2SCALE

Access to finance for inclusive agri-business development

Photo: Mahamane Toure | Cassava transport the Psaltry factory, Nigeria

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2SCALE consortium

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KEY MESSAGE

Access to finance is key in developing entrepreneurial activities and enhancing inclusive agribusiness. Value chain-based financing mechanisms, whereby 'ready markets' act as collateral, are viable options for input credit, pre-financing of sales operations and investments in infrastructure and equipment.

Introduction

Agriculture investments are required to enable smallholder farmers and processors, many of them living in poverty, to improve on-farm productivity, post-harvest and processing practices, as well as improve trade and marketing of agricultural commodities. The development of the agriculture sector is critical to addressing widespread poverty and advancing the sustainable development goals of reducing poverty and hunger.

Like many other agribusiness cases in African countries, 2SCALE partners are in need of financial facilities for different purposes, e.g. access to inputs, working capital, purchase and aggregation of products, extension of processing lines, and acquisition of new equipment.

2SCALE partnerships are strengthening local and value chain networks and are building capacity for collective action, including co-investment in developing and scaling up inclusive business models. However, despite the financing needs of farmers and agri-businesses, the financial sector strongly lacks the knowledge, incentives and skills to target and service the agricultural sector leading to severe financing constraints.

High interest rates are the most widely known bottleneck in rural or agricultural finance. In several countries, improvements have been observed in recent years, mainly due to the regulation framework that has reorganized the financial sector, i.e. by capping the interest rate for microfinance institutions (MFIs). In other countries, however, interest rates charged by financial institutions range from 20% to 50.5% per annum. This is unattractive – and makes business unprofitable – for smallholder farmers and small agribusinesses, considering the low productivity, intensive use of labor, and low sale prices.

Another major constraint that undermines access to finance for agribusinesses and smallholder farmers is a mismatch between the repayment schedule and the cash inflow of smallholders and small and medium enterprises (SMEs) in the agrifood sector. Many financial service providers are hardly aware of the working conditions in the agricultural sector, e.g. the seasonal nature of activities. Rigid repayment schedules also often limit possibilities to offer specific adapted credit conditions.

Despite some progress in recent years, financial institutions' low outreach remains a handicap, specifically for smallholder farmers living and operating in rural areas with little or no transport and communication infrastructure. The multiplication of rural banks and financial cooperatives is certainly a hope for smallholder farmers and SMEs. However, the services and products offered by the financial institutions are still insufficient for the reasons mentioned above. Furthermore, while individual smallholder farmers have limited assets, such as collateral, and management skills, collective action offers opportunities to develop the required capacities.

All these constraints hamper access to financial services and products and thus limit opportunities for smallholder farmers and SMEs to allocate resources efficiently, i.e. buy quality inputs, adopt efficient technologies, store products in appropriate conditions, and organize sales operations.

Challenges in financial inclusion can be summarized in three key questions. Firstly, how to adjust processes, services and products to the conditions of smallholder farmers and SMEs while improving the sector knowledge of financial service providers? Secondly, how to build and improve knowledge and skills of these value chain actors, particularly women and youth, to access financial services and products? Note, these first two questions refer to effective use, as well as availability, of financial services (Box 1). Thirdly, how to manage loan defaults and, in that respect, strengthen smallholder farmers' financial assets?

This paper presents 2SCALE interventions that provide answers to these questions. It also presents some examples of the use of information and communication technologies (ICTs) for improving financial services in the agricultural sector.

The reality for smallholder farmers and SMEs

Access to finance is important to all actors engaged within a value chain. Farmers and their organizations need finance to buy inputs, pay man labor, and to maintain their farms. A variety of such needs for funds were observed in most 2SCALE partnerships. In the vegetable partnership in Benin, for example, lack of funding to access improved seeds and fertilizers had, in the past, substantially affected smallholder farmers' capacities, specifically women and youth, to increase their production for meeting market demands, and hence increase their revenues. This was also observed in the cassava partnership in Nigeria where farmers needed financing to acquire improved stems, fertilizers and agrochemicals to increase their production and supply cassava to Psaltry, a local company processing cassava to starch. Smallholder farmers and women processors of rice and soybean in Benin and Ghana, respectively, continuously

BOX 1 | WHAT IS FINANCIAL INCLUSION?

Financial inclusion – as an aim – means that formal financial services, such as deposit and savings accounts, payment services, loans, and insurance, are readily available to all consumers and that they are actively and effectively accessing and using these services to meet their specific needs (definition adapted from the Global Partnership for Financial Inclusion https://www.gpfi.org/). Financial inclusion – as a process – seeks to address the specific constraints that exclude people, such as the vulnerable, women and youth from accessing, using and benefiting from financial services.

Joris Maatman | Meeting of a Village Savings and Loan Association (VSLA), Uganda

struggle for even tiny funding to invest in their business and increase their revenues. Such SMEs need finance to acquire raw material and improve facilities for storage, processing and packaging in order to meet market demands and standards.

