TECHNOSERVE
BUSINESS SOLUTIONS TO POVERTY

A Guide to Working with Informal Financial Institutions

June 2014

About TechnoServe

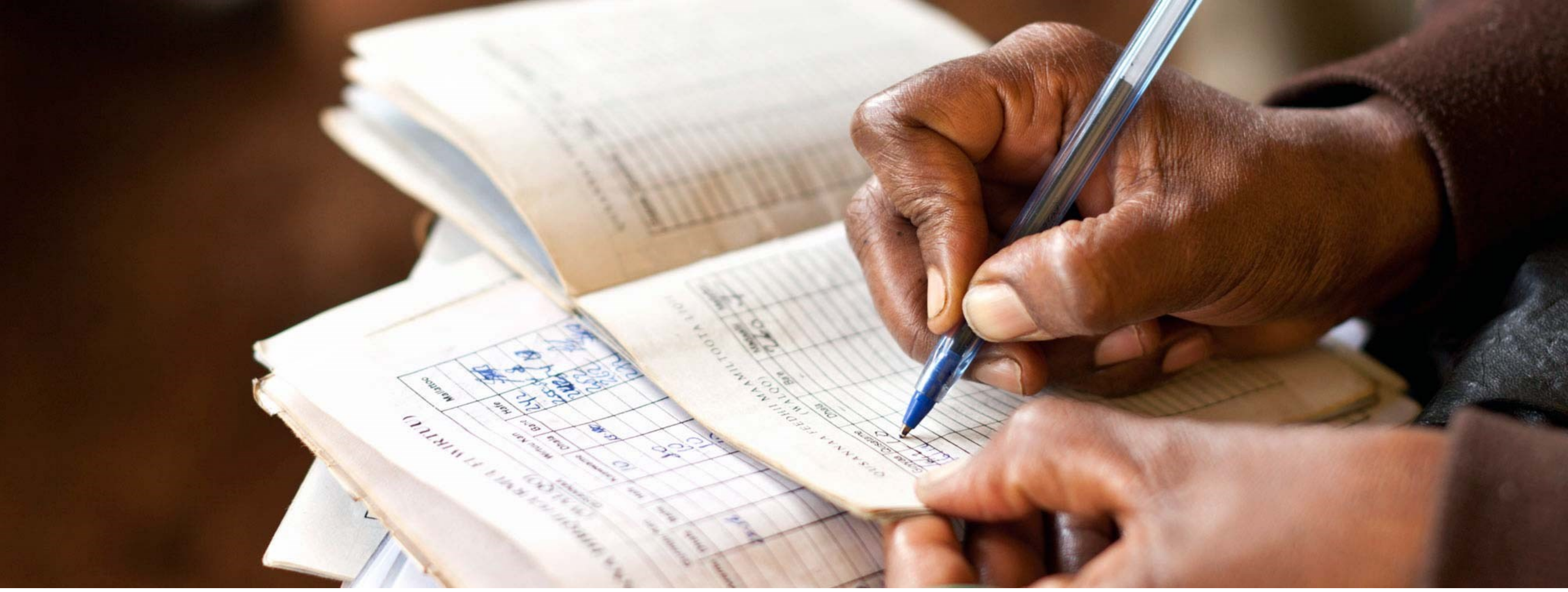
TechnoServe works with enterprising people in the developing world to build competitive farms, businesses and industries. We are a nonprofit organization that develops business solutions to poverty by linking people to information, capital and markets. Our work is rooted in the idea that given the opportunity, hardworking men and women in even the poorest places can generate income, jobs and wealth for their families and communities. With more than four decades of proven results, we believe in the power of private enterprise to transform lives.

To accomplish our mission, we support individuals and their enterprises in accessing financial products and services that are integral to their long-term growth and success. Our clients include smallholder farmers, farmer organizations, cooperatives and a variety of small and medium-sized enterprises (SMEs). We are particularly focused on addressing underlying gender dynamics that place women at a disadvantage. We also support the capitalization of larger agribusinesses, develop finance solutions for entire industries, and provide advisory services to financial institutions in order to help them efficiently deploy capital and deliver new and scalable financial services.

TechnoServe seeks to increase efficient capital flows, promote financial inclusion, improve transparency among market actors and drive overall economic growth by offering the following integrated financial advisory services and training:

- Strategic and Financial Analysis
- Capital Mobilization
- Portfolio and Risk Management

TechnoServe's financial advisory services are designed and implemented locally in more than 30 countries. Our work is guided by a worldwide "Access to Finance" practice group, which manages strategic relationships with regional and global financial services partners, and shares best practices, innovations and knowledge.



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Introduction

Despite increased attention and investment to spur agricultural growth and development, relatively little progress has been made in increasing access to finance for smallholder farmers.

Today, the availability and accessibility of financial products and services in rural areas and in agricultural value chains is still grossly inadequate to meet demand. This lack of access to reliable and affordable finance is a major constraint for millions of smallholder farmers who depend on agriculture for both food and income.

Historically, commercial banks and other formal financial institutions have avoided or failed to offer adequate financial services to smallholder farmers in rural areas. The Initiative for Smallholder Finance recently estimated that local banks meet less than 3 percent of overall demand. In the absence of commercial banks, informal community-based organizations, such as village-based savings and credit groups, serve as an important gateway through which rural farming communities can access much-needed capital (**See Box 2**).

In fact, these informal organizations are often most suitable when attempting to finance rural small-scale farmers in disaggregated and geographically dispersed value chains. They are sometimes the only financial provider actually able to lend directly to farmers and span the so-called "last mile" or "frontier" of smallholder finance.[1]

At the same time, microfinance institutions (MFIs) are starting to explore opportunities in agricultural lending, transforming service delivery and creating innovative financial products that address the unique risk profiles of smallholders.

