# Finance for Smallholders

## Opportunities for risk management by linking financial institutions and producer organisations

SUMMARY REPORT

npm platform for inclusive finance

Food & Business Knowledge Platform

Agri Pro Focus

# Colophon


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# Preface

**NpM, Platform for Inclusive Finance (NpM) supports its members amongst others through research, knowledge exchange, policy recommendation and representation of the sector. The Rural Finance working group of NpM has always played an active role in improving its members' activities to increase access to financial services in rural areas. In the past, themes that the working group worked on are Value Chain Finance and Member-owned financial institutions. This research 'Finance for Smallholders: Opportunities for risk management by linking financial institutions and producer organisations' has been carried out in the countries: Mali, Rwanda, Uganda and Ethiopia. This document is a Summary Report; the complete version, including the description of the cases (annexes) can be downloaded from the NpM website: (http://www.inclusivefinanceplatform.nl/about/publications).**

The working group coordinates its efforts with other organisations to leverage its knowledge and to make sure the work is complementary to other initiatives. NpM has worked with AgriProFocus for a number of years on the topic of rural finance. Jointly, the working group and AgriProFocus have coordinated the content of this research with the Food & Business Knowledge Platform (F&BKP), CGAP, Rural Finance and Innovation working group of the European Microfinance Platform, Agriterra and Wageningen University. Terrafina Microfinance coordinates the working group.

The topic of this research 'Finance for Smallholders' was chosen in line with the activities and policy of the members, the Netherlands government and the above mentioned organisations. To this end, the working group of NpM also provided expert input in the consultation round of the F&BKP, whom with this consultation contributed to the wider stakeholder input gathering by the ministries. The government considers the opinions and contributions that emerged from this F&BKP consultation as important building blocks in the development of the policy. The policy letter on global food security stated that: 'the focus is on small and medium-scale farmers as well as other rural entrepreneurs who could potentially serve market demand. Increasing these people's earning power is a powerful tool in fighting hunger and poverty and promoting economic growth.'

The Netherlands is internationally recognized as an expert and innovative partner for agricultural development and food security. Its activities are in line with EU policy in this field and play a visible and distinctive role at the UN within an integrated approach to aid, trade and investment. Knowledge, capacity and activity are the common themes.

According to Minister Ploumen: 'A problem that occurs in the food chain is access to financial services; this problem is dealt with already in different ways'. This research sets out different kinds of good practices for opportunities for risk management by linking financial institutions and producer organisations. The cases were selected out of the portfolios of the members and AgriProFocus. Early 2014, the Rural Finance group of NpM took the initiative, in cooperation with AgriProFocus, to investigate the financing of small producers and producer organisations (POs) in order to learn from, upscale and replicate best practices.

NpM hopes that this report will be useful and inspiring. We would be grateful if you provide us with your remarks, ideas or suggestions; we welcome your responses.

Josien Sluijs
*Director NpM*

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# 1. Introduction to the study

The members of NpM, Platform for Inclusive Finance (NpM) selected 14 projects financed by NpM members or AgriProFocus in Ethiopia, Uganda, Rwanda and Mali for the innovative way in which access to finance was created for smallholders. These projects showed that collaboration with farmers' organisations, cooperatives or informal farmer groups is crucial to sustainably creating access to finance for smallholders.
v
For this study, the members of NpM and AgriProFocus selected projects that have been operating successfully for a number of years. The research proposal was drafted in consultation with Terrafina Microfinance, Agriterra, e-MFP, CGAP and Wageningen University. Funding for the study was provided by the Food & Business Knowledge Platform, NpM and AgriProFocus.

**Smallholder finance – a priority for food security**
The worldwide priority for smallholder finance is undisputed. The large under-utilized potential in the hands of smallholders, especially in Africa, holds promise for both local food security and global solutions to feeding a growing world population. Smallholder finance helps to alleviate poverty in rural households and can contribute to ecosystem resilience. Furthermore, successful commercial operators in agrifood chains become responsible for inclusive and sustainable sourcing, while smallholders and their producer organisations (POs) move towards market-quality standards, improved yields and growth opportunities.

**New territory – not yet fully charted**
Smallholder inclusion through POs offers new opportunities for financiers. Several NpM and AgriProFocus members have piloted finance programmes linked to POs with their African partners. These programmes have taken them into rather uncharted territory: not standard microfinance, not standard agribusiness financing, not commercial value chain finance, yet building upon elements of all of these in the context of smallholder agriculture.

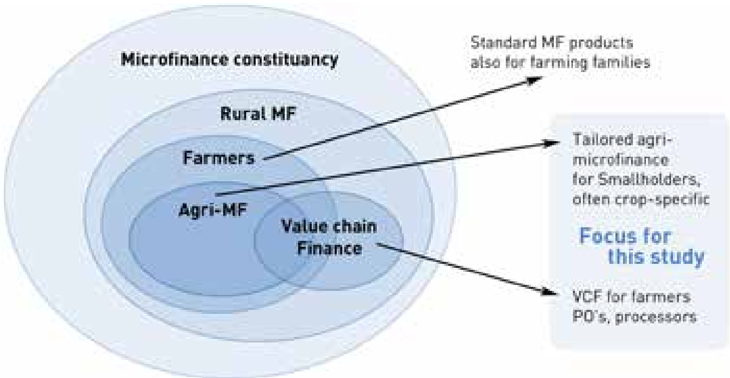

Figure 1: study focus and target group

The purpose of the study is to map practices from the 14 case studies and learn from good and innovative practices. The aim is to improve the approach of NpM/AgriProFocus and the members of both networks in their efforts to facilitate access to finance for smallholders.