However, several banks and MFIs collaborating with 2SCALE were previously – and still are – conservative about agribusiness finance. Either the agricultural sector is not included in their policy priorities, or they feel smallholders and SMEs are not eligible for finance since the sector is perceived as a highly risky one. This situation is aggravated by weak understanding of the sector, particularly the lack of information on actors along the value chains, their limited network of agencies to increase farmers' outreach (specifically those living in remote areas) and their inability to trace credit history or creditworthiness of those actors. So far, there is a mismatch between agribusinesses' financial needs and the financial products available, particularly for medium and long term investments in agriculture, since short term loans – for a few weeks – are usually provided by MFIs.

The 2SCALE approach for enhancing financial inclusion

The 2SCALE project has been instrumental in ensuring that SMEs and smallholder farmers are in a position to scale up their activities by accessing affordable financial solutions from financial service providers. This situation has been made possible by ensuring access and use of existing financial products and services or, in certain situations, improving them or coming up with new ones to fit the needs of farmers and SMEs.

In order to enhance access to finance within the 2SCALE partnerships, finance specialists – together with local 2SCALE staff and coaches – have developed interventions which follow a structured approach:

- **Needs assessments and inventory of available financial services and products.** This phase focuses on value chain actors' financial needs, and the inventory of financial services and products available. Assessing financial needs gives a profound understanding of the current business models and flow of funds in the value chain, both forward and backwards with emphasis on the actors involved. A specific attention is paid to women's needs related to their activities along the value chain, existing financing strategies and the gaps to be filled by new or additional financing schemes.
- **Matching demand and supply.** This phase includes the linking of demand for and the supply of existing financial services of products, as well as the design of new financial instruments. The design needs to take in account the specific focus of the partnership and therefore requires a tailor-made approach to a specific crop and/or value chain activity. Dedicated business or finance forums are organized by 2SCALE where value chain actors, financial service providers and other stakeholders in the value chain are invited for exchanging and agreeing upon the initial ideas on the design of financial instruments. Such events create mutual understanding and trust and enhance understanding of the underlying bottlenecks of accessing finance. In designing new or refining existing financial instruments, the focus should target the various actors in the value chain. One should ask what is there for the SMEs, the smallholder farmers, the vulnerable groups like women and youth?
- **Implementation of the financial instruments.** The newly developed financial instruments, which focus on business cycles and financial needs of targeted value chain actors, are piloted within a manageable timeframe and scope. It is essential that financial service providers believe in the services and products that have been developed, and are willing to rollover to a larger audience with focus on risk management measures, long term benefits and sustainability.

- **Evaluation and up scaling.** Based on successful pilots, clients and financial service providers agree on how to scale up the financial services and products. This process involves rolling out capacity building approaches for reaching a large number of actors, development of local skills (training of trainers), enlarging financial networks, and setting up a monitoring and evaluation system which is coordinated by 2SCALE financial specialists.

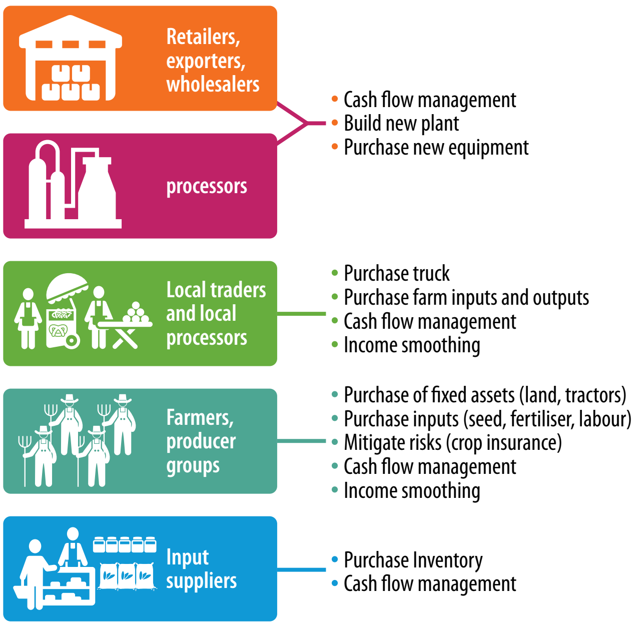
A key condition for successful implementation of this approach is the developing and strengthening financial literacy among smallholder farmers and SMEs.

Financial arrangements in 2SCALE partnerships

Various needs for finance

The 2SCALE staff work closely with value chain actors and financial service providers to avail a wide range of financing options based on needs (including cash flows) as identified in a value chain (Figure 1). Appropriate financing instruments will allow actors to expand their activities and ensure smooth cash flow.