However, a large knowledge gap still exists on how MFIs can adapt their model from urban and peri-urban areas to more effectively serve smallholders whose livelihoods are characterized by highly seasonal investments, exogenous risks and unpredictable returns. Additionally, MFIs themselves require stronger management and operational capacity to underwrite and monitor loan activity, and in some cases these institutions need greater liquidity.

Based on more than 40 years of experience and the results of several recent TechnoServe projects in Latin America and sub-Saharan Africa, this paper explores lessons learned in working with informal financial institutions. It is designed for practitioners working to address the gap between supply and demand in agricultural finance, and is intended to support efforts to unlock capital for smallholder farmers and rural entrepreneurs.

The paper also includes lessons learned and best practice recommendations for working with MFIs. Generally, there are many types of microfinance institutions. Depending on their structure and on the banking regulations where they operate, these institutions may or may not be considered "informal financial institutions," but they are included here because of their potential role in meeting the demand for smallholder lending.

BOX 2

Defining "Informal Financial Institutions"

Throughout this paper, we define "informal financial institutions" as groups that are collectively owned and managed by members. These groups mobilize savings from individuals and provide short-term loans to members, and sometimes to non-members, at varying interest rates, depending on their structure. They operate at the community or village level in rural areas that often lack commercial or formal providers of financial products and services. Included in this group are:

- savings and credit cooperatives (SACCOs)
- rotating savings and credit associations (ROSCAs)
- accumulated savings and credit associations (ASCAs)
- village savings and loans associations (VSLAs)

The Challenges of Rural Finance

Over the past several years, a number of institutions have introduced innovative methods of financing smallholder farmers, producer groups, cooperatives and agro-enterprises.

- Social lenders and technical assistance providers have designed flexible approaches to collateral requirements and tailored repayment schedules.
- Commodity traders and other buyers provide direct credit to the producer groups from which they source by embedding smallholder-financing models in outgrower schemes.
- Multilateral finance institutions and other donors have extended full or partial credit guarantees that in certain instances have been instrumental in boosting the confidence of local commercial banks, allowing them to overcome long-held perceptions of risk.
- Many of these financial institutions are benefiting from price risk management solutions as well as innovative information sharing and mobile payment platforms that reduce transaction costs and streamline lending processes.

These are certainly positive steps toward greater financial inclusion. Yet financial products and services are still out of reach for millions of smallholder farmers, especially subsistence farmers and those supplying local staple crops to domestic markets. While these groups do not require sophisticated financial products or large amounts of capital, access to affordable finance is still a necessary building block for sustainable livelihoods.

Although fragmented and undeveloped, some estimate the total demand for smallholder financing may be as large as $450 billion.[2] The vast majority of this demand goes unmet due to the slow and uneven expansion of formal financial institutions into rural areas. In 2010, only *1 percent* of commercial lending in Africa went to agriculture.[3]

With limited knowledge and understanding of the unique financial needs of smallholder farmers, commercial banks rarely see the upside of agricultural lending. Without insurance and risk management products, they are unwilling to expose their balance sheet to the uncertainties inherent in agriculture: the unpredictability of weather; the volatility of prices; and the vulnerability to pests, diseases and post-harvest spoilage.

Their limited presence in rural areas also restricts the ability of commercial banks to provide cost-effective and affordable services to remote and widely dispersed farming communities; the logistical hurdles and transactional costs for originating, disbursing and monitoring loans are simply too high.

And while a select group of social lenders and impact investors have developed novel models to provide finance to farmers and rural entrepreneurs, they are unable to scale to meet the needs of millions. This is largely due to the fact that their lending models require farmers to be aggregated, through producer groups or cooperatives. Typically, these groups also must have forward contracts in place for use as collateral. Yet since only 10 percent of the world's smallholders are organized in producer groups, social lenders can address only a relatively small slice of a very large population using their lending models. Today, social lenders satisfy less than 2 percent of the total smallholder finance demand.[4]

From the perspective of smallholder farmers, poor financial literacy, lack of credit history and limited collateral are among the most common hurdles to accessing finance. Yet even if farmers were able to access credit on a regular basis, the average cost of capital often remains prohibitively high.

Without access to financial products and services, as well as accompanying technical assistance and capacity building, smallholders are unable to invest in their land, purchase necessary inputs, expand production and increase their incomes. Their livelihoods remain constrained by low productivity and poor farming practices, and their opportunities for growth are stifled.

Understanding the Financial Needs of Smallholders

Of course, not all of the world's estimated 450 million smallholder farmers are alike. Their financial needs span a diverse continuum, from simple savings and small-scale borrowing to long-term credit and insurance products.

For instance, small-scale coffee farmers in Rwanda may require modest monthly loans, whereas a cooperative of soy farmers in Mozambique may need assistance negotiating forward sales contracts with international buyers. A wide range of factors contributes to this diversity of demand for finance. To capture the full range of smallholder farmers and their financial needs, there have been a number of different approaches to move beyond commonly cited "dollar-a-day" poverty thresholds and classify smallholders into segments based on the size of landholding, type of asset ownership, level of commercialization in farming and several other variables.

However, defining and differentiating smallholders is challenging. Even when done methodologically, such exercises are oversimplifications that fail to fully portray the diversity and dynamism of rural economies; a farmer's place in one segment today may not reflect his or her position tomorrow, or over the longer term.[5]

Despite these limitations, segmentation serves as a framework to broadly analyze and characterize specific financial demands and allows us to consider the types of financial service providers that can profitably address these needs.