The specific objectives of the study are:
1. To get better insight into how to provide appropriate financial products and services to smallholder farmers and their produce organisations;
2. To investigate current practices and methodologies to address the known problems and constraints of the small producers and POs related to accessing funds;
3. To map how linkage between these (potential) clients and MFIs and banks can be strengthened;
4. To compile lessons learned for policy guidelines and implications for the role of the Dutch support organisations in facilitating these linkages for appropriate access to finance; and
5. To give recommendations on how can best practices and guidelines can be incorporated into organisations that are members of NpM, AgriProFocus and e-MFP.

The detailed study including a description of the cases can be found on the NpM website: www.inclusivefinanceplatform.nl/about/publications. This document contains a summary of the main findings and recommendations of the study.

# 2. Observations from the study

The study investigated 1) the main financial instruments used in the 14 case studies, 2) the collaboration mechanisms and 3) the risk mitigation mechanisms. There was a great diversity in the cases that included MFIs, financial cooperatives and banks and companies. A brief description of these instruments and mechanisms is given below.

**Finance instruments**
The following instruments are used for smallholder finance in the 14 cases studied:

A ***Solidarity group lending:*** the standard microfinance model is also used for farming households. Loans are repaid in weekly or monthly instalments, but the timing of disbursement and repayment may take the growing season into account.

B ***Crop-specific microfinance with solidarity groups:*** in most cases the financial institution developed a crop-specific arrangement for smallholder loans in collaboration with the producer organisation (PO). This means that all major parameters are adjusted to meet the credit need for this specific farming activity, like the size of the loan, the timing of disbursement and bullet-type repayment after harvest.

C ***Microfinance to individual farmers:*** especially in the financial cooperatives loans are provided to individual farmers, while sometimes one or two co-guarantors may be required. Within these cooperatives or farmer associations, all members are farmers and, if possible, loans are tailored to members' (clients') needs based on an investigation of these needs.

D ***Finance by chain actor (embedded):*** embedded finance for farmers is quite rare in Africa. In the study there is one case in Uganda, the Cotton Conservation Initiative supported by the luxury cotton-clothing brand Edun, which provides finance to outgrowers.

E ***Financing by chain actor:*** linking MFIs and companies who collaborate in the chain is also not frequent in Africa. The case of financing in the malt barley value chain in Ethiopia is one example. The financial service provider (MFIs) provides input and, if needed, output loans. These loans are secured by a contract between companies and the MFI.

F ***Warehouse receipts:*** warrantage is a financial product that helps farmers to sell their produce at a better price. It is practiced by both MFIs and financial cooperatives. The warrantage product allows farmers to meet the daily family needs and wait for the remaining 40% to be paid at a better price after stocks are sold. The farmer cooperatives and the MFI jointly manage the stock, to guarantee the repayment (of loans) offered to farmers until the whole stock has been sold. The MFI contracts loans with individual farmers, and the loan payments are guaranteed by the stock managed by the PO. The cooperative is responsible for marketing the stock and it deposits the money received when the product is sold in a favourable season - and thus at a better price - in the farmers' accounts with the MFI.

G ***Wholesale finance through the PO:*** smallholders can also be financed by using the PO as a delivery channel. It is convenient for the lender because the PO can also perform tasks such as screening the farmer-borrowers. Wholesale finance is also applied to the post-harvest finance needed to pay the farmers in cash upon the delivery of their harvest to the PO. While the primary beneficiary is the smallholder farmer, the primary borrower is the PO, just like the warehouse receipt system in which the individual farmer is the borrower. These are examples of two-tier lending for post-harvest finance.

H ***Financing PO activities (like processing):*** in some cases of two-tier financing, the post-harvest component is used for processing by the next actor in the product chain. An example is the finance for the coffee hubs in the NUCAFE case in which working capital is provided for coffee processing (storing, grading and drying), even though the coffee hulling is still a separate business.

I ***Mobile banking:*** though only one project in the sample uses mobile technology, it is highly relevant to smallholder microfinance because it is another 'game changer' in the field of microfinance. MyAgro in Mali allows farmers to save (by buying credit on their phone) and to use that credit for agricultural inputs (fertilizer and seed packages) through a network of local village vendors.

# 3. Finance strategies – three modalities

**Three finance modalities**
The sample of projects shows a great diversity of financial institutions, finance instruments and their connections with producer organisations (POs). In general, there were 3 financing modalities.

**Type 1** : Direct finance to smallholders for farm inputs (pre-harvest)
**Type 2** : A two-tiered finance system that involves both pre-harvest finance to smallholders and post-harvest finance to the buyers of produce, mostly POs
**Type 3** : Agricultural Value Chain Finance (AVCF) that involves either type-1 or type-2 finance, together with arrangements with value chain actors.

**Type 1** : *Direct pre-harvest finance to smallholders*
Pre-harvest finance is provided for farm inputs (seed, fertilizer and pesticides), for farm services (e.g. ploughing, insemination) and for farm labour (e.g. when extra hands are required in a short harvesting period). This is done through standard group solidarity microfinance, often with crop-specific microfinance products, and the group solidarity methodology is combined with a credit product tailored to the needs of that crop (timing, repayment method, etc.). Invariably for the crop- specific credit product, a bullet repayment is used after the harvest. The mobile banking approach of MyAgro falls under this type of smallholder finance because the credit built up after the previous harvest is used for buying farm inputs from accredited local suppliers.

**Type 2** : *Pre- and post-harvest finance*
In the cases studied, post-harvest finance is complementary to the farm-input finance described above. Post-harvest finance can be provided for a variety of reasons. For crops with a concentrated harvesting period, and especially when freshness or shelf life is limited, there are price dips in the harvesting season when there are abundant supplies. Farmer cooperatives or farmer marketing organisations (FMOs) may create storage capacity for the farmers to postpone selling until prices have returned to their 'normal' level once supplies have levelled off. The second modality of this type is in the cases of the two-tier financial cooperatives like the unions in Ethiopia and Rwanda. Both are second-tier conglomerates of primary cooperatives. While the primary cooperatives finance the smallholders, the primary cooperative can be refinanced by the union. This finance does not need to be exclusively for the farm credit portfolio, but may also be used for investments in stores, transport or the processing equipment of the PO.