Figure 1 | Demands for finance by various value chain actors



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In order to make businesses strive and develop value chains, there are very different demands with needs to be satisfied at a certain moment. With the 2SCALE program interventions, the value chain actors are able to meet their stated needs with the right linkages to the right financial service providers. Value chain actors are expected not only to make their businesses more competitive and efficient, and hence increase their revenues, but also to respond to growing demands including those from low-income consumers. i.e. the Base of the Pyramid (BoP) markets. 2SCALE has facilitated various financial arrangements of which several examples are provided (see other papers).

Arrangements for accessing agricultural inputs

Institutional arrangements for accessing inputs involve four actors: the financial service provider, the input supplier, the product off-taker and the farmers' organization. The input supplier is not involved in the tripartite contract as a partner. The arrangement is commonly agreed upon by all actors through which funds and products flow.

In order to make the arrangement effective, smallholders and their organizations need to make the necessary arrangements. A business plan helps them to better evaluate the financial needs. Such a plan, while describing all production activities, specifies the actual financial needs for input supply (Box 2). Furthermore, the organization of farmers in groups often eases the loan process and ensures repayment with a cross guarantee from each group member. Last, but not least, sales contracts between farmers and product off-takers are to be concluded in order to guarantee complete remittance of their product after harvest. These contracts are used as a guarantee to access input credit from the financial service provider.

The farmers' organization issues purchase orders to the input supplier which specify types and quantity of inputs needed. Upon reception of the inputs, individual farmers sign a credit contract with their organization, with another farmer signing as witness and vouching for the credit recipient to reduce the risk of loan defaulting. The farmers' organization distributes the inputs among targetted farmers and provides a delivery acknowledgment to the input supplier. The input supplier submits the delivery acknowledgment to the financial service provider, which disburses the funds to the input supplier. After harvest, the farmers' organization delivers the product to the off-taker according to the sales agreement. Then the off-taker pays for the product via the bank account of the organization at the financial institution. The financial service provider deducts the input credit and interest and remits the balance to the account of the farmers' organization for their own use.

Contract farming

Contract farming involves a group of farmers who enter into a contractual agreement with a buyer (product off-taker) to supply volumes and qualities as agreed upon with the buyer. In turn, the buyer guarantees the off-take of the product. Contracts specify the terms and conditions, i.e. period, price, quality and quantity of the agricultural products to be delivered. Contracts often include embedded services, such as input supply and advisory and transport services to be provided by the buyer.

BOX 2 | TRIPARTITE ARRANGEMENT FOR INPUT SUPPLY IN THE PINEAPPLE PARTNERSHIP IN BENIN

Nine farmers' cooperatives are involved in the pineapple partnership in Benin led by the processing company, Promo Fruits Bénin. With the support of 2SCALE, Promo Fruits was connected to the financial institution, FECECAM (*Faîtière des Caisses d'Epargne et de Crédit Agricole et Mutuel*) and two input dealers, FOJEDEA (*Institut de Formation de Jeunes et de Développement de la Dynamique des Engrais dans l'Agriculture*) and SONAPRA (*Société Nationale pour la Promotion Agricole*), with which a tripartite agreement was concluded. 2SCALE facilitated the negotiations, which led to the reduction of the interest rates for input credits from 24% to 15% per annum. Based on this, businesses plans were elaborated for each farmers' cooperative and submitted to FECECAM. Installment and repayment periods were defined for a period of 24 months, with a moratorium of 18 months corresponding to the pineapple production cycle. After loan approval by FECECAM, the input dealers delivered the required inputs to the cooperatives and FECECAM paid the input dealers. After 18 months of the pineapple production cycle, farmers delivered their fruits to Promo Fruits, who paid them directly into their bank accounts. The financial institution deducted the loan amounts and charged the agreed interest rate, and the remaining amount was remitted to farmers' bank accounts that are held by FECECAM.

Several 2SCALE partnerships brought together smallholder farmers, the product off-taker and a financial service provider to develop a contractual agreement for farmers to grow products on behalf of the off-taker who, in return, collects and buys the products. As under the previous institutional arrangement, the signed contract between the farmers and the off-taker can be used to secure input financing by the financial service provider. In that case, the off-taker transfers funds from sales to the respective farmers' accounts held in the financial institution, which recovers input financing and ensures net payment to individual farmers (Box 3). The contracts may also stipulate that the buyer organizes the delivery of inputs – and other services – and includes the costs related in the prices to be paid to farmers (deduction).

The benefits by farmers from such an agreement include price stability, ensured markets and production support. Farmers, in turn, need to pre-estimate crop yields and analyze margins, which improves financing planning. However, there are risks involved since experiences show that contracts can be dishonored by either party. Farmers can side-sell or neglect their farms (which hinders quality and quantity). On the other hand, buyers may fail to collect and pay the farmers at agreed prices as per the agreement. It is prudent for

BOX 3 | CONTRACT FARMING BY SHALEM INVESTMENTS IN KENYA

Shalem Investments is a profit-oriented social enterprise whose core business is aggregating and marketing grain from smallholder farmers in the greater upper Eastern region of Kenya. Shalem Investments has developed an integrated out-grower business model that thrives on addressing the needs of rural smallholder farmers, i.e. improved access to quality inputs and reliable markets. It does this through contract farming and linking farmers with appropriate extension services so that they improve on production of target crops that Shalem Investments buys at predetermined prices and sells to predetermined markets.