The Consultative Group to Assist the Poor (CGAP) offers three distinct segments of households dependent on agriculture: non-commercial smallholders, commercial smallholders in loosely organized value chains and commercial smallholders in tightly organized value chains (**See Box 3**).

Today, agricultural lenders have focused on the most advanced segment: commercial farmers in tightly organized value chains. Yet the vast majority of smallholder farmers are not selling specialty crops to established export markets, demonstrating why there will always be a need for more informal sources of capital.

As smallholder farmers transition from non-commercial subsistence agriculture to small-scale commercial farming, their need for capital and specialized financial products and services generally increases, and their local savings group may no longer meet these evolving needs. In other situations, these organizations will continue to provide the first, last and only source of capital, as millions of individuals will never transition to commercial farming and are limited to informal providers to meet their relatively basic financial needs.

BOX 3

Segmenting Smallholder Farmers

Based on recent research from the Consultative Group to Assist the Poor (CGAP)[6]

NON-COMMERCIAL SMALLHOLDERS

- It is estimated that approximately 60 percent of smallholders are non-commercial subsistence farmers. Subject to frequent food insecurity and disconnected from markets and information, their low input and low output agricultural production is non-mechanized and generally limited to staple crops for home consumption.
- Most non-commercial smallholders are actually net buyers of food. With highly irregular and unpredictable income, their basic financial transactions tend to be too small to interest the formal financial sector. Rather, their need for finance can be met through various informal mechanisms, namely local savings and loan groups.

COMMERCIAL SMALLHOLDERS IN LOOSELY ORGANIZED VALUE CHAINS

- It is estimated that approximately 30 percent of smallholder farmers are commercial farmers in loosely organized, highly fragmented value chains. With access to a wider range of financial services and more land, information and market opportunities, these farmers typically grow a mix of undifferentiated staple crops and some higher-value crops, such as coffee or sugarcane. When possible, they sell surplus production to informal local or regional markets.
- These farmers are often able to conduct financial transactions at a size and frequency that may be attractive to formal financial institutions, including transactions related to the sale of harvest proceeds, loans in support of agricultural production and small consumer loans for personal consumption. Commercial smallholders in loose value chains probably have a higher capacity to save and are relatively more accustomed to saving in some form to get through the periods between harvesting their principal cash crops.

COMMERCIAL SMALLHOLDERS IN TIGHTLY ORGANIZED VALUE CHAINS

- Representing less than 10 percent of all smallholder farmers, commercial farmers selling to organized, interconnected and established value chains derive a significant portion of their income from higher-value crops often sold to export markets; staple crops are grown as well. They usually take a more business-like approach to farming, benefit from contract sales to relatively secure markets, and have access to necessary inputs, information and finance.
- Farmers within this segment are typically attractive customers for lenders. They demand and use a wide range of financial products and services, including working capital loans, equipment leases, long-term loans for capital investments and risk management products, such as weather index-based insurance and area yield-based insurance. Because they have the resources to grow high-value crops and the relationships with traders or buyers, farmers in this segment regularly benefit from value chain finance through contract farming and outgrower models.

Defining Informal Financial Institutions

Those working in the field of agricultural finance are subject to a set of poorly defined and inconsistent terms when it comes to defining various informal, semi-formal and formal lending institutions. For this reason, generalizations are difficult and exceptions are common.

At one end of the spectrum are so-called "formal institutions," including private commercial banks, state-owned banks and several types of non-bank financial institutions. Private equity and venture capital firms could also be included in this group, as could social lenders and impact investors. At the other end of the spectrum are various "informal institutions" that operate at the community or village level and are able to function with greater flexibility in rural areas than commercial banks.

Included in this group are savings and credit cooperatives (SACCOs), rotating savings and credit associations (ROSCAs), accumulated savings and credit associations (ASCAs), and village savings and loans associations (VSLAs), among others.[7] It is these institutions – collectively defined as *community-based financial organizations (CBFOs)* – on which this guide is principally focused.[8]

With some exceptions, CBFOs are informal deposit-taking institutions typically owned and managed by members. They mobilize savings from individuals and provide short-term loans to members and sometimes to non-members at varying interest rates, depending on their structure. In some cases, individuals must first buy a share of the cooperative or association to become a member. Shares can be purchased as a lump sum up front or can be paid in installments, and certain CBFOs may have mandatory deposit requirements and credit limits.

CBFOs obtain funding through entry fees, sales of shares, member deposits and interest paid on loans. Loan products typically offered by CBFOs to clients include short-term loans for production, longer-term loans for asset investments and revolving lines of credit that act as a cushion for daily expenditures.

If these associations require greater liquidity, some types of CBFOs have the ability to obtain external funding, but in practice they are often too weak and unorganized to meet lending requirements, and doing so has often led to their failure.

Informal associations like SACCOs and RASCOs are participatory, responsive to local needs and able to provide financial products and services to low-income, asset-poor individuals who may otherwise be seen as "unbankable." They also contribute to the development of local economies through their unique and strong linkages with the community. For instance, relying on community-based methods for supervising and monitoring borrower activity and repayment as well as using social collateral, in which members guarantee each other's loans, are signature features of these associations.

In certain countries, the percentage of the rural population accessing services through informal financial institutions is two or three times that of those using formal bank providers.[9] Although identifying the precise number of active savings groups is difficult, their reach remains significant, especially in sub-Saharan Africa, where the movement has had its greatest influence.