**Type 3** : *Agricultural Value Chain Finance (AVCF)*
Agricultural Value Chain Finance differs from the previous two finance modalities in that the financier actively participates in arrangements with chain actors (buyers, processors, input suppliers) and other stakeholders (facilitators, service providers, government agencies, certifiers). Actively involving the financier results in a more comprehensive understanding of risk management in the value chain.

Photo: Josien Sluijs, NpM, Platform for Inclusive Finance

# 4. Programme design

A striking point of the all the cases studied in this research was the great attention given in all cases to the whole programme set up, which often entailed a delicate process involving different stakeholders and several processes. The various projects usually went through a number of stages, not always chronologically. These stages are summarised below:

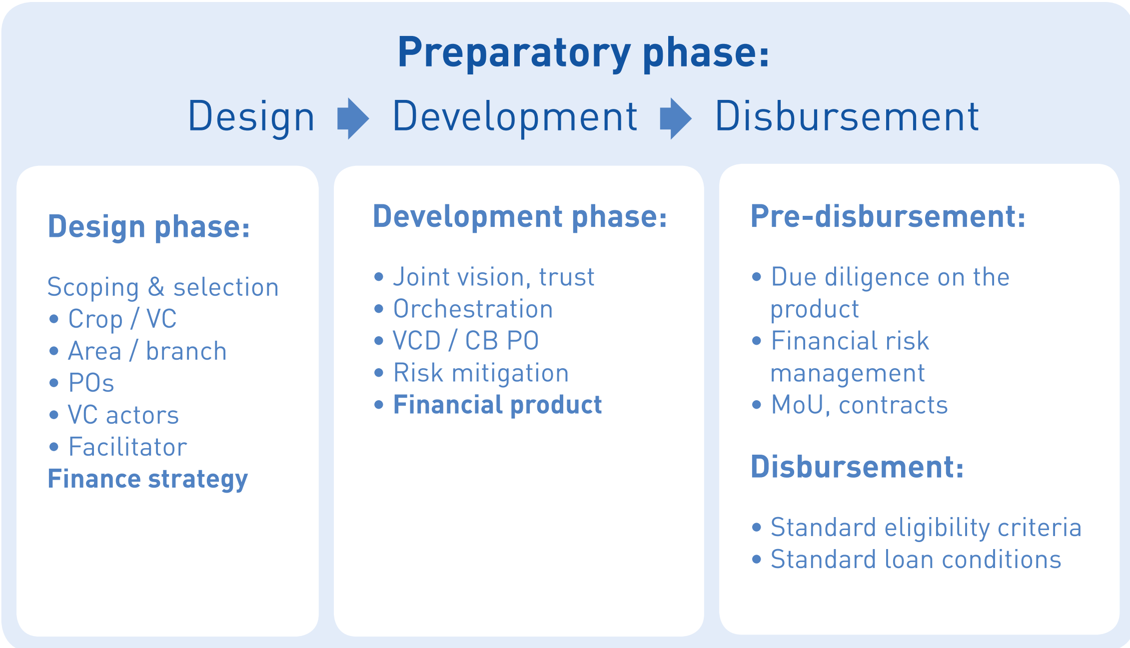


Figure 2: Different stages programme set up

## A. Design phase of the smallholder finance programming

**Nature of the programmes**

In most cases a preparatory stage is needed in which the leading partner - whether producer organisation (PO), financier or chain actor – defines the focus and invites potential collaborators around the table. What follows is a process of investigation and programme development that involves scoping, crop selection, PO screening, chain actor consultation and the orchestration of collaboration agreements. Most of the collaborating parties in the sample cases consisted of at least the PO and a financier. Additional stakeholders were engaged depending on the needs and opportunities. A smallholder finance programme was defined by the following criteria in the design phase:

a. Selection of the most promising crops and production areas
b. Selection of farmer groups and POs to pilot the programme
c. How can the availability of the necessary extension and farm support services be ensured for the participating farmers?
d. Availability of farm inputs and their availability at the time needed
e. Assessment of storage and bulking facilities as well as processing options
f. Assessment of how attractive the crop is to farmers
g. Assessment of availability of financiers
h. Assessment of probability of business case passing the financier's due diligence check
i. Assessment of credit needs and the requirements for the financial product.

**Scoping & selection**

In the process of developing a smallholder finance programming, a stage of design and development precedes the actual financial product development. The organisation taking the lead in the project usually first goes through a scoping exercise to identify the potential crops, the pilot area for the project, the actors to be consulted and possibly the facilitators or service providers to be engaged. In some cases, this is part of a Value Chain Development trajectory.

## B. Development phase

**Orchestration**

The next phase is project development. In this phase the lead actor has to talk to all parties that need to be engaged. In brief, this process is referred to as 'orchestration'. In value chain development programmes the term applies to the effort of getting inde¬pendent players in the value chain around the table. In this study some form of orchestration is used for all efforts to engage differ¬ent stakeholders in an agricultural product chain. Even in simple input finance, such activities may be required; for instance, to facilitate the availability of supplies at the right time or to protect farmers against unscrupulous traders. In most programmes studied, orchestration involved arrangements with a wide array of stakeholders, such as input suppliers, farm-service providers (including advisors and extension workers), bulking and grading places, storage facilities, processors and ultimate buyers in the market. Access to finance requires preparatory consultation and negotiation in which stakeholders make collaborative commitments to help improve smallholder production in terms of stable and premium pricing, improved agronomic practices, higher productivity and the adoption of sustainable farming methods. In the process, trust must be created based on shared value, shared risk, a voice for each actor and the ownership of productive assets across the agricultural value chain

## C. Financial product design and financial services

Once the focus of the project has been determined, a financial needs assessment is done at the farm level. This often results in a credit product design: a credit budget per farm related to the acreage cultivated for the crop concerned.