Sorghum is the main crop that Shalem Investments currently is aggregating and trading. Sorghum is a widely grown crop in Kenya and primarily produced by smallholder farmers. Currently, Shalem Investments works with over 7,000 smallholder farmers; they expect to double this number in the coming years. These farmers are mobilized into produce and marketing groups of between 20 and 50 members, which are supported by agribusiness agents. The agents mostly do the collection, bulking in selected collection centers, and subsequent delivery to larger companies, such as the East Africa Malting Ltd.

the parties entering into agreements to have a third party witness the agreement and act as an arbitrator in case one party fails to honor its part. In many cases, Ministry of Agriculture field officers act as third party witnesses.

Advancing working capital

Working capital are funds used to finance the daily operational costs of a farm or SME. Farmers and entrepreneurs need access to financial turn-over on an ongoing basis in order to successfully manage their business and develop their operations. In sum, they should always have enough capital on hand to manage these costs. Financing working capital for SMEs – particularly collectors, aggregators and small and medium processors – is key to their success as it allows them to buy and immediately pay for the product delivered by the farmers.

Smallholder farmers and small entrepreneurs often rely on outside financing for working capital from various sources, such as deposits in MFIs and credit unions, village savings and loans associations, family donations and grants. In addition, medium enterprises may turn commercial and development banks for accessing working capital. However, there are some challenges to getting a bank loan, e.g. banks may require extensive documentation to demonstrate the applicant's ability to pay back the loan and hence decisions may take several months; as a result, applications are often declined. Even when loans are approved, banks may restrict use of funds or require collateral as repayment guarantees.

Therefore entrepreneurs should weigh their financing options based on: the speed of access to finance; the ease and flexibility of repayment; and the ability to utilize the capital as they see fit. Before applying for any source of capital, entrepreneurs should learn about the financial service providers that are available and fully understand the funding terms and conditions.

Therefore, 2SCALE has been at the forefront in aiding smallholders and SMEs in coming up with viable business plans and bankable proposals and linking them to financial institutions for considering advancing working capital. For example, in the cheese partnership in Benin, Merry the business champion was linked to Vital Finance in Parakou to increase her white cheese sourcing funds from Fulani women. Same with OLAPI a woman led SME in the yellow maize partnership in Benin who was introduced to MFI ALIDé (*Association de Lutte pour la promotion des Initiatives de Développement*) to access working capital to process yellow maize to nutritious flour. Even though those amounts are marginal, they have substantially improved women lead businesses. In the same vein, with 2SCALE support, Oikocredit International provided working capital for Promo Fruit to acquire pineapple juice cans and meets its financial operation needs (Lakoussan, 2017).

Increasing financial institutions' risk taking capacity

Risks related to loan defaults

Compared to other sectors, higher default rates are recorded with agriculture financing as value chain actors fail more frequently in meeting their commitment with financial institutions. Despite efforts by 2SCALE and others, loans are not always fully and timely paid back. From 2SCALE experiences in the field, the following situations can be highlighted:

- **Crop and market failure.** Harsh weather conditions affect expected yield hence lower returns from the proceeds than expected. Similarly, bumper harvest can cause a glut in the market hence low income due to falling prices;
- **Side-selling.** This occurs in contract farming and collective sales through farmers' organizations when either arrangements are not clear for the individual or the off-taker (which maybe the farmers' cooperative) fails to comply with the contract. Such contracts suppose that, after harvest, a part of the product should be collected and delivered to an off-taker at a given price, which allows reimbursement of the loan and additional revenue for the farmer. However, farmers do not respect this when the off-takers delay the collect; or the current price on the market appears much higher than the previously agreed price specified in the contract. In such conditions, farmers usually run away from the mechanism put in place and become reluctant to repay the loan. Side-selling has been observed in sesame, maize, and soya 2SCALE partnerships and, accordingly, high loan default rates are recorded in these sub-sectors.
- **Failure of the buyer to honor the contract.** The buyer may also fail to honor the contract with farmers, either by refusing to take the product, or by delaying the payment so much that farmers and their organizations are unable to meet their loan reimbursement installments and deadlines. In some cases, often when there is not a written contract, the buyer can deviate from its initial products sourcing and look for other sources. This situation provokes farmers to sell their product in an open market at a lower price and they are therefore no longer able to reimburse the loan.
- **Loan diversion.** Loans may be diverted to other activities for which related risks are not well assessed and which might prove unsuccessful for smallholder farmers, or the loan is diverted to other purposes such as family emergencies, schooling, ceremonies and festivals, which affects ability to reimburse the loans.
- **Lack of information on financial services and products.** Lack of transparency or up-to-date information on loan disbursement conditions may also confront smallholders with unexpected costs, and therefore limit investments. As a consequence, they are not able to pay back the loan (Box 4). On the other hand, farmers' organizations often do not provide accurate information to financial service providers, notably about their credit history,