For example, organizations such as CARE and Catholic Relief Service have long pioneered the savings group approach to financial inclusion, which has since been replicated and scaled by local communities. These two organizations alone have helped establish more than 200,000 groups serving approximately five million members.[10] In Tanzania, a reported 5,424 SACCOs were registered as of early 2012, with more than 1 million members.[11] Similarly, Kenya reported more than 1,600 registered SACCOs with over 2.5 million members in 2012.[12] More broadly, a recent World Bank survey in sub-Saharan Africa found that 34 percent of individuals who saved in the past 12 months used only a community-based institution and not a formal financial institution.[13]

CBFOs are often the most accessible and/or only source of credit for smallholder farmers and rural entrepreneurs. Yet despite their scale and reach, these informal lending groups frequently suffer from challenges that can lead them to the brink of bankruptcy. We highlight two of the most common challenges on the following page.

Weak leadership and insufficient management skills.

Informal financial institutions are often poorly managed and suffer from significant capacity constraints. For instance, savings group leaders may have low levels of financial literacy, particularly regarding the time value of money.

Suitable loan monitoring procedures and proper accounting systems are also scarce. Despite stacks of hard-copy receipts, many CBFOs do not have audited financial records, nor do they have the systems required to manage their portfolios and run a profitable association in the long term.

Additionally, while most groups have "general assembly" and other meetings throughout the year, attendance by members is spotty, and the board often ends up making decisions with little knowledge or buy-in from the general membership. For instance, TechnoServe field staff reported that during a recent SACCO meeting held in Tanzania, only five of 70 members attended. Such situations are frequently the result of inadequate education and training about the roles and responsibilities of SACCO membership. In some cases, members incorrectly assume that their responsibilities end after electing board committees or hiring management. An active, engaged and informed membership is among the most important success factors for CBFOs.

Many groups have also suffered from corrupt governance and leaders who have utilized collective funds for personal gains, thus bankrupting the group, fueling distrust among current members and leaving behind a poor reputation of community lending in the eyes of potential members and creditors.

Constrained resource mobilization and under-capitalization.

Many informal financial institutions are capitalized solely through membership fees and member deposits and are therefore very dependent on an individual's propensity to save; low propensity to save results in low capitalization, and vice versa.

Yet without additional funds, these groups are unable to expand lending to farmers and may not be in a position to offer credit for long-term capital expenditures, such as rehabilitating aging farms or upgrading equipment. Additionally, because the same farmers in the same community generally demand capital at the same time—to purchase inputs at the time of planting or to hire labor at the time of harvesting, for example—the cash flows of informal lending groups can quickly become constrained, even when loan limits are imposed on individual borrowers.

This undercapitalization often leaves members with a shortage of credit when they need it most. And while some CBFOs can increase liquidity by accessing external finance, the use of donor-driven credit has in the past caused more harm than good. The availability of external funds can decrease members' incentive to save, and the funds may not be managed as carefully as members' own deposits. Perhaps most importantly, pouring in external donor financial support to CBFOs dilutes the sense of community ownership and trust that is so essential for the proper functioning of these informal institutions.

It is for these reasons that the provision of capacity building, market linkages and other business development services are critical ingredients in the success and development of informal financial institutions.

Best Practices When Working with Informal Financial Institutions

The following best practices are based on recent projects led by TechnoServe that seek to increase access to finance for smallholder farmers and rural entrepreneurs.

1. First determine the supply and demand for finance within the project location.

The first step in designing methods to fulfill smallholder demands for finance is to actually understand the nature and scale of that demand. In other words, find out what financial products and services smallholder farmers and their families need, keeping in mind their ability and willingness to pay.

Once that information is obtained, it is then necessary to identify and evaluate existing financial service providers and determine if their products adequately meet smallholder demands. When identifying existing services, organizations should pay particular attention to their costs, coverage, accessibility and frequency of provision since the perceptions and reality of offerings can vary dramatically among both users and providers.

It is essential to comprehensively map the financial landscape and ask the difficult questions early on when designing a project to avoid surprises during implementation. For example, a recent TechnoServe project in East Africa changed course after staff realized they had focused too heavily on partnerships with commercial banks and overlooked the important role that rural savings groups could play in providing loans to smallholder fruit producers (**See Box 4**).

2. Assess the needs of existing institutions and provide technical assistance to boost performance.

The provision of capacity building and technical assistance to institutions can lay the groundwork necessary to expand the size of the market addressable by MFIs and/or CBFOs, increase their organizational efficiency and ensure their long-term sustainability.

As discussed earlier, informal financial institutions frequently suffer from poor staff capacity. This includes a limited understanding of accounting and finance as well as inadequate internal management and operational controls, especially in relation to monitoring loan repayment. Support services come in a variety of forms, from high-demand tasks—such as helping to conduct due diligence or offering advice on organizational bylaws—to simple tasks, such as providing training on Microsoft Excel or designing template documents for loan applications.

When supporting MFIs and CBFOs, it is critical to maintain a participatory process. The success of informal institutions is dependent on mutual trust and community cohesion, so MFI staff or CBFO leaders must buy into the effort, take leadership in developing policies and procedures, and make their own decisions on issues like minimum savings amounts, interest rates and loan repayment terms.

That said, there are several resources available to help these institutions and their technical assistance providers in designing financial management policies, procedures and controls. For example, the World Council on Credit Unions has established helpful guidance for savings institutions in the form of more than 40 quantitative ratios that evaluate the financial health of an organization against average benchmarks.[14] Incorporating these or similar metrics into transparent, up-to-date and shareable dashboards becomes a key lever for strengthening internal capacities, encouraging good governance and improving overall management performance among CBFOs.

