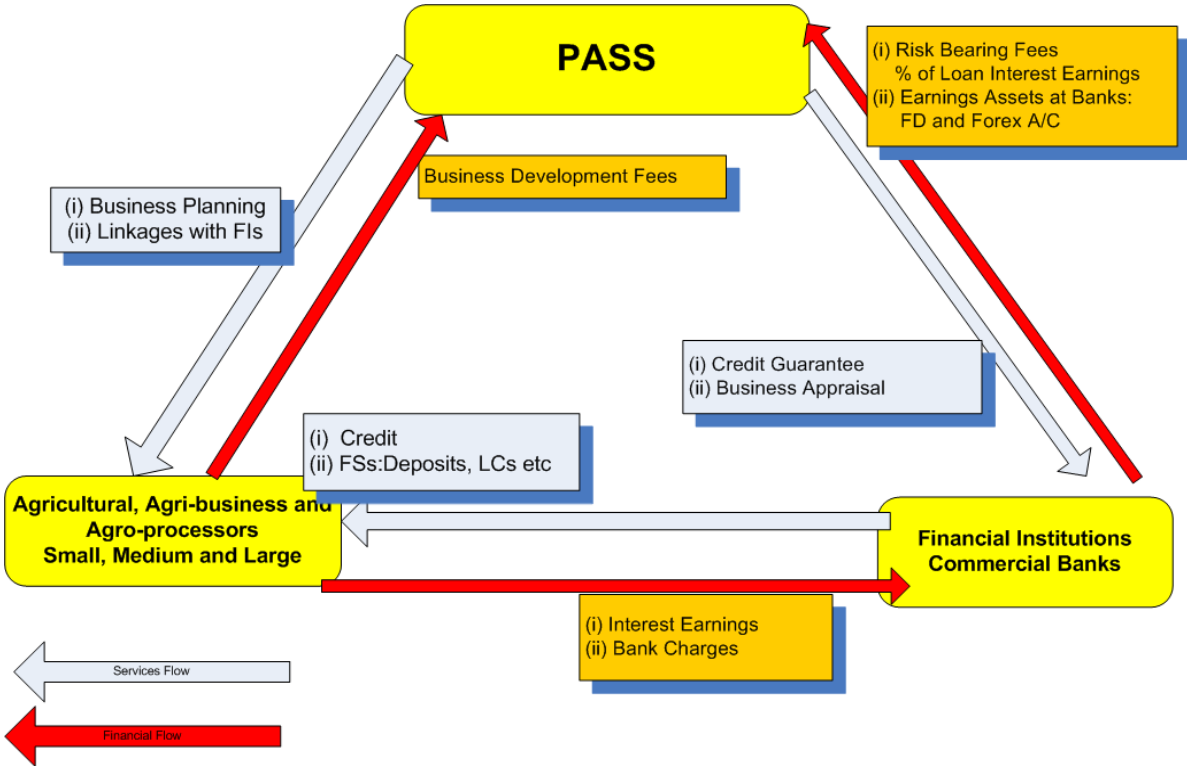
The PASS model is illustrated in Figure 5.8.

[88] The minimum threshold for farmers was five acres (circa three hectares) farmed or $600 minimum annual income (set above national average income) and for processors and farm service suppliers the threshold minimum annual income was US$ 1,500.

[89] The demand-side study undertook a listing exercise covering every household in a sample area (100,000) to determine the population of qualifying agribusinesses. From this population, a representative sample was drawn and 4,098 agribusinesses were interviewed.

[90] The supply side interviews covered a sample of 75 SACCOs and 195 informal groups.

Figure 5.9 PASS operating model



Source: Presentation, A. Temu, October 2008

The figure illustrates the tripartite focus of the PASS model, with PASS facilitating links between the enterprises and the banks. It provides services to the enterprise to assist them to access credit and charges a fee, though not at a cost-covering level. It also provides a range of CGF options to banks, including:

1. A modified Traditional Guarantee ('indemnity guarantee') – to guarantee individual loans;
2. A Lenders Option Guarantee ('portfolio guarantee') – the lender can decide in advance whether to guarantee loans on predetermined guarantee criteria;
3. A Linkage-Banking Guarantee ('institutional guarantee') – for pension funds and other institutions to lend to pre-qualified rural financial institutions for on-lending; and
4. Fixed equity hire purchase – enabling PASS to own assets until the agreement is paid off.

For the BDS, there is an up-front fee of TSH 30,000 (US$ 19) and a final fee of 2% of the requested loan. In cases where there is additional use of BDS, the fee for this service is 10% of the actual cost, with the balance of the cost met out of PASS's resources. The subsidy comes from the other income for PASS, from charges to the banks for providing the service to potential borrowers, and from Danida's core funding of PASS.

Information on the charges to the banks for CGF use was not available, as this appears to be commercially confidential. It is possible that these are not on a full cost-recovery basis.

Enabling environment prerequisites

For PASS, a benign enabling environment was identified as a key pre-requisite. This encompasses a stable, viable and competitive banking sector that is sufficiently capitalised, with surplus liquidity that a CGF can leverage. There is a risk that banks will move their poor

quality loans into the shelter of a CGF, creating losses for the fund, so avoiding this recycling of old loans is important if a CGF is to succeed.

Macroeconomic instability, either internationally or nationally induced, makes private investments more risky and so limits the demand for credit. It would also make banks more reluctant to lend for productive purposes and may push them to seek refuge in government debt, which may also yield higher interest rates if governments are running large fiscal deficits. In such circumstances, interest rates may increase to levels that deter private sector demand for credit. Inflation is also an issue, as it can rapidly undermine a CGF.

The existence of an effective credit bureau helps support SME lending, though it depends whether these bureaus have data on SMEs that can be utilised. Obviously, one benefit of bringing banks to lend to agricultural SMEs that have a track record of credit is to enable these businesses to build a credit history that could make getting future loans easier. Therefore, although a credit bureau could be helpful, a CGF may actually seek to focus lending to SMEs that have no credit track record.

A further enabling factor is the support of national government and key financial institutions. PASS has a senior member of the Ministry of Finance on its board and closely engages with the Ministry and, to a lesser extent, the Bank of Tanzania.[91] This has enabled PASS to undertake its work without finding unexpected blockages or hurdles. A key part of that support is ensuring that PASS's programme is aligned with Tanzania's key national strategies.[92] Many countries in southern Africa have strategies and policies that recognise the importance of the agricultural and SME sectors and support for PASS-type models would probably fit within most countries' national priorities.

A frequently mentioned issue is that PASS has earned the trust and respect of the banks it works with and of the government. This is an intangible factor, but the result has been that a high proportion of proposals (over 80%) are accepted, suggesting that as well as the proposals being prepared to a good standard, banks are probably also giving some weight to an applicant that is known to be being supported by PASS's BDS provision. Trust is a function of PASS's early activities to build relationships and deliver on what it promised to do for the mutual benefit of the parties. Having high-calibre staff, probably from within the formal financial sector, can also assist in establishing initial links and building credibility and ultimately trust.

Capitalisation requirements

The reported size of the CGF increased from TSH 1.4 billion (US$ 1.2 million) in 2003 to TSH 16.8 billion (US$ 14.4 million) in 2008. In April 2009, the volume of credit guarantees was TSH 18.5 billion (US$ 14.1 million) (OPM, 2009).[93]

These data suggest a relatively low CGF to lent funds leverage ratio of 1:1.1. A key factor for success would be to achieve a much higher leverage ratio, which would substantially reduce the capitalisation requirement relative to the amount of credit that is leveraged.

Sources of finance

PASS has been supported by Danida for 14 years, from 1998 to date, though the levels have reduced significantly from the establishment phase, as PASS is by now probably close to full sustainability.

[91] From the available information, this more limited engagement with the Bank is a weakness that should be addressed in a replication. The overt and covert blocking powers if key governmental institutions are not 'on-side' are significant potential stumbling blocks in replication.

[92] For example, Poverty Reduction Strategy Paper, National Strategy for Growth and Reduction of Poverty, Agricultural Sector Development Strategy and the Millennium Development Goals.

[93] Rates converted at TSH:USD mid-rate on 1 July of each year.

The nature of that support has changed, as well as Danida's own internal mechanisms for providing it – under different programmes – to an identified value of at least DKK 200 million (US$ 33.8 million).

Although PASS indicates that it was a joint initiative by Danida and the Government of Tanzania (GoT), it is unclear whether the GoT contributed funds to its early establishment. However, funding from a mix of government and funding partners is a possible model.

The evolution of PASS has taken a long time and it is only just reaching a self-sustaining point. This is not to say that it could not be done more quickly, especially because to a considerable extent PASS was engaged in pioneering work. However, it would be reasonable to suggest that a considerable amount of funding is needed because of the need to capitalise a CGF and that it is likely to take a number of years to reach a point of sustainability.

Degree of self-sustainability

Donor funds were used to subsidise services offered by PASS, initially as a means to attract clients. The intention was that once services proved valuable to clients, the level of subsidy would reduce. Developing stand-alone BDS is challenging, as SME clients find it difficult to appreciate the service value until it has been experienced, but have often then had the bulk of the value at a subsidised price in order to get them to try the service. Once a BDS provider offers services with a large subsidy then it can also become difficult for the provider to move away from the comfort of a third party paying the majority of the cost, as long as that third party is willing to continue to do so.

For PASS, it is explicit in its pricing model that the BDS service is loss making, since it promotes the fact that it recovers only 10% of the cost as a way to attract SMEs and needs to have a low entry price (US$ 19). However, as the PASS offering is a package, there may be merit in having a low entry price to encourage enterprise take-up, with more substantial cross-subsidising income coming from interest earned on unutilised CGF funds, and from fees for the CGF from the banks. Since the provision of support appears to be resulting in a high acceptance rate, the process appears to be substituting to some extent the bank's own appraisal process. There may even be savings for the bank in this partial outsourcing of the appraisal process, especially as part of the risk of default is covered by the CGF.

Delivery channels

PASS has representation in over 10 locations but does not have full national geographic coverage. As part of its model, it must have direct access to SMEs in rural areas to be able to assist them, as SME owners are unlikely to travel very far to access the service. However, a decentralised service is of benefit to the banks, as it enables a credible provider to work with rural dispersed SMEs over a period of time to develop an acceptable plan/proposal that can be funded. There is, therefore, a cost implication from decentralised services that would be minimised in relatively densely populated countries or regions of countries.

Timeframe for operationalisation

As noted, PASS has taken around 14 years to reach the point of full sustainability. This could probably be accelerated, though it would seem unlikely to take less than five years. Key factors would be the strength of the linkages with commercial banks and their willingness to use a PASS-type model. If such a body were (partially) owned by commercial banks, then that might facilitate making the model operational more rapidly.

A key factor in making PASS operational has been having competent and experienced human resources in the senior management team and as the providers of the BDS. Finding the calibre of people who are willing to work in decentralised locations with relatively informal SMEs could be a challenge and could slow down implementation due to the lack of good-quality applications that can be facilitated.

TA needed
In addition to the finance provided, two Danida advisers were allocated to PASS in its early phases, reducing to one (an Agribusiness Adviser) in the latter phases. This is an additional cost, but it potentially assisted with achieving self-sustainability.

Leverage potential
CGFs have considerable leverage potential, but so far PASS seems to have a very low leverage ratio for reasons that are not clear. A key factor for efficient replication is to significantly increase this leverage ratio.

In terms of development impacts and leverage, the PASS model is designed to have high developmental leverage through providing access to credit and financing. The reported results on farm productivity improvement are not surprising, given what is known about the benefits of access to finance. This model does have high-potential development leverage that would be self-sustaining for the businesses that benefit from access to finance.

5.6.5 Other aspects of relevance

Three other issues arise from the study that need to be raised:

1. The PASS model focuses on SMEs, leaving a gap for access to finance by micro-enterprises. This is partly addressed through PASS's work in facilitating formal financial institution finance to less formal financial institutions, such as rural SACCOs that on-lend to micro-enterprises and individuals. This type of facilitation, as well as directly linking agribusinesses to banks, is important in terms of expanding the development impact, but is not necessarily a requirement for replication.

2. Highly subsidised BDS can undermine emerging private provision and ultimately retard competition or innovative approaches. Also, through the subsidy, PASS is effectively limiting its choice of provider to its own staff. It should be noted, however, that PASS originally planned to use external BDS providers but it was forced to use in-house advisers because of the lack of suitable BDS providers. It is unlikely that fully self-sustaining BDS of this sort could be established by the private sector on a profit-making basis. The only private alternative might be if some of the services were embedded in other more profitable activities that they are related to. As noted, in some ways PASS is embedding BDS, using a mix of development funds and fees from the CGF to subsidise BDS provision. This would not necessarily be required in countries with a well-established BDS sector.

3. AgFiMS by contrast is more clearly a public good, as no one private entity could undertake this scale of primary research and, if they did, then the data would only be available for sale to entities that wanted it. Although FMT has had success with the banking sector in South Africa paying for the FinScope 'consumer' studies, the South African market is much larger and valuable compared to the relatively small and poorly served agricultural firms and farms in countries like Tanzania. Over time, there is scope for private sponsorship and syndicating research costs; however, the first step is to demonstrate the value of the research to the private sector.

5.7 CASE STUDY F: VCF: adopting an integrated approach

5.7.1 The rationale for including the case study

Agricultural VCF is increasingly being undertaken in many countries in Africa. It is an approach that has been tested and used widely in many other parts of the world and the key concepts in value chains are described in Box 5.5 below.

Box 5.1 Definition of key concepts in value chains

What is a value chain?
A value chain "describes the full range of activities involved in getting a product or service from conception, through the different phases of production and delivery to the final consumer" (see Kaplinsky, R. and Morris, M. (2002)).

Who are the players in a value chain?
Value chains involve a wide range of actors, which include input suppliers, producers, processors, and buyers (including wholesalers, exporters and national and global retailers). Apart from these, key players also often interact with other players – such as those providing financial services (which can be institutions or individual operators) and those providing support services (such as TA or extension services). These actors will have different financing requirements that reflect the activities they undertake.

What are some of the important features of value chains?

- The activities undertaken by actors in a value chain are focused on meeting market demand for specific products. In many cases, key actors aim for improved product quality and returns.
- There is often a high degree of communication and coordination among various chain actors, especially those that have a direct relationship – e.g. buyers and producers.
- There are costs and benefits for all stakeholders/actors involved in the chain.

How can value chains be upgraded to improve competitiveness?
Improvements within a value chain can be undertaken at various levels:

- Developing processes to increase production efficiency and reduce unit costs of production;
- Product development to improve product quality and increase value to consumers;
- Functional development to allow/facilitate firm entry into a new level of the value chain;
- Developing channels to facilitate entry of actors/new firms into a pathway leading to a new end market; and
- Inter-sectoral (inter-chain) improvements to facilitate firm entry into a new value chain based on a different product.

The experience with the use of VCF shows that as many small- and medium-sized farmers face problems accessing formal finance,[94] their participation in a well-structured and dynamic supply chain can improve their chances of obtaining financing.

[94] As indicated throughout the report, many producers – especially small-scale farmers – face significant financial access constraints. These include the lack of (traditional) collateral, being located too far from urban centres (i.e. they are typically located in villages that are difficult to reach, given the quality of infrastructure in many rural areas), lack of registered credit history, low and erratic cash income patterns (owing to the seasonality of agriculture and nature of other economic activities), and a high degree of social exclusion (which help to explain literacy levels and perceptions regarding market actors). On the other hand, the supply of financial services (especially to small-scale

As indicated in Box 4.1, VCF – or "the financial relationship between two or more actors within the value chain" (Neven, 2008) – can take two forms:

- Direct VCF, or *chain liquidity*, is where one value chain actor provides finance to another actor within the chain.
- Indirect VCF is where financing is provided from outside the value chain (such as by a financial institution), based on the specific borrowers' value chain activities (e.g. purchase contracts, advance contracts, promises to buy, or transaction history). This in turn can take two forms:
  - *Agricultural finance, which is the service provided by a financial institution to an actor within a value chain (e.g. a loan by a bank to a trader); and*
  - *VCF narrowly defined, which is anchored on the (usually tripartite) cooperation between agents along value chains and between them and a financial institution.*

The term 'VCF' is used in the literature in both the last, narrow sense and in the wider sense covering all forms of finance for agricultural value chains: it is usually clear from the context which is meant.

There are many different financial instruments that can be used in VCF.[95] The use of financing instruments is often limited only by what value chain actors are willing and able to provide and by what is permitted, given the legal and regulatory framework of the country involved.

VCF is an approach that has a number of advantages. It builds on existing relationships and the realities of the markets the actors in a chain operate within. Well-designed financing arrangements within value chains also help to overcome information gaps, and can generate a greater degree of trust between actors. Often, repayment options (for credit) are embedded within non-financial relationships and therefore make it relatively easy for lenders to enforce credit contracts. In some cases, VCF also facilitates the provision of much-needed TA for various actors in the chain.

This case study looks at successful cases of mutually beneficial partnerships among key actors involved in the production of agricultural crops, exploring the experience of various institutions in providing efficient VCF when there is a transparent partnership and clear alignment between actors along the value chain.

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producers) is constrained by the ability of financial institutions to develop appropriate products and delivery mechanisms, their perception of risk, and their high operating costs when providing services in remote areas.

[95] The range of financing instruments includes: (1) agricultural product-based – such as trade credit, input supply credit, agribusiness/marketing company credit, lead firm financing/contract farming; (2) accounts receivable-based – such as trade receivables finance and factoring; (3) physical asset-based – such as a warehouse receipts system and leasing; (4) instruments for risk mitigation – such as insurance, forward contracts and futures; and (5) financial enhancements – such as securitisation, loan guarantees and joint ventures. In some cases (e.g. in highly developed value chains), a combination of different financing instruments is used to deal with the specific requirements of various actors within the chain.

5.7.2 Successful VCF: the experience of Hortifruti (Central America) and BASIX (India)

Hortifruti (Central America): the role of an institutional buyer in facilitating farmers' access to finance

Hortifruti is an institutional buyer that belongs to a consortium built around a supermarket chain. It is composed of three separate but related firms, which together constitute the Agriculture Division of the *Corporación de Compañías Agroindustriales* (Corporation of Agroindustrial Companies). These three firms specialise in the procurement and distribution of fresh fruits and vegetables, basic grains (mostly beans and rice), and the supply of produce, meat and other staples to large institutional buyers (which include hotels, restaurants, hospitals, cruise ships, etc.).[96]

Hortifruti acts as the lead firm and works in partnership with producers who supply the required goods (fruits, vegetables and other produce). Hortifruti looks for producers who already have received and/or are working with international TA providers: it considers these producers to be more likely to be able to provide the quality and quantity demanded. Since Hortifruti does not pay for TA, working with producers already linked to TA providers can reduce its operating costs and dependence on imports. In countries like Nicaragua and Honduras, where Hortifruti operates, the availability of TA services to producers has helped Hortifruti (and other leading firms) to transition from being a net importer to a net exporter.

In this value chain, Hortifruti (as the buyer/wholesaler) works in close partnership with national and global retailers. The supermarket chain, Wal-Mart, which purchases from Hortifruti, has established quality standards, and these are applied on its behalf by Hortifruti and its network of producers.[97] The purpose of applying these standards is to ensure compliance with strict privately developed food safety and quality standards (equivalent to those adopted by EUROPGAP and the FDA). The kind of care that Hortifruti has demonstrated has earned the firm several food safety certifications and allowed it to meet other requirements for exports beyond Central America.

To achieve the desired results, Hortifruti has also taken on some agricultural extension functions in some of the countries it operates in. These are mostly carried out through the activities of Hortifruti field buyers (who are agronomists) and the frequent field visits and advice given to producers on developing production schedules, pest-control and cost-control interventions. For Hortifruti, this approach helps to assure the continuity of product delivery and enables them to maintain open communication with their producers (as well as to spot and resolve problems as quickly as possible).

To guarantee the best quality products that consumers seek, Hortifruti has gradually developed a bundle of relationships with small- and medium-sized local producers.[98] They

[96] In 2006, Wal-Mart acquired 51% of the stock in the holding company of the Hortifruti group. Wal-Mart is an important strategic partner, as it is the largest retailer in the world and the largest food retailer in the US.

[97] The standards encompass appearance, quality and presentation. To address food safety concerns, additional standards of traceability have also been implemented and monitored through barcoding. Hortifruti products are controlled from the farm itself, through technical recommendations and analyses of irrigation and rinsing water, as well as agrochemical analyses for residuals. To facilitate handling according to food safety standards, the farmers can buy packing materials, at preferential prices, from Hortifruti.

[98] By the end of 2005, Hortifruti was working with about 1,650 preferred suppliers in Costa Rica (up from 1,200 at the end of 2004), 550 in Nicaragua (up from 300), and 350 in Honduras (up from 300).

provide quality seed and packing materials, accompanied by some TA during sowing, harvesting, and post-harvest activities. The emphasis is on enhancing the ability of the value chain to handle large volumes while maintaining quality standards.

It is important to emphasise that there is an alignment of interests between Hortifruti and their producers: in effect, the buyer (Hortifruti) is supporting its own bottom line by investing in an assured source of quality produce. All of the support services extended to farmers (aimed at increasing productivity and developing better business practices) contribute to the learning of participating producers, enabling the upgrading of farmers' productive capacity and entrepreneurial skills.

In most cases, there are no formal (written) contracts with the producers, especially since most producers prefer flexible arrangements. Rather, as the mutually beneficial and stable relationship between buyer and producer evolves over time, an informal or implicit contractual arrangement is established. Nevertheless, these implicit contracts effectively guarantee a purchase, under certain conditions.[99] **For most of the participating farmers, these implicit agreements are valued as an intangible asset.** These farmers understand that under normal circumstances planting does not guarantee that they will be able to sell their produce; selling does not guarantee they will be able to obtain a good price; and a good price does not guarantee that they will be paid promptly or in full. The implicit contractual relationship between the producers and Hortifruti helps to reduce farmers' market risk. The arrangement ensures that the farmer has a buyer (i.e. it reduces the risks associated with the volume sold), who is willing to pay within some expected price range (i.e. price risk is reduced) and able to make the payment with certainty after a short period (i.e. payment risk is reduced). Among other advantages, farmers value the promise of comparatively stable prices (net prices that are usually, though not always, somewhat above wholesale market prices) and of a guaranteed market, as well as some expertise, TA (which they get free) and market information. The relationship with Hortifruti therefore enables the farmers to plan ahead, to use their own income to invest, and to diversify their crops in order to reduce their vulnerability to changes in market conditions.

The implicit contract plays an important role in triggering and in enhancing the creditworthiness of producers. The reduction or elimination of some of the market risks helps to encourage improved production performance and facilitate farmers' access to credit. (In some cases, access to external funding allows the producers to take advantage of new opportunities sooner rather than later.) The way credit and other financial services are provided to participating producers is linked to the development of the value chains, the way quality standards are introduced, and how the associated procurement practices and distribution channels are transformed and developed. During the early phases of the relationship between Hortifruti and a producer, financing will be sourced by the producer from more informal sources; however, as the relationship evolves, the farmer is then able to establish a history of production and sales and use his/her implicit purchase agreements in order to access financing from formal providers.

Hortifruti notes, however, that while the demand for financial services can escalate with the presence of an institutional buyer (especially if it purchases on behalf of a well-known supermarket chain), there will not always be an adequate response in terms of the supply of financial services. In some cases, the capacity or the interest (among financial service providers) is lacking: in such cases, value chain relationships (no matter how strong or well

[99] These implicit contracts provide a production calendar, the volumes required at each stage, and the standards of quality that need to be observed. The calendar allows the farmers to stagger their production, so that their planting and harvesting coincide with the dates and amounts of the purchase agreements.

developed) will have limited influence on the supply of financial services for producers. In Hortifruti's experience, for example, there have been substantial differences in the capacity and interest of various types of financial intermediaries in the three countries where it operates (Costa Rica, Honduras and Nicaragua). Many other factors that are outside the realm of what Hortifruti does help to explain the differences in how financial intermediaries respond to opportunities to provide VCF. In Honduras, for example, the collapse of a state-owned agricultural development bank and severe political intrusion in financial markets (including the passing of legislation for the pardoning of loans) have seriously affected the country's credit markets and explain the lack of appetite among banks to extend services to the agricultural sector. There are also regulatory asymmetries in Honduras, which penalise those financial intermediaries willing to extend their services in rural areas, even when the associated risks are not necessarily excessive.

BASIX (India): bundling financial and non-financial services

BASIX is an institution engaged in livelihood promotion. It provides services to more than a million poor households in India. Initially, when it started in 1996, BASIX's primary focus was delivering microcredit to its clients. In 2001, however, an impact assessment was carried out, which showed that only a little over half (52%) of its clients, who received at least three rounds of microcredit from BASIX, showed a significant increase in their income; the rest either reported no change in income level or even a decline in their income level. These results prompted BASIX to carry out a detailed study of its clients, which helped to explain the reasons for the increase or decline in income. The study revealed that clients were exposed to unmanaged risk, experienced low productivity and were subject to unfavourable terms in input and output market transactions. This study made it very clear to BASIX that there was a need to improve productivity, provide risk-mitigation services, and facilitate market linkages, as well as a need for rural producers to organise and come together to give them greater bargaining power in the marketplace.

BASIX therefore revised its strategy to provide a comprehensive set of livelihood promotion services to poor rural households. This new strategy involves the extension not only of financial services, but also of other complementary non-financial services to support agricultural, livestock and enterprise development and institutional development. This is referred to as the BASIX Livelihood Triad, which covers: (a) financial inclusion services; (b) agricultural, livestock and enterprise development services; and (c) institutional development services. Using a livelihood approach with a value chain business model, BASIX provides a comprehensive bundle of non-financial services to build farmer competitiveness and address their livelihood needs. These non-financial services encompass productivity enhancement, non-insurance risk mitigation (e.g. livestock vaccinations), local value addition (e.g. processing), identifying or developing alternative market linkages, skills development (e.g. entrepreneurship and awareness building), group formation, etc.

BASIX recognises that finance is just one of several value chain services required to enhance competencies, increase outreach, reduce transaction costs and reduce risk for farmers and other stakeholders. In addition to financial constraints, small farmers in developing countries also face market constraints in acquiring inputs (such as fertiliser, seeds and extension services). Returns to financial services are thus highly conditional on access to other, non-financial services. BASIX provides farmers with extension services such as soil testing and health monitoring of livestock, along with credit, in a way that maximises returns to credit services.[100]

[100] A similar approach is taken by the DrumNet Project in Kenya.

BASIX delivers its services through more than 1,000 livelihood services providers (LSPs), who act as extension agents. LSPs are BASIX employees; they are typically high-school graduates and receive training to act as '*para-extension workers*' or as '*para-veterinarians*'. Customers pay INR 450 (about US$ 10), to access agricultural, livestock and enterprise development services for a year. In 2009, the income generated by BASIX from these services was nearly INR 145 million (about US$ 3 million), and BASIX made a modest profit of nearly INR 22 million (US$ 450,000). As more LSPs reach the breakeven number of customers, BASIX expects profitability to improve. By the year 2010–11, BASIX employed 1,117 LSPs, serving on average 527 customers each (across sectors such as dairy, cotton, groundnut, vegetables, lac, pulses, soya, mushroom, handloom and bamboo crafts). In that year, 589,153 customers were registered for agricultural, livestock and enterprise development services and the total gross revenue generated reached INR 261.6 million, which represents 95.7% of the revenue generated by BASIX from consultancy services (see Table 5.4).

Table 5.4 BASIX's income from operations (2010–11), in '000 INR

	March 2011	March 2010
Micro credit services		
(a) Interest on loans to rural producers	2,902,001,495	1,393,464,561
(b) Loan processing and service fee	580,296,751	382,771,115
(c) Income from asset securitisation	180,310,688	98,402,276
Micro-insurance agency services	215,708,883	129,442,596
Income from consultancy services		
(a) Agricultural and business development	261,608,814	142,974,853
(b) Institutional development services	11,068,407	3,605,781
(c) Other consultancy services	465,433	1,685,460
Other services	**2,926,127**	**4,129,099**

Source: BASIX Annual Report 2010-11.