BOX 4 | CREDIT RECOVERY – CENTURY BANK

Century Bank was offering the Mwea Fruits and Vegetables Farmers Association in the Kenyan highlands with credit, specifically for accessing inputs. 2SCALE facilitated the signing of the agreement between the Association and the bank to offer credit at a rate of 16 % on reducing the balance. However, due to changes in market trends, the Century Bank raised the interest rate to 24% without prior notice to farmers. This significantly increased the repayments to much higher figures than expected and farmers were unable to repay as per the earlier agreement. Consequently, this hampered recovery efforts by the bank because the default amounts rose from 30% to 65%. This example shows how additional costs or increased transactional costs can hamper recovery of smallholder farmers loans.

the purpose of the loan or the real group size. When information is inaccurate, loan officers can make wrong decisions and attribute a loan amount much higher than the farmers' organization which it will not be able to reimburse.

- **Flaws in the selection process of beneficiaries.** In some cases, inappropriate selection of loan beneficiaries by leaders of farmers' organizations can be a source of default. This happens when there is a bad profiling of the group members, or when there are fictitious members who are granted the loans.

Management of loan defaults

For most financial institutions, the role of 2SCALE was critical in providing financial services to smallholders, their organizations and SMEs, not only through facilitating linkages with these clients but also to assist them in making good use of the loans. 2SCALE has experience with measures for preventing delays or failures in loan reimbursement which include the following:

- **Developing and strengthening financial literacy.** This is the ability to understand 'how money works': how someone manages to earn or make money, how that person or organization manages it, and how he/she/it invests it. Lack of financial literacy can lead to owing large amounts of debt and making poor financial decisions. For example, if one possesses financial literacy skills, the advantages or disadvantages of fixed and variable interest rates are concepts that are easier to understand and make informed decisions about (Box 5).
- **Profiling of beneficiaries.** This involves keeping a database of loan beneficiaries and the repayment status, which helps in identifying the defaulting ones who may not be eligible for future engagements.
- **Assessing financial needs.** It is always essential to carry out due diligence processes to understand the actual financial needs of the smallholder farmers and SMEs in order to avoid not only overfunding but also underfunding.
- **Reviewing financial products.** It is also essential to review existing financial products and identify their weaknesses, which might be a hindrance for reimbursements by smallholders and SMEs. 2SCALE has assisted financial institutions in refining existing products or developing new ones based on the needs of smallholders and SMEs and experiences with providing loans (Box 6).
- **Agreeing on group guarantees.** Members in a group or a network agree to commit their shares for each other in case of default. A limit is agreed based on the size of the credit and the worthiness of the person offering to guarantee (Box 6).

BOX 5 | DEVELOPING FINANCIAL LITERACY IN THE CASSAVA PARTNERSHIP IN NIGERIA

In the cassava partnership in Nigeria, financial literacy activities gathered cassava smallholder farmers, the financial institutions (First Monument Bank and Excel Microfinance Bank)and Psaltry International Limited and helped to improve their relations. It allowed the financial institution to identify eligible farmers that can access finance for mechanization and input supply (improved cassava stems, fertilizers and herbicides). At the same time, financial literacy sessions educated farmers about the preconditions to acquire a loan, i.e. required documents, interest rates charged, loan duration and amount for individuals, as well as cost-benefit analysis. Through production cost analysis and various simulations, farmers came to realize that they could not apply for any loan charging more than 22% interest.

BOX 6 | PARTICIPATION OF FARMERS' COOPERATIVES IN CREDIT RECOVERY IN THE SOYBEAN PARTNERSHIP IN GHANA

Diversion of funds, lack of due diligence in loan applications, crop failure and unwillingness of debtors to pay back their loans are specific causes for loan default in Ghana. In most cases, monitoring of loans post-disbursement has not been strong enough, thus creating a gap between disbursement and recovery. The involvement of farmers in the loan application processes is also predominantly very low. However, the case is different in the Saboba soybean cluster. The Bileegnan farmers' cooperative has a strong relationship with their financial service provider, Bonzali Rural Bank. The cooperative leadership negotiates with the bank on access to production credit for its members, including terms and conditions. Loan requests are collated from the primary cooperatives and submitted to Bonzali Rural Bank for processing. During disbursement, the cooperative is also actively involved and provides monitoring to ensure that all members who apply for a loan have access to land in the first place before disbursements are made to them. Monitoring visits during the production cycle and recovery of the credit are also carried out jointly with the bank. To be able to conduct these monitoring visits, the cooperative raises funds from dues which are charged to members during marketing. This strategy by Bileegnan has strengthened their relationship with Bonzali Rural Bank and ensured transparency and inclusion in the credit management process. Recovery has always been very high, averaging between 80 and 90%, for this cooperative in the soybean cluster.