BOX 4

Project Nurture: Securing Smallholder Finance through SACCOs

In 2010, TechnoServe received a four-year grant from the Bill & Melinda Gates Foundation and The Coca-Cola Company to help mango and passion fruit farmers in Kenya and Uganda double their fruit incomes. The initiative, known as Project Nurture, aims to improve the lives of 50,000 smallholder farmers by increasing the productivity and quality of their crops, developing and strengthening farmer business groups, and linking farmers to local and international markets.

TechnoServe recognized at the outset that improving credit access for smallholders would be essential to the project's success since establishing passion fruit orchards is significantly more capital-intensive than growing mangoes. For instance, farmers require capital to fund upfront costs (e.g., seeds, potting materials, fertilizer and trellis structures to support vines), purchase crop protection inputs and hire additional labor. Together, these costs typically amount to $400.

In Uganda, TechnoServe established a relationship with Centenary Bank, one of the country's main commercial banks. Backed by a memorandum of understanding and a $100,000 cash guarantee from TechnoServe, Centenary Bank began issuing small loans to passion fruit farmers participating in Project Nurture, with a fixed annual interest rate of 22 percent, compared to a market rate of 29 percent. In Kenya, TechnoServe negotiated a similar agreement with Equity Bank and offered a $200,000 cash guarantee. Equity Bank lent to smallholders at a reduced annual interest rate of 13 percent, compared to the 17 percent market rate. Throughout the project, TechnoServe's business advisors also worked closely with local champions in Centenary and Equity branch offices, sharing information about the production and marketing of passion fruit, such as detailed profit and loss projections.

BOX 4 (Continued)

Project Nurture: Securing Smallholder Finance Through SACCOs

Over the course of two years, though, only 187 of approximately 2,000 Ugandan passion fruit farmers obtained a loan from Centenary Bank, while only 208 of approximately 6,000 passion fruit farmers in Kenya received credit from Equity Bank. Total disbursements in both countries reached $145,920, falling short of expectations.

Farmers reported that collateral requirements for Centenary and Equity were simply too onerous, and the banks did not offer a grace period prior to the start of loan repayments. Women were at a particular disadvantage when attempting to access credit due to their lack of property rights that would otherwise be used as collateral. Because of this, most farmers bypassed partner banks entirely and instead viewed local SACCOs as more convenient sources of capital; although these informal institutions did not require any collateral, annual interest rates were often higher (e.g., 36 percent in Uganda).

Realizing the central role that SACCOs were playing in helping Project Nurture farmers access credit, TechnoServe shifted its strategy and begin working more directly with informal financial groups. In Uganda, for instance, TechnoServe business advisors helped farmers establish new SACCOs and worked with district-level government staff to make sure these new groups were registered, a requirement under Ugandan law. Today, more than 2,200 passion fruit farmers are accessing credit from approximately 50 local SACCOs throughout Uganda and Kenya. Some farmers have borrowed from these SACCOs multiple times and have been able to diversify their production.

In retrospect, deciding to partner exclusively with commercial banks caused the project team to unintentionally ignore and potentially undermine the role that SACCOs play in providing rural finance. The overall effectiveness of loan guarantee funds was also questionable. These funds were intended to hedge against the risks of investing in a new and unfamiliar crop for which both farmers and the banks had limited experience. To some extent, however, this assumption proved untrue; the guarantee funds were not enough of an incentive for either Centenary or Equity to expand lending and reduce collateral requirements.

3. Engage early and at all levels.

When development organizations and other facilitators decide to partner with existing informal financial institutions, particularly MFIs and large-scale SACOOs, it is critical that they involve them early on, including during the proposal development phase. Discuss from the beginning which organization will be responsible for what actions and identify appropriate communication and decision-making channels, especially in cases of non-payment.

In the case of MFIs, building relationships across the entire organization and at all levels is also essential. Typically, processes between senior leaders at the headquarters and managers and loan officers at branch offices are weak and can break down on a daily basis. For example, when brokering a partnership with a local MFI in Haiti, TechnoServe started at the top: It obtained the buy-in and necessary backing of the MFI's general director before establishing relationships with day-to-day contacts at the regional branch level (**See Box 5**).

4. Educate members, clients and the community.

In addition to building the capacity of management, it is important to educate members and clients about the benefits and risks of informal savings and lending. CBFOs are cooperatively run, and like all cooperatives, it is essential to have an informed and active membership so that they can effectively contribute to the organization's growth and success while also demanding transparency.

Because awareness of informal financial institutions is very low in some countries or there is a significant lack of trust, it is also important to sensitize the broader community to attempt to overcome what are often deeply held negative views of MFIs and SACCOs, including real or perceived concerns over corruption and poor governance. Effective sensitization may also result in a greater savings mobilization that will lead to the growth of the CBFO.

5. Empower loan officers with knowledge of farming systems and agricultural markets.

Among the most important steps an informal financial institution can take to build their capacity, reduce the likelihood of clients defaulting on loans and avoid their own insolvency is working to fully understand the complexities of farming systems and agricultural markets.

Given the level of agricultural risk these informal lending institutions face, sectoral knowledge is paramount. This involves understanding the specific agricultural crop, production cycle, actual and attainable yields, cost of production and marketability of products.

Such knowledge can be achieved by having an outside organization train loan officers or SACCO leadership, or by having paid or volunteer agronomists involved in loan origination and monitoring. Ideally, institutions should build teams that combine experts in agricultural and livestock markets with financial specialists. Having staff who are aware of the market in which their clients operate, regardless of how informal it may be, leads to better engagement with and monitoring of the agricultural households they serve.