Table 5.5 below shows that, on average, BASIX spends less than US$ 3,000 per LSP, which allows it to generate profits from these operations.[101]

[101] Aside from salary and operating expenses, no other overhead expenses (such as non-cash expenses, depreciation and amortisation) are allocated to consultancy services. All other overhead expenses are accounted for in total (i.e. given net income generated by all of BASIX's business segments, which include its microcredit operations, micro-insurance, customer services and consultancy services, under which agricultural and business services falls under).

Table 5.5 Estimating the average cost per LSP (2010–11)

Total revenue from agri/BDS	INR 261,608,814
Estimated net profit (segment result) from agri/BDS	INR 122,814,700
Estimated value of operating expenses attributable to all agri/BDS	INR 138,794,114
Total number of LSPs	1,117
Ave. cost / expenditure per LSP (per annum)	INR 124,256
Ave. cost / expenditure per LSP (per annum)	US$ 2,701

Source: Values for total revenue are based on those reported in the BASIX Annual Report 2010–11. Other values are based on own calculations. The estimated net profit is assumed to be 95.7% of the total net profit generated for consultancy services (which is INR 128,333,020 in 2010–11).

Notes: These calculations should be treated as merely indicative of the likely value of operating expenses per LSP, given that: (a) more than 95% of the revenue generated from consultancy services comes from agri/BDS; and (b) labour/salary costs are expected to form the bulk of the expenses for running agri/BDS. The average annual cost of about US$ 2,701 per LSP is indicative of the low labour costs in the country – where entry-level employees with Bachelor's degrees can receive about US$ 2,300 per annum.

As at March 2011, BASIX had more than half a million customers using its agricultural, livestock and enterprise development services. Apart from providing agro-technical advice and support to clients, BASIX has also helped to link customers to input and output markets. WBII was also provided to more than 10,000 farmers for different crops and in different agro-climatic zones, in collaboration with private insurance companies (see Case Study D for other examples of weather insurance).

It is important to note that it has taken BASIX about six years to reach this operational scale, and its experience reveals some important lessons. The frequent field visits and interactions with farmers showed that:

- Small farmers preferred cost-saving and risk-reducing interventions over yield-enhancing interventions (which require larger cash outlays).[102]
- It was not operationally feasible to manage this multitude of interventions for a large number of crops. BASIX therefore focused on a few crops grown by a large number of farmers – such as groundnuts in southern Andhra Pradesh, cotton in northern Andhra Pradesh, and soybeans in western Madhya Pradesh.
- Over time, BASIX staff learned how to customise its services for different agro-climatic zones. This in turn enhanced farmers' willingness to pay for BASIX's services.

Customer satisfaction surveys conducted by independent audit teams found a high level of satisfaction among clients (nearly 80%). Those who were dissatisfied, however, cited 'inadequate visits by the LSPs' as the main cause for dissatisfaction, in terms of frequency and/or quality. To improve the delivery of its services, field executives introduced tighter monitoring of service delivery, which is proving to be quite expensive. BASIX is therefore

[102] An example of a welcome intervention was the stem application of pesticide in cotton, which reduced the incidence of pest multiplication and thereby reduced the need to undertake a large number of pesticide sprays later. Another example was introducing soil testing, which led to more precise and economical application of fertilisers. In the case of livestock production, simple practices like vaccination and periodic deworming (especially of dairy animals) were more cost-effective than the procurement of crossbred animals that produced higher quantities of milk.

pilot-testing mobile phone-based monitoring of service delivery, through which farmers will be able to report incidents of no visit or poor service.[103]

The challenge for BASIX will be balancing staff productivity (given very high caseloads of more than 500 clients per LSP), which the institution deems important to ensure profitable operations, and being able to effectively deliver the non-financial services required by its clients.

5.7.3 Lessons learned and replication in southern Africa

The experiences of Hortifruti in Central America and BASIX in India in developing value chains, as well as those of other value chain actors in other parts of the world, underscore a number of important lessons that may be useful to value chain actors in southern Africa.

A key lesson is that a value chain systems approach is crucial to informing financial service providers in their lending decisions and product development for agriculture. Decision-making with regard to the extension of credit at the client level and in terms of the overall portfolio will benefit from using a better understanding of a value chain – including the assessment of its strengths, risks and trends and the specific clients' position and competency within the chain. Value chain lenders recognise that they must understand a value chain completely; when lending to one actor in the chain, the performance of the loan is essentially linked to the performance of other value chain actors.[104] Moreover, value chain knowledge allows for the structuring of finance to reduce the risk of non-repayment and can help to reduce providers' transaction costs.[105]

As production and marketing systems become more integrated and the value chain develops, the demand for financial services embedded into or linked with the value chain is also expected to continue to grow. This might require the introduction of new players (e.g. other types of financial institutions) that can respond to the growing demand for financial services (especially if credit and other financial services were only previously extended by non-financial institutions or through informal mechanisms).

[103] The International Rice Research Institute in the Philippines also uses mobile-phone applications to maintain communication with and extend information (regarding fertiliser use and market prices during harvest) to its affiliated farmers. This application is part of the financial services package that is offered through a mobile-phone-based savings account.

[104] For example, if a bank lends to a farmer's cooperative, the cooperative's entire income is based on: a) the ability of affiliated farmers to produce the agricultural products in the right quality, quantity and timing; and b) the buyer's ability to purchase the produce from the cooperative. In some cases, the borrower may on-lend to another value chain actor further up or down the chain, e.g. an input supplier may provide credit (or deferred payments) to producers to pay for inputs.

[105] A useful case example is Root Capital, a not-for-profit social finance institution working in international, regional and domestic value chains, which provides credit to small and growing business that are typically unable to secure financing from commercial banks. Root Capital's model involves understanding a value chain's unique dynamics, which allows the lender to mitigate risk and structure loan products that best meet borrowers' needs. The client's buyer benefits from increased reliability of producers and enhanced product quality. In order to serve the working capital needs of small and growing business with limited physical assets, Root Capital lends against purchase order contracts secured with reputable buyers. It also provides financial advisory services to improve potential borrowers' ability to manage a loan, as well as to strengthen existing clients' financial capacity. Services include accounting and reporting systems, cash flow management and governance, among others.

Credit alone is not enough. A more holistic approach is needed, which includes a range of financial and non-financial services, such as BDS and agro-related TA.

- To fully serve the needs of rural and agricultural clients, financial services other than credit (such as savings, leasing and insurance) are often required.[106]
- Rural/agricultural clients also need access to the critical non-financial services that will enable them to grow their businesses and expand value chains. These services include organising (small-scale) producers, improving agricultural practices, providing access to inputs, etc. Providing TA to develop value chains, while improving access to financial services, is effective because it helps farmers to invest more productively in their livelihood activities, acquire vital information that would help them maximise investments and increase productivity, and access more profitable markets.[107]

The use of a more holistic approach requires thinking systemically, and not in a linear or one-dimensional way: in value chains, creating an impact in one area or level will have an impact on others. It is important to consider how interventions directed at certain actors within a value chain can have serious implications on the incentives and risks of other actors in the chain. It is therefore critical to understand the dynamics of transactions (between various actors) and to build trust across the value chain. A successful VCF approach should therefore look not only into financing needs, but also at market linkage and TA requirements for each key player in the chain in a way that reduces risks and costs for users and providers of financial services.

The integration and consolidation of agricultural value chains can happen organically with time, but the process can be speeded up with TA. Governments and development partners can play an important role in helping to accelerate the consolidation of agricultural value chains and improving producers' access to finance by removing barriers, facilitating access to information and TA.[108]

It will be helpful to identify partners with aligned incentives in order to create a 'demonstration effect'. Commercial banks are often conservative and risk averse, especially in environments where the repayment culture may have been damaged; they may not

[106] Some financial institutions, in particular commercial banks, can sometimes take a holistic view (given their scale and operational scope), whereby parallel financing of value chains can be provided to complement the value chain's internal finance (e.g. input-supplier credit extended to producers). Some banks may also be able to provide a wider range of services that cater to the specific needs of different actors within a value chain. In some countries like Malawi, for example, some banks are starting to show interest in contract-farming arrangements – and address the demand for financial services among lead firms as well as their affiliated producers. A potentially serious problem, however, is that such an approach could expose banks/financial institutions to systemic risk in the value chain: if one player (e.g. the processor) fails in the chain or if the market price of the product crashes, the entire chain could fall into default at the same time.

[107] It is instructive, for example, that Mercy Corps, which conducted a study in 2011 to analyse its programmes that combine value chain development with financial services, found that providing holistic support to develop value chains and farmers' access to finance reaped greater results than stand-alone programmes that only focused on facilitating access to credit/financial services.

[108] The horticultural sector in Honduras, for example, has benefited from TA, with targeted education of small farmers helping to integrate small producers into their supply chains. Various technical assistance providers (e.g. Fintrac, ACDI/VOCA, TechnoServe, etc.) play an important role in improving producer quality, building market research capacity, and demonstrating successful integration mechanisms. Moreover, by playing the role of honest brokers, they can bring value chain actors together in a way that facilitates access to finance and provides mutually beneficial opportunities that strengthen the competitiveness of value chains as a whole.

therefore be the best initial partners for agricultural finance or may not be willing to participate in VCF. Once agricultural finance can be proven to be profitable, however, financiers will be keen to expand their investments and more financial institutions are expected to be attracted to the market. This will, however, be limited by broader financial market conditions – as demonstrated in the case of Honduras.

5.8 CASE STUDY G: Strategies adopted to lower the cost of supplying rural financial services

5.8.1 The rationale for including the case study

As argued in other case studies, financial service providers, especially commercial banks, face significant challenges in extending services to rural areas, especially very remote locations. Setting up and operating branches in rural areas can be very costly. Not only are there significant challenges resulting from the lack of or inadequacy of infrastructure (e.g. roads, power, telecommunications, etc.) in remote locations, but there are also high transaction costs associated with the traditional way of delivering financial services to dispersed populations. The large geographical spread of clients, coupled with poor transportation and communication infrastructure, adds to the monitoring and enforcement costs of financial institutions and the compliance costs of rural clients. In countries like Zambia, for example, there are a limited number of banks and other formal financial institutions operating in rural areas: many financial institutions explain their absence in rural areas in terms of the much higher cost of doing business in rural parts of the country (compared to more densely populated, urban centres).

In many cases, banks and other financial institutions also have a limited understanding of agricultural markets and limited expertise in delivering rural financial services. Many are sceptical about providing services to agricultural activities and tend to perceive those in rural areas as generally having a poor credit culture and limited ability to save. Moreover, financial institutions often find it quite difficult to attract qualified and trained staff to work in rural areas without offering much higher compensatory benefits.

In some cases, rural areas may be served by MFIs or community-based financial institutions such as SACCOs. These types of institutions have certain advantages over formal financial institutions such as banks: in theory, their cost structure allows them to more cost-effectively deliver services in remote locations characterised by lower population densities. However, the capacity constraints that characterise them and their operational scale generally prevent them from effectively serving the needs of low-income households and small enterprises in rural areas. Many MFIs in Zambia, for example, are new and still have relatively small-scale operations (e.g. fewer than 5,000 clients). They require capacity building support to reach substantially more clients and provide the kinds of products and services that are needed by individuals and enterprises engaged in agricultural activities. Capacity constraints are all the more pronounced for institutions such as SACCOs, which often have weak governance structures.

This case study discusses approaches adopted in countries that enable a more cost-effective way of delivering financial services in rural areas. In particular, it looks at two types of institutional arrangements: in section 5.9.2, the development of lower-tier types of financial institutions is showcased, such as the rural bank model adopted in the Philippines; and, in section 5.8.3, the linkage-banking model in Mongolia is the focus.

5.8.2 Developing rural banks in the Philippines as providers of rural financial services

Rural banks are popular in rural communities in the Philippines. Unlike other formal financial service providers in the country,[109] they tend to operate branches in more remote areas (including secondary municipalities) and, as a result, a significant proportion of their clientele include those who depend on agriculture for their livelihoods. They are considered to be at the forefront of expanding financial inclusion in the Philippines: their financial service outreach covers over 85% of municipalities and cities, they are culturally and geographically close to rural-based clients and they extend services to farmers for all of the various stages of production (from purchasing inputs to marketing of their produce).[110]

Table 5.6 Overview of the Philippine banking system (March 2012)

Type	No. of institutions	No. of branches	No. of ATMs	Percentage of branches in the National Capital Region[111]	Percentage of total outstanding loans accounted for by agriculture
Universal and commercial banks	38	4,866	9,478	47.21%	9.6%
Thrift banks	71	1,474	1,301	36.43%	5.7%
Rural and cooperative banks	614[112]	2,123	218	4.10%	32.9%

Notes: Microfinance-oriented banks are licensed as either thrift or rural banks.
Source: *Bangko Sentral ng Pilipinas* (Central Bank), data as of March 2012.

[109] The Philippine banking system includes universal and commercial banks, thrift banks and rural and cooperative rural banks. Universal and commercial banks represent the largest category in terms of resources. They offer the widest variety of banking services among all financial institutions. Thrift banks, on the other hand, include savings and mortgage banks, private development banks, stock savings and loan associations and microfinance thrift banks. They are engaged in accumulating savings (from depositors) and investing them, including the provision of short-term working capital and medium- and long-term financing to businesses.

[110] This tier includes both rural banks and cooperative rural banks, which are differentiated in terms of ownership: rural banks are privately owned and managed, while cooperative rural banks are organised and owned by cooperatives or a federation of cooperatives.

[111] Data on the geographical distribution of bank branches do not show the distribution between urban and rural areas in the country, only the regional distribution. Regions will have significant disparities (in terms of population density, poverty concentration and overall level of development) and will include both urban centres and rural areas. The largest urban centre is the National Capital Region (Metro Manila), where almost 50% of the branches of universal and commercial banks are concentrated.

[112] Of which, 574 are rural banks, and 40 are cooperative rural banks. In 2009, the Central Bank introduced new regulations increasing the minimum capital for all banks, including rural banks. This has resulted in mergers and acquisitions and some closures within the rural banking sector: the number of rural banks declined to 647 in 2010 from 674 in 2009. Despite the decline in the number of rural banks, rural bank branches inched up to 2,124 in 2010 from 2,093 in 2009.

Rural banks tend to be small, locally owned enterprises. Unlike large commercial banks, their size and structure usually allows decisions (e.g. on loan applications) to be made more quickly, without the need to refer decisions to the bank's headquarters or branch at a provincial capital. Rural banks' overhead costs are also usually much lower than that of other types of banks, which gives them a greater chance of realising a profit even from a large number of small-scale, high-cost transactions (typically associated with a microfinance/rural finance portfolio).

Table 5.7 Required minimum capital requirements for banks in the Philippines

Type of bank	Amount (in million Pesos)	Amount (in million USD)
Universal banks	4,950.0	110.0
Commercial banks	2,400.0	53.3
Thrift banks		
With head office in Metro Manila	1,000.0	22.2
With head office in cities of Cebu and Davao (major cities outside Manila)	500.0	11.1
Other areas	250.0	5.6
Rural banks		
In Metro Manila	100.0	2.2
In Cebu and Davao	50.0	1.1
In all other cities	25.0	0.55
In 1st to 4th class municipalities	10.0	0.22
In 5th and 6th class municipalities	5.0	0.11
Cooperative banks	10.0	0.22

Source: Central Bank: Basic Guidelines for Establishing Banks.

In 1998, the Microenterprise Access to Banking Services (MABS) Programme was initiated (funded by USAID, in cooperation with the Rural Bankers Association of the Philippines). The programme is designed to encourage the Philippine rural banking industry to significantly expand access to financial services. It provides TA and training to partner rural banks in order to enable them to develop and improve financial services (i.e. savings, loans, and money-transfer services) tailored to meet the needs of microenterprises, small farmers, and low-income households.[113] The MABS approach includes intensive one-on-one TA, workshops, seminars, on-the-job coaching and exposure and training visits to participant banks (provided on a fee basis). This has facilitated:

- The development of innovative products and services such as micro-agri and micro-housing loans;
- The use of technology, such as mobile-phone banking, to lower costs and improve the banks' operational efficiency; and
- Partnerships with insurance service providers to develop and offer appropriate micro-insurance products to their clients.

[113] See http://www.rbapmabs.org/home/.

Since its inception in 1998, the MABS Programme has helped provide training to more than 600 rural banks in the Philippines. The capacity building support extended to rural banks has not focused solely on the development of products and on addressing delinquency issues (which have plagued some rural banks). New technologies have also been introduced to improve institutional efficiency, e.g. enhancements to MISs and banking software programmes, the introduction of PDA collection systems, performance-monitoring systems, and mobile-phone banking services. This comprehensive approach to building capacity is considered key to the success of the programme. Consultants also provide TA in market research and identifying new/assessing existing markets. The programme has also recently implemented activities to link rural banks with insurers, ATM platforms and mobile-banking partners. This has facilitated building of strategic partnerships such as a partnership with Globe Telecom's G-Xchange, which enabled participating rural banks to become channels for the distribution of cash transfers to very poor households.

Impact on institutional performance and access and uptake of services

Over the last decade, the Philippine rural banking sector has posted solid results: rural banks are currently at par with commercial banks in terms of return on assets, return on equity and profitability indicators. Their gross loan portfolio grows at an average of about 1% annually, while deposits generated are growing by more than 3% per year.

Many rural banks used to keep only manual records. The MABS Programme has, however, facilitated the shift to an automated reporting system and upgrading of the core banking system not only to allow rural banks to comply with new supervisory and regulatory requirements but, more importantly, to allow them to offer a broader range of services to their clients. Participating rural banks and their clients recognise the benefits of these new enhancements, e.g. reduced teller lines and shorter ATM queues, real-time balance enquiries from anywhere, reduced cash-based transactions, new sources of revenues for banks, and improved 24/7 banking services.[114]

In terms of product development, the programme has assisted rural banks to develop new or fine-tune existing products, including micro-savings and agricultural loans. The micro-agri loan product, for example, was first launched in 2004 and was taken up by 18 rural banks with more than 58 branches.[115] In a span of only two years, over 43,000 loans with a value of about US$ 13 million were disbursed to small farmers.[116]

5.8.3 Linkage-banking scheme in Mongolia: XacBank's franchise model

The challenges in delivering financial services to dispersed populations in rural areas have prompted a growing number of financial institutions to experiment with the application of technology solutions to address these challenges. However, while many of these are highly innovative and have proven successful in certain contexts, they often cannot overcome the specific barriers that limit the provision of financial services in very remote areas. For

[114] Interview with Cantilan (Rural) Bank's Head of Strategic Management, Melvin Yu, cited in: A. Banerjee (2012): Improving Core Banking Systems to Improve Branchless Banking Services – Lessons from Cantilan Bank.

[115] The micro-agri loan is differentiated from traditional agricultural loans that require only a lump sum repayment due at the time of harvest. The terms and conditions applied to a micro-agri loan consider the borrower's various sources of revenue (typically, poor households in rural areas rely on agriculture for their incomes, but also cope by engaging in other activities such as petty trading and seasonal labour). In many cases, the loan requires that 60% of the principal amount be paid in monthly instalments, and the other 40% is paid in a lump sum at the end of the repayment period.

[116] Repayment performance data for this particular loan is not available.

example, some ICT applications require a certain level of infrastructure, an enabling policy and a supportive legal and regulatory environment, and sufficient institutional capacity and human resources, which may not always be present in developing countries. Many countries in the SADC region, for example, have only recently begun to review and develop policies and regulations to support the development of more integrated payments systems or the introduction of mobile-banking services. They also face serious challenges in terms of the level of physical infrastructure in rural areas, leaving many areas isolated from basic services and markets.

It is in this context that the usefulness of linkage schemes is discussed. Facilitating linkages between the formal, semi-formal and informal financial sectors is an approach that has been tested and used in many countries, particularly to help address the limitations that some formal financial institutions face when operating in more remote locations.

XacBank's approach to expanding financial services in rural areas

In Mongolia, one of the biggest challenges to expanding and deepening financial access is low population density – a characteristic that some SADC countries share. Mongolia has a population density of only 1.6 people per square kilometre, which is one of the lowest in the world. The problem becomes all the more pronounced when we consider rural Mongolia: 65% of the total population live in urban areas, while 35% in rural areas inhabit a total rural land area 86 times larger than urban areas. The low population density and poor level of infrastructure make it extremely difficult for rural-based households to access basic services, including financial services.

XacBank is a leading MFI in Mongolia, strategically focused on rural markets. In the last decade, it has captured a larger share of the market in rural areas, compared to the banking sector as a whole. It has an impressive branch network, having grown from 20 branches in 2003 to 50 branches by the end of 2010, allowing it to have nationwide presence. Despite this performance, XacBank nevertheless recognised that its rural clients were still largely served by branches that are located in the provincial (*aimag*) centres, while the majority of the rural population live in districts (*soums*) outside the *aimag* centres.[117]

In order to more effectively reach clients in *soums* where a full-fledged branch office in most cases cannot be economically justified, XacBank adopted a linkage-banking model by partnering with local SACCOs. The bank recognised the potential of SACCOs as partners, given the latter's position in local communities and their relatively low administration costs. At the same time, however, SACCOs faced a number of challenges, such as weak governance, limited financial management skills and lack of experience in developing demand-driven products. In order to effectively engage SACCOs as partners, XacBank therefore had to extend intensive capacity building support to these institutions.

This partnership was framed using what XacBank refers to as a *franchise model*. By using SACCOs as its franchisees, XacBank does not need to establish full-fledged branch offices in remote areas. The existing branches at the *aimag* centres provide monitoring and supervision (i.e. the review of financial statements and portfolio reports, similar to an internal audit), as well as advice and guidance to SACCO franchisees. The SACCOs, on the other

[117] Traditional branches of XacBank are established at the *aimag* centres, except in three large *soums*. There is typically no branch at the *soum* level, given the limited scale, high transaction costs, limited connection to transfer transaction data and the lack of qualified human resources to serve as bank staff. In order to break even, XacBank estimates that a branch needs a population of at least 10,000–20,000; however, a typical *soum* has a population of only 2,500 (where about 600 are estimated to be potential borrowers). *Soums* can be as much as 150 kilometres away from the *aimag* centre.

hand, review and approve loan applications on their own, independent of XacBank branch staff.

The start-up costs (incurred by XacBank) for establishing a franchisee includes the salary and incidental expenses (per diems) of three staff, who are deployed in the field to support the development of the SACCO. The staff spend most of their time training a local SACCO (that has expressed an interest in becoming a XacBank franchisee). In the initial stages of the relationship, staff members spend a considerable amount of time with the SACCO but, as the relationship evolves, the frequency of visits to the SACCOs is reduced.

To qualify, SACCOs are expected to have total assets equivalent to at least US$ 2,000.[118] In order to increase the loan capital of the franchisee, XacBank provides a wholesale loan (initially US$ 3,000), which is considered an incentive to the SACCO. Most SACCOs typically want to take on larger wholesale loans. However, XacBank encourages SACCOs to build their own capital (and membership) by committing to lend as much as 80% of the qualifying SACCO's total equity.

While the franchise model has been effective in some cases, XacBank's experience in partnering with SACCOs has been marked by a number of difficulties:

- The start-up costs (to establish and develop the partnership) are high due to the need for intensive capacity building of SACCOs. Many are fairly young/newly established and require considerable support. The initial expectation (of XacBank) was that the franchise model would break even in a relatively short period (i.e. within a year). It has, however, concluded that some subsidy might be required to cover the cost of SACCO capacity building and facilitate longer-term support to these institutions.
- XacBank also recognised that the full commitment and buy-in from local community members and key stakeholders of the SACCO are crucial. SACCO member-owners must be fully convinced of the need for an SACCO and they must be fully engaged in governing their institution. Some SACCOs are subject to political interference, which makes it difficult for XacBank to engage them as partners and build their capacity to deliver financial services to a growing number of members sustainably.

In view of these challenges, XacBank therefore sought a 'transition strategy' that would enable it to eventually introduce the franchise model more effectively at a later stage. This strategy consisted of introducing mobile banking units to service some of the *soums*. A typical mobile banking unit consists of a driver and two credit officers, who travel from a branch in an *aimag* centre to *soums*, usually covering a radius of 50–100 kilometres, once or twice a month.

In each *soum*, a committee is formed, called the Loan Approval Committee (LAC).[119] During the visit, the mobile banking crew meets the LAC members, reviews the loan applications (that are received by the LAC members between the visits), approves qualifying loans

[118] The findings of the ADB Rural Finance in Central Asia Regional Technical Assistance project (which was launched in 2003) showed that, on average, each SCC had almost 60 members and almost MNT 22 million (US$16,000) in total assets. See Lamberte *et al*. (2003). SCC assets are expected to consist mostly of loans to members.

[119] The LAC is responsible for promoting the (loan) product, distributing loan applications, distributing repayment schedules (to borrowers), monitoring loan performance, collecting late repayments (where applicable), receiving loan applications, informing the branch of any outstanding/pending loan applications, reviewing loan applications and approving them together with the mobile bank crew. The LAC members are compensated based on performance by XacBank, which takes into account the quality of the loan portfolio.

together with the LAC, and disburses the loans. Loan repayments are also collected during these visits.

XacBank prioritises those *soums* with populations of more than 3,000. On average, XacBank estimates that a mobile-banking unit is able to break even after five to six months of operation. A portfolio of US$ 40,000 in a given *soum* is typically sufficient scale to break even, in XacBank's experience.

Impact on access and uptake of services

The number of XacBank clients has grown dramatically over the span of seven years. At the end of 2003, the bank was serving 18,610 borrowers. This grew to 71,276 by the end of 2010. (The bank was also serving 175,485 depositors by the end of 2010.) This growth is largely explained by the expansion in XacBank's branch network, having added four to five branches to its network per year in the period 2004–2010.

It is, however, important to point out that, by 2010, XacBank was working with a total of 75 SACCOs, through which 8,735 clients (borrowers) were being served, which accounted for 12% of the total number of XacBank's clients. The bank therefore considers the approach of working in partnership with SACCOs to be a useful complement to the work undertaken by its branches in expanding the reach of its services. The bank has also actively participated in a number of rural finance programmes, such as IFAD's Rural Poverty Programme (in collaboration with the Government of Mongolia): this programme has targeted *aimags* that are mainly agricultural and livestock-breeding regions.

In recent years, XacBank has also started to expand into SME finance (the missing middle), with many of its branches now engaged in rolling out products that target SME clients.[120] It is therefore not surprising that the proportion of XacBank's rural-based clientele declined from 66% in 2005 to 53% in 2010. That said, the bank remains committed to expanding into rural areas (alongside catering to underserved urban-based client groups, such as SMEs); and it still continues to capture the largest share of rural-based clients of all the banks operating in Mongolia. XacBank recognises that the combined use of different approaches and investing in building the capacity of partner institutions (whether they are SACCOs or LACs) are required in order to service clients in more remote locations effectively and sustainably.

5.8.4 Replication in southern Africa

Replicating the approach of developing rural banks

Some SADC countries are starting to explore introducing new tiers of formal financial service providers. In countries like Zambia, for example, some MFIs (NGOs) are now able to acquire licenses as privately owned micro-deposit-taking institutions, which have a limited range of services compared to banks but are nonetheless able to provide the kinds of services needed by low-income individuals and enterprises in rural areas.[121] It is in this context that the experience of building and supporting lower-tier financial institutions (such as rural banks in the Philippines) will be meaningful to consider.[122]

[120] Many SME clients are located in more urban/peri-urban areas.

[121] Some stakeholders in Zambia have also expressed an interest in further exploring the introduction of other types of financial institutions (e.g. lower-tier banks, such as rural or community banks), given the dearth of providers in rural areas and the recognition that commercial banks will be too constrained to expand their services and operate branches in more remote parts of the country.

[122] It is important to note that in other countries where *rural banks* are licensed to operate (e.g. in Ghana and in India), the ownership structure of these institutions differ from those that operate in the

There will surely be a different set of challenges associated with building new institutions from scratch or transforming MFIs into institutions that appreciate the commercial merits of providing services to unbanked, rural areas. The starting point in many SADC countries differs from that in countries like the Philippines (where rural banks have been in existence for quite some time). It is helpful to note, however, that despite the relatively long history of rural banking in the Philippines, many of these rural banks suffered from significant institutional capacity constraints that kept them from growing and expanding the reach of their services and needed the support of a programme such as MABS.