Guarantee funds

Guarantee funds are an overarching institutional arrangement, which involves a public funder (e.g. the Dutch Embassy through the 2SCALE project), that addresses the bottleneck faced by smallholders and SMEs to provide the required collateral for accessing finance. Even if farmers own land, mainly in rural areas, those lands are not secured with a land owner title to ensure its usage as a tangible guarantee of the loan. One way to address this issue is to support farmers to build trust with a financial service provider by setting up a guarantee fund within the financial institution. A guarantee fund is a specified sum of funds set aside by a project in a financial institution to act as a financial fallback in offering flexible credit facilities to identified groups of smallholder farmers and SMEs (Box 7).

A guarantee fund is different from a credit line. It is a fund to leverage financial institution's investment in the agricultural sector and significantly improve loan conditions, i.e. low interest rates, reduction of the loan screening fee and loan disbursement procedures, suppression of tangible collateral, no requirement of upfront savings, flexibility of the loan (in line with the cash flow cycle of activities), possibilities for both group and individual loans, and development of adapted products. Furthermore, with the guarantee funds, credit

BOX 7 | GUARANTEE FUND IN THE VEGETABLE PARTNERSHIP IN BENIN

Vegetable farmers in southern Benin were facing various constraints for developing their business, e.g. low investment capacity for irrigation system development and maintenance, lack of man labor, and difficult access to inputs. Furthermore, the farmers were not eager to contract loans with financial institutions in the area because of the high interest rates charged, the rigidity of the loan repayment conditions, and the required collateral. Most financial products were tailored for product marketing and not for investments in production capacity. All these constraints hampered the competitiveness of vegetable producers' associations who decided to partner with 2SCALE. The management of the guarantee fund – provided by the Dutch Embassy in Benin – concluded between IFDC and the MFI ALIDé (*Association de Lutte pour la promotion des Initiatives de Développement*) with flexible terms and conditions was a unique opportunity for vegetable producers' association to access loans. Loans for input finance and farm maintenance are provided with a one-year tenor and bullet repayments upon product sales. The Sèmè Kpodji vegetable producers were able to access investment loans to acquire a drip irrigation with a tenor of 3 years, including one year of grace with annual installments.

risks are co-supported between the guarantee fund and the financial institution, and hence reinforce the accountability of the financial institution in its loan processing.

Re-inventing savings culture for resource mobilization

Savings are essential in loan granting to value chain actors, especially for smallholder farmers. On the one hand, it allows farmers to anticipate loan repayment, especially for voluntary term deposits. When some unlikely event happens, which may disturb the loan repayment schedule, farmers can use part of their savings to meet their commitments. Savings are also an option for reducing collateral challenges and an opportunity for farmers to show how they are performing in their business and thus allow financial institutions to have an idea on related cash flows. On the other hand, savings and other capitalization strategies are critical to reduce the need for external finance; particularly when external finance is relatively expensive (e.g. currency devaluations, high interest rates).


Joris Maatman | Harvesting Swiss chard in Kenya

Savings thus appear to be a key option to mitigate defaulting risk, and therefore financial institutions encourage savings while paying back loans. Moreover, a clear savings plan helps to increase farmers' own resources that can be invested to expand value chain activities. The 2SCALE program encourages farmers to save in different ways, but typically with financial institutions. Therefore, 2SCALE has supported the implementation in West and East Africa of Village Savings and Loan Associations (VSLA, Box 8 and 9). A VSLA is a more formal, structured and democratic version of the informal savings groups found in villages. The main difference is that the VSLA methodology provides a better organized and more accountable system that even the least literate, and least influential group member can understand and trust.

Implementation of this methodology involves sensitization and training to raise farmers' awareness of the importance of savings, especially during financial literacy training, credit management coaching, and other related activities.

A VSLA is composed of 15 to 25 self-selected individuals who agree to save money as a group who meet weekly to deposit money in a fund. A management committee, elected by the group, is responsible for managing the funds. In a VSLA, savings is flexible across members and over time. Members do not have to save the same amount as

BOX 8 | WHAT IS A VSLA?

A VSLA is a group of people who save together and take small loans from those savings. The group activities run in cycles of one year, after which the accumulated savings and the loan profits are distributed back to members. The purpose of a VSLA is to provide simple savings and loan facilities in a community that does not have easy access to formal financial services.

In West Africa, the concept of VSLA is currently transitioning from VSLA to Community Saving and Loan Associations (CSLA) as this is targeting more and more different communities in the same village. Those communities might be formed based on the professional status, gender or people having similar economics or financial needs, or working in the same sector. A CSLA operates the same way as a VSLA.

