INCLUSIVE INNOVATIONS

Offering Non-Bank Finance Solutions for Smallholders

HIGHLIGHTS

- Enterprises have innovated in mitigating credit risk in agricultural finance through input financing, group lending, and using contractual agreements as collateral.
- They reduce market risks for farmers through flexible repayment structures and bundling non-financial services in the value chain with credit.
- Enterprises conduct farmer training to improve financial literacy among smallholder farmers. They design products, such as committed savings programs, to reduce farmers' debt burden.

Development Challenge

Limited access to financial services, especially credit, is a major challenge to smallholder farmers in low-income geographies such as Latin America, Sub-Saharan Africa, and South and Southeast Asia. The aggregate demand for credit from these regions is estimated to be more than USD 200 billion, of which only around USD 50 billion is presently met by formal and informal financial institutions and value chain actors. Smallholder farmers face a number of challenges in accessing appropriate and adequate financial services, such as lack of flexible credit products and last-mile access, and low capacity to service debt. Inadequate access to finance causes smallholder farmers to confine themselves to sub-optimal inputs, which results in lower yield. This makes their produce less competitive in the market and also increases the risk for other upstream value chain players due to low quality and uncertain supply. Lower incomes force cash-strapped farmers into a debt cycle, where they seek credit to repay previous loans.

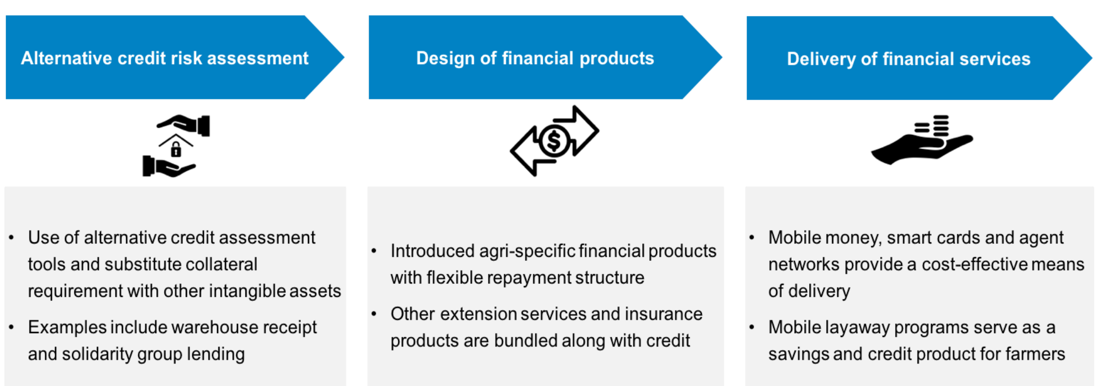
Business Model

Access-to-finance solutions include alternative techniques to assess credit worthiness, new products to address variable cash flows and ICT-based products to ensure last-mile reach. Most finance providers are structured as banks and MFIs. Some finance providers are also structured as non-profit organizations (such as One Acre Fund) or social investment funds (such as Root Capital)

Finance providers have adopted the following innovative strategies:

- Financing instruments that use agri-based assets and inventory to substitute for property collateral and mitigate credit risk. Examples include input financing in which inputs provided on credit are considered as collateral, and joint-liability group lending, in which group members are responsible for collecting payments on time and co-guaranteeing each other.
- A flexible repayment structure: enterprises have developed solutions that analyze and match payment terms to the irregular cash flows of different activities. Many enterprises use cash-flow based evaluation methods that allow them to effectively assess the harvest cycle and determine the best product fit for the farmers.
- Many enterprises offer bundled services such as financial education, agri-inputs, capacity building and market links, along with financial services such as credit, savings and micro-insurance. Direct-to-farmer finance providers often provide agronomic support services to smallholder farmers to mitigate production and price risks. These services most often include training to promote agricultural best practices and improve yields.

Features of Financing for Smallholder Farmers Business Models



Implementation: Delivering Value to the Poor

Awareness

Most finance providers run financial literacy programs in parallel with their credit delivery, either by themselves or by tying up with external trainer partners. Enterprises usually do not charge the farmers separately for financial education and the cost is factored in the interest calculation or subsidized by the government or donors. Finance providers have adopted many different ways to create awareness. Opportunity International has developed DVDs, TV and radio segments, comic books, games and role-playing activities.