The key lesson to be learned from the experience of developing rural banks in the Philippines is the importance of an enabling policy, legal and regulatory environment. The MABS Programme recognises that without the cooperation of institutions such as the Central Bank of the Philippines and the Rural Bankers Association of the Philippines (RBAP), successfully supporting more than 600 small financial institutions would have been difficult, if not impossible. Throughout the programme's evolution, these key institutions have maintained an active stake in the development of the rural banking sector. The Central Bank has, for example, developed guidelines (circulars) that clarify the role of rural banks, and has consistently provided, in a timely manner, guidance on the development of new products and branch expansion by rural banks. The existence of a fully functioning association of rural banks has also been instrumental in facilitating dialogue within and between the sector and other key stakeholders in the financial sector.

It is also important to highlight that the development of the rural banking sector in the Philippines involved a comprehensive approach to institution-building. Moreover, the MABS Programme is a long-term programme: it is currently in its fourth phase of partnership with the rural banking sector in the Philippines. This comprehensive approach and long-term view is necessary in order to effectively build the capacity of financial institutions.

Lessons learned from XacBank's experience

While the mobile-branch approach appears to be an effective transition strategy, XacBank recognises that this provides people at the *soums* with only very limited financial access. As the mobile-banking unit visits any given *soum* only once a month, it is not able to offer a wider range of services, including, for example, savings facilities. The bank is therefore exploring ways of offering these services using technology applications (in both its franchise arrangements with SACCOs and its mobile-banking units). Even if the infrastructure is ready or available, XacBank recognises that it will be necessary to determine whether the potential scale (in terms of the number of customers) is large enough to ensure a critical mass for the economic viability of providing certain services.[123]

The use of technology-based solutions (including, for example, mobile-phone-based financial services) can indeed help financial institutions like XacBank to reduce transaction costs, address fraud and improve staff productivity. XacBank recognises, however, that institutions must not consider the technology to be a complete substitute for a delivery mechanism. It can work as a supplement to the delivery mechanism (e.g. to support linkage-banking schemes with other types of providers like SACCOs) but it is crucial for financial institutions to remember that clients, especially those in the lower end of the market, still prefer human interaction. Also, there are certain critical functions, such as loan appraisals,

Philippines. In Ghana, for example, rural banks tend to be more community-based (and therefore have ownership and governance features that are similar to open financial cooperatives), while in India rural banks are largely state-owned financial institutions.

[123] Meeting volume requirements might perhaps require building in additional services, or working with even more partner-institutions (e.g. other financial institutions and merchants in the local *soum*).

that still need to be conducted by branch staff and require their personal interaction with clients.

Moreover, the interface between a bank (like XacBank) and any other partner-institution or agent (e.g. a SACCO or a more informal association at *soum* level) will, at a point, need appropriate regulation. XacBank also underscores the importance of financial education, especially among rural-based clients who have not had previous dealings with any formal financial institution.

5.9 CASE STUDY H: Reform of development banks

5.9.1 The rationale for including the case study

Government-owned development banks, or DFIs, still dominate in many countries and assert their role in the extension of credit and other financial services to the agricultural sector. The general experience with DFIs in many developing countries, however, has not been successful. Many of these institutions have been found to do more harm than good: they typically suffer from grave operational inefficiencies, poor quality loan portfolios and exposure to (loan) concentration risks, all of which make them unable to perform as they have been mandated to. Many of these government-owned development banks fail to reach their targeted clientele and, even in cases where they may have done so, this was usually on the basis of unduly high subsidy costs. Various studies on the performance of individual DFIs underscore that in most cases there are incentive and governance problems in their operation that help to explain recurrent problems, such as poor loan origination and contract enforcement. These create or foster non-payment among borrowers. Many of these institutions also have high administrative expenses (resulting from overstaffing and non-transparent pay practices). Moreover, many of them are also engulfed in corruption, political manipulation of lending activities, and capture by powerful special interests. All these factors have resulted in large losses among many DFIs, which have required recurrent recapitalisations at very high fiscal costs.[124]

These state-owned DFIs or development banks typically have a specific mandate (from the government) to make long-term credit available to promote economic development in particular regions or sectors.[125] While these banks may be required to operate in a commercial manner, many of them find it difficult to do so while fulfilling their mandate.[126] In

[124] Some useful examples include Banrural in Mexico, a development bank, which provides financing to the rural sector. In 1999, the amount of recapitalisation by the government amounted to US$ 1.1 billion – even after a significant downscaling of the bank's operations in previous years (Brizzi, 2001). The two largest public banks in Turkey (Ziraat Bank, an agricultural bank, and Halk Bank) had to be recapitalised in 2001, by an amount equivalent to 15.5% of the country's GDP (Fouad et al., 2005).

[125] The sectors typically include agriculture, manufacturing, SMEs, etc.

[126] There seems to be an inherent contradiction between DFIs' social policy mandates and the pressure to maintain commercially sound operations and avoid losses. Their social policy mandates expose them to a high-risk clientele and limit their capacity to diversify risks (whether across economic and geographic sectors or across target segments of the population). These institutions therefore tend to achieve low profits or incur losses, which are often magnified by their weak risk management systems, high administrative expenses, and their being subject to political interference. In order to minimise losses (which create a huge fiscal burden), some development banks are placed under the same regulatory and supervisory standards as private commercial banks. In some cases, this leads them to operate less risky and more lucrative lines of business, competing with other private banks. However, as their activities become increasingly inconsistent with their social policy

some cases, DFIs have therefore considered other business models, such as moving away from retail credit and providing more complex financial services (e.g. guarantees, refinancing, apex/wholesaling facilities), which helps to lessen their credit risks and makes them less subject to political interference.

The harm done by many DFIs – especially those that have been actively engaged in retail lending (in the countryside) – is often manifested in terms of the crowding-out effect of their activities. Potentially sustainable private sector financial institutions end up having very little or no incentive to expand their services to marginalised areas or unbanked populations in the face of DFIs' subsidised interest rates and poor loan recovery.[127]

It is important to recognise that development banks across countries are heterogeneous. There are a number of cases that can be considered as success stories, some of which are covered in this case study. This section discusses the experience in some countries with regard to rationalising the role of DFIs. Despite the negative reputation of DFIs, some of them have successfully undergone significant reforms, as a result of which they are fulfilling an important role in the agricultural financial market in terms of sustainably reaching a significant number of clients in rural areas (directly or indirectly) and providing demand-driven products and services. The institutional experiences discussed in this case study include Bank Rakyat Indonesia, Land Bank of the Philippines, the Development Bank of the Philippines, and the Agricultural Bank of Mongolia. The case study looks at the kinds of reforms undertaken by these institutions and the resources required, as well as the commitment demonstrated by key actors involved in the reform process.

5.9.2 Examples of successfully reformed DFIs

Bank Rakyat Indonesia (BRI): Shifting away from subsidised loans
In the early 1980s, BRI offered mainly subsidised loans to promote agricultural production (specifically of rice) through its rural branches – the Unit Desas. The results were typical of the experience of many similar development banks that provided such services. The interest rates charged did not allow BRI to cover its costs, which resulted in losses, and subsidised lending created incentives for non-repayment among some borrowers. These losses resulted in a fiscal burden to a government that was already under pressure, given the low oil prices of the 1980s. The decision to discontinue such lending was therefore considered, which would have meant the closure of the Unit Desas.

The government was, however, advised at that time to consider a revolutionary reform for BRI's Unit Desas. Under this reform initiative, the branches would be required to be individually sustainable. This was to be achieved by discontinuing subsidised lending and simultaneously focusing on deposit mobilisation. In order to successfully carry this out, an effective incentive system needed to be in place: Unit Desa managers and staff would be rewarded with performance-based incentives (bonuses) based on branch profitability. BRI's leadership also paid attention to the importance of market research to help design loan and deposit products that would be attractive to potential clients in diverse rural areas.

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mandate, political pressures re-emerge, which then push their activities back towards meeting their social mandates. Hence, a new cycle of losses and recapitalisations ensues.

[127] In Peru, for example, the government initially ordered the liquidation of the state-owned agricultural development bank in the 1990s. However, as the Peruvian countryside was without any provider of financial services, the government found it necessary to offer alternatives, including initial subsidies to create private *cajas rurales* (rural-based non-bank entities that provide both lending and deposit services), which were not successful. In the end, the government had to resort to creating a new agricultural development bank, which had a limited role (given opposition by international development agencies to funding it, as well as limitations in the government's own fiscal resources).

The results of this reform initiative were remarkable. The deposit liabilities of the 475 BRI Unit Desas in West Java, for example, increased on average by 53% during the first nine months of 1989, registering an annual growth rate of over 70%. In the past decade, BRI has continued to lead the way in terms of deposits mobilised among all MFIs reporting to the MIX Market. Its average deposit balance (about US$ 267), which represents about 17% of average per capita income in Indonesia, also demonstrates how the bank is able to reach out and serve low-income clients.[128] It also continues to maintain a high-quality loan portfolio, with a non-performing loan (NPL) rate of not more than 5%.

In 2003, 30% of BRI's equity was sold on the open market and by 2007 private sector holdings reached 46% of BRI's equity, which many consider a highly favourable endorsement of the bank's performance. The bank also continues to reap numerous industry awards and recognitions.

BRI's experience shows that state-owned DFIs can indeed successfully embark on a reform process and effectively provide credit and other financial services needed by rural producers – without the need for subsidies. Its reform entailed a process of shifting from disbursing credit to motivating loan recovery, establishing clear budgetary targets, increasing the level of autonomy of management (with respect to the government as shareholder), and introducing effective staff incentive systems and encouraging greater staff accountability. The heavier emphasis placed on mobilising savings also played a critical role.

BRI has also been actively engaged in developing demand-driven products, including those that target agricultural producers. Under the Rural Income Generation Project, jointly financed by the Asian Development Bank, IFAD, and the Government of Indonesia, BRI supported the development of self-help groups (SHGs), many of which consisted of small-scale farmers. Microcredit was extended to eligible SHGs, some of which required financing for their agricultural production and post-production activities (e.g. packaging). BRI considers this lending product to be successful: many of its SHG clients have registered improvements in terms of production quantity and quality. Furthermore, the value of saving has also been instilled in many of the SHGs that were formed. BRI has since expanded this type of SHG lending to cover disaster-affected areas, where it has used a combination of matching grants, savings and loans to help in reconstructing livelihoods.

Landbank of the Philippines (LBP): thriving in the midst of a difficult political environment

The LBP is a government-owned bank that provides retail financial services, primarily targeting clients in the rural and agricultural sector. LBP is considered an unusual case, given its history as a state-owned bank that was able to survive during a period when two other large government-owned banks became insolvent, which created a huge burden for the government.[129] Moreover, LBP subsequently prospered in a period of financial liberalisation, becoming as large and successful as leading private commercial banks operating in the Philippines.

It is important to note that LBP has performed well despite the fact that, as a state-owned financial institution, its mandate goes beyond simply providing banking services to the rural and agricultural sector; it also provides support to major government programmes in the areas of agrarian reform, agriculture and fisheries modernisation, and livelihood support. It is also responsible for various subsidiaries and other agencies, which consist of entities that

[128] A low savings balance is an indicator of (poverty) outreach.

[129] The two state-owned banks that became insolvent were the Development Bank of the Philippines and the Philippine National Bank.

are unrelated to banking as well as those that offer complementary services. In addition to providing wholesale finance to rural financial institutions, LBP offers TA and capital investments for rural banks and cooperatives.

LBP has been heavily involved in extending loans and other financial services to local government units and government corporations, especially in the priority areas of agricultural infrastructure and other related projects. Its mandate to go beyond the provision of financial services to promote agriculture and support the development of the rural sector has undoubtedly reduced its potential profitability. For LBP, its main burden resulted from government policies (in the 1980s) that made it one of the primary channels through which subsidised and directed credit flowed. These policies threatened the bank's sustainability; indeed, it was these policies that led to the bankruptcy of the other two major government banks in the 1980s.[130] Many rural banks during this period also participated in channelling loans to fund rice production on subsidised terms and many of them neglected deposit mobilisation and became heavily dependent on LBP wholesale lending funds. This had disastrous results: about one-third of the 1,200 rural banks that existed at that time became bankrupt and another third were so weakened that they could be salvaged only by a massive government recapitalisation programme administered through LBP. In the same period, LBP experienced even more serious difficulties with its lending operations through cooperatives: overdue and defaulted loans to credit cooperatives were even more problematic compared to rural banks.

Given these experiences, LBP decided to dramatically change its approach to rediscounting, reflecting the dramatic changes that also ensued in the 1990s in the Philippine government's financial policies. Programmes of subsidised credit were abandoned and policies were adopted to rationalise the role of government entities, thereby enabling them to become primarily involved in supporting the expansion of private sector participation in finance. As a consequence of this shift, LBP began lending at market rates to its larger agricultural and rural clients. For small-scale clients, however, it sought to operate more at the wholesale level by providing discount funds to various types of financial intermediaries. Significantly, LBP also changed its approach towards these intermediaries, given its previous negative experience in the 1980s with subsidised interest rates.

Today, LBP is focused primarily on ensuring that the intermediaries it works with are financially sound and focused on the market segment that it wants to serve, i.e. small-scale rural producers. Although rural banks continue to access funds from LBP (and are LBP's lowest-risk intermediaries), the rural banking sector in the Philippines has also dramatically evolved in the last decade and many rural banks are now active in mobilising deposits and are therefore less dependent on LBP's rediscounting facilities. LBP has also increased its engagement with cooperatives: apart from offering wholesale funds to cooperatives, it is also actively engaged in the provision of TA to improve their financial and managerial performance. LBP considers this a strategic investment on their part: for LBP to live up to its mandate, it needs strong retail financial institutions that are able to provide services in rural areas of the country. Over the years, LBP's leadership have actively participated in programmes that promote transparency through standardised accounting and developing performance indicators for the cooperative sector.[131]

[130] This period was marked by crony capitalism in the Philippines, where former President Marcos and his friends/allies exerted undue influence on many government-owned banks.

[131] LBP has, for example, supported efforts to improve the regulation of credit cooperatives, working in partnership with the Department of Finance and the National Credit Council.

An important feature of LBP, which helps to explain its success, is its governance. LBP's board, unlike that of the other two state-owned banks that went bankrupt, has always been legally constituted in such a way that only a minority were appointed directly by the Philippine president. The Secretary of the Department of Finance is the LBP Chairperson, who has the incentive to resist outside interventions in LBP's operations that could lead to excessive risk-taking or losses, which would become a fiscal problem.

LBP continues to deliver remarkable performance on many levels – achieving profitability while mobilising small-scale deposits and lending to important sectors such as rural microenterprises and SMEs, farmers and fisher-folk, and agribusinesses. Over the years, it has also participated in various programmes funded by development agencies such as the World Bank, the Asian Development Bank, and bilateral development agencies from Japan (JICA) and Germany (KfW).

Development Bank of the Philippines (DBP): playing a strategic role in supporting supply chains

As a DFI, the DBP is considered an important vehicle for accelerating sustainable economic growth in the country. Its key mandate is to provide medium- and long-term financing to address the needs of agricultural and industrial enterprises, with a focus on small- and medium-scale industries, particularly in the countryside. DBP also supports the growth of domestic capital markets and is the country's major conduit for international funds from multilateral and bilateral institutions for official development assistance programmes and grants.

Its 60-year history is, however, marked by a number of difficult periods, particularly in the 1980s when the bank's viability was undermined by an increasing number of NPLs. DBP went bankrupt and required recapitalisation by the government. After the ousting of President Marcos in 1986 the new government issued Executive Order No. 81, which reorganised the bank and gave it a new charter. All the bank's non-performing assets and liabilities were subsequently transferred to the government and DBP went through a reform process that included a thorough revision of its credit process and a training programme for all bank staff to ensure that its new lending thrusts were internalised and implemented. By 1995, DBP was granted a universal banking license and three years later had its charter revised. Under the revised charter, DBP's authorised capital increased sevenfold from PHP 5 billion (about US$ 100 million) to PHP 35 billion (US$ 700 million). Today, DBP continues programme-type lending to strategic sectors such as infrastructure, transportation, telecommunications, power and energy, SMEs, agriculture and food security, education, health care, housing, microfinance, and the environment.

DBP's flagship programme is the Sustainable Logistics Development Programme (SLDP), which is aimed at addressing the needs of logistics or the physical distribution of goods and services. As an archipelago with more than 7,100 islands, distribution is critical to the country's food security. The SLDP supports the government's goals of achieving global competitiveness, poverty alleviation and attaining food sufficiency at the local, regional, and national levels. SLDP financial assistance is focused on the physical asset requirements of a sustainable distribution system of maritime transport and related transport by land.[132] The programme facilitates close collaboration between the private and public sectors to bring about cost-effective ways of moving goods, services and people, all through the provision of financial assistance and TA. Through SLDP, investments to improve the transport,

[132] The programme seeks to support the development of progressive long-haul shipping, which constitutes the country's national backbone in terms of transporting bulk agricultural products, as well as the development of short-haul ferry systems to link the islands to the various growth centres of the country.

warehousing and distribution infrastructure are supported. This includes investments in post-harvest activities, such as processing, bulk drying, storing, handling and trucking, as well as establishing a connected refrigerated chain (from producers to consumers).

DBP's lending under the SLDP covers a broad range of projects in the distribution and supply chain, encompassing farmers, traders, consolidators, warehousing and transport operators, and including wholesale and retail distributors. The working capital needs of small-scale producers, traders and entrepreneurs are addressed through DBP's micro and SME lending programmes. Larger investments to support capital equipment and fixed asset purchases, on the other hand (e.g. vessels and bulk carriers, cargo handling and storage equipment) are supported through DBP's project financing programmes. As of 2008, DBP has supported the financing of more than 200 projects (with financing amounting to more than US$ 300 million).

DBP's experience demonstrates that it is possible for a DFI to successfully undergo reform and become a significant player in the agricultural financial sector. In 2009, loans to small-scale farmers and fisher-folk reached PHP 29.5 billion (about US$ 590 million). These loans were extended through 1,054 accredited cooperatives and 393 countryside financial institutions (which include rural and cooperative banks). Almost 500,000 small-scale producers benefited from these loans.[133]

Table 5.8 LBP loans to priority sectors (December 2011)

Sectors	Percentage share to total loan portfolio
Priority sectors	**67.8**
1. Farmers and fisher-folk	12.4
2. Microenterprises and SMEs	8.4
3. Livelihood loans	2.1
4. Agribusiness	8.4
5. Agri-infrastructure (through local government units)	12.7
6. Agri-related projects (through government-owned and controlled corporations)	15.9
7. Environment-related projects	2.6
8. Social housing	2.6
9. Schools and hospitals	2.7
Other sectors	**32.2**

Source: www.landbank.com.

The bank recognises that one of the critical steps undertaken during its reform process was the adoption of policy reforms that provided the needed framework to facilitate: (a) greater participation of private financial institutions (including rural banks and cooperatives); (b) the adoption of market-based interest rates; and (c) the emphasis on proper management and utilisation of credit funds.

[133] In January to June 2012, LBP released PHP 11.6 billion in loans to 236 partner financial institutions, benefiting 129,792 small-scale farmers and MSMEs nationwide.

Khan Bank: Agricultural Bank of Mongolia

From its creation in the early 1990s, the Agricultural Bank of Mongolia has been a major provider of rural financial services, with staff of 2,600 and a network of more than 300 rural branches. The bank carried a significant number of NPLs, most of which were related to political interference (e.g. this included lending to government-owned entities). The bank therefore went into receivership in 1996 and again in 1999 as a result of ineffective reforms following the first receivership. Because of the importance of the bank in rural areas, another reform was attempted in 2000, this time with the support of international development agencies. The reforms included a management contract that explicitly excluded any government intervention in the operations of the bank, the only exception being prudential supervision by the Central Bank.

The non-intervention of government in the bank's operations allowed the bank's new management to pursue a strategy that sought to make branches profitable, rather than simply closing unprofitable branches. This strategy included designing and implementing financial products that are specifically targeted to certain client bases. For example, the loan products included herder loans (a product that reflects Mongolia's predominant traditional rural activity), loans for micro and small businesses, pensioners, employees, etc. Decision-making was also decentralised, allowing local branch managers to decide on loan applications, supported with performance-based incentives for managers and branch staff. Strong internal audit processes and financial controls were also established in order to ensure that decision-making discretion was not abused.

Within a few months of its reform, Khan Bank managed to break even and by 2002 the bank achieved a return on equity of over 50%, which is more than twice the average of Mongolia's banking system. By the end of 2003, the bank had expanded to cover 98% of Mongolia's rural communities, with 350 branches.

Under its new ownership, Khan Bank continued to show outstanding performance. At the end of 2007, MIX Market ranked it among the top 10 MFIs worldwide in terms of deposit mobilisation (with an average balance of just under US$ 300, or about 25% of Mongolia's per capita national income).

Khan Bank has also continued to play other important roles, such as adopting ICT to improve its financial services, establishing 55 ATMs (more than half of which are located in rural areas), and being the first to offer mobile-phone banking in the country. The bank has a diverse range of loan products, which allows it to respond to the needs of various clients (and reflects the differences in local area characteristics). Similar to other reformed development banks, Khan Bank also pays particular attention to the importance of deposit mobilisation. By early 2004, deposits exceeded US$ 75 million, 80% of which are deposits from individuals. Government deposits declined in importance – from over 50% of total deposits in 2000 to less than 10% by the end of 2003. These successes allowed the government to undertake a process of privatisation of the bank in 2003 (awarding ownership to HS Securities of Japan, for US$ 6.85 million).

5.9.3 Lessons learned and replication in southern Africa

The experience of reformed DFIs show that it is possible for such institutions to make the necessary shifts to allow them to become formidable players in the financial sector and truly serve the needs of individuals and enterprises in the rural and agricultural sector. The cases discussed illustrate that there are different viable paths, e.g. institutional reform that can be followed by privatisation or without subsequent privatisation. Despite these differences, it is important to emphasise that the reform process for all successful cases of DFIs (such as those discussed in this case study) have been built around eliminating subsidies and moving to market-based lending in order to make these development banks profitable and

sustainable. This required adopting zero-tolerance for *ad hoc* interventions by government officials in banks' lending decisions.[134] Moreover, improving governance required the strengthening of the internal audit and financial control functions within these banks.[135] Lastly – and just as critical – these successful DFIs also shifted their strategic focus to include successful deposit mobilisation.

It is meaningful to note that many of these successful DFIs have managed not only to balance their social/public mandates with their commercial objectives but have used their special position to facilitate the development of financial markets. This required facilitating public–private partnerships, through which DFIs can help to overcome coordination failures and possible disincentives and obstacles for other private actors to participate (e.g. the perceptions of risk that are generally associated with the agricultural sector by commercial financial institutions). That said, it is important to emphasise that these successful DFIs did not undertake such activities merely on the automatic assumption of a lack of access to credit and other financial services in certain areas: many of them invested in understanding market realities (e.g. through market research), which allowed them to design interventions and products that are directed at solving the specific market failures that underlie the problems of access. This is an important role that strong DFIs can play in the development of rural financial markets. Given their status as state-owned entities (i.e. that they have 'patient capital'), they are better able to undertake certain initiatives that the private sector may not be as willing or ready to carry out (especially without any prior demonstration or indication of success). In other words, DFIs can have a useful catalytic function in kick-starting the provision of certain financial services.

It is also important to note that the successful reform of many development banks required the commitment of the respective governments, not only to adhere to certain standards of operational independence but also to undertake important policy reforms to rationalise the role and functions of state-owned financial institutions and the government's involvement in the provision of financial services.

What is required to successfully reform DFIs is well understood in many countries, but it is important to recognise that reforms often entail a long process and tend to take a long time to work. Long-term political and financial commitment as well as TA to individual institutions are required.

[134] The Prudential Standards, Guidelines and Rating System for African Development Banks and Finance Institutions, promulgated by the African Association of Development Finance Institutions (AADFI) in March 2009, are now widely accepted as the core standards for DFIs in Africa. As spelt out in the AADFI standards, DFIs must have an appropriate governance structure and a sufficient level of operational independence to enable them to meet requirements. See, in particular, the standards relating to 'Sufficient Independence from Government', 'Management Independence and Incentives' and 'Operating in Accord with Reasonable Commercial Principles'.

[135] In the case of DFIs that are actively involved in the provision of retail financial services (e.g. BRI), the strengthening of these functions enabled these banks to decentralise lending decisions and enabled them to better respond to the needs of the local markets they served.

5.10 CASE STUDY I: Mobile money – scale or substance?

5.10.1 The rationale for including the case study

The explosion in the use of mobile phones across Africa has led to much speculation that mobile money will provide the answer to the striking lack of access to finance for many Africans, particularly in rural areas. As of September 2011 there were more than 620 million mobile connections in Africa. Over the past 10 years the number of mobile connections has grown by on average 30% per year and it is forecast to reach 735 million by the end of 2012 (GSMA, 2011). This represents a huge opportunity for financial institutions, mobile network operators (MNOs) and others to offer mobile money services both to those who are already banked and to those who do not currently have access to financial services.

Mobile money has the potential to dramatically increase access to rural and agricultural finance in southern Africa. It significantly lowers the cost and ease of accessing financial services and can be used anywhere there is sufficient mobile phone infrastructure. It can reduce, or even avoid altogether, the need to physically access bank branches, which are located predominantly in urban or peri-urban areas. For example, in South Africa, which has much the most advanced financial infrastructure in the region, only 5% of the country's 8.1 million rural poor have a bank 'within reach' and it takes the average South African 58 minutes to access a financial services point (IFC, 2009). Add to this the cost of travelling to bank branches – both in actual terms and in terms of loss of earnings as a result of the time spent travelling to and from the bank and waiting in bank queues – and mobile money becomes a compelling prospect.

This case study is therefore highly relevant in the southern African context. We explore the potential for mobile money to increase access to, and the depth of, financial services in rural areas by exploring two very different models that have already been tested in southern Africa but are poised to expand more widely in the region: WIZZIT in South Africa and M-PESA in Kenya. **WIZZIT** has expanded to Zambia and Botswana[136] and is potentially replicable in the other study countries. Despite its dramatic success in Kenya and recent rapid growth in Tanzania, **M-PESA** has yet to break into the rest of the southern African market on a substantial scale: it is active in South Africa but has not taken off as rapidly as anticipated. Other mobile money models are also emerging in each of the study countries.

Not only does mobile money promise to significantly enlarge the **scale**, or breadth, of financial inclusion, it also has the potential to expand its **scope**, or depth. It is this increased scope – offering a range of financial services on mobile money platforms – that has potentially revolutionary implications for development: as the financial diary research reported in *Portfolios of the Poor*[137] demonstrates, poor people need a wide variety of financial instruments to manage their complex financial lives.

There is inevitably a trade-off between scale and scope, between the numbers of people reached and the range of services made available to them. This is well exemplified by the contrast between M-PESA in Kenya, which reaches over 14 million people but essentially offers only money transfer services, and WIZZIT, which offers a full range of banking services but currently reaches fewer than 400,000 people.

[136] It is also expanding to Rwanda, Tanzania, Romania and Namibia (interview with WIZZIT, August 2012).

[137] Daryl Collins, Jonathan Morduch, Stuart Rutherford, and Orlanda Ruthven (2009). *Portfolios of the Poor: How the World's Poor Live on $2 a Day*.

It has been noted that there is a qualitative as well as a quantitative dimension to opening up access to finance. David Porteous, a leading mobile money expert, classifies mobile money as being either 'transformational' or 'additive', or somewhere between the two (Porteous, 2007). **Transformational** banking provides services in such a way that unbanked people are targeted. **Additive** initiatives supply another channel or type of service for the banked. Some models are more transformational than others. As WIZZIT explicitly targets unbanked and under-banked people in rural/remote areas and townships in South Africa, it can be considered primarily 'transformational'.