BOX 9 | VSLAs IN THE RICE AND SOYBEAN PARTNERSHIPS IN GHANA

In a country where 70% of the population are not involved in the formal banking sector, it is highly expected that savings culture and other investment opportunities are not fully utilized by a majority of people. This is very common among smallholder farmers and other grassroots actors. 2SCALE in Ghana has facilitated access to financial inclusion for producers and SMEs in the rice and soybean partnerships through the scaling of VSLAs. These associations have improved access to low-interest credit for producers and SMEs, and also enhanced savings among them. So far, a total amount of GHS (cedis) 1.3 million has been mobilized in savings, out of which GHS 1 million has been disbursed as loans to members. About 4,563 producers and SMEs (including 3,485 women) are benefitting from this scheme. These associations have received training on financial literacy and business management skills, and are also linked to financial institutions where they save their funds after a period of mobilizing substantial amount of members' contributions. From a non-bankable position, as the groups were perceived, they have now become attractive to a number of financial institutions due to their ability to mobilize these savings. Matured VSLAs are progressively weaned off in a sustainable manner and sensitized on other investment opportunities.

each other; and they do not have to save the same amount at each meeting. Also, by saving more frequently in small amounts, the poor can build their savings more easily; and this contributes to improving household security.

Savings are maintained in a fund from which members can borrow in small amounts, up to three times their individual savings. Loans are for a maximum period of three months in the first year and loans may be repaid in flexible instalments at a monthly service charge determined by the group. Each group may also have a social fund, which provides members with a basic form of insurance. The social fund serves as a community safety net and may serve the entire community, including group members and non-members, e.g. emergency assistance, festivals and funeral expenses.

In order to track individual savings and loan liabilities of its members, VSLA uses a simple passbook that is appropriate for groups with limited literacy and numeracy skills. The VSLA passbooks, loan fund and social fund are maintained in a lock-box, which is safeguarded by the group box-keeper between meetings. The lock-box has three padlocks and the keys are held by three group members, who are not management committee members. The system is robust and ensures that there can be no manipulation of the group's passbooks or funds outside of group meetings. Once the VLSA fulfills its functions, attracts more members and is well managed, it can 'graduate' to become a Savings and Credit Cooperative Organization (SACCO – Box 10).

Innovative ICT-based solutions in agricultural finance

The wide-spread availability and accessibility of internet through smartphones, which are more and more affordable for smallholders and small-scale entrepreneurs, provide opportunities for innovative financial service provision. ICT-based innovations have the potential to speed up financial operations, reduce transaction costs and enhance transparency. Innovations have contributed to reduced transactions costs for farmers, which enable them to access more convenient financial services resulting in more efficient farming. 2SCALE has been at the forefront with partners and collaborated with firms to foster innovative ICT-based technologies in agriculture finance, as shown by the following two examples:

- **Mobile money disbursal.** Umati Capital in Kenya advances payments to dairy farmers, who deliver milk to the processing enterprise Eldoville Dairies, through a mobile-based application. Farmers apply for the payment by Umati Capital based on deliveries made. Umati Capital receives farmers' requests and, in turn, asks for approval from Eldoville Dairies before disbursing the approved amount to the farmer via M-PESA, the mobile money transfer system which is being operated by Safaricom. Later, Umati Capital pursues Eldoville Dairies for the payment made to the farmer.
- **Mobile agri-wallet.** Through an agri-wallet mobile phone application, potato farmers are able to save money for the procurement of next seasons' agricultural inputs. Dodore Kenya provides the platform through which 10 to 20% of farmers' proceeds are locked in a savings account. Dodore Kenya will unlock the account when the next season commences as agreed upon by the two parties.

The latter is an ongoing pilot of an ICT-based savings system for anticipating purchase of inputs, which helps farmers avoid using their savings for all kinds of other purposes in between harvest and the start of the next farming season. Eventually, the farmers

BOX 10 | FROM VSLAS TO A FARMER-BASED SACCO IN UGANDA

The emergence of strong VSLAs meant that the risks associated with large amounts of savings was real. 2SCALE supported the Masindi District Farmers' Association (MADFA) in the west of Uganda by providing training on business skills and strategic planning for 15 well-organized VSLAs. Out of the 15 VSLAs, three emerged with a business idea of converting into a SACCO. 2SCALE provided further assistance in training, registration and development of credit and savings manuals to assist in operational work. To date, the three converted VSLAs have become fully-fledged SACCOs and membership has grown from 30 to 130 members on average for each. This has boosted savings culture and created confidence within the organization members.

MADFA is at the center of providing three interlinked types of services. 1) MADFA SACCO provides financial services to farmers to ensure they can finance inputs and other needed purchases for the production of maize, beans, soya bean and sunflower. 2) MADFA delivers agriculture extension services to its members before they access financing from the SACCO to ensure the loans are put to productive use. 3) MADFA has also entered into a partnership with Masindi Seed and Grain Growers Ltd., one of the three licensed warehouse operators in Uganda, to facilitate farmers to bulk their produce during harvest time and their linkage to remunerative markets. The three institutions serve the same membership and work in a way that complements each other for their members' benefit.