**Parameters of credit product development**

In all cases, specific credit products were developed for the crop and the farmers concerned. This was invariably done by staff of the financial institution involved and based upon their confidence in the programme developed in the design phase. Box 3.4 shows the main parameters to be determined for a new credit product. In all cases, crop-specific credit productswere developed that included the timing of disbursement and repayment, eligibility criteria and security arrangements tailored to the specifics of the smallholder finance programme.

Photo: Fransien Wolters, Terrafina Microfinance

### Main aspects of credit product design

- Timing of client screening, disbursement and repayment
- Debt service method; regular instalments, bullet repayment, harvest instalments
- Interest rate (APR) and calculation method; flat or reducing balance.
- Loan size (amount/ha, minimum and maximum)
- Client appraisal criteria / procedure
- Eligibility criteria
- Security arrangements, guarantors, mandatory savings, collateral
- Loan conditions

Figure 3: Main aspects of credit product design

Risk assessment is important for financiers in smallholder finance.  This is a major concern in the financial product development process. The study showed that credit appraisal and due diligence are not only done on the basis of individual smallholder clients. In order to assess the feasibility of credit delivery to this specific group of smallholders, the financier needs to consider the following topics as part of its due diligence;

1. The ***crop*** – What are its characteristics and what are its specific risks? What quality standards apply, how are they measured, how is grading done, and how can farmers be certified?
2. The ***farming system*** – How does farm production take place and what risks are related to it? What factors influence production volumes, and what is done to prevent crop failure?
3. The ***farmer's organisation*** – What role does the PO play in helping farmers succeed in their production plans and how well is it equipped to perform these roles? Can the PO be relied on when it also performs tasks in the credit cycle (e.g. screening farmers, assessing the land cultivated, etc.)?
4. The ***market*** – How is produce marketed? What is the nature of the market (spot market, local traders, corporate buyers, processors, etc.)? Is the market stratified in terms of the quality produced? Which markets are accessible to the farmers, also in terms of the available storage and transport facilities? What the market risks (contract compliance, price volatility, etc.)
5. The ***business case*** – What are the gross margins for farmers and what is the monthly/ seasonal cash flow? Is debt servicing possible? What are the margins for price volatility? Are farmers paid on time?
6. The ***financial service*** – What are the financial risks of this programme? Do standard (micro) finance procedures suffice or should more security arrangements be formulated?

These six topics are the core of the due diligence process carried out by the MFI and need to be included in the product design phase.

With this risk assessment, critical parameters can be translated into eligibility criteria or loan conditions to be applied at the individual smallholder level. Because the financial institution takes part in formulating the project, the due diligence process is not static. In discussions with stakeholders, the financial institution expresses its conditions and concerns, and the project subsequently takes shape.  The different aspects of risk management are discussed below.

Photo: Josien Sluijs, NpM, Platform for Inclusive Finance


## *Ad. A & B: Risks related to the farming component: crop and farming system*

Table 1 illustrates typical items in the risk assessment of the farm product and how it is produced by the participating farmers, together with the type of measures included in the FPP to mitigate those risks.

| Due diligence checklist | Risk factors | Risk mitigation measures (examples) |
|---|---|---|
| **1. Farm product**<br>Quality - characteristics for cultivation, harvesting, storage & processing | • Lack of quality seed<br>• Post-harvest loss of quality<br>• Mixing of grades<br>• Lack of quality awareness<br>• Lack of knowledge of GAP<br>• Lack of on-farm equipment<br>• Plant diseases | • Links to seed supplier – better plant variety<br>• Better use of farm chemicals<br>• Farm extension, agronomist<br>• Education on post-harvest<br>• Coaching by PO<br>• Quality grading tools |
| **2. Farm production**<br>Production capacity, yield, farm inputs, GAP, farming system | • Lack of working capital for farm inputs and labour<br>• Crop failure, poor weather<br>• Poor farming techniques, declining yield<br>• Lack of farm inputs, cheating by traders<br>• Low yield per ha, traditional farming<br>• Poor prices, volatility | • Pre-harvest farm finance<br>• Crop diversification<br>• Crop insurance<br>• Irrigation, dug wells<br>• Link to research institute<br>• Approved input suppliers<br>• Link to farm extension agents, tractor service PO<br>• Bulk buying by PO, storage |

Table 1: Due diligence and risk management – farming component

## *Ad. C & D: Risks related to PO and the market: farmers' organisations and the market*

POs and farmer cooperatives are traditionally the prime movers in strengthening the market position of smallholders in both their capacity to meet markets needs and their negotiating power. Being democratically organised voluntary organisations, the governance structures of the various farmers' organisations reflect the educational level of the farmers who volunteer for board functions. Even when programmes to train board members have been set up, regular elections make training a recurring effort. Union structures mitigate the governance risks by their institutionalised capacity-building activities and supervisory functions. For chain actors, especially the off-takers of farm produce, POs are a valuable conduit for improved farm supplies and farm finance. In these programmes both parties want to be certain that the PO can perform the functions it undertakes to carry out. Several risks are related to the strength of the PO since the PO will use it negotiation power to mitigate the market risks through trade arrangements with chain actors. Table 2 shows how both elements of risk management are identified and mitigated.

| Due diligence | Risk factors | Risk mitigation measures (examples) |
|---|---|---|
| **3. Farmers' organisation (PO)**<br>Commercialisation of farmers, their loyalty to PO, PO strength, PO ability to link farmers to chain actors, finance and non-financial service providers | • Lack of working capital finance to ensure cash payment of farmers upon delivery of the crop<br>• Farmers lack business knowledge / attitude<br>• Weak management & governance<br>• Poor loyalty, side-selling, lack of consensus among farmers, lack of trust in PO<br>• Lack of extension capacity<br>• Lack of transport capacity | • Post-harvest finance to the PO or the off-taker in the chain<br>• Farmer-led business development training<br>• CB for board members<br>• PO appraisal by or for the FI<br>• Quantity pledge, premium pricing, forward contracting, cash payment upon delivery<br>• TOT model for farmers<br>• Processor collects<br>• Finance fairs, FFPs |
| **4. Market**<br>Chain structure, price trends, reward for quality, competition, uncertainty | • Dependence on spot markets – low prices<br>• Disruptive trading<br>• Weak negotiation position<br>• Price volatility<br>• Seasonal price drop<br>• Small margin for farmer<br>• Capacity to meet market quality standards | • PO bulking & selling<br>• PO links to better markets<br>• PO bypass local traders<br>• PO – MoU with processor<br>• Forward contracting<br>• PO stores – warehouse receipts<br>• Certification of farmers<br>• Coaching, transparent grading standards, grading tools |