5.10.2 M-PESA

M-PESA originated in Kenya but has now been replicated in Tanzania, Afghanistan, South Africa and India. M-PESA was launched in Kenya in 2007 and by April 2011 had more than 14 million[138] users and 27,988 agent outlets (Safaricom, 2011). M-PESA was originally intended to be used by one MFI, Faulu, but during its development it was quickly recognised that it had much wider potential than this. Safaricom were also initially interested in introducing M-PESA in order to reduce mobile phone churn: offering M-PESA as an additional service meant that clients were more likely to hold onto their numbers longer to ensure that they can participate in the system, especially to receive money. This therefore decreased churn, and the necessity to open new numbers for existing users. This in turn decreased costs (through not have to start up new numbers) and ensured continuing income on existing numbers. It also resulted in fewer dormant numbers.

At one level, M-PESA has had a massive impact on financial inclusion in Kenya. The usage of semi-formal financial services in Kenya (including mobile-banking platforms such as M-PESA) increased from 8.1% in 2006 to 17.9% in 2009, while the proportion of the population with access only to informal financial services decreased from 35% to 26.8%. The share of the population excluded from any financial service decreased from 38.3% to 32.7% (FinAccess 2009).[139] These statistics suggest strong gains in financial access resulting from the introduction of M-PESA. Research into the impact of M-PESA in Kenya indicates, however, that while its extensive outreach is remarkable, its transformational impact is limited, both in terms of reaching the unbanked and, even more so, in providing the wide range of financial services that poor people need. Firstly, there is evidence to suggest that M-PESA is not actually serving the very poorest or previously unbanked. In 2010, 72% of M-PESA clients lived in households with at least one account with a formal financial institution, indicating significant overlap between the user base of M-PESA and and that of banks (CGAP, 2010).

Secondly, one of the main criticisms of M-PESA is that it is simply a money transfer service and does not offer a full range of financial services to its customers. Some observers maintain that therein lies the success of M-PESA compared to other models such as WIZZIT that are trying to offer a range of financial services: in truth, M-PESA's customers do not really want bank accounts, but rather want effective ways to send money home to their families (Harvard Business School, 2010). It is indeed important to recognise that money transfers can also cover other financial transactions, such as payment of accounts/instalments: for example, M-PESA can make it easier to purchase farm inputs or can be used by farmers to pay their insurance premiums under the Kilimo Salama scheme, as explored in Case Study D. However, M-PESA's 14 million customers are generally only making about two transactions a month: this suggests it is not 'daily relevant', which may be

[138] 14,008,319 (Safaricom 2011).

[139] Information from FSD Kenya and OPM research.

in part because of the limited product offering but also because it is expensive: a basic payment/remittance costs KSH 30 (US$ 0.31) (MicroSave, 2011).

There have, in fact, been various attempts to adapt M-PESA to offer a wider range of financial services but these have had varying levels of success. For example, Safaricom and Equity Bank developed a bank-based model called M-KESHO which was launched in May 2010, enabling M-PESA users to open M-KESHO savings accounts through M-PESA agents. By May 2011, however, only 718,000 M-KESHO accounts had been opened (Safaricom, 2011), a tiny proportion of the total number of M-PESA users.[140] There may be several reasons for this slow uptake: it could have been a result of flawed product design rather than a problem with the channel itself. For example, perhaps the interest rates offered on savings were too low to incentivise people to save. Other adaptations have included:

- A pre-paid Visa card (Prepay Safari Card) issued through M-PESA by I&M Bank;
- The use by Musoni MFI of its own computer software to service clients through M-PESA; and
- A pre-paid health card issued by Changamka.

Most financial institutions are offering their existing products through the M-PESA channel, mainly for existing clients or to attract new clients with a similar profile. In other words, they are adapting their existing products and services for use through M-PESA rather than using the M-PESA platform to develop innovative products and services that would appeal to lower-income customers and thus to extend financial inclusion (MicroSave #93, 2011). Most financial institutions have encountered difficulties in attempting to extend their products and services through M-PESA, including technical difficulties arising from their inability to adapt their own operating software to the M-PESA platform as well as difficulties in agreeing on pricing structures (MicroSave #94, 2011). As a result, a substantial proportion of the population is using M-PESA as an addition to bank savings accounts rather than as a full-scale substitute.

While this does offer a great opportunity for un- or under-banked people to build up a useful lump sum, which therefore facilitates savings, the concern in relation to financial inclusion is that poor people will use M-PESA as a substitute for more comprehensive financial inclusion. One expert calls this 'low equilibrium financial inclusion' or, put simply, 'poor quality, high cost and potentially high risk financial inclusion'[141] (MicroSave #95, 2011). On the other hand, evidence is emerging of unexpected benefits of M-PESA in facilitating the use of traditional, informal networks of financial entrustment and reciprocity that can be of considerable benefit to poorer people. M-PESA extends the reach, reduces the cost and improves the security of such transactions.[142] Susan Johnson, who has been undertaking extensive fieldwork in this area, concludes that 'the formal sector needs to understand what the informal sector does so effectively if formal inclusion is to become a reality' (FSD, 2011).

[140] There also appear to have been difficulties in reaching agreement between the partners on how M-KESHO should be operated and priced.

[141] 'High risk' because of the lack of customer privacy resulting from the close involvement of agents in their transactions (although this is, of course, also the case with conventional bank accounts handled by agents) and also because, although money in transit is held in trust accounts, ring fenced from Safaricom's own funds, Safaricom may be unable to repay senders and pay receivers in the event of the collapse of Safaricom.

[142] For example, funds needed for school fees, hospital bills, funeral expenses, emergencies or merry-go-round contributions are now easily requested by mobile phone and sent via M-PESA.

'M-Paisa' was launched by Roshan, the leading mobile operator in Afghanistan, in 2008 and claims to provide 'an essential service to 97% of the unbanked population in the country whilst eliminating common financial barriers, especially in the remote and rural areas of the country.'[143] It offers a range of financial services, including person-to-person money transfer, disbursement and repayment of microfinance loans, airtime purchases, bill payments and disbursement and receipt of salaries. The original M-PESA model has also been adapted to include a voice recognition tool so that M-Paisa can also be used by illiterate customers. M-Paisa is specifically targeted towards microfinance clients and Roshan also formed a partnership with the First Microfinance Bank of Afghanistan (FMFB-A) to facilitate loan repayments through M-Paisa for their client base. Currently, over 5000 FMFB-A customers are using M-Paisa to make their weekly or monthly loan repayments (IFC, 2010).

In India, M-PESA was first piloted with HDFC Bank in Sikar province in 2010, and in 2011 ICICI Bank also started working with M-PESA. These are the two largest independently owned banks in India.

In Tanzania, M-PESA is the market leader in terms of mobile money; as at December 2011 it had 2.2 million users, while the three other players each had less than 0.5 million (FSDT, 2011). By February 2012 it was reported that this had increased to 3 million users.[144] Mobile money in Tanzania is developing in a way that could significantly increase financial inclusion. First, the pricing in Tanzania is significantly lower than in Kenya: in some cases it is one tenth of the price (TSH 50 (US$ 0.03) to send up to TSH 10,000 (US$ 6.29)). Secondly, there are three MNOs in competition in the market, compared with one dominant provider in Kenya, Safaricom, which has virtually monopolised the market and left other MNOs unable to compete effectively. Having competing MNOs creates room for innovation of products tailored to the needs of the poor and the rural unbanked, as well as creating a downward pressure on prices. Thirdly, the MNOs have all dedicated significant resources to the development of their platform and agent network. Mobile money has reached the tipping point in Tanzania and can be expected to reach significant scale and have an important impact on financial inclusion (OPM, 2012).

M-PESA has been less successful in penetrating the South African market. In contrast to Kenya, regulations require that mobile money operations are bank led. Vodacom had no choice therefore but to partner with a bank, Nedbank, and in September 2010 they announced the launch of M-PESA in South Africa. M-PESA has been slow to penetrate the South African market, however. When it first launched, Vodacom projected that it would sign up 10 million users in the following three years but by May 2011 it had only registered approximately 100,000 customers.[145] The gap between expectations for M-PESA's performance and its actual performance can be partly attributed to significant differences between the Kenyan and South African financial sectors, the regulatory framework and the timing of M-PESA's launch in the respective countries. In Kenya it was the pioneer in the market and quickly gained a monopoly but in South Africa it was following other pioneers, including WIZZIT, and entering a market where large South African banks had already launched mobile money services. According to MoneyWeb, a South African investment website, *'a tough regulatory environment with regards to customer registration and the acquisition of outlets also compounded the company's troubles, as the local regulations are more stringent in comparison to our African counterparts. Lack of education and product*

[143] http://www.roshan.af/Roshan/M-Paisa.aspx, accessed 18 June 2012.

[144] Information provided to OPM by Vodacom.

[145] http://www.techcentral.co.za/m-pesa-disappoints-for-vodacom-sa/23167/ [accessed 28 June 2012]

understanding also hindered efforts in the initial roll-out of the product."[146] In June 2011, Vodacom and Nedbank launched a campaign to re-position M-PESA and in July 2012 claimed to have reached 1 million M-PESA users in South Africa.

5.10.3 WIZZIT

WIZZIT was launched in South Africa in 2005 and was a pioneer in mobile money service provision. It is also being replicated in Rwanda, Tanzania, Zambia, Namibia and Botswana. In some cases, this expansion has involved the use of WIZZIT's mobile banking platform but not its business model. As these operations are relatively new, there are no statistics available on usage to date outside South Africa.

Around 400,000 people in South Africa have opened accounts with WIZZIT (IFC, 2012a). This number is small in comparison with M-PESA's 14 million users in Kenya, but the range of financial services offered to clients is much greater. WIZZIT allows customers to open and operate bank accounts, deposit and withdraw cash and effect money transfers between people and businesses. WIZZIT has also developed and piloted a microcredit product for MSMEs: during the pilot phase, 475 loans valued at a total of ZAR 1,656,000 (US$ 220,800) were disbursed and WIZZIT now plans to roll out the MSME micro-lending programme nationally (IFC, 2012b). The WIZZIT model and its distribution network also potentially allow a further extension of services, including insurance and pension products and a wide range of other services.

A defining feature of WIZZIT compared to most other mobile money offerings is that it was started by two social entrepreneurs with an explicitly social objective: to increase access to finance for the estimated 16 million unbanked/under-banked adults in South Africa. Their policy of benefiting the poor extends to employing, as WIZZIT employees and WIZZKids (WIZZIT agents in local communities, typically unemployed university graduates from low-income communities), as far as possible, those who have previously been unemployed (Napier, 2010). Unlike its South African competitors (FNB, MTN, Standard Bank and, more recently, Nedbank, who have partnered with M-PESA), WIZZIT does not require users to have an existing bank account (as WIZZIT itself provides normal bank account facilities) and it is compatible with early generation mobile phones popular in low-income communities. The facility even works with customers who use pay-as-you-go mobile-phones. In addition to being able to conduct phone-to-phone transactions, WIZZIT account holders are issued Maestro debit cards that can be used at any ATM or retailer.

Given this mission to reach the unbanked, WIZZIT has deliberately tried to keep its fee structures low. A 2006 study into mobile-phone banking and low-income customers used WIZZIT as a test case and reported that WIZZIT's customers found WIZZIT convenient, accessible and affordable (Ivatury and Pickens, 2006). A WIZZIT account is as much as one-third cheaper than an account at one of South Africa's big retail banks for the same basket of services. WIZZIT also employs over 800 WIZZKids to promote the product and help unbanked customers open accounts. The study revealed that while WIZZIT's customers are indeed poor, they are not among South Africa's poorest: they tend to have more income and assets and be more financially and technologically sophisticated than other low-income South Africans. This is backed up by 2010 South Africa FinScope data that show that the growth in usage of mobile money is particularly marked in Living Standards Measure

[146] VodaCom, Nedbank present a new game plan on M-PESA: http://www.moneyweb.co.za/mw/content/en/moneyweb-financial?oid=545137&sn=2009+Detail [accessed 28 June 2012]

(LSM)[147] 7–8 and those who earn ZAR 4,000 and above on a monthly basis. FinScope data also provide some useful insights into mobile money. In 2010, nine out of 10 adult South Africans had access to mobile phones and 12% of the population use mobile money, compared with 4% in 2009, 2008 and 2007 (FinScope South Africa, 2010).

The 2006 study brought out some interesting attitudes towards mobile money. Both WIZZIT customers and non-customers said they were open to using new technology but still valued human interaction: this would suggest that a bank-based model may be more appropriate for some customers. Most non-customers surveyed knew little or nothing about mobile banking and perceived it as expensive and complicated. Some who were unemployed also considered themselves as ineligible for bank accounts (Ivatury and Pickens, 2006). It is possible that these attitudes will have shifted as mobile money now reaches many more people than it did in 2006, but they suggest there may be a need for mobile money providers to work to increase the financial literacy/capacity of their clients or potential clients.

With the emergence of other mobile money services and other financial institutions targeting low-income customers, WIZZIT has found it difficult to find a secure foothold in the South African market. It is struggling to compete with the large South African banks' mobile money services and is not well known in the market. This was further hampered by the fact that WIZZIT initially deliberately positioned itself as a 'virtual bank' with no physical presence, which made it very difficult to gain people's trust, particularly when they were being asked to entrust their money to this little-known company. WIZZIT tried to counteract this by relying on WIZZKids' standing in their local communities but they failed to reach scale by this method. WIZZIT therefore adjusted its strategy in 2009–2010 and started to establish physical kiosks. WIZZIT's experience seems to support the view that one cannot have branchless banking without having some kind of 'bricks and mortar' presence as a foundation of the service.

As mentioned above, WIZZIT also is not well known in the market. It has struggled to compete with the bigger banks in terms of building a recognised and trusted brand. It did not have a sufficient marketing budget to establish a brand and therefore was forced to rely on lighter touch forms of marketing, including using the post office to complete the sign-up process and WIZZIT Promoters, a street-level, roving sales force paired with fixed WIZZKids posted outside WIZZIT-branded merchants. WIZZIT is also facing stiff competition from banks in expanding into rural areas, as the latter have the advantage of familiar and trusted branding. Capitec Bank is a particularly strong competitor, as it explicitly targets low-income customers but has high visibility in the marketplace and is growing rapidly. Capitec has succeeded in doing what WIZZIT had intended to do, i.e. bringing down the cost of banking significantly while offering access to a fuller range of banking facilities than just money transfer.

In its early days, WIZZIT explored entering into partnerships with the larger South African banks to develop their mobile-banking products and services. They almost reached agreement with one of the larger banks but the partnership was not taken forward. It is highly probable that WIZZIT influenced the mobile money market in South Africa through these discussions and it is possible that these banks then developed very similar models to the WIZZIT model. Therefore, WIZZIT has influenced thinking in the financial industry both in South Africa and outside of the country. All of the large banks in South Africa have adopted mobile banking as part of their product offering and most are moving towards targeting lower income clients. Standard Bank has adopted a WIZZIT-style model as part of their inclusive

[147]The South African Advertising Research Foundation (SAARF) LSM has become the most widely used marketing research tool in Southern Africa. It divides the population into 10 LSM groups, 10 (highest) to 1 (lowest) (http://www.saarf.co.za/LSM/lsms.asp).

banking model because 'WIZZIT proved that mobile banking and in-community agents could work as a model.'[148] This effect has not been restricted to South Africa: banks in other countries have also adopted mobile banking and many mention WIZZIT as being a pioneer in this area.

WIZZIT has been replicated in several other countries, both in SADC and elsewhere. In some cases the adoption of WIZZIT is seen as a two stage process, the first phase being the adoption of the technology and the second the adoption of the business model. In most of the replication countries WIZZIT's partner banks have adopted the WIZZIT technology but not the business model. The main success stories in terms of numbers of clients are Banque Populaire de Rwanda with over 1.2 million customers and Zanaco in Zambia with over 420,000 customers.

In Zambia, the partner bank, the Zambian National Commercial Bank (Zanaco), has adopted both WIZZIT's technology and its business model. In particular, they use the remote account opening and WIZZKid aspects of the business model. Zanaco's mobile offering is called Xapit and has enjoyed rapid growth, attracting 200,000 new customers to the bank in its first two years, and it now has more than 400,000 users. As Xapit uses WIZZIT's remote account opening features and WIZZKids (who are called Sales Agents) it explicitly targets the previously unbanked in rural areas and can therefore be considered transformational. Xapit has become one of the main actors in the mobile banking market in Zambia.

5.10.4 WIZZIT and M-PESA compared

Key features of WIZZIT and M-PESA are compared in Table 5.9.

[148] Inteview with members of the Inclusive Banking Division in Standard Bank.

Table 5.9 Comparison of M-PESA and WIZZIT

	M-PESA	**WIZZIT**
Year of launch	2007	2004
Licensee	Safaricom (non-bank led)	South African Bank of Athens Ltd. (bank led)
Business model	Run by an MNO, with transfer pricing between the phone and the money transfer operations	A stand-alone business operating through all mobile networks
Number of accounts	14,008,319 (April 2011)	395,160 (Feb 2012)
Number of agents	27,988 (April 2011)	2,168[149] (WIZZKids) (July 2012)
Products offered	Money transfer	Money transfer, debit card, open and operate bank accounts, deposit and withdraw cash, loans to MSMEs
Minimum balance	None	None
Monthly fee	None	None
Fee per transaction	US$ 0.31 (basic money transfer)	US$ 0.15–0.78 (depending on service)
Donor(s)	DFID directly and through MicroSave, plus TA to CBK from FSD Kenya and the Alliance for Financial Inclusion	IFC, State Secretariat for Economic Affairs of the Government of Switzerland (SECO), CGAP
Level of donor funding	£1 million (DFID), plus technical assistance from Microsave, FSD and AFI	IFC/SECO: US$ 750,000 (TA); US$ 1.76 million (investment); CGAP: US$ 856,851
Replication in other countries	Afghanistan, India, Tanzania, South Africa	Botswana, Namibia, Rwanda, Tanzania, Zambia, Romania

5.10.5 Lessons learned and replication in southern Africa

A regulatory environment conducive to the development of mobile money is obviously a very important factor in enabling its take-off. The Economist Intelligence Unit in 2010 noted that *'Kenya has a global reputation for innovation and dynamism in microfinance'* and placed Kenya in the top ten of 54 developing countries assessed on a range of indicators covering the regulatory framework for finance, the investment climate and institutional development (Economist Intelligence Unit, 2010). Kenya's regulations allow for both bank-based and non-bank-based mobile money operations. Kenya's regulators at the Central Bank of Kenya (CBK) have been much lauded for their intelligent, open and flexible approach to regulating mobile money. The CBK has an ethos of being sensitive to private sector needs, including the need for financial education, for example shown through their support for the Kenya School of Monetary Studies.

Many believe that Safaricom benefited from the lack of a formal regulatory framework, arguing that regulations imposed without any prior experience of branchless banking would have been too strict and confining (CGAP, 2010b). Recognising this, the CBK issued only a letter of no objection, permitting the launch of M-PESA under certain conditions, and then

[149] Of which approximately 1,200 are active.

monitored its evolution very closely indeed (OPM, 2010). Once they were confident that the MNO transfer services could work on the basis of sound principles, and that they knew how to regulate them, the CBK launched the draft Electronic Retail Traders and Electronic Money Issuers Regulations in February 2011. This was a classic case of the 'test-and-learn' approach to developing the regulation of innovative financial productsendorsed by the G20 in 2010.[150]

South Africa's regulatory environment is, arguably, less conducive to the development of mobile money. Since non-banks are not permitted to issue e-money, MNOs and other providers interested in mobile money have been forced to develop joint ventures with banks. The requirements for obtaining a bank licence were (and still are) very high[151] which would have made it impossible to create a low cost account and would have destroyed WIZZIT's revenue model. Serious discussions were held with two of the Big 4 banks but they decided not to partner with WIZZIT as they felt that the revenue model would not work and they had concerns about the target market not being willing to use mobile phones for banking. WIZZIT is formally a division of the South African Bank of Athens Ltd. and the bank provides WIZZIT with the licence to operate, although functionally WIZZIT operates as a separate entity (Napier, 2010).

The ownership of M-PESA was also an enabling factor in its development. Prior to its launch and in its first year, the Kenyan government was the majority owner of Safaricom while Vodafone, an international MNO, was the minority owner (with 40%): this doubtless assisted Safaricom in its initial stages and also provided the CBK with some comfort (CGAP, 2010b). There is no government ownership/involvement in WIZZIT as it is owned by a variety of shareholders, including IFC, OikoCredit and AfriCap.

Donors played a crucial role in the development of M-PESA. Safaricom's original pilot for M-PESA was supported by a £1 million grant from DFID's Financial Deepening Challenge Fund (OPM, 2010). After piloting a mobile money transfer system, Safaricom applied to the CBK in 2006 for permission to roll out M-PESA. There was a serious risk that CBK would not approve the roll-out because Kenya had no regulations for mobile money in place that that time. CBK approached FSD Kenya for advice and they brought David Porteous, a leading expert in the field, to Nairobi for a week to advise the CBK on how they could manage mobile money without regulations in place. He advised that although CBK had no regulations they did have powers; he then worked with them to draft the letter of no objection on the basis of which M-PESA was launched. FSD Kenya also provided considerable support to M-PESA, both directly and through their support to MicroSave, an important provider of TA to M-PESA in its early days. Finally, the support of the Alliance for Financial Inclusion (through its Knowledge Transfer Programme) to the CBK in drafting the Agent-Banking Guidelines meant that the regulations drew on the extensive experience of Brazil and Colombia of agent banking.

WIZZIT was the brainchild of two South African entrepreneurs and was started by them, so it is essentially a private sector driven initiative. WIZZIT has, however, also received funding and TA from CGAP, the IFC and SECO. The IFC is a shareholder in WIZZIT and has also provided TA in the form of a three-year advisory services project in conjunction with SECO to support WIZZIT's replication, expansion and capacity building, for which the funding is US$ 750,000. CGAP also supported WIZZIT in 2008 and 2009 to increase its customer base to 500,000 new clients: this has still not been achieved.

[150] This phrase was first used by the GSM Association and was then adopted by the G20 in its 'Principles for Innovative Financial Inclusion' in June 2010 (G20, 2010)

[151] Currently the capital requirements for obtaining a bank licence is R 250 million

WIZZIT's South African operations have not experienced the growth originally envisaged in South Africa, but its expansion into other countries has been more successful. The combination of factors that has influenced these two separate developments appears to include: differences in markets; the presence/absence of a large partner (trust, scale, management, marketing budget); differences in model (more integrated with physical infrastructure of existing banks regionally); and key differences in regulatory environments.

This case study demonstrates the importance of finding the right mobile money model for the particular context in each southern African country. We have explored two very different models, both of which have noticeable advantages and disadvantages. While M-PESA has enjoyed considerable success in Kenya it provides only a narrow range of services and has been unable to penetrate the market in South Africa. While WIZZIT has not achieved scale in South Africa it does provide a full range of banking services and it has enjoyed greater success in its replication countries.

5.11 CASE STUDY J: Finding alternative collateral – China's online receivables registry

5.11.1 The rationale for including the case study

As argued in Case Study C, enabling access to finance for SMEs in Africa is crucial for wider economic development as they play such an important role in creating jobs, especially at the community level in rural areas. SMEs are often held back by financial constraints. In southern Africa, and indeed the rest of the developing world, the majority of SMEs' physical and financial assets are in the form of equipment, inventory and receivables, yet most financial institutions do not recognise these 'movable' (or 'saleable') assets as collateral; indeed, in many developing countries, the regulatory environment does not support the use of movable assets as collateral. This presents a particular problem for small-scale farmers and small agribusinesses as the majority of their saleable assets will be movable, in the form of farming or processing equipment.[152] This case study explores a national online registry for pledges of receivables and leasing which has been created in China. The case study is relevant to the six study countries as it directly addresses the difficulty many farmers and rural SMEs face in finding suitable collateral to enable them to access loans from financial institutions.

5.11.2 China's online security interest registry[153]

The creation of the online registry was part of a much larger IFC Secured Transactions Advisory Project in China, from 2004 to 2011. The People's Bank of China (PBOC, China's central bank) recognised that the majority of Chinese SMEs were facing financing difficulties and therefore requested TA from IFC to modernise China's secured transactions system. The main objective of the resultant project was to increase access to credit for firms, particularly SMEs, through the development of an appropriate legal and institutional framework to allow and facilitate the use of movable assets, such as receivables, as collateral for loans.

Before IFC's intervention, Chinese banks were reluctant to provide credit to SMEs which had little or no real-estate collateral. They were reluctant to accept movable assets as collateral because of the unfavourable legal framework and their lack of knowledge and experience in dealing with movable assets. The enabling environment did not in any case allow for the widespread use of movable collateral. China's secured financing laws restricted the use of this form of collateral and the secured transactions law lacked the essential elements required to support the efficient and effective utilisation of the secured lending market. It was impossible to create security interest over revolving and future assets and there was no registry for security interests on some assets, including receivables (IFC, 2012a).

The PBOC Credit Reference Centre (CRC), with support from the IFC, created a national online registry for pledges of receivables for leasing. The receivables registry was created in 2007 and leasing was added in 2009. It is China's first nationwide, central and online registry for secured transactions. The registry enables the use of movable assets such as receivables as collateral for loans. The receivables registry incorporates all the key features of a modern movable collateral registry: it is a single, unified registry; it is easily accessible online; it has user accounts; it uses a notice-based registry in which certain information is

[152] However, some other possible sources of collateral are 'non-movable' such as crops produced (against which warehouse receipts can be issued) and fixed assets such as buildings (houses, business premises) and vehicles for non-farm.

[153] Except where otherwise indicated, the main source for this case study is Dahlberg (2011).

limited to the creditor/debtor; and it uses centralised information. The registry design was based on other registries but with innovations in terms of policies and functionalities that arose as a result of the expertise of the project team. The fees charged for the registry are reasonable. Until October 2010 registration was free but a small flat fee (RMB 100 or US$ 16) has now been introduced to ensure financial sustainability. The receivables registry is easy to use and efficient and feedback on the user experience in terms of the registration system has been overwhelmingly positive (IFC, 2012a).

The IFC project therefore reformed the entire secured transactions system. This was done in three steps:

1. IFC supported the development of the new Property Law in China, which was enacted in 2007. The new law adopted a number of important principles of modern secured transaction systems and, among other things, allowed for movables lending, including receivables, paving the way for the online receivables registry.
2. The online registry was launched in October 2007 for account receivables and leasing was added in 2009.
3. IFC supported public awareness and capacity building activities. Training and capacity building were key to the project's overall success and were aimed at clients and public and private sector stakeholders, including banks, non-bank financial institutions (NBFIs), companies and lawyers. This helped to build banks' expertise on movable asset financing. By July 2011, 61 awareness-raising events had taken place and more than 3,000 people had been trained.

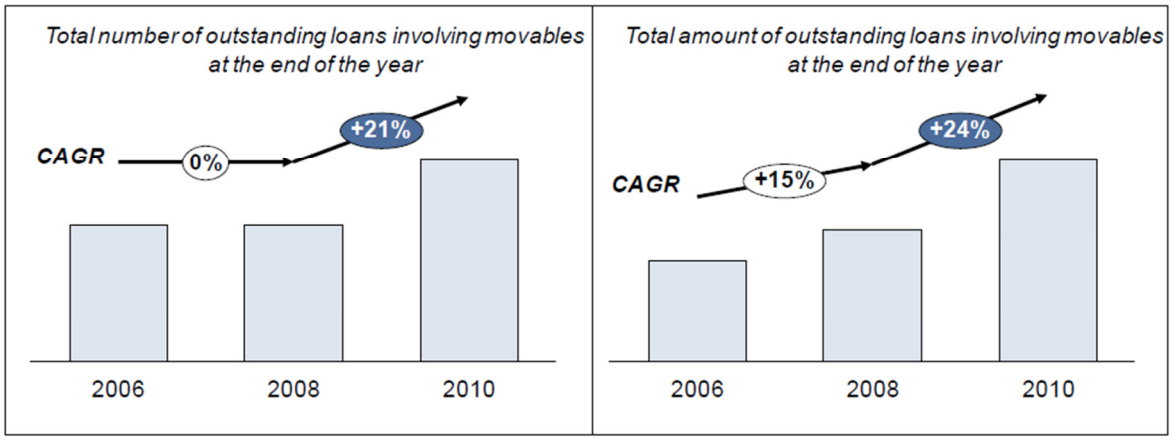
5.11.3 The impact of the registry

Like SMEs in other countries, most Chinese SMEs' assets are in the form of equipment, inventory and receivables and 71% of Chinese SMEs interviewed in a 2005–06 survey reported access to credit as their largest business constraint (IFC, 2012a). When IFC first started its secured transactions project in 2004, financial institutions mainly accepted real property as security when lending to SMEs. Less than 7% of their outstanding business credit was secured exclusively with movable assets, mostly inventory and equipment. However, more than half of the assets owned by Chinese SMEs were movable assets, such as accounts receivable.