BOX 5

Unlocking Finance for Smallholder Mango Farmers in Haiti

In 2010, TechnoServe and its partners launched the Haiti Hope Project. Haiti Hope aims to double the mango incomes of 25,000 Haitian farmers after five years of participating in the project. Achieving this goal will raise the standard of living for beneficiary farmers and contribute to the long-term development and revitalization of the country. The Haiti Hope Project is a public-private partnership comprised of The Coca-Cola Company; the Multilateral Investment Fund (MIF), a member of the Inter-American Development Bank Group (IDB); the U.S. Agency for International Development (USAID); and TechnoServe. The project is also supported by the Clinton Bush Haiti Fund, the Soros Economic Development Fund, and other international and local organizations.

Bringing together public and private sector actors, TechnoServe is also helping to unlock finance for smallholder farmers who are excluded from the country's financial system. To address the financial needs of farmers before and during the mango harvest, TechnoServe conducted a comprehensive review to determine possibilities for farmers to access short-term loans. But most financial service providers in Haiti have a limited rural presence, and very few have dedicated knowledge of agriculture-based cash flows.

Recognizing the limited risk appetite among Haitian banks, TechnoServe negotiated a loan guarantee of $230,000 from the Clinton Bush Haiti Fund to encourage lending. With this guarantee in place, TechnoServe then mapped potential financial service providers throughout the country. Sogesol, a local microfinance institution, agreed to implement a short-term loan program and test the agricultural lending market.

BOX 5 (Continued)

Unlocking Finance for Smallholder Mango Farmers in Haiti

In designing a tailored loan product with Sogesol, TechnoServe consulted the leadership of farmer business groups in two rural locations. These group leaders provided input on the terms of the loans and helped identify 125 farmers to participate in pilot programs. Together with Sogesol, TechnoServe project team spent nearly two years adjusting the structure and delivery of the credit product, named "Agripro."

The loans are designed to be a good business decision for both the farmer and Sogesol. They range in amounts from $50 to $125 and are repaid in four months at an interest rate of 2.5 percent a month, plus a 3 percent commission – the lowest rate in the market for loans of this type. After repaying the original $50 loans, farmers are then eligible to borrow at higher amounts. With three four-month lending cycles, farmers are able to establish credit history and build a relationship with Sogesol by the end of the first year, thus helping to ensure long-term and sustainable borrowing opportunities in the future. TechnoServe also encouraged farmer business groups to form credit committees to encourage their members to repay and establish a relationship between the farmer business group and Sogesol.

When TechnoServe began working with Sogesol in 2011, the MFI lacked resources and experience for working in rural areas. TechnoServe initially provided transport and logistics support, organized farmers to meet with loan agents, and provided extensive support to Sogesol staff to help manage the planning and coordination of due diligence interviews, disbursements, and reimbursements. The project also helped ensure the consistency of information provided across Haiti by the loan agents, and has provided training to farmers on management of credit and income generating activities.

Sogesol has now extended loans worth more than $1.4 million to approximately 8,000 farmers, and 96 percent of borrowers have fulfilled their obligations to repay their loans, significantly higher than their overall portfolio. Additionally, because lending to smallholders has been validated by high repayment rates and constant demand, Sogesol has committed to continue financing smallholders. Since 2013, Sogesol has managed its own logistics thanks to investments in vehicles, and taken increasing responsibility for planning and coordination by hiring a dedicated agricultural loan manager and credit officers. In 2014 Sogesol agreed to phase out the guarantee facility while continuing to integrate new borrowers. As a result of its experience with Haiti Hope, it has created a mainstream agricultural loan product for when farmers successfully cycle out of the existing loan.

6. Embed financial literacy training for smallholder farmers within SACCO and MFI networks.

Regardless of which form it takes, credit makes sense only when a certain amount of predictable income and viable commercial activity are present.

In many cases, the provision of credit may not necessarily be the optimal first step in supporting a smallholder farmer. For example, TechnoServe learned that merely discussing the option of loans was not enough, and it was clear that farmers struggled with concepts like forecasting farm revenue and determining what size loan they should take.

Therefore, informal financial institutions, or organizations partnering with them, should leverage their networks of smallholder farmers to deliver financial literacy training. In rural communities, savings groups and other informal institutions can be very effective vehicles for promoting financial literacy, thus fostering a savings culture and helping smallholders, especially women, achieve a level of financial independence. This must be the first step for farmers seeking to acquire credit.

For the past two years, TechnoServe has worked with informal lenders to deliver simulation-based financial literacy training called "Farming as a Business" to smallholder farmers who are just beginning to commercialize. Delivered through nine different four-hour modules, the goal of the training is to teach farmers and entrepreneurs to keep financial records and enable them to use these records to make informed business decisions (**See Box 6**). For instance, curriculum on quantifying yield, calculating sales and profit, and understanding price formation allows farmers to determine the breakeven points necessary to cover costs.

These lessons are followed by more advanced topics, such as crafting budgets and business plans, modeling cash flows, understanding the value of savings, and identifying borrowing needs and appropriate loan options.

7. Document and track informal loan repayment history to demonstrate creditworthiness.

By building a history of prompt loan repayment, farmers and farmer groups can improve their overall creditworthiness and send a positive signal to commercial lenders. In this way, loan repayment records serve as a tool to help smallholders transition from informal to formal banking, if they choose to do so and if formal lending opportunities are available.