Acceptance

Enterprises that provide a wide range of financial products tailor-made according to the crop type, harvest cycle, tenure, and cash flows find better acceptance among the farming community. For example, AMK in Cambodia offers bullet and amortization loan structures, individual and group lending, in-field and branch repayment options, and USD and local currency options. Loan disbursements need to be in sync with the crop cycle. Proximity Finance in Myanmar provides farmers with ongoing access to credit (working capital) in ticket sizes ranging from USD 150 to USD 230.

Accessibility

To make financial products more accessible, some enterprises have made smart design modifications to plain-vanilla credit instruments. For example, the Rural Resilience Initiative links labor-based safety nets that provide cash or food in exchange for work on community projects. This is an innovative approach to helping communities better manage risk. Enterprises have also developed agent networks to expand their outreach in rural areas. For example, Financiera Confianza has established customer service points in small shops in rural areas where farmers can withdraw and repay. Enterprises also adopt innovative means to provide last-mile access. Bancamía offers services through telephone banking, which enables the enterprise to accept loan applications over the phone and sell types of financial services.

Affordability

Many finance providers leverage mobile banking platforms to reduce farmers' time and cost for availing finance. ICT-enabled service delivery reduces the outreach cost for the farmers too, making the financial services affordable. Opportunity International uses a hub-and-spoke delivery model whereby hub branches are opened in market centers, and mobiles and POS machines are used as access points in the surrounding rural communities. Many enterprises adopt a cross-subsidization model wherein they offset the low cost of finance to smallholder farmers with higher priced value-chain finance for traders and processors.

The major components of costs incurred by finance providers are for customer acquisition and risk management. Providing micro loans is more expensive than lending large amounts, as the costs of loan appraisal, monitoring and follow-up are fixed regardless of the ticket size of loans. The cost of funds for finance providers ranges from 6 percent to 12 percent depending on the geography and source of finance.

The main revenue streams for finance providers to smallholder farmers are the interest payments and fees from registration, processing or subscription. The revenue is derived from the differential margin between the interest rate and cost of funds. Enterprises such as One Acre Fund customize the principal repayment to the preferences and capacity of the individual farmer. They manage cash flows by leveraging grants, and set disbursal dates according to harvest period for each value chain. Enterprises such as Vasham also allow for a single balloon repayment of principal and interest when the loan is due.

Finance providers forge strategic partnerships in areas such as business development, product design, credit disbursal and collections. Some enterprises employ a unique partnership model to improve the supply chain efficiency along with providing finance. DrumNet, a Kenyan NGO, partners with banks, input suppliers and agri-buyers and facilitates direct financial transactions among them instead of burdening the farmer.

Results and Effectiveness

Improving access to finance can increase farmers' investment choices and provide them with more effective tools to manage risks. In turn, appropriate technologies to measure credit-worthiness can direct more private sector lenders and capital into the farming community. For example, in Malawi, the use of fingerprints to identify farmers allowed lenders to pinpoint sub-prime borrowers. Therefore, farmers were hesitant to default, and lenders were incentivized to engage in more transactions.

Adapta Sertão is a network of organizations that aims to assist small scale farmers in adapting to climate change in the semi-arid community of Pintadas, Bahia, Brazil. Adapta Sertão established a local micro-credit bank with loan services tailored for small-scale family farmers. Through Adapta Sertão, small farmers could buy productive irrigation equipment, making them more resilient in the face of a fast-changing climate.

Well-structured financing can help farmers find a pathway out of the cycle where low investment leads to low returns. Some smallholder lenders, such as Green Bank of Caraga in Philippines, have implemented commitment savings (savings accounts that farmers can only access after they reach a certain committed savings goal). Opportunity International Bank in Malawi also offers tobacco farmers a product where they can set aside their profits from harvest to fund the inputs for the next season.

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This series on Inclusive Innovations explores business models that improve the lives of those living in extreme poverty. Editors are Elaine Tinsley and Natalia Agapitova. Researched and developed by Intellecap. *August 2017*