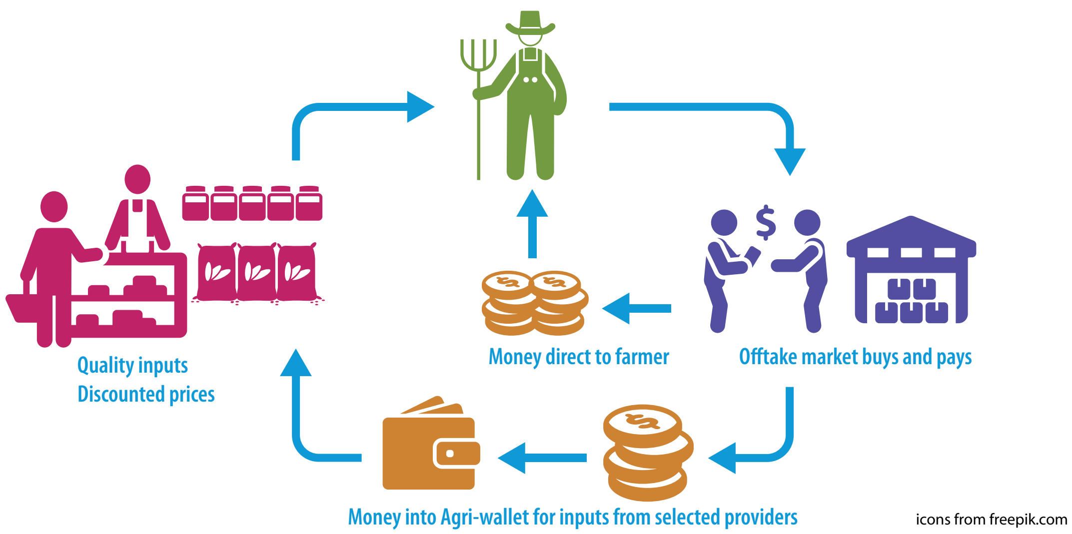
find that they do not have to over rely on debt financing to secure inputs. Farmers, off-takers and input suppliers need to agree on using the savings system. First of all, farmers have to agree with the off-taker to channel all their payments through the platform. Secondly, farmers, the off-taker and Dodore Kenya decide on a percentage of proceeds that will be locked in the savings account managed by Dodore Kenya for a specified period of time. Thirdly, an input supplier is selected by farmers from whom the inputs will be sourced. Both parties agree on pricing and discounts of the inputs (Figure 2).

Input suppliers are allocated telephone numbers which farmers use for transactions. When the farmer is in need of inputs, he visits the input supplier and makes a withdrawal of an amount equivalent to the inputs purchased. This amount is credited to the input supplier electronically. The farmer picks the inputs without accessing the cash. This transaction, which does not involved handling of cash, works with selected suppliers; the farmer cannot access the cash but only the inputs.

Lessons learned

In all institutional arrangements for inclusive financial service provision, record keeping by smallholder farmers and other entrepreneurs in the agri-food sector remains essential; not only for themselves (in order to take well-informed decisions) but also for financial service providers, which need to be informed on cash flows, financial assets and management skills. Therefore, financially literacy training and

Figure 2 | Flow of funds and products in the agri-wallet system



skills development for financial management merits continuous attention, particularly through adapted training methods and material for smallholders and small-scale entrepreneurs. Many may have the required entrepreneurial mindset but many are also illiterate.

In order to get credit from financial institutions, submitting business development plans often remains a condition, particularly for SMEs and farmers' organizations. Business development plans guide entrepreneurs when managing their enterprises and it forms the basis on which the financial institution decides on providing credit. Some entrepreneurs and staff from farmers' organizations confessed that they could not interpret the business plans that were drawn up by consultants on their behalf hence their reduced ability to negotiate loans and subsequently navigate their business activities. Coaching of entrepreneurs remains the most appropriate option, not only during the elaboration of business plans but also throughout implementation since many business plans are too ambitious and competition in the market is rude.

Financial service providers still expect collateral security from loan applicants for reasons of risk mitigation and they often require formally registered assets, such as land, to use as collateral. Value chain-based financing mechanisms, whereby 'ready markets' act as collateral, are viable alternatives. This also implies that particularly farmers' organizations need to follow this path and undertake the necessary organizational reforms to become viable enterprises, i.e. genuine cooperatives with qualified and skilled staff.

Access to finance *per se* is not a guarantee for success; it often requires complementary services such as agricultural extension and bulking and storage facilities. Finding the right service providers, building mutual trust and facilitating tailor-made institutional arrangements remains a challenge.

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Joris Maatman | Winnowing soybean, Uganda

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