This is an often overlooked yet incredibly beneficial aspect of informal lending activities. For smallholder farmers, a positive track record may result in lower interest rates and reduced collateral requirements. Yet for this to work, informal financial institutions must build and maintain accurate and transparent recordkeeping systems. They must also work with commercial lenders to establish stronger communication and information -sharing channels

BOX 6

Farming as a Business Series Curriculum

MODULE 1
Intro to Farming as a Business

MODULE 2
Farm Production

MODULE 3
Sales & Marketing

MODULE 4
Farm Profitability

MODULE 5
Farm Finances

MODULE 6
Household Decision Making

MODULE 7
Farm Budgeting

MODULE 8
Savings & Loans

MODULE 9
Farm Planning

8. When working with MFIs, location matters.

Unlike community-based financial organizations, which are almost always located in the heart of rural villages, MFIs have traditionally located themselves in urban areas. Because of this, they often fail to understand and navigate social constructs in rural settings.

For example, in designing a program in Latin America, TechnoServe staff heard from one MFI that they wanted their "rural" loan program to be within 30 minutes of the regional capital office; this misses the point and essentially creates another urban loan program.

Despite a small batch of success stories, MFIs have a long way to go in understanding how to work outside of cities. Organizations seeking to work with MFIs need to be highly selective when deciding which institution to partner with. The bottom line is that to serve rural clients, it is essential for MFIs to employ staff in rural locations.

9. Think long-term and commit time and resources.

Fundamentally, working with informal financial institutions and MFIs demands significant time and resources. Organizations funding and delivering technical assistance and capacity building must think in terms of years. For instance, in Haiti, TechnoServe provided Sogesol with 100 percent of its transportation needs during the first two years of the Haiti Hope Project (**See Box 5**). Without this, its staff would have been unable to travel to rural villages. Over time, Sogesol has invested in expanding its own fleet of vehicles, yet the organization still struggles to build a rural network of loan officers.

TechnoServe also has learned that it is essential to assign a full-time position whenever possible to coordinating and managing financial service partners from the beginning of a project. This liaison must have the knowledge, bandwidth and patience to provide extensive daily support to the partner for a wide variety of projects, including some mundane tasks such as checking and rechecking loan repayment information.

10. But not too long-term; design a clear, realistic and responsible exit strategy.

Equally important is designing a clear exit from providing technical assistance and capacity building. Benchmarks and timelines should be established and agreed upon at the start of the project in order for the CBFO or MFI to gradually assume responsibility. At the start of a project or partnership, it is important for both parties to identifying which support services are “one-off” measures, and which will be needed on an ongoing basis.

11. Refine and improve delivery channels.

In rural communities dispersed across remote regions, the logistical barriers to accessing financial products and services are considerable. Because of this, it is important for donors, governments and NGOs to support financial institutions to innovate and adapt their delivery models to reduce transaction costs.

This can involve simple fixes, such as having farmers apply for, receive and reimburse loans on the same days and at the same location. Or it can mean introducing mobile banking units that go directly to clients rather than requiring clients to travel. It can also involve mobile information systems: using mobile phones to issue loan disbursements and monitor repayment, for example.

For example, since rural Kenyan farmers participating in the East Africa Dairy Development program were deemed too risky to receive commercial loans, several village-based dairy farmer business associations created their own village banks. Monthly pay is deposited into accounts, where members can access cash and apply for loans that are borrowed against their monthly milk income (**See Box 7**).

BOX 7

EADD: Integrating Savings and Lending into Rural Milk Collection Hubs

Funded by the Bill & Melinda Gates Foundation and implemented through a partnership between TechnoServe and Heifer International, the East Africa Dairy Development (EADD) program aims to strengthen the overall dairy sub-sector and double the dairy-related incomes of 179,000 smallholder farming families in Kenya, Uganda and Rwanda. The program is reaching this goal by improving livestock health to increase milk production, organizing farmers into business collectives and expanding market access.

Prior to EADD, dairy farmers were fragmented, unorganized and had weak bargaining power, often selling milk at below-market value to informal traders. Farmers also lacked access to information on animal husbandry, markets and prices, and banks perceived them as too risky for loans. To overcome these challenges, EADD helped farmers establish "dairy farmer business associations" (DFBAs) to ensure better payment terms by aggregating their production through a sophisticated milk reception method.

Each DFBA has approximately 2,000 members and functions as a cooperative, whereby farmers purchase shares and become owners of the dairy business, earning dividends based on milk sales. However, not all cooperatives pay dividends. Every morning, farmers deliver fresh milk at the nearest collection center. After the milk is tested for quality, farmers receive a receipt indicating the liters they have delivered that day and their cumulative deliveries for the month. The receipt also indicates veterinary and other services recently used by the member, the costs of which are later deducted from their monthly payments under a "checkoff" system. A small fee is also subtracted from their payment in order to pay off the DFBA loans.

Because commercial banks viewed individual farmers as too risky, 24 DFBAs created their own village banks for members. And since their members' pay is deposited into savings accounts before being issued at the end of the month, members can use the checkoff system as collateral to apply for loans. To support their efforts, TechnoServe assisted DFBAs in conducting feasibility analyses, developing their business plans, recruiting and training staff, and building performance monitoring systems.

For example, Lelan Dairy Company, an EADD partner cooperative in western Kenya, started an informal savings and credit service for its dairy farmers, known as Lelan Financial Services. Because it was the only provider of savings and loans in the area, it soon began registering members who were not part of Lelan's dairy cooperative, including teachers who wanted their salaries to be sent there. Today, Lelan Financial Services has nearly 600 savings accounts, with women holding 45 percent, and a $70,000 loan book.

BOX 7 (Continued)

EADD: Integrating Savings and Lending into Rural Milk Collection Hubs

Since EADD commenced in 2008, the project has set up and strengthened 81 dairy farmer business associations, with more than 195,000 members across all three countries. Many of the pre-existing DFBAs have secured subsequent financing on fully commercial terms to fund business expansion and diversification.