Table 2: Due diligence and risk management – PO/market component

Photo: Terrafina Microfinance

## *Ad. E & F: Risks related to agribusiness viability and finance*

VThe two are related, not just because viability is of prime concern for financiers, but also because the business plan needs to show the cash flow deficit for which the finance is sought. In other words, the financier has to be convinced that the business case or value chain is viable.

**Financial analysis of farming and agribusiness**

This relates to the analysis of the actual credit and liquidity needs. Post-harvest finance is usually a working capital credit to a PO or agribusiness to bridge the cash flow deficit between buying and selling the crop. If both transactions are done on a cash basis, the timing, duration and volume of the cash flow deficit – in other words the credit need – can easily be established. The actual credit can be connected to sales agreements between farmers and companies or POs as well. The timing of financing and repayments crucially depends upon the average collection period for debtors and the average payment period for creditors (farmers). The study showed that POs and agribusinesses do not normally maintain accurate and updated monthly accounts with clear cash flow projections and that this is a clear area for capacity building.

| Due diligence checklist | Risk assessment items | Risk mitigation measures (examples) |
|---|---|---|
| **5. Business case/viability**<br>Viability of farming, cash flow of farmers<br>Viability PO<br>Cash flow PO level | • Farmers divert to other crops if margin too small<br>• Farm business drained of cash due to late payment<br>• PO unable to pay farmers on time (ACP debtors)<br>• Cash handling / fraud<br>• NFS not sustainable | • Farm finance programming<br>• Credit eligibility depends upon performance<br>• Post-harvest finance to farmers using warehouse receipts<br>• Working capital finance for PO to cover ACP debtors<br>• Training financial management & accounting<br>• Chain actors take over donor role |
| **6. Finance**<br>Access for farmers, credit needs, eligibility, capacity FI, financial products, loan delin-quency management | • No FI willing to finance smallholders<br>• FIs lack agri-knowledge<br>• FI agri-risk avoidance<br>• Standard product not appropriate for farmers<br>• Diversion by farmer | • Scouting & sensitisation FIs<br>• FFP<br>• TA for financial institution<br>• Guarantees and warehouse receipt financing<br>• Crop-specific credit products developed<br>• Control by PO |

Table 3: Due diligence and risk management in a farm finance programme

The financier of a farm finance programme needs to make a go/no-go decision based upon due a diligence analysis that includes a risk analysis (taking into account the management of agricultural risks by stakeholders), a credit needs assessment, a financial analysis and the requirements for an appropriate finance product. The financing party must also decide whether to focus on pre-harvest finance, post-harvest finance or both. Table 3 provides the details of risks related to business and finance. In the study two specific financial instruments for risk management were found: warehouse receipts and guarantees. Some of the more sophisticated risk management instruments were not applied, such as Insurance through weather-indexed risk management products, futures and options markets (for hedging against price risks). There are a few such markets in Sub-Saharan Africa. While these markets are still small in SSA, the South African Futures Exchange (SAFEX) is the biggest and oldest in Africa. However, commodity exchanges are still being created, e.g. recently in Ethiopia and currently in Rwanda.

# 5. Lessons learned from the study

The modalities of smallholder finance together with farmers' organisations offer a much wider range of risk management instruments beyond the traditional approaches of financiers. Apart from some clear observations on financial instruments, methodologies and risk-mitigation strategies employed, the study also revealed some more general lessons learned that could be useful for practitioners on the ground as well as for donors and investors.

## Lesson 1
### *Risk management as a common agenda*

The study showed that it was possible to engage different stakeholders in risk management. Crop failure or agricultural stagnation is in nobody's interest.
Hence it proved possible to come to operational agreements with chain actors (input suppliers, buyers, processors) and farm service providers (like extension agencies) to design a plan of action to mitigate agricultural risks and to translate this plan into operational agreements (MoUs or contracts). While producer organisations (POs), financiers and chain actors each have their own responsibility in managing risks, the comprehensive approach towards managing agricultural risks provides a common agenda for action that is in everybody's interest.