The online registry for accounts receivable was launched in October 2007 and for leasing in 2009. The registry now encompasses most movable financing products, including inventory finance, other accounts receivable products, purchase order finance and agent services. As a result of the reforms, the factoring industry was introduced in China and the value of domestic factoring had reached a volume of US$ 21 billion by June 2011. By this date, Chinese businesses had also received more than US$ 3 trillion in credit through more than 385,000 loans derived from accounts receivable financing (IFC, 2012a). Among the registry's 5,000 users are banks, guarantee companies, law firms, finance companies, and pawn shops. Many of the beneficiaries are small businesses: 68,575 SME borrowers have secured loans using accounts receivable. All 21 of China's largest national banks are users of the registry. Financial institutions have generally found movables financing to be low risk and have therefore increased the number of commercial loans involving movable assets. China's Big Five banks[154] posted strong gains in the share of financing secured by movable assets in 2010. As shown in Figure 5.10, this grew by 21% per year in the period 2008–2010, compared to no growth in 2006 to 2008, and the value of loans grew by 24% per year.

[154] Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank and Bank of Communications.

Figure 5.10 Growth of commercial loan portfolio secured by exclusively movable assets



Source: 50 FIs surveyed in six provinces of China (Anhui, Guangdong, Shaanxi, Shandong, Shanghai, and Zhejiang)

Note: CAGR stands for 'compound annual growth rate': the year-over-year growth rate of an investment over a specified period.

Source: Dalberg, 2011

However, smaller financial institutions in China – which are important sources of finance for SMEs – have not yet adopted accounts receivable financing. Only 7% of the total share of registrations in the registry is represented by local domestic banks. These banks perceive accounts receivable lending as higher risk because they generally do not have the required technical expertise to develop new procedures for verifying and monitoring assets.

Some of the larger Chinese banks claim that the secured transactions reforms, including the online registry, have triggered some improvements in their risk-management practices. Some banks report that they use movables financing as a way of mitigating the risks of lending to SMEs because it gives them increased access to the performance data of the business.

The Chinese SMEs that have secured loans using movable assets are overwhelmingly positive about the impact on their business. 88% of respondents to a recent evaluation of IFC's secured transactions project claimed that their businesses grew as a direct result of obtaining accounts receivable funding. Women have also benefited from the project: 63% of the SMEs surveyed that had used accounts receivable to secure their loans were owned by women.

The project has also carried out substantial awareness-raising and capacity building activities. Around 3,000 people have participated in workshops, training, and awareness-raising events.

As a result of the reforms, the movables-financing sector has not only increased in size but has also expanded its product offerings. This has often been as a result of service providers being in closer contact with SMEs and therefore hearing their ideas for product development. There has also been the demonstration effect of market leaders and smaller, more specialised financial institutions. PBOC and IFC also convened regular events and these were cited by financial institutions as a useful source of information about new product innovations. Financial News, a leading Chinese newspaper in financial news reporting, independently reported 36 cases of such product innovations and later published them in a book in September of 2010. PBOC also collected more than 200 cases of product

innovations and published 120 of them in a book with significant inputs from the IFC project. Many of these product innovations are directly relevant to rural and agricultural finance, as shown in Table 5.10.

Table 5.10 Product innovations in movable financing

Type	Financial Institution	Collateral involved	Detailed description
Inventory	Industrial Bank	Warehouse receipts	Pledging of standard warehouse receipts from Shanghai Futures Exchange to obtain short-term financing primarily for liquidity purposes. The bank monitors market value of the receipts to ensure a minimum coverage ratio on the credit limit.
Inventory	Bank of Communications	Wheat (raw ingredient)	The company needs large financing to acquire wheat stock from June to September. Wheat is used as a collateral, and the bank also works with the warehousing company to sign the monitoring/pledging agreement.
Inventory	Baoji City Feng County Credit Cooperative	Mineral	The company was able to secure a loan based on existing inventory after the prices _ had fallen drastically due to the financial crisis. The financing obtained gave short-term liquidity necessary to sustain the business over a low tide.
Supply chain financing	China Merchants Bank	Supply chain collaboration	"1+N" supply chain financing consists of a core enterprise of good standing and smaller enterprises occupying different parts of the chain. Credit limit to the smaller enterprises is based on the financial information derived from the supply chain collaboration provided by the core enterprise.
Supply chain financing	CITIC Bank	Steel and iron financial network	Operates on the idea of the steel/iron factory as the core enterprise; provides financial products to facilitate the transactions within the supply chain, including commercial bills and loans. The bank utilizes purchase orders as collateral for short-term liquidity financing.
Supply chain financing	Bank of Communications	Inventory logistics	Bank supplies financing to coal wholesale distributor with coal inventory pledged as collateral; inventory is held under custody of third-party logistics and depository company, which helps to monitor the value/quantity of inventory, and provides support for transport on behalf of the enterprise.
Floating charge	China Minsheng Banking Corp.	Gold jewelry floating charge	Third-party company monitors daily prices of gold and the quantity of collateral from gold jewelry firms for the bank. Credit limit is adjusted when gold price falls below 5% of set price; the business needs to "top up" when the market value of the collateral falls below 110% of the pledged value.
Floating charge	Jingshan County Rural Credit Cooperative	Livestock (turtles) floating charge	Turtles (and other livestock) pledged as collateral, using lowest market value. Duration of the loan is determined based on life/breeding cycle of the livestock. Focuses on stable markets with mature technical competency, low risks of diseases.
Equipment and machinery	Qiqi Harbin Longjiang County	Agricultural equipment	Mortgages for agriculture equipment, for farmers that wish to purchase equipment but do not have financing. Actual loan amount depends on value of the equipment and other available guarantees.
Intellectual property, trademarks	Shanghai Pudong Development Bank	Intellectual property and trademarks	Bank employed third-party valuation experts to assess the value of a software company's intellectual property and trademarks. The bank also works with government exchange platform to legally pledge the IP/trademark right to the bank. Risk is shared among third-party assessment agency, the bank, and government guarantee co.
Intellectual property, trademarks	Chengdu Huifu Guarantee Co.	Bean-product trademark	Mutual guarantee/trademark provided as counter-collateral. Bean-product businesses belonging to a registered association enjoy the right to use this trademark, which can be used as a counter-collateral.
Equity stake	Suizhou Zengdu Hufeng Village Bank	Equity stake	Pledging of equity stake in a subsidiary co. Scope is still limited as objective valuation as well as monitoring difficult in an unlisted company; realization of value also difficult for an unlisted stock.
Other special innovations	Construction Bank of China	Artwork	Traditional Chinese artwork owned by a cultural organization pledged as collateral. Valued by a team of five experts with on-site due diligence and market research, further employed third-party management to monitor and facilitate any logistics on exhibitions.
Other special innovations	Huaxia Bank	Mutual support fund (mutual guarantee)	Guarantee/risk fund draws contributions from each member enterprise; each member is responsible not only for its own loan repayments but also the potential defaults of other members. This allows companies that trust each other and understand each other's business to enter into group lending.
Other special innovations	Ducang County Rural Cooperative	Livestock and livestock insurance	Breeding pig livestock and its associated insurance pledged as collateral; in case of any losses, compensation will go directly to the bank. Expands scope of possible rural financing channels.
Other special innovations	Ducang County Rural Cooperative	Livestock and livestock insurance	Breeding pig livestock and its associated insurance pledged as collateral; in case of any losses, compensation will go directly to the bank.

Source: Dalberg, 2011

5.11.4 Detailed description to enable replication in southern Africa

As explained above, the creation of the online registry is part of a much larger IFC Secured Transactions Advisory Project in China. This project ran from 2004 to 2011 and its total cost was US$ 1,539,168. Finance for the project was provided by the Investment Climate

Department of the World Bank Group (formerly FIAS), IFC's Project Development Facility and SECO. The project has achieved impressive leverage from this funding: approximately US$ 3.5 trillion of accounts receivable financing was registered between 2007 and June 2011. It is important to remember, however, that similar results cannot be expected in southern African countries given the size of their economies compared to China.

The secured transactions project in China was established to address several challenges. These included a restrictive legal and regulatory framework for movables financing, a lack of capacity of financial institutions in this area and a lack of awareness of movables financing among smaller SMEs, particularly in rural areas. One of the successes of the online registry in China is that IFC took a structured and holistic approach to addressing these challenges. The project first established a conducive enabling environment before attempting to develop the movable assets registry. The creation of a more conducive enabling environment entailed supporting the development of the new Property Law in China, which was enacted in 2007. As mentioned above, the new law adopted a number of important principles of modern secured transaction systems and, among other things, allowed for movables lending, including receivables, paving the way for the online receivables registry. The IFC also organised a number of awareness-raising activities and training courses to build the capacity of key stakeholders in movables financing.

The registry itself, and the wider secured transactions project, appear to be sustainable. The Chinese government and the banking sector were closely involved in the project and appear committed to the continued modernisation of the secured transaction system in China. The CRC, which hosts the registry, shows no sign of encountering financial or operational difficulties and the flat fee (introduced in October 2010) for using the registry should help to ensure its financial sustainability. The CRC has one to two full-time staff who maintain the registry service and around five staff who organise special events related to the registry. This is a small team given the size of China's economy but this is encouraging, from a resources point of view, for small economies who may be interested in developing a similar system/structure. CRC actively promotes its business and has plans to improve the design and features of its web portal.

Some useful lessons for replication have been learned from the implementation of the secured transactions project in China. Four key success factors identified by the IFC project team are:

- **Partnering with a politically powerful agency** with market knowledge and administrative capacity. The PBOC has been a strong champion for SME finance and reform of secured transactions;
- **Positioning the project as market development** rather than one specific reform, aiming to achieve complementarity wherever possible. This project worked at all levels, from the Central Bank to financial institutions, SME owners, etc., and invested in awareness-raising and capacity building to ensure success;
- **Merging local knowledge with global expertise**: the project team was made up of IFC global and local staff and representatives from the PBOC; and
- **Having a professional team in place over time**: although this is not always possible, the fact that the programme manager had been involved in the reform process since 2003 added substantial value to the project.

The project also benefited from the remarkable growth and development in the Chinese economy during the project period. It is unlikely that replication in southern African countries, with less favourable macroeconomic environments, would produce as impressive results as those in China.

The IFC is currently working on a secured transaction project in Malawi and is likely to start working in Zambia during 2012. In Malawi, it is working with the Ministry of Trade and Industry to free the flow of credit to Malawian businesses, including SMEs, and is taking a similar approach to that adopted in China. First, the project aims to modernise Malawian law to recognise and enforce transactions secured with personal property. Then it will establish a web-based collateral registry for creditors and train stakeholders on the benefits and utility of the new secured transactions system (IFC, 2012b).

5.12 CASE STUDY K: SaveAct – doing more than enabling people to save in rural South Africa

5.12.1 The rationale for including the case study

Savings-led initiatives are spreading rapidly in rural areas throughout sub-Saharan Africa. Historically, microfinance initiatives have focused on enabling the poor to access *credit* in order to start and grow their own businesses but, as the financial diary research reported in *Portfolios of the Poor*[155] demonstrates, poor people need a wide variety of financial instruments, including savings, to manage their complex financial lives, as also explained in Case Study I. The ability to save money is key to helping the poor to increase their assets *before* getting access to credit and minimises the risk of getting into debt. According to SEEP, a leading international microfinance network, 'demand worldwide for reliable savings services is estimated to be five times greater than the demand for loans.'[156]

This case study features a savings-led model being rolled out in South Africa by SaveAct, a local NGO. The model has enjoyed remarkable success in enabling access to finance in rural South Africa and is potentially highly relevant to other countries in the region. Many rural households and businesses in these countries are unable to access finance from commercial banks or MFIs because they are unable to meet the stringent Know-Your-Customer (KYC) or collateral requirements of these institutions. This is particularly true for small-scale and emerging farmers. Sometimes it is also just too expensive and difficult to access bank/MFI branches in rural areas. 46% of the 3 to 4 million rural households in South Africa are 'banked' (FinScope South Africa 2011) and 35% of the 2 to 2.5 million rural SMEs are 'banked (FinScope Small Business Survey, 2010). However, even if a household/SME has a bank account, accessing the account usually involves expensive travel, the interest received is low compared to the return on savings with informal groups and banks do not even offer easy access to credit.[157] Savings-led groups, on the other hand, tend to be in rural areas and often serve those who are unable to access finance from more formal institutions, or those whose needs are not being fully met by such institutions.

Savings-led groups are in operation throughout the developing world and operate in similar ways to the SaveAct model profiled in this case study. Community-managed savings-led approaches to financial services for the poor have a long and successful history, particularly in India where there are over 2 million SHGs, serving 30 million members.[158] One such approach, VSLAs, has been pioneered by CARE International and has been successfully adapted by other agencies including Plan, Oxfam, Catholic Relief Services and the Aga Khan Foundation, reaching approximately 2 million very poor people in 22 countries (MasterCard Foundation, 2011). CARE International developed the VSLA model based on the traditional savings practices in Niger in the 1990s and since then the model has spread, to 57 countries (Allen, 2012) undergoing refinements and adaptions to local circumstances along the way.

[155] Collins et al. (2009).

[156] Quoted in SaveAct (2012c).

[157] Almost all 'banked' rural households and SMES interviewed for FinScope (2011) have savings/transmission accounts: very few have loan accounts.

[158] For the historical dimension of building upon traditional savings practices, see Robert Stone. 'Two hundred years of savings banks: the wheel turns full circle', *Enterprise Development and Microfinance*, Vol. 22 No. 2, June 2011.

5.12.2 SaveAct: operations and impact

SaveAct has been pioneering and supporting savings-led groups in rural South Africa (in KwaZulu-Natal and the Eastern Cape) since 2005.[159] This South African NGO aims to 'respond to poverty in the region by promoting SCGs as effective instruments for accessing financial services, building sustainable livelihoods and empowering women and other vulnerable groups.' SaveAct trains the rural poor to form savings groups, become financially literate and develop business opportunities, thus helping create and keep wealth within communities. The NGO gives particular priority to agricultural development. Through SaveAct's SCGs, the rural poor are able to manage their own finances, save money, make loans to each other and earn interest to build their capital, without the intervention of formal financial institutions or taking loans from either MFIs or loan sharks, who are prevalent in South Africa.

SaveAct builds on an existing savings culture in South Africa: the model mirrors the *stokvel*[160] – a widespread indigenous, informal method of saving in South Africa – so participants can easily identify with the model. However, according to Anton Krone, founder and director of SaveAct, they have 'removed much of the risk and lack of rigour that often characterises those groups. Thus members prefer the saving model to the *stokvel* because of the transparency of transaction and control that it brings to their money. Savings groups offer annual payouts with high returns at low risk. Loans are more readily available. As a result we are struggling to keep up with the demand for the training of new savings groups' (SaveAct, 2012c). SaveAct also offers better administration, business development support, training, etc. than *stokvels* aswell as ensuring that all savings capital is paid out to each member with interest in proportion to their savings annually at a time agreeable to all members, not simply in rotation. Furthermore, loans can be made to any member throughout the year, as agreed by the group (see below).

In 2012, SaveAct is working with more than 16,000 members in over 650 groups. It has experienced solid growth, moving from 600 members in 2008 to 10,000 in 2011 (SaveAct, 2012c). This uptake has been entirely demand-driven and SaveAct is now struggling to meet the growing demand for its groups as word spreads around communities about the groups and their benefits. Around 90% of SCG members are women (Delany and Storchi, 2011). SCG members have learned to operate savings and lending activities, create emergency funds and become financially literate, enabling them to achieve greater economic stability, manage health threats including HIV/Aids, and develop sustainable livelihoods. Research has found that 47% of savings group members started new enterprises after joining their groups. The majority of these members indicated that they did so because of the financial and social support they found in their group (SaveAct, 2011).

SaveAct predominantly targets rural communities as they tend to be much more socially stable than urban communities. Consequently, most groups are made up of members who have known and come to trust each other for extended periods. This is one of the main reasons for the low default and membership attrition rates that characterise SaveAct's SCGs (see below). SaveAct is experimenting a little with groups in peri-urban communities, but has yet to try to operate in towns and cities. The demand for expansion in rural communities is so great that this is not seen to be a high priority.

Wherever possible SaveAct works in partnership with other actors. These partners bring a complementary contribution to the complex challenge of enabling sustainable livelihoods in

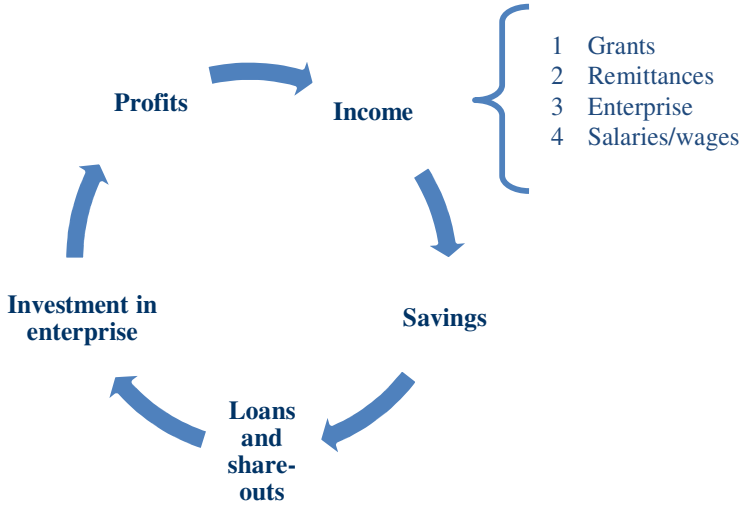
[159] SaveAct launched its first groups in late 2007 following a successful pilot in 2006–07.

[160] These are essentially ROSCAs

rural South Africa. For example, in the area of local livelihood development, partnerships with other organisations have helped SCG members to better understand local economic opportunities, particularly around farming, and identify potential markets and areas of cooperation. There are also close links between NGOs supporting people living with HIV/Aids. The impact of these links has been two way: already existing HIV support groups have adopted the SaveAct model and, as a result of HIV/Aids awareness-raising activities among existing SaveAct groups, some members have come forward to HIV testing and are now on anti-retroviral medicine.

FinMark Trust has recently commissioned research into SaveAct that has provided some insights into the impact that the SCGs are having on people's lives. The research indicates that the groups provide support for their members to develop more sustainable livelihoods and that 'virtuous circles' are continually being created, as illustrated in Figure 5.11.

Figure 5.11 Virtuous circle of savings and small enterprise activities



Source: Delany and Storchi, 2011

Pooled savings provide capital which then gets invested into small enterprises. Of the total savings capital of the groups, about nearly US$2 million (at an average annual of about $120 per member), roughly 2/3 is loaned out at any moment. More than 50% of SCG members are involved in their own MSME income-generating activities and more than 50% borrow from their group to provide start-up or working capital for their MSME. Profits are then either reinvested in the enterprise or put back into the group's savings. This provides the basis for further borrowing and own MSME-generated income. A community-based promoter says 'members borrow money to improve their businesses and they know that they can borrow money from the group if anything in their business is lacking. It is a two way process because [when] I have sold things, I take the profit and save it to the saving scheme' (Delany and Storchi, 2012).

The research also found that the SCGs act as platforms to build social capital and reinforce community relationships and action. Many group members have re-discovered a sense of community and togetherness through saving and working together. In the words of one of the members: 'we now care what happens to one another as members. If you see something that you think will benefit your neighbour then you tell them' (ibid.).

SaveAct can also be considered to be providing rural households and businesses with the required knowledge and skills to enter the formal financial sector. Although not an explicit aim of SaveAct, through participation in the groups themselves and with the additional financial education and business development training received from SaveAct members are better equipped and empowered to save and access credit from commercial banks. FinMark Trust concludes that 'savings group members are […] model banking clients in the making, with this model optimising intermediation opportunities for the formal financial sector' (Delany and Storchi, 2012). SaveAct is interested in exploring links with commercial banks, particularly given the current excess liquidity at certain stages of annual savings cycles among the groups, due partly to the injection of social grant payments, and to liquidity shortages at some other stages, although the formal sector remains alien and inaccessible to many of SaveAct's groups. There are also inherent risks involved as funds are kept by group treasurers in locked boxes. While this is convenient, it creates security risks that could be addressed through bank deposits.

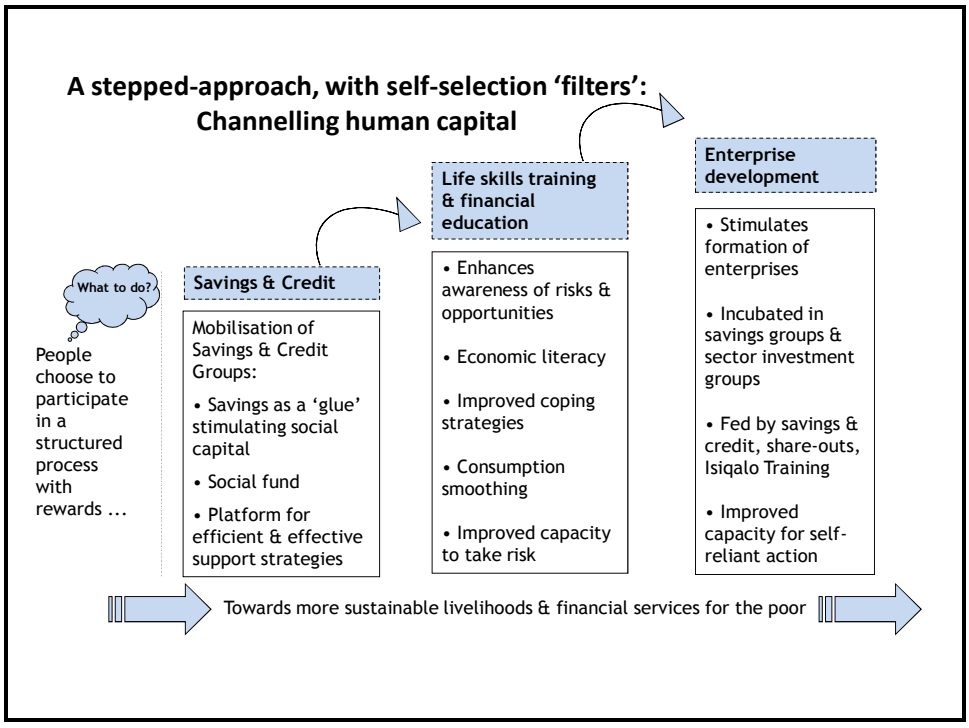
Research has also recently been conducted into the impact of participating in SaveAct's groups on people affected by HIV/Aids. It is estimated that around 30% of SCG members are affected by HIV/Aids (SaveAct, 2011). The study presents evidence of consumption smoothing and improved coping mechanisms among people affected by HIV/Aids who are members of SCGs. More stable consumption levels among participants provide greater protection from insecure and volatile flows of income, making them more able to meet basic household needs. Results indicate that 'coping strategies have been strengthened, and overall vulnerability to the impact of adverse shocks has been cushioned' (Barber, 2011).

Research carried out in 2009 into the impact of SaveAct found that it was having a positive impact at individual, household and community level. All participants interviewed were able to save money and many of them had used these savings to develop businesses or to improve the lives of their families. The research claims that participants' income-generation capacity has developed in large part due to the SaveAct programme. The participants in the enterprise development training also saw growth and development in their businesses. There were also some reported psychological benefits: all participants interviewed reported greater self-confidence and hope due to the SaveAct programme and many claimed that for the first time in their lives they were able to achieve their goals and dreams. Interviewees reported that the SaveAct model stopped them from worrying about money as it provided them with 'accessible, safe and reliable, non-exploitative access to money.' Most interviewees reported that they felt that they had achieved greater financial independence and that this had impacted significantly on their role at a family and individual level, in terms of feeling empowered to make decisions (van der Riet, 2009).

5.12.3 Detailed description of the SaveAct model

SaveAct trains and mentors SCGs in the nuts and bolts of running a group, financial education and enterprise development. It introduces different components of this training in steps, as shown in Figure 5.12.

Figure 5.12 SaveAct's phased approach



Source: Delany and Storchi, 2011

All group members are first trained in savings, lending, social fund management, record keeping, adopting a constitution and sharing out capital on an annual basis. The financial education training then aims to increase the awareness of group members of the importance of managing their money, including household budgets. It emphasises the importance of savings and investing and enables the trainees to plan for variations in expenditure and to deal better with unanticipated shocks. The enterprise development training is then delivered. This is designed to enable participants to identify business opportunities and plan and manage a business. Participants study the market, assess their skills and resources, identify potential opportunities, consider the input costs, assess potential profitability and develop a business plan to either improve an existing business or start up a new business. The course is specifically designed to enable people of different levels of literacy, including those who cannot read or write at all, to participate on equal terms.

As part of SaveAct's commitment to enhancing agricultural development, participatory value chain analysis is also sometimes undertaken as part of a Participatory Economic Action Planning process. This enables participants to gain a detailed understanding of the economic opportunities and limitations in their sub-region. Where this has taken place it has led to the formation of commodity interest groups made up of entrepreneurs drawn from across savings groups. These entrepreneurs have gone on to develop strategies to secure cheaper and better-quality inputs for agricultural development or to explore opportunities for pooling their resources to access markets (SaveAct, 2012a). For example, a group of potato farmers formed as a result of this training and has managed to advance its interests with minimal support from SaveAct. The group went from placing an order for 30 bags of seed potatoes in the first year, to 50–60 bags in the second year and 450 bags in the third year.

While SaveAct's focus on agricultural development is very welcome, there may be some issues around the practicality of this approach. If SaveAct has a group of farmers all cultivating the same crop (which is highly likely as they live in the same area) all group members are likely to require payouts at the same time and have surpluses at the same

time. This could potentially be difficult for the group to manage. In response to this problem, SaveAct groups schedule their annual pay-out point accordingly. A number of homogeneous farmer SCGs have been formed to collect savings for annual inputs. These tend to have a higher proportion of men, who tend to borrow less frequently than women who have a greater diversity of needs, so the returns that these groups generate for their members tend to be lower than the roughly 30% p.a. average for SCGs as a whole. If the groups rely significantly on marketing to dispose of simultaneous annual surpluses, and local markets have limited absorption capacity, there are instances where members have been able to negotiate for purchase by external buyers, some as large as South Africa Breweries, which has an annual order for 500 tonnes of maize in one community near Bergville, Kwa Zulu Natal. Also, if the area experiences a bad season/harvest the group could potentially be left with less savings as the entire area is prone to the same risks. However, the three largest sources of savings injected into SCGs are social grants, remittances and income from members' own small enterprises (including agricultural enterprises). So even if a group is made up largely of farmers and is exposed to covariant farming risk, following a poor farming year the other two major sources can still be relied on for savings capital.

The SCGs are self-selected by members of the community and, once they have been trained, operate independently. The members form a group, usually made up of 10–25 adults from the same rural community and including both men and women, although women tend to predominate numerically. Members of the group save in shares on a monthly basis (e.g. ZAR 50 to ZAR 100 per share), allowing for flexibility in the amounts saved. Savings are invested in the loan fund, from which members can borrow and repay with interest. Loans and interest are repaid into the capital fund and in this way their shares earn interest, which they use to increase their investment. Members can borrow up to three times their share value. The loan can be repaid over a period of three to six months, depending on the age of the group (newer groups tend to have a shorter repayment period in order to minimise risk).