The project demonstrates how informal financial services can be integrated into value chain structures, and how they can also serve as an interim stepping-stone to accessing commercial loans and more sophisticated financial products. To date, EADD farmers have earned more than $113 million for their milk deliveries. Average milk intake at the collection centers has increased from 529,000 liters per month to 3 million liters per month. Today, farmers are earning an average of $0.30 per liter, whereas the average before EADD was $0.20.

Following the successful completion of the pilot phase in October 2013, the second phase of the project, which also includes Tanzania, commenced in November 2013 and is expected to end in 2018.

BOX 8

STRYDE: Entrepreneurial Finance for Rural Youth in Northern Uganda

Partnering with The MasterCard Foundation, TechnoServe launched the Strengthening Rural Youth Development through Enterprise (STRYDE) program in 2012. The program is designed to enable 15,000 rural youth ages 18 to 30 in Kenya, Uganda and Rwanda to have a more successful transition into economically independent adulthood and increase their opportunity, ability and motivation to engage in income-generating activities. In its first two years, STRYDE has graduated 4,600 trainees, who have created more than 1,200 new businesses and secured more than 800 jobs.

In Northern Uganda, 1,700 youth received training on how to access finance to start or expand their ventures. As always, the ability of these entrepreneurs to access credit depends on the availability of collateral. And for rural youth, the vast majority of whom are unemployed and lack stable incomes, collateral is nonexistent.

To overcome these challenges, TechnoServe altered its approach from negotiating linkages with formal banks to focusing on helping youth create new savings groups and take part in existing groups. STRYDE training was fine-tuned to emphasize group coherence, trust and organization through various learning modules.

Establishing New Saving Groups

A group of 17 STRYDE participants from the Atem Ki Koma Youth Group in northern Uganda organized themselves to form a saving club, known locally as a “Bolicup.” Over time, individuals qualified to borrow against the collective savings, with pooled liability among the group, to establish small-scale trading businesses. They also developed a constitution and appointed a leader who is responsible for approving loans. All members are eligible to save and borrow, although lending amounts depend on an individual's contribution to the fund.

Within the first year, they had collective savings of UGX 3,550,650 ($1,400). By comparison, the average annual income of youth in northern Uganda applying to a government conditional cash transfer program in 2008 was approximately $200, meaning that if all 17 youth contributed equal amounts to the Bolicup, they would have each saved 40 percent of their income.[15] TechnoServe also connected these youth with more established savings groups in the community so that they could receive training and establish similar systems.

Because of the flexibility of group savings and lending, TechnoServe has seen increased inclusion of women in the Bolicup. For instance, Labol Lilly sells vegetables in Laliya Market in Bungatira Village in Uganda’s Gulu District. After repaying a loan to an MFI, she started borrowing from the Bolicup immediately after her STRYDE training, borrowing $60 against her savings of $20. In August 2013, she took out another loan of $80 against her savings of $70, without needing to provide collateral or involve her husband.

Graduating to Existing SACCOs

Following the creation of Bolicup, TechnoServe’s STRYDE youth trainer established links to other area savings groups, including the Bungatira Farmers Savings and Credit Cooperative. As STRYDE participants grow their businesses and require more substantial loans, they have joined Bungatira, through which they are able to access credit as individuals and as a STRYDE youth group. For example, several members of Atem Ki Koma Youth Group have been able to save and borrow from Bungatira: A STRYDE participant named Betty Acca was able to borrow $800 for her restaurant and another participant named Lakuc Geoffrey borrowed $400 for a mushroom growing project. Another nearby youth group has also been able to save $600 with Bungatira.

The experience of STRYDE in northern Uganda highlights how some of the most vulnerable segments of society—and those without any collateral or credit history—can leverage community savings and lending to launch and grow their own rural businesses in the absence of formal finance.

Conclusion

When considering the growing interest around engaging the private sector in designing and delivering financial solutions for rural smallholders, paying more attention to informal institutions may seem like taking a step backwards.

In fact, there is often a strong bias against working with informal providers due to perceptions that they are inferior in terms of efficiency, sustainability and reliability. How does working with a 35-member SACCO in a rural village bring about systemic change to close supply/demand gaps in agricultural markets?

Although informal financial institutions certainly have challenges, we have seen that they also play a vital role in helping smallholders access finance. In some cases, informal providers may serve as a stepping-stone or bridge for smallholders to eventually graduate to more commercial financing. For example, youth entrepreneurs taking part in TechnoServe's STRYDE program are building a valuable history of savings and loan repayment (**See Box 8**); in the future, this information could be used to help them access products and services from commercial financial institutions.

Overlooking or circumventing SACCOs and similar groups entirely in favor of commercial banks can exclude the vast majority of smallholders and may derail a project. And despite the best efforts of such commercial banks to expand lending to the agricultural sector, their reach will always remain limited. There will always be a need for informal institutions to serve the hardest-to-reach and least-organized farmers.

It is also important to take a holistic view of the financial services and products that smallholder farmers and rural communities demand. Access to credit is a necessary condition for agricultural growth and development, but it is not sufficient. A 2008 article in the Stanford Social Innovation Review accurately notes that few financial service providers help their clients use credit to create and grow successful businesses.[16] While loan repayment is important, ending poverty does not depend on repaying one's loans; it depends on creating a profitable enterprise and generating wealth.

For a smallholder farmer, this can be done by making improvements in productive assets, such as land restoration; obtaining and properly applying inputs; expanding and diversifying production; and establishing sustainable trading relationships to market their crops and livestock and generate income.

Therefore, parallel efforts are also needed in providing technical assistance, financial literacy training and various other business development services that are typically beyond the mandate of formal and informal financial institutions, whose resources are already stretched.

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