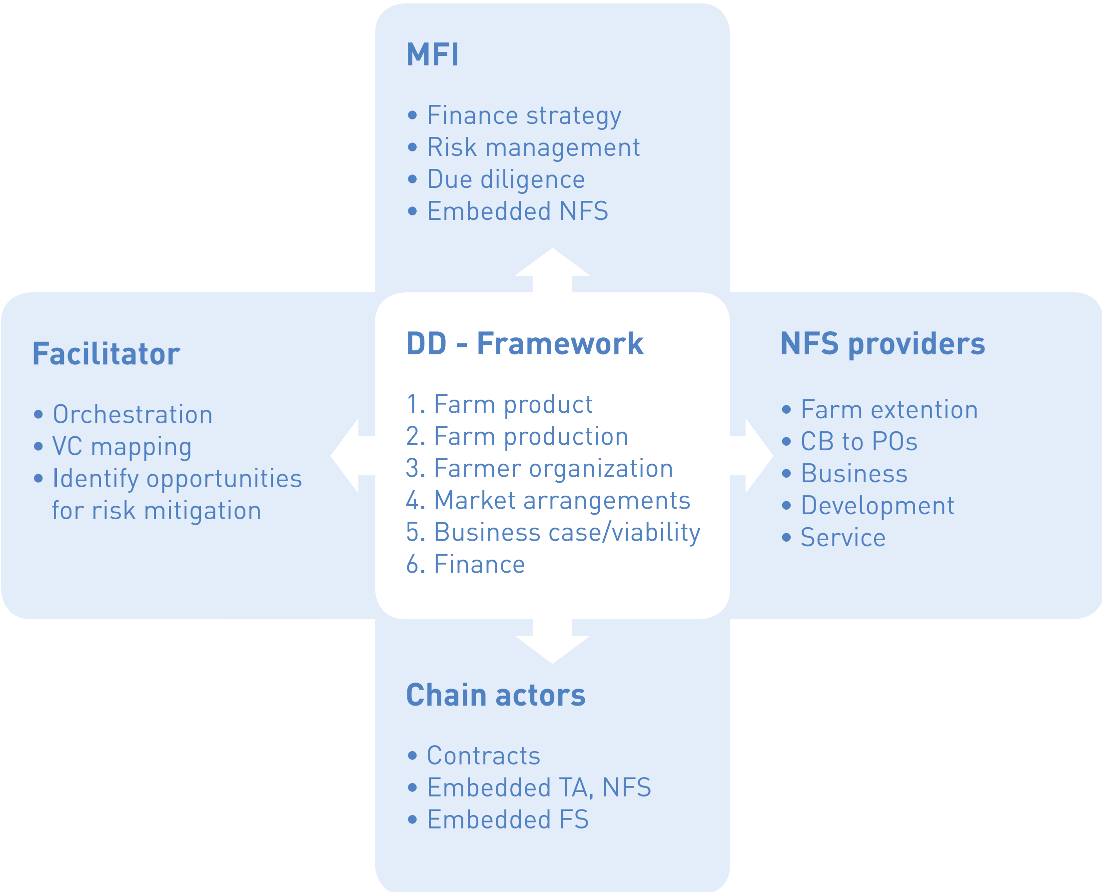


Figure 4: Risk management as a common agenda

## Lesson 2

### *Access to finance relates not just on financial risk management*

Most cases demonstrate quite convincingly that it is possible to create access to finance for smallholders without sophisticated financial risk-management instruments such as structured finance, crop insurance, agricultural price- management instruments or commodity exchanges. There is a wide range of risk-mitigation options in smallholder agriculture when resources within the agri-chain are mobilised. Most of these deal with the root causes of risk in agriculture such as poor farming practices, non-access to inputs, ignorance about quality and grading, dependence upon local spot markets and the extremely weak negotiating position of individual smallholders. Much can be achieved by exploiting all of the opportunities in the value chain for risk-mitigation measures relating to farming, good agricultural practices, farmers' organisations, market arrangements and viability enhancement. Mitigating agricultural risks requires risk mapping and the orchestration of stakeholders in the chain to agree on the necessary measures. Since financiers directly benefit from effective risk mitigation in farming and marketing, there is more access to finance.

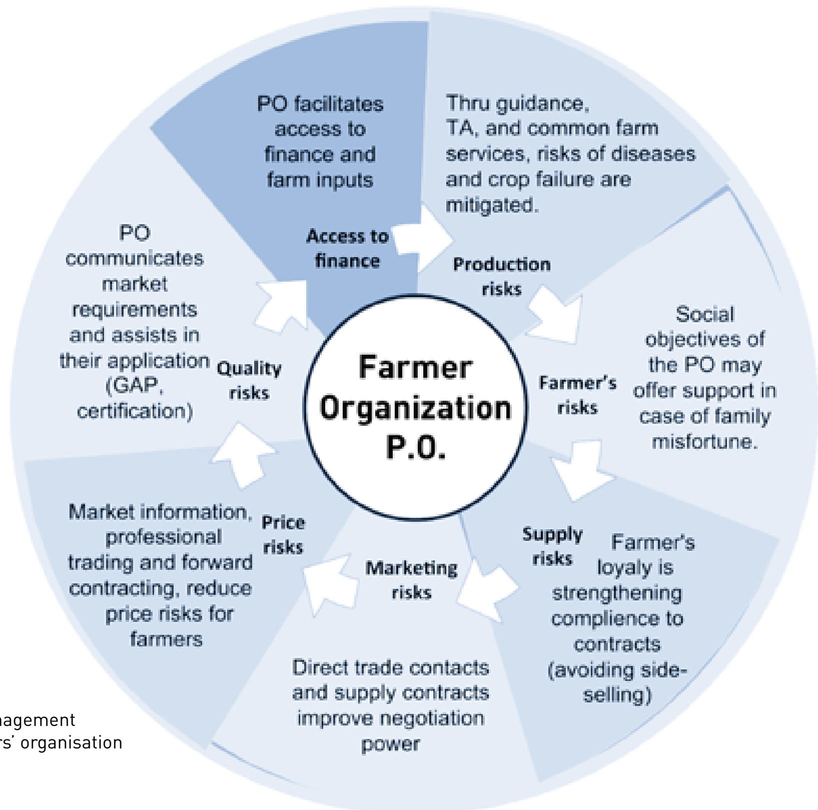


Figure 5: Risk management potential of farmers' organisation

## Lesson 3

### *Farmers' organisations are vital for exploiting the full potential of risk management in smallholder agriculture*

Risks have been managed through a great many different risk mitigation measures. None of these would have been possible without the farmers' organisation (PO). Diagram 4 illustrates these measures as a virtuous circle – activities that reinforce one another. This implies new roles for farmers' organisations. Traditionally, POs were focused on advocacy and on improving the farmers' standard of living. The latter is achieved through supporting functions in the process of farming and marketing, savings and credit operations, produce processing and sometimes all of these measures. Moreover, a new theory of change is emerging for POs, in which the requirements of commercialisation open new perspectives and bring new challenges. Chain actors and financiers see POs as a bridge to smallholders and as important vehicles for joint action towards risk management. They see themselves supported when engaging in new functions and simultaneously being assessed in their ability to perform them. Ideally, most smallholder finance programmes should offer POs the opportunity to build management capacity.