The terms for borrowing and the interest rate are decided by the group during the training but the interest rate must not exceed 10% per month. Having said this, it is hoped that most groups agree on a rate below this as this equates to around 285% per year, which is not an affordable interest rate. However, this rate is still far less than that charged by most loan sharks – the only other readily accessible source of finance for most rural people – who typically charge 50% per month. Also, all members, including those who do the borrowing, benefit from the high return (on average more than 30% per annum) from lending at this mutually agreed rate. It is also important to remember the high direct and indirect costs people in remote rural areas need to bear to access finance from formal financial institutions, if indeed they can meet the necessary requirements (in terms of KYC etc) to access formal financial services. A more promising option could be to lend limited amounts to groups in times of shortage of liquidity, using groups' collective savings as collateral and their inherent knowledge of their members to overcome information asymmetries. The big caveat in such an instance would be not to flood groups with liquidity, as has happened elsewhere (e.g. West Africa), with the invariable consequence of collapsing the entire scheme.

The group also decides how often to meet, although thus far all groups have decided to meet once a month, normally just after they have received their social grant payments, so as this is when they have the greatest opportunity and most need to save (SaveAct, 2012b). In South Africa in recent years, social grants have injected money into rural communities on an unprecedented scale. Many households are highly dependent on these social grants but they are all too often not optimally used. SCGs offer grant recipients a safe and convenient place to turn a proportion of their social grants into savings each month (ibid.). Savings groups in South Africa are amongst the highest investors in savings groups in Africa. This is in a large part due to the monthly social grants received by some 80% of SCG members. Remittances from income from employment in urban areas are another significant

contributor. As SCGs assist members to develop their enterprises, larger investments are being made with an increasing role being played by income from this source.

Group members also pay a monthly contribution into a social fund. This fund is used to assist members in times of emergency or family crisis, such as a family death, and the funds are given to the member as a grant (SaveAct, 2012b). In effect, this is a form of self-insurance for loans made to members of groups who are unexpectedly unable to repay.

The SCGs are, by design, open, transparent and accountable. All transactions are carried out at the meetings in front of all members of the group. Each group has a lockable cash box with three locks and three sets of keys in order to prevent theft and unauthorised transactions. Each member has an individual record book (which is kept in the cash box) where all his/her savings and loan transactions are recorded. Each group develops its own constitution which governs the management of the group. The members elect a management committee, made up of a chairperson, a record keeper, a box keeper, two money counters and three key holders. The length of the group's cycle is decided by the group and is usually 12 months. At the end of the cycle, the group's capital, together with the profits made, is shared out between members. The share received by each member is in proportion to the amount he/she has saved throughout the cycle (SaveAct, 2012b). As groups mature they often schedule their share-outs to capitalise on economic opportunities such as buying agricultural inputs (SaveAct, 2012c).

The statistics from the SaveAct groups look impressive. The average return on savings generated by internal lending is more than 30% per annum. Repayment rates on loans within the groups exceed 99% and group retention rates are around 99% (SaveAct, 2012c). Stimulated by the inflow of social grants, remittances and earnings from self-owned MSMEs, the collective assets of all the SCGs total more than ZAR 15 million and the average loans book is around ZAR 10 million (Delany and Storchi, 2012). This proves the capacity of poor rural communities to save and mobilise capital given an appropriate medium through which to do so (SaveAct, 2012a). SaveAct have worked to develop a model that was sufficiently familiar, simple and transparent to gain the trust and catch the imagination of rural communities on a broad scale.

5.12.4 Detailed description of the SaveAct model to enable replication in southern Africa

The SaveAct model is potentially replicable in other countries in southern Africa. Almost every country in the region has its own history of group-based savings, making it potentially an easy transition for participants into SCGs or similar structures, although for successful replication, the SaveAct meodel would have to be engineered and experimented with in the particular contexts of different countries. The poor and very poor require low-risk, low-cost financial services that they understand and trust. Savings groups offer this in a uniquely empowering way. In some areas where SaveAct works, the take-up of the model exceeds 80% of all households. The SaveAct model works best in established communities where neighbours know and respect each other: this tends to be more the case in rural areas but SaveAct has also experienced high demand in peri-urban areas with strong group functionality.

However, although there are many positive aspects of the SaveAct model, it is also hampered to a certain extent by the same problems encountered by VSLA models throughout the developing world. It is very difficult for VSLAs to significantly scale-up their operations. Although SaveAct's growth has been good, moving to 15,000 members in four years, this is nothing like the scale of growth achieved by other microfinance service providers. For example, M-PESA reached 11 million people in four years.

There are also some questions about the sustainability of such VSLA models: the groups themselves can be considered sustainable but they require substantial support and training for the first 18 months before they become self-sufficient. This inevitably comes at a cost. There are also questions around the long-term sustainability of VSLA groups: the evidence to date on this point is mixed. During field work in East Africa, OPM encountered donors who expressed concern whether groups would survive for long after donor support ended; on the other hand, there were examples where CARE had build relatively strong Apex organisations that supported and were supported by VSLAs long after the CARE programme ended.[161] However, the SaveAct model differs from the CARE VSLA model and has been designed with sustainability in mind: every SaveAct member makes a small payment of ZAR 2 to the facilitator at each meeting, so the facilitator gets R40-50 from each meeting; if a facilitator runs 20 groups, they will be getting in around ZAR 1,000 a month: this should provide sufficient incentive to keep the groups running in the absence of external support. There can be considered to be four stages of sustainability:

6 Preventing implosion;
7 Moving to expansion/scaling up;
8 Innovation; and
9 Tackling the problem of scalability through linkages with formal financial institutions.

There is evidence to suggest that it takes between two and three years for schemes like SaveAct to become sustainable and move into significant growth: this timescale is necessary to build trust and familiarity.

As explained earlier, SaveAct was established in 2005, starting its first groups in 2007. It is therefore still a relatively young and growing organisation. Funding for SaveAct was initially provided by the Ford Foundation, described as 'critical' to SaveAct's early success, but has now come to an end (SaveAct, 2011) as the Foundation's priorities have changed. Other donor partners are the Vesper Society, Misereor (an agency of the German Catholic Church), South Africa's National Development Agency, and the European Union. Total donor funding from 2009 to the end of 2012 has been around ZAR 8.2 million (around US$ 1 million). Considering that SaveAct is serving around 15,000 people, this works out at around US$ 67 per head: this is fairly expensive when compared to other microfinance services (although economies of scale may reduce this in future) and suggests that the approach is not as sustainable as it might first appear. Having said this, the groups themselves are sustainable, as explained later.

As northern donors are tending to increasingly focus on lower income countries than South Africa and generally have fewer funds available as a result of the global economic downturn, SaveAct is looking increasingly to partnerships with South African corporate social investors, including financial institutions, and to social enterprise opportunities to sustain its work. Its long-term vision is to transform into a social enterprise and therefore become less dependent on donor funding. This would constitute a more sustainable model, but brings certain risks as it would mean diversifying the current offering and could potentially lead to mission creep. The current vision is to use the network of community-based promoters to introduce and sell new products to group members but this would necessarily be a low-

[161] For example, a multi-sector CARE programme in Kisarawe, Tanzania, supported the development of over 60 VSLAs and an Apex, the Kisrawe Jumimaki Apex. The CARE project ended in 2003 but when CARE retrained to Kisarawe five years later in 2008, they found that 64 VSLAs had continued to operate and continued to support and be supported by the Apex (OPM, 2009). In Rwanda, OPM met Associations of VSLAs in 2010 that were enabling VSLAs to link to the Banque Populaire de Rwanda, though it was too soon to say whether this would lead to sustainability.

margin/high-volume model and SaveAct estimates that it would therefore need a membership of 60,000 to 100,000 members to make this strategy viable.

In developing and rolling out its model, SaveAct has benefited from close links with VSL Associates. Having initially received advice and support they now work in partnership, providing training to other organisations on the VSL methodology. Thus, SaveAct is also contributing to potential replication of its model in other countries.

As touched on earlier, the SaveAct groups themselves are proving to be self-sustainable. Once they have completed SaveAct's training and mentoring, which usually lasts between 12 and 18 months, almost all of SaveAct's groups have continued into new cycles of self-sustained activity. The groups receive ongoing support from community-based promoters selected from established savings groups. Some services are also delivered through local partners where possible. These promoters are paid a small fee by group members (ZAR 50 (US$ 6) per meeting per group, which works out at ZAR 2–2.5 (US$ 0.25) per member) and they have a dual role: to mentor the groups to maturity and to respond to demands from others in the community who want to form new groups (SaveAct, 2012c). They also offer financial education. SaveAct estimates that the end cost per group member of providing the 18-month long support is around ZAR 150 (US$ 18). However, this amount seems low, given the overall level of funding compared with the number of people served, as explored above.

Initially, SaveAct encountered some challenges in establishing a credible and effective start-up of new groups. People were sceptical until SaveAct had gained their trust that they had members' interests at heart and until they received the first share-outs. Since then, demand has tended to grow rapidly, largely through word of mouth. Start-up involves establishing the normal systems of governance and management of a SCG, securing specialised training in the model,[162] developing effective supervision and monitoring systems, training a sample of groups and monitoring their progress. It is possible to add other aspects such as financial education at a later stage. Group establishment may take six to 12 months. Initial testing and monitoring would benefit from a full cycle of the groups moving to share-out (12 to 18 months).

Since the savings group can set the share value at any level, there is no significant capitalisation requirement that acts as a barrier to participation. There have been no reports of exclusion from SaveAct groups for economic reasons.

The costs of implementing such a programme will vary from country to country and region to region. It is usually more costly to start such a programme in remote locations, but once established and operating these costs can be reduced dramatically via economies of scale. An essential part of the SaveAct approach is the effective leveraging of local capacity and skills from within communities. The fact that community-based contractors to SCGs can provide training in the model for a fee from the SCG creates local work opportunities and puts in place capacity to service SCG needs in the long term, thus contributing to programme sustainability and ensuring that there are trainers available to train groups whether or not the NGO still has a presence in the area.

The strength of the model creates many leveraging opportunities. Most other financial services and enterprise or agricultural development initiatives will experience more 'bang for their buck' by partnering with savings initiatives of this kind. Also, the SaveAct model creates the foundation/platform for financial institutions to offer other services, such as housing

[162] SaveAct conducts training with VSL Associates in South Africa. Similar courses are offered in other parts of Africa.

loans, to enter rural communities successfully. The proliferation of organised groups with functional financial services creates scope for many new ventures across a spectrum of economic and social development opportunities. Finally, the fact that SaveAct is a local NGO means that it can take a long-term perspective on the role it can play in increasing access to finance in rural areas of South Africa and beyond, by providing its SCG members with their first taste of appropriate and readily accessible loan finance.

5.13 CASE STUDY L: Regional cooperation in agricultural and rural finance: what can AFRACA learn from APRACA?

5.13.1 The rationale for including the case study

The African Rural and Agricultural Credit Association (AFRACA) is a regional association that promotes cooperation and facilitates mutual exchange of information and expertise in the field of rural finance in Africa. It is made up of institutions involved in rural and agricultural finance in Africa, including central banks, commercial banks, agricultural banks, MFIs and national programmes. AFRACA's vision is *'a rural Africa where people have access to sustainable financial services for economic development'* and its mission is *'to improve rural finance environment through the promotion of appropriate policy frameworks and to support member institutions so that they are able to provide sustainable quality to the poor rural population.'*[163] AFRACA is divided into five sub-regions: East African, West African (Francophone), West African (Anglophone), Central African and Southern African (SACRAT) sub-regions. AFRACA has a sister organisation in Asia, the Asia-Pacific Rural and Agricultural Credit Association (APRACA). This case study explores the lessons that AFRACA could learn from APRACA.

This case study is relevant to the southern African context as AFRACA, and more specifically SACRAT, could be playing a more effective role in the development of rural and agricultural finance in southern Africa. It has the potential to provide a considerably more important platform for exchanging ideas between countries and practitioners in rural and agricultural finance than at present.

AFRACA and APRACA are both Regional Agricultural Credit Associations (RACAs) established by the FAO. Following the 1975 World Conference on Agricultural Credit, the FAO promoted the establishment of RACAs consisting of financial institutions serving agriculture and rural households and businesses. The work of the member-based RACAs includes:

- Fostering cooperation for improving rural and agricultural financing;
- Undertaking and publishing inter-country studies on matters of common interest in the field of rural finance;
- Organising training programmes and learning exchanges of personnel and experts among members; and
- Facilitating cooperation on rural finance projects between members and donors.

There is a third RACA called the Near East–North Africa Rural and Agricultural Credit Association and a fourth partner association in Latin America, the Association of DFIs in Latin America. The RACAs have now become financially and operationally independent from the FAO and today work on joint research, joint collaboration on conferences and technical workshops with the FAO as partners.[164] All the RACAs are now members of the apex of apex bodies, CICA (the international confederation of rural and agricultural credit associations).

[163] http://www.afraca.org/ [accessed 25 June 2012]

[164] http://www.fao.org/ag/ags/agricultural-finance-and-investment/strategic-partners/en/, accessed 26 June 2012.

In the rest of this case study we describe AFRACA and APRACA and the links between them, and conclude with a discussion of the main differences between them and what AFRACA can learn from APRACA

5.13.2 AFRACA

AFRACA is an association of banks, financial and other institutions involved in providing financial services to the rural population of the continent. Its membership consists of central banks, commercial banks, agricultural banks, development and cooperative banks, MFIs and microfinance networks. AFRACA was founded in 1977 and currently has 104 members in 29 countries. Its secretariat is based in Nairobi, Kenya.

AFRACA works in partnership with its members, research institutions and development partners to increase rural outreach and to improve provision of financial services through more appropriate banking practices and innovative financial products. AFRACA's programme is supported by its members and IFAD and has specific activity-based relationships with various development organisations including the Technical Centre for Agricultural and Rural Cooperation (CTA), GIZ, Danida, FAO and USAID.

The regional sub-groups of AFRACA, including SACRAT for Southern and Central Africa, aim to enhance and promote AFRACA's activities in their respective regions. Specifically, they recruit new members, raise awareness of AFRACA's activities, and help to mobilise resources from sub-regional entities, such as SADC. They are also supposed to support policy development and advocacy, though according to Stephen Makanga, AFRACA Programme Coordinator, this has not really happened effectively yet.

According to Makanga, AFRACA plays the following roles in increasing access to rural and agricultural finance:

- **Lobbying and advocacy**: this is done through a thematic approach to issues around the subject of agrifinance. Following thematic workshops, recommendations aimed at promoting rural/agrifinance are generated;
- **Strengthening the advocacy role of AFRACA for rural and agricultural finance**: this is mainly conducted through partnerships with members, development partners and stakeholders with the capacity to influence policy. Some of the main partnerships include such institutions as central banks and other regulatory authorities, the African Union, and MFW4A;
- **Information and knowledge management**: the knowledge gained from workshops, visits and other activities is shared with and through members and development partners by means of quarterly newsletters. AFRACA also produces a biannual publication and maintains a website;
- **Building the capacity of staff of member institutions**: AFRACA organises training courses in specific agrifinance subjects. They also organise tailor-made exposure visits to successful rural/agrifinance models; and
- **Sharing best practices in rural/agrifinance products and services** through AFRACA's technical exchange programme for its member institutions. The aim of the programme is to contribute to increased uptake of financial services by rural populations.

One of AFRACA's activities is to arrange conferences and fora. These include agribank fora, which AFRACA organises in collaboration with the FAO. There was an agribank forum in Rwanda in July 2012 (theme: 'Enhancing Agricultural Value Chain Financing through Innovations towards Food Security in Africa') and previous fora themes include 'Africa Agricultural Value Chain Financing' in Kenya in 2007 and 'Financing Options for Agricultural and Rural Development in Sub-Saharan Africa' in Nigeria in 2010. These fora bring together

representatives of financial institutions which lend to the agricultural sector, non-financial companies working in the sector (e.g. promoters, producers, processors, exporters, marketers, and input suppliers), government authorities and other supporting international organisations. This is done in order to raise awareness of agricultural finance models and approaches and examine lessons, trends and innovations that are happening in Africa and other parts of the world to improve the accessibility of financial services to the rural poor, mainly farmers. AFRACA also co-organised and co-sponsored the Expert Meeting on Managing Risk in Financing Agriculture in South Africa in 2009.[165]

AFRACA claims to have seen a lot of progress in its member institutions: many have been able to increase the uptake of financial services in part as a result of inter-institutional sharing of best practice and, since this was facilitated by AFRACA (through its technical exchange programme), it can be attributed, at least partly, to their work. Evaluations of AFRACA have provided some measures of its effectiveness in increasing access to rural and agricultural finance.

AFRACA faces a number of challenges in its efforts to increase access to rural and agricultural finance, including:

- **Inadequate resources to capitalise on existing research** in rural/agrifinance policy: AFRACA believes the key to addressing the gap between the supply and demand side of financial services is to follow up on research in policy and provide support to produce relevant research outputs that can be followed up/implemented. AFRACA could workwith IFAD's rural finance Knowledge Management Partnership in collecting, collating and disseminating existing research and could perhaps commission one or two key pieces of research where there are gaps in the knowledge base;
- Moving the **recommendations generated during discussions at workshops into practical action**; and
- **Too little, or a lack of, coordination** of the different stakeholders working towards increasing access to rural and agrifinance. There are many initiatives being carried out by lots of different institutions but these are not being coordinated. This lack of coordination results in replication of efforts and limited impacts.

On this final point, this is an important role AFRACA could play but the association may need capacity building support to be able to effectivel play this role. The need for such a coordinating role player is emphasised as Kampala Principle number 1 (KP1) for increasing agricultural financial inclusion in Africa.[166] There have been some steps towards AFRACA taking on this role as part of the implementation of KP1: it is the subject of one of the processes that the continent-wide Agricultural Finance Stakeholders Working Group (AFSWG) is now developing.

AFRACA has a three-tier organisational structure comprising a General Assembly, Executive Committee and a Secretariat. The **General Assembly** is the highest policymaking body of AFRACA and meets every two years to set the broad policies for the operation of AFRACA, review progress and decide on the next steps for the association. Members of the executive committee are elected by the association's members. The **executive committee** is made up of eight members: the AFRACA regional chairperson, vice chairperson, the five sub-regional chairpersons and the Secretary General. The key role of the committee is to have overall

[165] Other organisers/sponsors included the FAO, the Land Bank of South Africa, and the World Bank.

[166] The Kampala Principles were the product of the June-July 2011 MFW4A/GIZ-driven 'Zipping Finance and Farming' conference in Kampala and have since been accepted and used by, among others, the G20 in their agricultural finance position paper.

responsibility for operational policies, guidelines and strategies, and it also supervises and monitors the activities of the Secretariat (which has eight staff, of which three are technical: the Secretary General, the Programme Coordinator and the Stakeholder Relations Officer). The committee meets twice a year. In order to enhance and complement the work of the Executive Committee and the Secretariat, AFRACA Goodwill Ambassadors and an AFRACA Ex-officios platform are being initiated in 2012 as support structures: it remains to be seen how effective these will be.

5.13.3 APRACA

APRACA was first proposed at the Regional Seminar on Agricultural Credit for Small Farmers in 1974, sponsored by the FAO. It was formally launched in India in 1977 under the auspices of the FAO. The General Secretariat of APRACA was established at the FAO Regional Office for Asia and the Pacific premises in Bangkok, Thailand. Initially, APRACA was made up of 37 institutions from 16 countries but by the end of 2011 its membership had increased to 60 institutions in 23 countries.

APRACA's vision is *'to work for rural growth and development, with priority emphasis on the uplift of rural poor'* and its mission is to pursue *'promotion of the efficiency and effectiveness of rural finance and access to financial services in order to broaden the target group.'*[167] In essence, APRACA is a regional association that promotes cooperation and facilitates mutual exchange of information and expertise in the field of rural finance. The organisation facilitates cooperation in improving and planning the financial arrangements for rural and agricultural development. It provides a platform for systematic interchange of information on sustainable rural and agricultural financial services. APRACA is also actively engaged in conducting inter-country studies on matters of common interest in the field of rural finance, including dissemination (publication and distribution) of such studies across members. It also organises and coordinates training programmes on rural finance and facilitates the exchange of personnel/experts among members. APRACA also works closely with a number of donors and extends related consultancy services (including preparing project proposals and implementing projects).

APRACA's objectives are to:

- Foster cooperation in improving and planning the financial arrangements for rural and agricultural development;
- Establish among the members a machinery for systematic interchange of information on sustainable rural and agricultural financial services;
- Encourage and assist in undertaking inter-country studies on matters of common interest in the field of rural finance, as well as publishing and distributing such studies;
- Organise and coordinate training programmes on rural finance, also facilitating the exchange of personnel/experts among members;
- Provide services related to consultancy, research and publications in the field of rural finance; and
- Facilitate cooperation on rural finance projects between the members and donors, including assistance in preparing project proposals and implementing projects.

APRACA has the following three agencies with responsibility for the areas of training, consultancy and publications. All the activities of the different agencies are coordinated by the Secretariat:

[167] APRACA's website: http://www.apraca.org/2012/vision_mission.php, accessed 26 June 2012.

- **APRACA Publications:** this is based in Mumbai, India, and collects and edits relevant rural finance materials, such as articles from members on innovative rural finance schemes for publication in APRACA's quarterly journal, the APRACA Journal of Rural Finance. The agency also publishes technical books on rural finance;
- **APRACA-CENTRAB:** this is the training arm of APRACA and is hosted by the Land Bank of the Philippines in Manila. CENTRAB formalises and coordinates existing informal arrangements for stimulating and facilitating cooperation in the area of training and research and of promoting better understanding of financial, monetary, banking and economic development matters, particularly relating to agriculture and rural finance; and
- **APRACA Consultancy Services (ACS):** this is based in Jakarta, Indonesia and provides development consulting services of relevance to, and in support of, APRACA's objective and programmes. ACS mobilises and deploys experts from APRACA member and non-member institutions to conduct expert consultations related to rural development and poverty-alleviation programmes, as well as undertaking studies on rural finance policy reforms and financial innovations.

APRACA has worked with other development partners on various programmes relating to the development of rural and agricultural finance. These include:

- APRACA-GTZ (now GIZ) Regional Programme on Linkage Banking and Grassroots Financial Systems Development (1995–1997);
- APRACA-ILO-SDC Regional Programme on Collateral Substitutes (1998–2001);
- APRACA-IFAD MICROSERV Programme (1996–2001): The Programme included the identification of innovations, lessons learned and insights with regard to rural and micro-finance as well as their dissemination in the region;
- IFAD-APRACA FinPower Programme (2007–2011): APRACA implemented the Regional Programme of Accelerating the Financial Empowerment of Poor Rural Communities in Asia and the Pacific through Financial Innovations.

5.13.4 Links between AFRACA and APRACA

As both AFRACA and APRACA were founded by the same organisation for the same purpose in the same year there are close links between them and the two institutions reportedly have a good working relationship. They sometimes carry out exchange visits, through which delegates can learn about best practices from the other region. For example, in December 2011, 13 AFRACA members and secretariat staff went on an exposure/benchmarking visit to APRACA's Secretariat in Thailand. The two associations discussed mutual cooperation activities and the visitors attended the opening session of the APRACA FinPower Regional Forum. They also visited the Bank for Agriculture and Agricultural Cooperatives (Thailand) and the Bank of Thailand. According to Makanga, AFRACA also benchmarks its activities against APRACA's, with a view to improving AFRACA's services to its members and to the rural and agricultural sector more widely.

5.13.5 What are the main differences between AFRACA and APRACA and what can AFRACA learn from APRACA?

Despite having significantly more members that APRACA (104 compared to 60), AFRACA has a much more limited organisational structure and far fewer staff members. AFRACA appears significantly under-resourced in terms of staffing, with eight staff, of which only three are technical. As explained above, APRACA has structured itself into specialised units, focusing on specific areas such as publications and training. This means that APRACA is better placed to serve its members more effectively and in a more targeted and specialised manner.

APRACA has also developed closer links with the FAO than AFRACA. This has enabled APRACA to be more effective than AFRACA at leveraging the FAO's, and the UN's, visibility and resources.[168]

Finally, as explained above, APRACA has taken a much more active role in operationalising rural and agricultural finance programmes than AFRACA. AFRACA has tended to focus more on advocacy, knowledge sharing and advocacy roles than a hands-on role but perhaps could, in future, operationalise programmes relating to rural and agricultural finance, or arrange specialist consultants for this purpose. AFRACA's key constraint is its lack of financial and human resources – it is impossible to fulfil their entire mandate with the level of resources they currently have in place.

[168] AFRACA has for some years received its core financial support from IFAD, as opposed to the FAO.

6 Conclusion

It is clear from the longlist of case studies in Annex C that in recent years many interesting and successful innovations have been introduced in agricultural and rural financial services throughout the world. It is even clearer from the main and subsidiary examples cited in Chapter 5 above that many of these innovations provide a rich source of best practice examples that can be drawn upon in planning the improvement of agricultural and rural finance in southern Africa.

The issues faced by the six focus countries in rural and agricultural finance are brought out in the situation analysis in Chapter 2. The essential issues are usefully distilled in the categorisation of bottlenecks to VCF in section 5.2.4, in relation to the cluster farming case study (Case Study A):

- **VCF bottlenecks**: mainly (a) insufficient trust between the actors across the value chain; (b) poor incentives for repayment of loans; and (c) poor incentives for using other financial services such as insurance, savings etc.;

- **Agricultural finance bottlenecks**: mainly (a) lack of products to serve rural smallholders; (b) insufficient skills for risk assessment and management in the financial sector; and (c) inadequate rural banking infrastructure (branches/service points/agents/mobile network infrastructure to enable mobile banking); and

- **Bottlenecks with sector-wide impacts**: asymmetries of information and power among different actors across the value chain.

These bottlenecks apply not only to VCF and to agricultural finance in general but also to non-agricultural rural finance. Each of the examples in the case studies has been successful in mitigating one or more of these bottlenecks in specific ways.

Finding mechanisms to **build trust between economic actors and to improve payment incentives**, for example, is a key theme in the Critecnia model of clustering in Peru in Case Study A as well as NorminVeggies in the Philippines. The VCF model in Central America and India in Case Study F builds on existing relationships and the realities of the market within which actors in a chain operate. Well-designed financing arrangements within value chains also help to overcome information gaps and can generate a greater degree of trust between actors. Repayment options (for credit) can, for example, be embedded within non-financial relationships and therefore make it relatively easy for lenders to enforce credit contracts. Another innovation that improves the incentives for repayment is the receivables registry in China in Case Study J. Production risk insurance initiatives like Kilimo Salama in Case Study D and M4P initiatives like PASS in Case Study E deal with trust issues for both suppliers and users by solving problems of moral hazard that discourage the supply of crop insurance and, through the linkage with inputs rather than crops, helping famers feel more comfortable with, and better understand, the role of insurance. In the case of PASS, trust is built by having a mutually trusted intermediary that helps prepare the business plan/case that banks are more willing to finance because they trust the intermediary.

New products and services described in the case studies include ANED's micro-leasing business in Bolivia and NLCL's in Pakistan in Case Study B, the China receivables registry in Case Study J and the promotion of savings groups through SaveAct in South Africa and similar initiatives described in Case Study K.

The new products also include MVC and its innovative ways of linking remote, often small investors with MSMEs through such initiatives as Kiva and Funding Circle, as described in

Case Study C. These MVC undertakings also, to some extent, seek to overcome the bottleneck of **insufficient skills for risk assessment and management in the financial sector**, by establishing simplified algorithms for identifying investee partners. In many cases, banks and other financial institutions have a limited understanding of agricultural markets and limited expertise in delivering rural financial services. Many are sceptical about providing services to agricultural activities and tend to perceive those in rural areas to generally have a poor credit culture and limited ability to save. Moreover, financial institutions often find it quite difficult to attract qualified and trained staff to work in rural areas without offering much higher compensatory benefits. Direct attempts to tackle these problems are exemplified by the PASS Trust in Tanzania in Case Study E, while AgFiMS in the same case study seeks to increase the information available about the sector and reduce information asymmetries.

Linkage banking in the Philippines and Mongolia as described in Case Study G not only helps to reduce information asymmetries of this kind but also mitigates the bottleneck of **inadequate rural banking infrastructure**. Overcoming the bottleneck of branch infrastructure is also central to the WIZZIT and M-PESA examples of mobile money in case Study I, as well as the sale of crop insurance through input stockists by Kilimo Salama in Kenya in Case Study D.