## Lesson 4

### *Microfinance and SME finance are linked*

Chapter 1 contains a diagram of the smallholder finance landscape showing a neat distinction between the segments of smallholder farmers served by microfinance institutions and producer-based groups served by social lenders. In the cases reviewed in this study, such separation often does not exist. In many samples, over half of the cases, the post-harvest finance is disbursed by the microfinance organisation to the buyer, whether a PO or private agribusiness. This brings the financial transaction into the sphere of SME finance, thus removing the boundaries between microfinance and SMF finance.

The more comprehensive approach towards risk management offers new opportunities for sustainable finance, provided financiers are able to recognise the merits of such linking arrangements between banks and MFIs or between MFIs and financial cooperatives. The observed need to ensure both pre- and post-harvest finance suggests the need to transcend the original domain of microfinance since larger working capital loans are needed for POs or buyers of the produce. And finally, the programming phase preceding finance arrangements provides the financier with the opportunity to take a more pro-active role in creating a safe financial environment.

## Lesson 5

### *New roles for financiers*

In two-third of the cases the initiative for collaboration came from the financier. The 'expense' for financiers to be actively involved in these efforts is rewarded by lower default risk expenses. Financiers can also greatly contribute to these arrangements through their expertise, public standing and contact networks.

After the withdrawal of governmental institutions from agricultural finance, the frontline of financial services for smallholders is now formed by a variety of microfinance providers (MFIs, credit cooperatives and sometimes banks). These providers face several new challenges:

- First they need to build up a minimum of expertise to deal with risk management in agricultural finance.
- Second, they have to revise their due diligence so as to accommodate a more comprehensive understanding of risk management.
- Third, they have to develop tailor-made financial products for the specific crop and market concerned.
- Fourth, they have to think of possibilities for engaging in 'hybrid finance', both at the microfinance level (pre-harvest credit) and at the PO or agribusiness level. Alternatively two different FIs can collaborate to serve the input and output finance components.
- Finally, a more pro-active role is required of staff in the development of farm finance programmes. Invariably, all this requires (external) support in staff capacity-building, product development and facilitation.

Photo: Marloes van den Berg, NpM, Platform for Inclusive Finance

## Lesson 6

### *The crucial role of facilitators*

In new areas of smallholder finance, it is crucial to plan and budget for a professional facilitation function. Without that, most of the successes of inclusive finance described in the cases studied would not have materialised. The person or organisation assuming this role, must be well prepared for the function because facilitators face a number of dilemmas, such as:

- Non-ownership – A facilitator should stimulate, mobilise, create, but not become, or be seen, as the owner of the process.
- Impartiality – On the one hand, ideally one of the permanents actors in the market – PO, VC actor or financier – should steer the process. On the other hand, impartiality is a prerequisite if a facilitator is to be trusted by other actors.
- Prevent dependency – A facilitator becomes an expert in the process and thus may be relied upon by all parties. This may unwillingly create a situation of dependency that jeopardizes the sustainability of the process once the facilitation contract comes to an end. This situation can be prevented by setting a clear time horizon for the facilitation function and by formulating a clear exit strategy.
- Graduation of actor roles – While initially a professional facilitator may be needed to prime the pump, one or more of the local actors should gradually takeover. This gradual transition should be well planned and should be based upon the parties' firm commitment to assume full responsibility.

Photo: Josien Sluijs, NpM, Platform for Inclusive Finance

# 6. Implications for funding agencies

The above ten topics for 'good practice' guidelines, are formulated in terms of processes for practitioners in Africa and based on the study results. Implications for investors and social lenders are discussed below.

1. **Facilitate preliminary farm finance programming**
   As the cases of NpM partners showed, investing time in preparing a new smallholder finance programme is considered highly beneficial for generating access to finance, for stimulating comprehensive risk management and for supporting the commercialisation process of smallholder agriculture.
2. **Facilitate new roles for producer organisations (POs)**
   Investors must allow for capacity-building programmes to strengthen the producer organizations in their roles of marketing and linking to financial service providers.
3. **Facilitate and support new roles for partner financiers**
   Financiers of smallholder farming face several new challenges. Investors and financiers need to allow financial institutions the possibility of building up staff expertise, developing appropriate products and adjusting due diligence processes to facilitate the comprehensive management of agricultural risks. There are ways to mitigate agricultural risks in the chain. Investors and social lenders could stimulate their partner FIs to adopt a more comprehensive understanding of agricultural risk management. Investors and social lenders could coach their partner FIs in asset-based lending: self-liquidating loans backed by stocks in a tripartite agreement with the seller and buyer of the produce or warehouse receipt mechanisms.
4. **Mixture of micro- and agri-finance (hybrid finance implications for funding agencies)**
   The need for both pre-harvest and post-harvest smallholder finance implies that the 'departments' for microfinance and agri-business finance should collaborate. It may also imply collaboration between a social lender and a (grant-based) investor able to support microfinance development for smallholders. Hybrid finance creates new opportunities for partner identification. Exiting MF partners may suggest POs or SMEs for agri-business finance, and existing agri-business partners or social lenders may be invited to suggest MF institutions that finance their smallholder suppliers. Social investors must be aware of the risk of under-financing in working capital finance to agribusiness (see GP10 above). Tools for financial analysis could help POs and agribusinesses to better understand the seasonal nature of their cash flow and to assist FIs in more accurate assessments of credit needs.
5. **The need for blended funding and investment**
   The modernisation and commercialisation of smallholder finance in Africa cannot be undertaken by social lenders and commercial banks only. Although most of the coaching of farmers and PO staff should be mobilised with the supply chain, there are still often tasks for professional facilitators and service providers that require initial grant investments. A fair combination of grant financing and debt financing is needed to kick-start new finance modalities for smallholders.