Many of the case studies involve important initiatives either to reduce **asymmetries of information and power among different actors** across the value chain or to mitigate the impacts of those asymmetries through better legislation, regulation or meso-level infrastructure. As argued in Case Study E, this can be most effective when based on M4P, thus taking a holistic, market development approach that facilitates rather than directs the extension of the private sector into rural finance. Direct government provision of finance, for example through state-owned development banks, does not have a very successful track record, but as illustrated by the examples of BRI in Indonesia, DBP in the Philippines and Khan Bank in Mongolia in Case Study H, it is possible to successfully reform DFIs in a way that enables them to play an important role in the agricultural and rural financial market.

The first phase of the three-year programme to increase access to and the uptake of rural and agricultural financial services in southern Africa was a study examining and documenting the current state of rural and agricultural financial services in six SADC countries. The case studies in this report seek to build upon the first phase of the programme by identifying best current practices and innovations from across the African and international spectrum that are amenable to application and adaptation in the SADC region. It is hoped that the material provided in the description and analysis of the case studies in this report will provide useful material for the final phase, the objective of which will be to work with policymaking and strategy-formulating bodies in the public and private sectors of the six countries. The ultimate aim will be to:

- Develop overall appropriate policy frameworks and strategic approaches to address the agricultural and rural financial services challenges in each country and in the region;
- Assist country- and regional-level programmes towards operational action and impact in terms of access and uptake; and
- Provide a benchmark for agricultural and rural financial services in southern Africa and to develop a structure for long-term monitoring of progress.

Annex A **Terms of reference**

Study of African and International Innovations and Best Practices at the policy level, industry level, supplier level and client level to improve access to agricultural and rural financial services in Southern African countries

1. Introduction

Created with initial funding from UKaid from the Department for International Development, FinMark Trust is an independent trust whose business is controlled by seven trustees from countries in Southern Africa. FinMark Trust's purpose is to 'make financial markets work for the poor, by promoting financial inclusion and regional financial integration'. It does this by conducting research to identify the systemic constraints that prevent financial markets from reaching out to these consumers and by advocating for change on the basis of research findings. Thus, FinMark Trust plays a catalytic role, driven by its purpose to start processes of change that ultimately lead to the development of inclusive financial systems that can benefit all consumers.

The Centre for Inclusive Banking in Africa (CIBA) was established at the University of Pretoria in 2004 funded by the Microfinance Management Institute as part of an international programme to establish centres of microfinance excellence in Costa Rica, India, the Philippines and South Africa. Its goal is to improve financial inclusion through affordable access to a range of responsible financial services for low-income households and enterprises provided by sustainable financial institutions. CIBA conducts research, education and training and dissemination and, through a wide network of relationships, has established itself as a significant force for improving financial inclusion in sub-Saharan Africa. CIBA manages FinMark Trust's agricultural and rural finance theme area.

Access to financial services is an important contributor to enterprise productivity the world over. In Sub-Saharan Africa, where most people still live in rural areas and agriculture is the mainstay of the rural economy, access to financial services of all kinds still appears to be poor. Yet, relatively little is known about the demand for, supply of and effective level of access to rural and agricultural financial services and about the policies, institutions and many other factors that determine them. At the same time, few case studies internationally provide guidance in terms of innovative and appropriate rural and agricultural finance service provision at the supplier and client level. Indeed most studies assume that access to credit is the main constraint, ignoring the importance of a wide range of other rural and agricultural financial services and products, as well as the uptake thereof.

As part of its purpose to make financial markets work for the poor in Africa, FinMark Trust commissioned the Centre for Inclusive Banking in Africa in 2010 to undertake a study to examine and document the current state of rural and agricultural financial services in southern Africa, as the first phase of a 3-year programme to increase access to and the uptake of such services. Research undertaken in six Southern African Development Community (SADC) countries – Botswana, Malawi, Mozambique, South Africa, Zambia and Zimbabwe – was completed in mid-2011 and the findings are presently being documented. A short summary report will be published in January 2012 and longer regional and country reports are expected to become available shortly thereafter.

The findings of the first phase are intended to contextualize the second and third phases of the programme. As the next step in moving forward from the status quo, the essence of the second phase is to identify best current practices and innovations from across the African

and international spectrum that are amenable to application and adaptation in the SADC region. The objectives of the final phase will be to use the findings of the first and second phases to work with policy-making and strategy-formulating bodies in the public and private sectors of the six countries:

- to develop overall appropriate policy frameworks and strategic approaches to address the agricultural and rural financial services challenges in each country and in the region
- to assist country and regional level programmes towards operational action and impact in terms of access and uptake, and
- to provide a benchmark for agricultural and rural financial services in southern Africa and to develop a structure for long-term monitoring of progress.

2. Project objectives

The terms of reference inform the second phase of the programme, the objectives of which are to address and provide comprehensive answers to the questions:

- what categories of public and private sector intervention are needed at the macro, meso, micro and client levels in order to address the rural and agricultural finance challenges in the region?
- what are the best African and international current practices and recent innovations in respect of each of these categories of intervention?
- what are the circumstances and main drivers that have enabled these practices to develop and bear fruit?
- and what is needed to enable such practices to be applied with success in the six countries in the study and in SADC as a regional economic community?

3. Project Scope

3.1 The research for the study will be primarily, if not exclusively, desk-based. However, the consultant(s) may also conduct a limited number of key informant interviews to contextualise, update, expand and acquire other important information from project implementers and financing institutions.

3.2 Given the breadth and depth of the issues and the limited timeframe and budget, it is anticipated (but not mandatory) that the consultant(s) will be experienced, senior present/former academic(s)/professional consultant(s)/researcher(s), who will lead a team of consultants, all with appropriate disciplinary backgrounds.

3.3 In addition to fulfilling requirements 6.1 - 6.4 below, the project proposal will be required to contain a clear, comprehensive thematic structure for the study and an explanation of how the consultant(s) intend to ensure that the extensive material to be covered will generate a report that is comprehensive, but not unduly voluminous and that is easily readable by policy-makers, strategists and related non-specialist readers in the southern African region and elsewhere. An end product of the study is intended to be a text that will also serve as a learning resource for regional and international students.

3.4 The report should contain or display:

- a set of working definitions
- a clear understanding of the nature and implications for rural and agricultural financial services in the southern African context

- an outline of the main challenges for increasing access to and the uptake of these services
- an appreciation of the client reality of the region and an appropriate accompanying segmentation of the market
- an identification of the major gaps in public and private sector policy at the macro, meso, micro and client levels in respect of agricultural and rural financial service provision and uptake in the southern African region, informed by the regional summary report and other sources
- in respect of each of the gaps/needs identified, details of the best practice policy/approach/model proposed to address it, including:

  a. the rationale for the proposal
  b. one or more examples of where it is in operation and what the impact on access and uptake has been
  c. an outline of the essential features of the design and operating procedures
  d. enabling environment prerequisites
  e. capitalization requirements and expected sources of finance and degree of self-sustainability
  f. delivery channels
  g. timeframe for operationalization
  h. technical assistance needed
  i. expected costs and benefits
  j. leverage potential
  k. any other aspect(s) that the consultant(s) consider relevant.

4. Deliverables

4.1 A proposal (of not more than 10 pages), as outlined in 3.3 above and fulfilling requirements 6.1-6.4 below

4.2 An initial report (of not more than 15 pages) within one month of the date of award of the contract, tabling the research design and giving details of initial implementation activities as well as providing a detailed draft outline of the final report. Under each heading, sub-heading and section in the outline, there should be a short description of the expected content.

4.3 An interim report within three months of the date of award of the contract

4.4 A draft final report within four months of the date of award of the contract

4.5 A final report – incorporating a table of contents, an executive summary (of not more than 5 pages), lists of tables, figures and acronyms, comprehensive referencing and all appendices – within six months of the date of award of the contract

4.6 PowerPoint and/or other appropriate presentations, prepared and delivered by the consultant(s), as determined by the Agricultural and Rural Finance Theme Coordinator at FinMark Trust, for a regional agricultural and rural financial services policy and strategy conference to be convened by FinMark Trust in August 2012

4.7 Country, thematic or other contributions, derived from the report, PowerPoint presentations and other relevant sources, for a learning resource publication to be published by FinMark Trust.

4.8 Participation (in person or remote) in meetings of the Technical Committee, to be appointed by FinMark Trust to oversee the project, to be held within two weeks of the date of submission of the initial, interim and draft final reports, as detailed in 4.2, 4.3 and 4.4 above.

4.9 Provision of a senior member of the team, at a level of effort of not more than five days per month, to assist, during August, September and October 2012, in preparing the report for publication.

Annex B List of documents

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Annex C **list of case studies**[169]

	Country	Name of Initiative	Target population/group	Implemented by (Org)	Description	Innovative feature(s)/best practice example	Gap/constraint addressed	Evidence/assessment of the success of intervention	Challenges
1	Bangladesh	Northwest Crop Diversification Project	small-scale producers, especially women farmers	Funded by AsDB, implemented by various NGOs (including BRAC)	Collaboration between BRAC, the Bangladesh government's Agriculture Extension Department and the AsDB. The key outputs include: (1) Farmer Training and Extension, (2) Farmer Mobilization and Credit Support, (3) Adaptive Research; (4) Marketing Support, (5) Pilot Agribusiness Credit Line, and (6) Project Management Support.	Provision of high-value crop production techniques, including "green" technologies for organic manure. With Bangladesh highly susceptible to extreme weather events, the project includes introducing climate-resilient varieties of crops in drought and flood-prone areas.	Northwest Bangladesh is historically more neglected and poor. The soil tends to be sandy and water tables deeper than in other regions. Agriculture in Bangladesh's northwest region could not keep farmers out of poverty despite the fact that all available lands are being cultivated and cropping intensity is already at 175%.	The project successfully increased farmers' incomes and empowered the women in agricultural communities. The project is currently supporting over 94,777 small farmers in Rajshahi division, and has disbursed over Taka 1,834 million (USD 26.87) million for cultivating high value crops.	Still limited agricultural R&D capacity in the country (including institutions providing extension services)

[169] In order to keep the table readable, we have not been able to reproduce all the columns (e.g. detailing costs to implementer and end user and time required to roll out the intervention) in this annex: the complete spreadsheet can be shared on request

2	Bolivia	Micro-leasing for rural areas	Small producers of cotton	ANED (National Ecumenical Partnership for Development)	Lack of productive infrastructure in rural areas as well as the lack of access to capital sources to acquire them was one of the main obstacles for the development of agricultural production and agribusiness in rural Bolivia. The leasing programme initiated by ANED aimed to overcome this bottleneck. The key factor to explain the success of the scheme was the involvement of the providers of equipment as an integral part of the operation: their presence not only guaranteed that ANED was able to offer better financial conditions to the lessee but also help to provide training to the lessee in the better use of this equipment.	Involvement of the providers of equipment as an integral part of the operation: their presence not only guaranteed that ANED was able to offer better financial conditions to the lessee but also help to provide training to the lessee in the better use of this equipment. Another important innovation was the repayments were designed to fit with the cash flow of the lessee. Other important feature of the programme is that is aimed not only to individual producers but also to co-operatives and producers associations, which reduces the total cost of the operation for the lessee. ANED integrated the advance payment as part of the different lease payments, so to avoid small farmers to pay a huge amount of money at the beginning of the contract.	Lack of access to financial services, and in particular, lack of access to large amount of capital to invest in infrastructure.	During the first three years of operation, ANED bought almost 500 pieces of machinery and equipment for a total value of USD 600k. Most of leasing operations in Bolivia were used to buy either tractors (53%) or irrigation pumps (28%)	The main challenge in Bolivia for micro-leasing is the reduced size of the secondary markets in Bolivia, as a result of its isolated position in the continent. That makes more expensive to fund "rare" equipment.

3	Bolivia	Strategic alliances for scale and scope economies	Rural population	FADES	Supply of a wide range of non-traditional financial services in rural areas. Given FADES' own limitations, however, this choice required strategic alliances with public and private organizations. The development of alliances has been deemed a necessary condition to address the burden of fixed costs that the extensive infrastructure of branches, needed for rural outreach, represents. The supply of additional services creates economies of scale and economies of scope at the branch level, facilitates liquidity management throughout the organization, and allows a diversification of FADES' sources of revenues, contributing to FADES' overall sustainability. Some linkages have reduced client transaction costs and assisted in the development of markets and infrastructure. In other cases, the linkages have allowed FADES to bypass regulatory constraints, as in indirect deposit mobilization through regulated intermediaries	Inter-institutional linkages are a mechanism for supporting each branch's efforts in becoming self-sufficient, by generating economies of scale and of scope at the branch level. FADES offers multiple non-traditional financial services. These services did not result from isolated initiatives; they are part of a strategy based on an integrated vision of the promotion of rural development. FADES' non-regulated nature, however, restricts its operations and prevents it from mobilizing deposits. FADES thus established strategic alliances to supply financial services other than credit and transfer payments.	Lack of access to non-conventional financial and non-financial services in rural areas	The success of the scheme has allowed FADES to increase their number of branches from 24 in 200 to 66 in 2004, increasing their loan portfolio from USD 11.7 million in 2000 to USD 17.7 in 2004. The rural portfolio of FADES represents 92% of the total portfolio of the institution.	The main challenge in the development of linkages is the creation of trust between partners. A careful selection of partners is mandatory as it may be harder and costlier to break apart than create a linkage. In FADES experience, compatibility in terms of size, goals, and operational procedures is critical.

4	Bolivia	Venture Capital for small/medium size agri producers	Small/medium size agri producers	ProCredito Bolivia	Venture capital is a type of financing recommended by specialised investing companies to young companies showing good growth rates and great potential, but which lack sufficient own funds or have no access to credits.Projects must show at least an expected 10% return per year. However, they must also have a significant social impact on the rural area. Partners must have at least 3 years' experience in their field of expertise, own an established business and show a transparent management of their activities. Once the project is approved, the increase of capital is made and in certain cases a new company is created. Upon termination of the contract,the venture capital funds give their shareseither to the company or to third partiesand the created company is dissolved. Thegains are distributed proportionally according to the shareholders' participations	It replaces the relationship between borrower and lender - the company and the FI become now partners. They are in the same boat now and the gains of the business are also the gain of the FI. The more the business gains, the more the FI gains as well. The FI provides funds for IT and help the business to formalize their situation. Capital and interests are repaid via benefits.	Lack of access to long-term finance	In June 2004 PDR and PIE investments amounted to 2 million dollars for 46 investments. These are concentrated in the primary sector (several agricultural products, fishing and livestock products, wood, cochineal, flowers) and the secondary sector (agro-food, textile, medicine and construction industries).	As in many other examples of rural production, usually the main challenge is to improve the market opportunities for the agri-business. The FI must do a lot of work in this area too.

5	Botswana	Herd-select insurance	Smallholder Farmers	FTISC (SA), Alexander Forbes, Agri-insure Botswana	Multi-peril insurance - livestock and crop	Animals can be selected for insurance. Crop insurance based on a guaranteed yield, established by past production	Selective livestock cover	Still in pilot phase, but little information available as commercial in nature	Possibly the acceptance of insurance which is not widely understood
6	China	Broadband for Barefoot Bankers	Financially underserved in rural areas	PlaNet Finance and Microsoft, working with Fondation Chinoise pour la Réduction de la Pauvreté	Barefoot bankers have gained basic computer skills. They can use computers to better process loan applications, serve more poor clients, and facilitate information flow to their rural beneficiaries. Furthermore, clients of microfinance programs are able to access more useful and accurate information after undergoing training at the Digital Hubs.	Creation of 'digital hubs' for those in rural areas to access information; use technology to increase rural outreach	Lack of access to finance in rural areas	•Establishment of three Digital Hubs in rural areas of China •The first successful off-the-shelf MIS implementation in China •Modification of the microfinance Web Portal to report on B4BB progress and findings. •Seminars fostering communication and promoting Public-Private Partnership between China and Europe.	Need for good internet infrastructure/connectivity

7	China	National Online Registry - Credit Information Center	SMEs	People's Bank of China with support from IFC	After the historic enactment of the Property Law in China supported by IFC's Secured Transactions Program in October 2007, the People's Bank of China Credit Information Center created a national online registry for pledges of receivables, the first of its kind in China. The new receivables registry is easy to use and efficient, incorporating all the key features of a modern movable collateral registry.	Online registry for pledges of receivables: the first of its kind in China	Difficulty for farmers/rural SMEs to meet collateral requirements	As of June 2011, businesses had received more than $3 trillion in credit through more than 385,000 loans. Many of the beneficiaries were SMEs. Among the registry's 5,000 users are banks, guarantee companies, law firms, finance companies, and pawn shops.	Restrictive legal and regulatory framework for movables financing; need for increased capacity of financial institutions; lack of awareness of movables financing among smaller SMEs, particularly in rural areas

8	El Salvador	Introducing rural finance into an urban microfinance institution: ProCredit	Small farmers	ProCredit	Banco ProCredit El Salvador was started as an NGO in 1988 to serve urban micro entrepreneurs. Over time it grew and developed a well performing portfolio, but continued to limit its operations to urban areas. In 1992, it began to modify its individual lending technology to fit the demands of rural clients, and started experimental lending in favourable areas with lower risk farmers. A pilot project was initiated by granting loans to small farmers producing vegetables. The success of this pilot led to an expansion in lending to riskier farmers. Over time, the rural portfolio has grown and the organization has successfully met two major external shocks, an earthquake and a collapse in maize prices.	It is possible to develop credit technologies for rural areas and small farmers that simultaneously meet ProCredit requirements of controlling costs and risks while providing clients with services appropriate to their demand and characteristics.	Farmers' lack of access to financial services	Since the programme was created in 1998, the number of outstanding loans has grown from 6,156 to 24,973 in 2006, almost 30% of the total portfolio of the institution.Portfolio at risk over 30 days to outstanding portfolio at the end of each year has decreased from 4% in 1998 to 1.9% in 2006.	The high density of population in El Salvador (853 people per mile square, compared to 898 in Rwanda) facilitate this kind of evolution in urban financial institution. The main challenge faced by ProCredit is to reach the most remote and less populated areas in the country.

9	Ethiopia	Ethiopian Commodity Exchange (ECX)	Small-holder farmers; commodity traders	Owned by members; established with support from UNDP	Provides secure, low-cost platform for farmers to trade agricultural goods in an otherwise tradition-bound system suffering from unusually high transaction risks and costs. Guarantees the integrity of the products traded, quickly and reliably disseminating market price movements to all traders. Creates a physical and electronic trading platform and market information system, ECX performs warehouse management and quality certification. It also guarantees payment against delivery, solving any commercial disputes through a fair and professional arbitration system.	Electronic trading platform and market information system	Inability of farmers to avoid high transaction costs and risks; information asymmetry	The exchange has handled transactions worth USD 240 million since December 2008, amounting to over 160,000 tons of coffee beans. An estimated 850,000 small-holding farmers (mostly producers of coffee, sesame and other cash crops) - around 12 per cent of the national total – are now involved in the ECX system	(i) In its first year, the exchange faced a number of challenges, including fears that Ethiopia's world- class coffees would be lost, as high and low quality beans were mixed together on the trading floor; (ii) Commodity Exchanges have failed in other countries, including Zambia: why has Ethiopia's succeeded?
10	Ghana	Africa	mi-Life	Micro-ensure, MFS Africa, MTN Ghana, and Hollard Insurance	Mi-Life is life insurance available through MTN's Mobile Money. Premium is for two people at 0.25% of the value insured per month up to c. $3,000. Monthly deduction from m-money balance, so no need for bank account of monthly cash payment. Cover lost for the month if no credit from which to deduct. Claim and queries all through cell menus. SMS reminders about the service (deductions due etc.)	Promoting low cost insurance through cell phones. Platform for other insurance services. World's first example.	Low cost life cover	Not available, but anecdotal reports of high demand	Main challenge is the awareness of life insurance

11	Multi-country	InVenture Fund	MSMEs	Inventurefund	InVenture partners with MFIs and NGOs to find the most promising entrepreneurs (mainly women) who are ready to expand their businesses. Offers basic money management via SMS service - data submitted daily, and reports sent back weekly. Provide investments with a revenue sharing model. Entrepreneur profiled on web and investors select business and terms offered.	Joint venture investments combined with loans, paid by profit share	Joint venture investments combined with loans, paid by profit share	Investments are reported monthly and payments tracked. No overall evaluation available	Screening and repayment
12	Hondura s	Fertile Land	Small horticultura l producers	Local NGOs, Hortifruti and formal banks	The project is a successful alliance between small horticultural farmers, formal banks, and a wholesaler (Hortifruti). In addition to non-financial inputs, Hortifruti provides training covering all aspects of horticultural production to farmers, using local NGOs to provide training. This training includes best manufacturing practices, as production is aimed to be exported to US and Europe. Formal banks provide funding up to 60% of the cost of production, without demanding any collateral. Hortifruti provides an additional 30% of the funds required for inputs. Hortifruti guarantee a fair-trade price for the producers.	It is possible to provide efficient value chain finance when there is a transparent partnership clear alignment between actors along the value chain with the same interests.	Lack of access to financial services; lack of training; lack of access to retailers.	Since its creation, the scheme has been successfully working with 525 producers in Honduras. Their production increased from 1,669,200 pounds to 5,289,872 pounds between 2002 and 2006.	Removing trade barriers in the Central American region is critical to increase the size of markets and therefore develop economies of scale in the area.

13	India	Bundling financial and nonfinancial services: the experience of BASIX India	Small-scale producers	BASIX	BASIX in India provides services such as soil testing and health monitoring of livestock, along with credit, to farmers in a way that maximizes returns to credit services. (Similar to the Drum Net Project in Kenya.)	BASIX's approach is grounded on the "livelihood triad": which combines (a) Financial Inclusion Services, (b) Agricultural, Livestock, and Enterprise Development, (c) Institutional Development Services.	Small farmers also face market constraints in acquiring needed inputs (such as fertilizer, seeds, and extension services). Returns to financial services are thus highly conditional on access to other nonfinancial services.	BASIX has reached almost 200,000 customers in the agricultural sector, and almost 700 producer groups, cooperatives and federations.	Not sure how the cost of non-financial services is recovered (i.e. whether this cost is recovered through grants or passed on to client-groups).
14	India	Financial Wellbeing report	Rural clients	Kshetriya Gramin Financial Services (KGFS), with support from IFMR Trust	KGFS' rural branches use an automated 'financial wellbeing report' to better understand households' financial needs and flows as the basis for offering them credit and other products. The report is generated on the basis of detailed information that loan officers ('wealth managers') collect about each member of the household, including income, expenses, assets and liabilities, as well as the goals of the household. KGFS staff members visit each client's home every 6 months to update the report and give financial advice.	Use of an automated report to assess credit history/worthiness. Also enables loan officer to offer more appropriate financial products: automated report suggests 2 or 3 products to meet the household's goal.	Difficulty of checking credit in rural areas as many people do not have formal ID and there is widespread lack of credit information/credit registry.	Each KGFS serves around 3.5 million rural populations (an average of 2 districts) through branches set up in remote rural areas. A branch serves 2,000 households on average within a radius of 4-5 km. At the end of 2011, KGFS Had 110 branches and managed a loan portfolio of $10 million.	KGFS management are keen to link staff financial incentives to improvements in household financial well-being: in order to do this they need more experience and data. Challenge to establish an index that staff can clearly understand and relate to their own performance. Also difficult to establish clear causality in changes to financial wellbeing to a particular staff member's intervention

15	India	Warehouse Receipts System	Small-scale farmers	National Bulk Handling Corporation in India	India's largest support company for warehouse receipt financing, operating both out of public warehouses and (private) field warehouses. At peak season organizes US $2 billion worth of finance for agricultural commodities, on behalf of agents for banks. Efficiency of system means individual farmer can come to a warehouse with product, have it tested, fill out loan forms and have money credited to his account by the next day. Farmers are also given smart cards and mobile phone access cards.	Large scale, efficient and cashless.	Moving from the credit risk of a borrower to a performance risk, basically through risk mitigation mechanisms	Secure collateral management gives access to finance on easy terms and competitive rates through tie-ups with banks. It saves farmers from distress sale during crop harvest season and reduces their dependency on seasonal price variations.	Achieving enough scale; existence of other important actors in the supply chain (e.g. traders, warehouse operators, etc.)
16	India	Weather-based crop insurance	Small-scale farmers	BASIX	A local area bank of BASIX India, KBS, collaborates with ICICI Lombard General Insurance Company to provide weather-based crop insurance to small farmers based on rainfall data in the region over the past 30 years.	Crop insurance: Pay-outs are based on the deviation of actual rainfall from the predetermined rainfall index.	Demand-side risk features of small-scale farmers	It is difficult to clearly establish how successful weather-based crop insurance interventions have been, although there are design features that are noted to be promising (e.g. linking with broader consumer education with product marketing to induce better take-up of insurance product, simple pay-out procedures, etc.)	Significant investment costs associated with start-up activities; enabling better take-up of insurance services especially among low-income individuals (who are not familiar with insurance products)

17	Kenya	Agency and mobile banking in Kenya	Rural households	Financial Sector Deepening Trust Kenya	Supported the process behind the decision of the Central Bank of Kenya to open banking channels to non-bank agents, based on an analysis of the policy options. An amendment to the Banking Act (passed as part of the Finance Act 2009) allowed banks to start using agents to deliver financial services.	Enables small shops, petrol stations, pharmacies and other retail outputs to act as agents for M-Pesa services, notably cashing out.	Cost and access to money	23,000 agents signed up	How to build on M-Pesa's money transfer service to offer a more complete range of financial services
18	Kenya	Index-Based Livestock Insurance (IBLI): Building delivery infrastructure	Livestock farmers	International Livestock Research Institute (ILRI), Equity Insurance, Swiss Re and UAP Insurers - support for microinsurance innovation facility	Satellite imagery used to monitor the landscape - if images show a lack of pasture then assume animals are likely to die and the owners receive a pay-out. Use range of media and methods to promote and to explain the concept of insurance. Sales via cell phone registration. Agents deposit Ksh 50k.	Satellite images used as a measurement tool for insurance to assess pay-out of means and evaluate the current situation. Used games to teach pastoralists about insurance	Production risk	$1.1m of livestock covered	No early pay outs so pastoralists did not see reasons to pay
19	Kenya	M-PESA: Mobile money for unbanked	Rural households	Safaricom	Mobile technology enables e-money transfers between mobile-bank-accounts & includes a cash-out mechanism via one of 22,000 agents or can pay for goods.	Cash transfer mechanism with a large network of agents for cash out. Creating new spin off service opportunities.	Cost and access to money	More than 14 million users now have access to mobile money services	How to use M-Pesa to increase financial inclusion and depth

20	Kenya	Kilimo Salama – Index-based Agriculture Insurance	Small-holder farmers	Working in partnership with agri-businesses committed to working with smallholder farmers under the Kilimo Salama product. In 2010, those companies were MEA Limited (fertilizers) and Syngenta East Africa (chemicals and seeds on behalf of Seed Co.), Kenya Meteorological Department, Safaricom, NGO CNFA AGMARK.	Microinsurance for Kenyan farmers: Weather index based insurance. Weather index based insurance offers a method to insure farms as small as one acre by replacing costly farm visits with measurements from weather stations as the indicator of drought conditions. The weather stations measure the rainfall and these measurements are compared to an agronomic model specifying crops rainfall needs. If the needs are not met, all farmers insured under that station receive a pay-out. If the needs are met, none of the farmers receive a pay-out.	Uses mobile phone technology: stockist registers farmers using a camera-phone to scan a bar code on each input sold. Farmer receives SMS confirming the policy instantly; distributed in a way that is relevant to farmers, through local agrovets; made affordable through partnerships with agri-businesses; Weather stations are used for monitoring as well as tailored extension messages.	smallholders' unwillingness/inability to invest in better seed and fertilizer	By May 2011, insured more than 22,000 farmers: largest agri insurance scheme in Africa	Distribution to small-scale farmers in remote areas: •Striking a balance between Indemnity based and Weather Index Products•Insufficient weather data, number of automatic weather stations, Quality historical weather data. •Regulatory approvals for alternative distribution channels.
21	Kenya	BIMA YA JAMI – Insurance for the family	Rural households	Swedish Cooperative Centre (SCC) The Cooperative Insurance Company Ltd (CIC) National Health Insurance Fund (NHIF), Kenya	Bima ya Jamii means insurance for the family - one insurance policy costing Kenya Shillings 10/day to covers subscriber, spouse and dependent children. Every family gets a card, which gives free treatment in affiliated hospitals. Card enables access to compensation for family members in case of accidental death or permanent disability of the family breadwinner and funeral expenses.	Microinsurance product (3-in-1) covering health, accidental death and disability, and funeral), available on a large scale through member-based organizations and MFIs in Kenya. Daily payment	Rural vulnerability	Jan 2009 - 17,000 policies at $50	Understanding of insurance and points of health delivery

22	Malawi	Weather insurance	Smallholder farmers	OIBM	Weather-based crop insurance compensating farmers based on weather station records - adjusted trigger point based on different crop and timing. Payment is based on an amount per mm below the trigger point, up to the insured value. Requires farmer to be 20kms of a weather station	Insurance based on a weather index, tailored to particular insured crops (tobacco, maize etc.)	Production risk	Still limited uptake, but being incorporated into lending packages to protect borrowers and lenders	Understanding the issue of insurance when no claims experience, and relatively high cost of the product
23	Malawi, Rwanda and Tanzania (& India and Philippines)	Dry Day Weather Index Insurance	Farmers	MicroEnsure and local partners	Index insurance that focuses on number of consecutive 'dry days' over a longer period and also number of days for which there is 'deficit rainfall' over a shorter period (towards the end of first period) Two (linked) risks bundled; Should crop failure occur before the beginning of the second risk period, farmer supported to replant the crop and achieve a reasonable harvest. If more than 22 days of dry weather, then pay-out commences and rises up to full amount by 30 days. Risks adjusted by crops.	Focus on critical time periods for agriculture not whole season. Splits into two events, one of which can be addressed by re-planting (if dry post planting so seeds do not germinate)	Production risk and replanting	Not available.	Limited coverage of reliable weather stations to track rainfall. Considering the use of satellite data for rainfall, but not yet commercially available

24	Mongolia	XacBank Mongolia: Franchise Model (agent banking)	Rural based clients	XacBank	In order to reach clients in areas where opening a full-fledged branch office is not justified economically, XacBank believes a local savings and credit cooperative (SCC) is the most feasible option (given their low administrative costs). However, to become an effective outreach strategy in rural areas, limitations of SCCs need to be addressed: such as weak governance, limited financial management skills, and lack of experience in demand-driven product development. To address these limitations intensive capacity building is necessary at least at the beginning. XacBank has chosen to use a franchise model to support local SCCs as a vehicle to extend its financial services to rural remote areas.	XacBank is strategically focused on rural markets: In order to break even, it estimates that a branch needs a population of at least 10-20 thousand. Yet, a typical soum has a population of 2500 people only, of whom 600 are potential borrowers. Average soum is 150 km far away from the aimag (province) centre.The Franchise Model of XacBank elaborate on arrangements / relationship between XacBank and SCCs.	High start-up costs (branching out in rural areas); Building working linkages between formal financial institutions and community-based institutions	Compared to the banking sector as a whole, XacBank has a larger share of the market in the rural area; XacBank has gained an increasing share of the lending market.	Establishing details of partnership agreements, to ensure alignment of incentives and goals between the banks and SCCs; Start-up cost is high due to intensive capacity building, including promotion, training and technical assistance in establishing and strengthening SCCs. In Mongolia, the cooperative model is just emerging as a rural development strategy and it requires a national level effort to provide extensive support. The franchise model does not break-even in the short run, so there is a need for a subsidy to cover the capacity building costs. Commitment and buy-in from the local community members and key stakeholders is crucial.

25	Multi-country	APRACA: Asia-Pacific Rural and Agricultural Credit Association	Governments and practitioners across the region	APRACA Secretariat	APRACA is a regional association that promotes cooperation and facilitates mutual exchange of information and expertise in the field of rural finance.	Provides a platform for exchanging ideas between countries, practitioners	How to ensure that relevant practitioners / market participants across the region have access to information (for lesson-learning, etc.)	As of the end of 2011, a total of 60 institutions in 23 countries in the Region are affiliated with the APRACA as its members.	Ensuring commitment and active involvement of members
26	Multi-country	Financial Marketplace	SMEs, but with rural focus	Finance Alliance for Sustainable Trade (FAST)	Online platform to link FIs and borrowers.	The Marketplace bridges the financing gap by helping borrowers and financial service providers connect efficiently. The Financial Marketplace enables producer groups to search for a lender that offers services for their specific type of business. These criteria can be certification(s) held, product type(s), location of enterprise, loan amount required and length of term desired.	SME finance	-	-

27	Multi-country	Reform of Agricultural Development Banks in Asia	Farmers	Various DFIs, with support from donors (e.g. IFC) for technical assistance	Cases to consider: a. National Bank for Agriculture and Rural Development (NABARD) in India, as an apex lender; b. Land Bank of the Philippines (its role in value chain financing); c. BRI Indonesia; d. Agricultural Bank of Mongolia	Despite the negative reputation of DFIs, these development banks have been reformed and are reaching a significant no. of clients, providing demand-driven products, etc.	Rationalizing the role of DFIs in the financial services market	These development banks are considered success stories in the literature: many of them have very clear roles (e.g. as an apex/wholesale lender) and are managed professionally (i.e. following the standards of other commercial banks).	Given the ownership structure of many of these development banks (i.e. majority owned by government), the challenge is how to align government (political) interests with the capacity to sustainably provide market-led financial services.
28	Pakistan	Micro-leasing (targeted at rural areas)	Farmers, micro-enterprises in rural areas	Network Leasing Corporation Limited, a leading micro-leasing provider in Pakistan.	Provides leases for both new and used assets of values between US $17-1,760, with rural leases available in the areas surrounding major urban locations. Examples of products that have been lease purchased include donkey-pull carts and livestock. By 2004, 21% of NLCL's lease portfolio by value and 43% of its leases were in rural areas.	First formal institution in Pakistan to focus on micro and small leases; Leasing may incur lower transaction costs compared to collateral-based term loans due to lower costs in developing and enforcing contracts in rural areas, where asset registries and judicial systems for contract enforcement are especially poorly developed.	To successfully undertake financial leasing operations, organizations need not only well-trained staff, but also high-quality lease origination processes, accounting and internal control systems, and overall portfolio risk management.	NLC had a lease portfolio of more than US$2.4 million in rural areas. Low lease losses, strong client demand for asset financing, and a favourable legal and policy environment made rural leasing a profitable business for the company.	Viability of leasing company; enabling environment to support the provision of leasing services

29	Peru	Creating linkages between farmers, private companies and commercial banks		Critecnia Peru	Critecnia is a private company specialized in creating linkages between cotton producers and commercial banks. They work in areas without access to financial services.	1-the use of economies of scale in buying supplies 2-obtaining better prices for the sale of products as well as benefiting from tax breaks generated from buying these supplies 3-Experience and reputation of Critecnia's management- especially their knowledge. Proper selection and training of area coordinators. 4-Individual responsibility of loan payment eliminates the possibility of the entire company having its credit rating degraded.	Lack of access to financial services; lack of access to markets; lack of agricultural skills and training.	Increased outreach significantly- loans increased by 86% from '96 to '98. In 98, there were six companies with 500 members with the amount financed total of $2,127,776. The average loan disbursed in '98 exceeded $4,000.	Critecnia is a family owned group with close ties to cotton production and trading, which was originally formed to provide general advice services to cotton producers. The main factor to explain the success of Critecnia is their deep knowledge of the cotton industry. Likewise the main challenge is to replicate this knowledge in other agricultural sectors.

30	Philippines	Clustering Strategy: the experience of Normin Veggies Philippines	small-scale producers	Marketing consolidator: Normincorp	NorminVeggies (Northern Mindanao Vegetable Producers' Association, Inc.) is an association of vegetable farmers and stakeholders in Northern Mindanao who organized and bonded together to undertake and implement strategies in response to upgrading and finding new market opportunities within the vegetable industry, by innovating and increasing its value adding activities. A cluster is an informal group of 5 to 10 small scale farmers who commit to undertake a common marketing plan for a particular product (or set of products) for identified markets. Each product cluster has a designated lead farmer who acts as the coordinator of the production of all the farms involved in the cluster. The lead is the farmer who is the best farmer for that type of vegetable. S/He is also responsible for teaching the other farmers in the cluster of applicable production techniques in order to maintain the quality specified by the market.	Integrated package of technical assistance provided to develop clusters of small scale producers proved effective in meeting market requirements in terms of quality, volume, variety and frequency of delivery. Demonstrates / shows where cost of 'development assistance' might be recovered (i.e. paid for by small-scale producers.	No economies of scale (among many small-scale producers); lack of access to markets	Higher profitability for small-scale producers, improved quality of harvesting and post-harvest activities.	Determining whether and how costs for organizing and training farmers can be recovered.

31	Philippines	Strengthening rural banks in the Philippines	small-scale producers, micro-enterprises, low-income HH	Programme funded by USAID; implemented by RBAP	The program is an initiative designed to encourage the Philippine rural banking industry to significantly expand access to microfinance services. To do so, the program assists partner rural banks in the Philippines to increase the financial services they provide to the microenterprises, small farmers, and low-income households by providing microfinance technical assistance and training. Trained banks in turn develop and improve financial services – loans, deposits, money transfer services - specially tailored to microenterprises, small farmers, and low-income households. Under the program rural banks are encouraged and assisted to develop and offer new and innovative products and services such as micro-agri and micro-housing loans, to utilize technology such as mobile phone banking to lower costs and improve efficiency of their operations, and to work with partner insurance service providers to develop and offer appropriate micro-insurance products to their clients.	Comprehensive programme: combines support in product development (e.g. micro-savings, agri credit), payments (mobile money), and institutional development (incl. MIS development). No funding of the loan portfolio!	Rural Banks have certain advantage over other banks: (a) they offer excellent geographic coverage (there are about 1800 Rural Bank branches located throughout the Philippines, covering over 85% of all municipalities in the Philippines); (b) they tend to small, locally owned enterprises, with much lower overhead costs (than other banks). But they are unable to invest in R&D/product development, although they are keen to serve new markets (that are not currently served by banks).	Improved profitability of participating rural banks, greater outreach (increase in deposits, clients), range of services offered; as of 2009, 500 rural banks (with more than 500 branches) have participated in the program.	How to rationalize support to privately-owned institutions to ensure that incentives do not get distorted, and identifying specific areas that can be funded by grants / donor funds

32	South Africa	WIZZIT	Unemployed graduates, unbanked in rural areas	IFC/SECO	WIZZIT is a mobile phone-based banking facility that targets unbanked/under banked South Africans. WIZZIT does not require users to have a bank account and is compatible with early generation cell phones popular in low-income communities. The facility even works with customers who use pay-as-you-go cell phones. In addition to being able to conduct cell phone-to-cell phone transactions, WIZZIT account holders are issued Maestro debit cards that can be used at any ATM or retailer. WIZZIT employs over 800 "Wizz Kids" - typically unemployed university graduates from low-income communities - to promote the product and help unbanked customers open accounts	Use of WIZZKids; low cost; range of banking services - not just money transfer	Lack of access to finance in rural areas	Over 400,000 people in the country have opened accounts with WIZZIT. Over 800 WIZZKids employed	Selection and development of suitably skilled and motivated staff, staff supervision and how to incentivize loan officers to continue marketing for long hours each day in the first few months of their deployment, until they have built a base of clients in an area, delinquency management, lack of repayment culture
33	Tanzania	AGFIMS	Policymakers, any stakeholders in agricultural sector	FSDT (funded by DFID, Danida, RNE, Cida, Sida, WB); Rockefeller; Gatsby	The Agricultural Finance Markets Scoping (AgFiMS) is a diagnostic tool which provides research data about the demand for and supply of financial services in the agricultural sector. Its aim is to help boost the supply and access to agricultural finance in Africa through market-leading innovation and policy change	Sharing reliable information to inform policy makers; builds on success of FinScope	Lack of reliable information about financial services in agricultural sector	None yet - launched in December 2011 and will take a while until success can be assessed as aiming at policy change	Need for clear methodology in order to enable replication in future

34	Tanzania	BioRe organic cotton	(cotton) smallholders	BioRe	Support cotton farmers through loans for seeds under organic contract farming. For each kilogram of seed cotton a farmer delivers, BioRe pays an input subsidy into a special bank account. Farmer has a passbook showing how much in this account. The next season, the farmer can use the passbook to obtain seeds and bio-pesticides from the company.Passbook schemes used to be common throughout the cotton sector in Tanzania, but fell out of use.	Incentive to sell cotton linked to a 'credit' for inputs via a farmer pass-book scheme.	Supply of inputs		
35	Tanzania	EFA - SME finance	Missing middle: financing SMEs in agricultural value chains	Equity for Africa Ltd	Small businesses are unsophisticated, have low collateral levels and operate in an unpredictable environment, making them expensive and risky to serve. EFA's model overcomes this by: a) Providing one product at scale to one market, so investment management processes can be standardized. Lowers costs and improves scalability. b) An equipment focus. Provides an effective collateral substitute. c) A relationship-based approach. Enables EFA to offer flexibility with a formal rescheduling facility.	Innovative features: Focus on providing one product at scale to one market. Equipment focus. Relationship-based approach.	SME finance		Lessons learned: a) To be sustainable and create substantial impact, small investments need a low-cost, high-volume approach. Requires standardization to reduce specialist skills need. b) Flexible repayment is essential for small enterprises.

36	Tanzania	PASS Trust	small- & medium farmers and agribusinesses	Danida	Provides Business Development Services (BDS) and a Credit Guarantee Fund (CGF). PASS's facilitation is an important factor in the CGF success as many guarantee schemes are reliant on the banks to appraise the loans. PASS has supported both the banks and the borrowers at every stage through parallel appraisals of business and their plans. Led to more rational, better informed credit decisions by the banks and greater understanding by the agro-enterprises of how to manage their debts.	Combines BDS with financial support in the form of credit guarantees.	Lack of collateral; low entrepreneurial capacity of farmers	Over 35,000 farmers have been supported by PASS and have obtained loans to the tune of Tshs 95 billion. Key success factor: offers a variety of complementary services to agribusinesses 'under one roof'. Has converted into a sustainable trust rather than a donor-supported project	Not really able to reach poorest sections of farming population due to high upfront fee and tendency for clients to be near urban/peri-urban centres; struggled to reach financial sustainability

Annex D **Country analysis of constraints to rural finance services provision and uptake**

D.1 Botswana

	Constraint	Gap	Ideas for potential solution(s)
MACRO			
1	Subsidised and directed credit - CEDA (Citizens Entrepreneurial Development Agency) etc	Private sector provision for SMEs	Privatisation plans of DFIs + BBS, BSB, NDB and reappraise public sector role
2	Mandatory interest ceilings on commercial loans result in large low risk loans only	MSME credit	Policy reform
3	Have to have bank account to get bank loan - minimum income requirement to get a/c	Widespread access to finance for the unbanked	Policy reform
MESO			
1	Weak NBFI lobby	inappropriate policies	Links to effective meso level bodies
MICRO			
1	Size of the country and low population density means high cost of banking services	Accessing fin infrastructure, accounts and transfers - limited m-banking	M-banking expansion
2	Limited access to finance for MSMEs and those employed in agriculture	Innovation in collateral requirements and remove mandatory interest rate ceilings	encourage product innovation
CLIENT			
1	Low investment in herds to improve quality and off take ratios	Lack of long term credit for investment	Risk mitigation

D.2 Malawi

	Constraint	Gap	Ideas for potential solution(s)
MACRO			
1	NBFI regulation is new - roles of regulator and regulated still to be 'learnt'	Certainty in regulatory outcomes	Training and exposure to countries that have also undergone significant regulatory reform
2	Agency banking not yet rolled out and just being experimented with	Availability of rural cash in and out points	Fast track experiments and learning
3	Macro-economic instability - inflation, devaluation, and related operational problems for agricultural sector	Stable, predictable, conducive investment environment	Macro-reforms and stabilisation - process began in May 2012 following devaluation and discussions on resuming donor aid
MESO			
1	Limited functioning of MAMN and MUSSCO	Poor representation of issues, weaker capacity building within the sector	Capacity development partnerships with successful counterparts
2	Inter-operable switch for banking	Efficient services	Recently commenced WB FSTAP project addressing this
MICRO			
1	Government financial institutions undermine the sector	non-governmental FIs deterred/limited from investing/expanded	Privatisation/reform
2	Limited interest in rural - high cost, low income, high risk, traditional views	Lower cost delivery mechanisms	M-banking/SCTS for building volumes
3	Government interference in agricultural markets creates unpredictability	certainty for farmers and buyers to invest	Effective contract farming mechanisms
4	Limited interest in MSME finance (non-agric)	Finance for investment	Micro-leasing
CLIENT			
1	Seasonal incomes from farming and trading	Cash flow smoothing	savings and credit innovations
2	Vulnerability to shocks - household (illness..) and farming (drought, prices)	Production and household risks	savings and insurance innovations
3	High levels of financial exclusion	Appropriate entry level services	SCT/VSLA/ROSCA/entry products
4	Low financial literacy	Inability to make good financial choices	FSTAP has a component to survey financial literacy needs and then address

D.3 Mozambique

	Constraint	Gap	Ideas for potential solution(s)
MACRO			
1	Land is the property of the state as a constitutional requirement. Due to a lack of security of land ownership, small farmers have little incentive to make long-term investments, including improvements in soil quality, development of irrigation systems, or planting trees and crops with long maturity.	People cannot use land as collateral. People have no incentives to invest in their land.	The problem with land tenure in Mozambique is complex. State ownership of the land is deeply rooted in the Marxist origins of the state, so it's difficult to promote constitutional reform that may overcome this obstacle. Value chain finance is a possible solution - strengthening the links between producers and other actors along the value chain, so they, rather than banks, can provide agriculture finance.
2	Mozambique is showing a tendency of concentration of financial operators and network products and services in major urban centres, while most districts of the country (77 of 128) do not have a single bank, ATM or POS. The picture is similar when it comes to cooperative financial institutions and microfinance.	Farmers and FI seem to live in separate worlds. They don't know each other, they don't work together. It means that products offered are often not suitable or accessible to much of the population than formal services. Loans to agriculture constitute only 17% of the total customer base assets of commercial banks. In addition, almost all of these loans to the rural sector are for large-scale producers, processors and large merchants	Considering that scenario, it could be tempting to say that m-banking could be a potential solution. It is not, as the lack of financial education would make the use of a service such m-Pesa completely useless. Exploring linkages between formal (preferably MFIs) and informal could be a good starting point.
3	Despite their practical relevance, SMEs still do not hold their place in economic policy. But this is not the only problem: there is need to substantially improve their management, the design of their business plans based on an open market and increasingly	Obviously, there is not any kind of articulated policy to improve SMEs. There is need to establish partnerships, internal and external, for their feasibility and better access to financial resources. Management must necessarily be more transparent, accounts should be audited and published for employees, customers and so that suppliers can increase their levels of trust and credibility on the management and business sustainability. SMEs also need venture capital, so as to avail themselves to share in management, to bring technical support and cheaper financial resources.	
MESO			

1	Lack of marketing infrastructure	Farmers cannot take their products to markets	Long-term investment policies. Concentration of projects of rural infrastructure in certain geographic areas with relatively high population density and high potential for agricultural development.
2	Improvement of educational and health facilities is a major priority	Lack of skills is one of the key factors constraining rural sector development	Improving financial education
3	The setting up of processing plants to add value to farmers' products and infrastructure for livestock development is also important	The possibility of adding value to agriculture crops seems very distant in MZM	Strategies to strengthen links between farmers and traders along the value chain are critical to increase added value to agri products.
MICRO			
1	Commercial banks typically will not lend to small producers due to the high cost of providing financial services. Small farmers lack collateral.	No access to financial services	Pilot programmes creating linkages with MFIs
2	Value chain finance is not working properly - lack of trust between producers and traders. Former complain about the low price received while latter complain about the low quality of the product	Value chain finance does not work.	Joint-capital.
3	Inequality in the relationship between producers and traders - food security creating chronic dependence of producers on the enterprises	Lack of trust	Develop pilot programmes that stimulate trustful relationships along value chain
CLIENT			
1	Lack of appropriate information about the availability, terms and conditions of credit and deposit services, which discourages potential customers to seek satisfaction of their needs.	Farmers cannot make informed decisions - they don't know what products are more suitable for their necessities.	
2	Potential borrowers struggling with elevated risk: reduces willingness to borrow. Fear of encountering problems servicing the debt and suffering loss of assets pledged as collateral.	Farmers are fearful of getting in contact with financial institutions.	
3	High transaction costs incurred by potential depositors, which reduces the net return on their savings interest earnings.	Farmers cannot get access to basic financial services	
4	Lack of technical skills amongst farmers	Low yield	

D.4 South Africa

	Constraint	Gap	Ideas for potential solution(s)
MACRO			
1	Fiscal policy: taxes on bank charges increase cost of accessing formal financial services (in both rural and urban areas)	Affordable formal financial services	Development of alternative sources of financial services that do not require salary information e.g. mobile money
2	National Credit Act: disadvantages non-salaried people in terms of accessing credit: many rural residents are not salaried; requirement for tighter risk assessment procedures; makes non-salaried lending much less attractive.	Affordable/accessible credit for non-salaried people	Development of alternative credit mechanisms that do not require salary information e.g. mobile money
3	Infrastructure: lack of good roads, electricity and internet connections in rural areas discourages FIs from offering financial services, restricts rural residents' ability to access such services and pushes up transaction costs.	Access to affordable financial services in rural areas	Agent banking, barefoot bankers, mobile phone banking
MESO			
1	Property rights: communal land tenure system means land cannot be used as collateral of loans	Assets to use as collateral	Alternative collateral (e.g. moveable assets, online receivables register)
MICRO			
1	Lack of appropriate, affordable financial products that meet the needs of low-income, rural residents	Affordable/appropriate products for low-income, rural residents	Examples of products specifically tailored to rural clients; support to financial institutions to develop tailored products
2	Fear of losing assets due to failure to repay a loan	Clear understanding of actual implications of failure to repay loans	Financial literacy programmes targeting rural populations
3	Commercial banks tend to be located in urban areas	Access to bank services in rural areas	Agent banking, barefoot bankers, mobile phone banking
CLIENT			
1	Low levels of financial literacy in rural areas	Understanding/awareness of financial products available	Financial literacy programmes targeting rural populations

D.5 Zambia

	Constraint	Gap	Ideas for potential solution(s)
MACRO			
1	Limitations in terms of public good infrastructure (e.g. roads, power, mobile coverage)	Innovative mechanisms to link dispersed populations to markets	Combination of: • Strengthening non-bank sector, • Introducing other tiers, • Promote an integrated financial system: e.g. through linkages / partnerships between current suppliers
2	Need for coherence between rural finance policies and government intervention (other national policies)	Rural Finance Policy and Strategy need to be developed (already underway)' to be aligned with other policies	
3	Need to 'build trust', especially in light of previous bank and cooperative failures	Legal / regulatory reform (some already underway), including review of supervisory framework (to include SACCOs)	
4	Some regulatory constraints – e.g. for establishing branches		
MESO			
1	Payment infrastructure not fully operational	Legal / regulatory reform; implementation of new Acts that have recently been passed, including identifying specific agencies and strengthening their capacities	Strengthening meso-level associations (e.g. associations)
2	Lack of collateral registry for movable assets (e.g. crops, vehicles etc.)		
3	Lack of information available for market analysis	Weak meso-level institutions that can provide the platform for information-sharing	
4	Nascent business models		
5	Limited supply of financial sector capacity building organisations	No effective central facility for accrediting skills and training; need for industry-wide information on skills gaps and shortages	
MICRO			
1	High costs of setting up and operating branches in remote areas, which explains the lack of / limited number of financial institutions able to service the rural financial services market	High-risk perceptions regarding agricultural activities	Same as macro above, to be supported by: • Appropriate incentives for FIs, • Establishing facilities to support capacity building of FIs, etc. (e.g. through apex mechanisms)
		Institutional capacity constraints, especially among non-bank financial institutions	
		Lack of capacity specifically needed to extend rural financial services	
		Lack of capacity specifically needed to extend rural financial services	
CLIENT			

1	Low levels of income and asset base	Inability to provide (traditional) collateral required by financial institutions	Strengthen institutions providing agro-technical support to farmers: • To facilitate clustering / aggregation • To support crop diversification • To facilitate access to markets
2	Vulnerability to risks (e.g. high HIV incidence)	No / poor access to insurance services	
3	Highly dispersed population	Isolation from markets means that many don't have access to information/training, and other services	
4	People's perceptions of / misconceptions about financial institutions		Financial education

D.6 Zimbabwe

	Constraint	Gap	Ideas for potential solution(s)
MACRO			
1	**Hyper-inflation and dollarization:** MFIs lost financial assets during crisis. Many stopped lending in 2009. Far fewer MFIs than before crisis (now around 95 compared to around 300 before the crisis); caused high interest rates and decline in value of collateral.	Limited semi-formal financial service provision	Capacity building support to existing MFIs; encourage growth of informal financial service providers; development of alternative sources of financial services e.g. mobile money
2	**Land reform policy:** caused international isolation, reduced foreign exchange and foreign investment. Prevented banks from lending to smallholder farmers because of lack of secure collateral and risks associated with unstable claims to land. Banks won't accept 99-year leases given to land occupants: not secure and non-transferable.	Assets to use as collateral	Alternative collateral (e.g. moveable assets, online receivables register); credit guarantee funds
3	**Lack of liquidity in economy:** FIs severely constrained in making loans; if can do so tend to charge high interest rates and lend on 30 day terms only. Also tend to lend to urban clients. FIs subject to lending restrictions and have mandatory interest rate ceilings.	Affordable access to credit	Development of alternative sources of financial services e.g. mobile money
4	**Contraction of financial sector:** uncertainty over economic policies and macroeconomic instability	Limited financial service provision	Development of alternative sources of financial services e.g. mobile money
5	Government agricultural funding schemes distorting the market	Space for private sector to finance agriculture	
6	Troubled Financial Institutions Act: resulted in 7 banks being placed under curatorship, one closed and another liquidated: loss of faith in banking system and reduced supply of financial services.	Confidence in banking system	Financial education programme

7	Poor infrastructure: road, communications, electricity. Difficult for rural households to access financial services; pushes up transaction costs of FIs operating in rural areas	Access to affordable financial services in rural areas	Barefoot bankers, agent banking, mobile banking
MESO			
1	Capacity constraints: infrastructure, technical, training, social exclusion and institutional capacity	Capacity of financial institutions	Capacity building support
2	Lack of capital for banks to provide wholesale finance to MFIs	Wholesale finance for MFIs and resultant lack of affordable finance for clients in rural areas	Alternative wholesale finance providers; encourage linkage banking
MICRO			
1	Credit tends to be on short-term basis: lack of finance for medium and long-term productive investment, particularly for farmers	Affordable/accessible medium and long term credit	Development of alternative credit mechanisms that do not require salary information e.g. mobile money
2	FIs concentrated in urban areas	Access to financial services in rural areas	Barefoot bankers, agent banking, mobile banking
3	Many leasing/hire firms no longer operate	Access to leasing services	Development of private sector leasing companies
4	Largest banks in terms of network (Agribank and POSB) struggling to capitalise and making huge losses	Access to financial services in rural areas	Barefoot bankers, agent banking, mobile banking
5	Closure of rural bank branches as a result of (i) loss in client base arising from land reform; (ii) downsizing in response to unstable macroeconomic environment	Access to financial services in rural areas	Barefoot bankers, agent banking, mobile banking
CLIENT			
1	KYC: need for proof of income/employment to open bank account	Access to financial services for non-salaried people	Tiered KYC (e.g. Mexico model)
2	Inappropriate and unaffordable products offered by banks	Affordable/appropriate products for low-income, rural residents	Examples of products tailored to rural clients; support to financial institutions to develop tailored products
3	Fear of asset seizure if fail to repay loan: in 1990s many farmers lost their moveable assets due to non-repayment of loans to AFC	Clear understanding of actual implications of failure to repay loans	Financial literacy programmes targeting rural populations
5	Lack of financial literacy/knowledge of products available	Understanding/awareness of financial products available	Financial literacy programmes targeting rural populations