***Widening the sources of good practice documentation***
For the type of smallholder finance involving farmer organisations, there are good reasons to widen the scope of good practice literature as a source base. There are currently three types of sources for international best practice documentation that are relevant to smallholder finance. The first is the agricultural microfinance literature in CGAP. The second is the Initiative for Smallholder Finance, publications by donors, investors and social lenders. Social lenders finance both microfinance institutions and POs and agri-business. The third group refers to value chain finance, where NpM partners have been involved in publications in conjunction with the European Microfinance Platform and international organisations like FAO, IFAD and the World Bank. The cases included in the current study show features of each of these three groups.

# Annex: Cases included in the study

| Partner | Crop | Financial institution | Partners in the Netherlands |
|---|---|---|---|
| Ethiopia | | | |
| E1. Amhara Credit Unions | Tef and Maize | Union of MPC | TMF |
| E2. Wasasa | Coffee | MFI | Cordaid |
| E3. Buussa Gonofa | Malt Barley | MFI | Rabobank Foundation (RBF), TMF |
| E4. SETIT | Sesame | Union of MPC | Agriterra, TMF |
| E5. Finance fairs | Not crop specific | Many | AgriProFocus (APF) |
| Rwanda | | | |
| R1. Duterimbere IMF Ltd. | Maize | MFI | TMF, APF, RBF |
| R2. Uniclecam Eju Hesa | Cassava Maize and vegetables | SACCO Union | TMF, APF, RBF |
| R3. Amasezerano Community Bank Ltd. | Various crops | Bank | TMF, APF |
| R4. Union des CLECAM Wisigara | Irish potatoes | SACCO Union | TMF, APF, RBF |
| R5. Finance fairs | Not crop specific | Many | APF |
| Uganda | | | |
| U1. Technoserve Conservation Cotton Initiative | Organic cotton | Crane Bank | RBF |
| U2. ENCOT MFI | Maize, rice and beans | MFI | HIVOS |
| U3. NUCAFÉ | Coffee | Centenary Bank | Agriterra |
| U4. Finance fairs | Not crop specific | Many | APF |
| Mali | | | |
| M1. Biocarburant | Jatropha nut | MFI Paseka | TMF |
| M2. SORO YIRIWASO | Coton, Maize, Rice | MFI | ICCO, TMF, APF |
| M3. My Agro - Mali | Sorghum, Maize, millet, peanuts | Mobile banking | APF |
| M4. Finance fairs | Not crop specific | Many | APF |

# About:

## NpM, Platform for Inclusive Finance (NpM)

NpM, Platform for Inclusive Finance, promotes inclusive finance as a contribution to poverty alleviation in developing countries. The platform, established in 2003, brings together developing organisations, social investors, private foundations and commercial banks from the Netherlands. Together with the Dutch Ministry of Foreign Affairs, the 13 Dutch members share a commitment to expanding access to finance in underserved regions and anticipate the changing need in the sector to grow towards a responsible industry.

The members of NpM are active in over 90 countries. They support organisations that offer financial services to community-based organisations, cooperatives, non-governmental organisations, banks and other financial institutions. The NpM members also support various global initiatives in order for the industry to grow in a sustainable and responsible way.

The members of NpM have different fields of expertise and offer a broad range of financial services at each development stage of a microfinance institution (MFI).

NpM has several thematic working groups, of which one is on rural finance. The rural finance working group aims to build, share and exchange knowledge and case studies on rural finance. Not only on what is working well but also on what is not. The rural finance working group follows closely all other rural finance initiatives and working groups on similar and related subjects. It will coordinate efforts and make sure the work is complementary where possible. The members of the working group are: Rabobank Foundation, ICCO, Hivos, Oxfam Novib, Cordaid, FMO and Terrafina Microfinance (coordinator).

www.inclusivefinanceplatform.nl

npm platform for inclusive finance

## AgriProFocus

AgriProFocus is a partnership with Dutch roots that promotes farmer entrepreneurship in developing countries with the aim of rallying together professionals, expertise and resources around a joint interest in farmer entrepreneurship. The AgriProFocus network members are organizations and companies that gather, train, connect and provide inputs and credit to farmer entrepreneurs and producer organizations. The network operates both at a Dutch (-based) level and at a developing country level, the latter in so-called country networks. Currently AgriProFocus has 13 country networks of which 12 in Africa and 1 in Indonesia.

The country networks a.o. facilitates the matching of financial institutions and farmers and for that purpose they have organized several finance fairs. NpM would like to connect to AgriProFocus in order to know more of the challenges faced by farmers and farmer organizations to access MFIs and banks. Through AgriProFocus and its country networks we can easily access their network of producer organizations, MFIs, banks and supporting organizations.

www.agriprofocus.com

AGRI PRO FOCUS

## Food & Business Knowledge Platform

The Food & Business Knowledge Platform aims to facilitate a better understanding of how food systems work and how they can be strengthened. By developing a more focused knowledge agenda, the Platform seeks to nourish practices and policies with solutions and business opportunities for sustainable food and nutrition security.

Nearly one-eighth of the world's population suffers from chronic hunger. And the world's population is projected to reach nine billion in 2050. Thus, the demands on land, water and climate, as well as the supply of affordable and good quality food, are growing significantly. The F&BKP is an open and independent initiative where representatives from international networks and organizations of business, science, civil society and policy come together. We share, critically reflect on, generate, deepen and improve (interdisciplinary) knowledge and feed practices and policies on food and nutrition security. We do so by identifying knowledge issues that are relevant now and in the future, we initiate action, learning and research, we disseminate lessons learned and we highlight promising innovations that will contribute to local and global food and nutrition security. To start, the Platform will create a research agenda and prioritize knowledge themes, such as Food Wastage, Nutrition Security and Partnerships.

The Food & Business Knowledge Platform has financed this research together with NpM and AgriProFocus.

www.knowledge4food.net

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