ACCESS TO FINANCE IN AGRIBUSINESS PARTNERSHIPS

Insights from 2SCALE

Thematic Paper

2SCALE Consortium

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The Netherlands-funded 2SCALE program aims to promote inclusive agribusiness and ultimately to improve rural livelihoods and food and nutrition security. To do this, the program is designed as an agribusiness incubator, working with smallholder farmers, private enterprises, and other partners in nine countries across sub-Saharan Africa.

2SCALE offers various types of support to private companies and farmer groups, enabling them to produce and sell quality food products to local, national, and regional markets, and particularly to low-income consumers. Project support includes technology transfer, capacity strengthening, and market linkages, as well as other key elements such as improving access to finance – vital, but often sorely lacking in the smallholder sector.

This document aims to share the successes and lessons learned from 2SCALE's efforts to improve access to finance. It describes the project's approach, its the emphasis on financial inclusion, case studies, and lessons that could be applied by other development projects.

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ACRONYMS

2SCALE	Toward Sustainable Clusters in Agribusiness Through Learning in Entrepreneurship
A2F	Access to Finance
BoPInc	Base of the Pyramid Innovation Center
CSLA	Community Savings and Loan Association
FCMB	First City Monument Bank
ICRA	International Centre for development oriented Research in Agriculture
ICT	Information and Communication Technology
IFDC	International Fertilizer Development Center
MADFA	Masindi District Farmers Association
NGO	Non-Governmental Organization
PO	Producer Organization
ROSCA	Rotating Savings and Credit Association
SACCO	Savings and Credit Cooperative
SME	Small and Medium Enterprise
ToT	Training of Trainers
UN	United Nations
VSLA	Village Savings and Loan Association

1 INTRODUCTION

A2F enables smallholder farmers to invest in crop protection and farm inputs to improve yield and quality and helps them integrate into commercial markets.

Access to finance (A2F) is critical for any agribusiness, whether a farm or small company.

Access to finance helps businesses grow.

- A2F enables small farmers and entrepreneurs to expand their existing operations or create new ones, and thus escape the vicious cycle of low input, low output.
- Finance allows "upstream" companies to increase capacity: input manufacturers can offer more or higher quality products, and service providers can upgrade the range and quality of support they offer to farmers.
- Finance allows "downstream" companies to increase processing capacity, purchase larger volumes from farmers, and offer better value to consumers.

Access to finance can make value chains more efficient.

- Improved A2F can bring value chain actors together to align their investments, improve coordination, and increase profits. This, in turn, will accumulate savings, part of which can be re-invested for further growth.

Access to finance for weaker groups (financial inclusion) creates a multiplier effect.

- A2F both requires and strengthens financial literacy. Financial literacy (an important part of 2SCALE's capacity building program) not only empowers poor households financially, it also allows them to make better choices on household finances and nutrition.

The United Nations Secretary-General's Special Advocate for Inclusive Finance for Development has provided a broad base of evidence asserting that access to financial services increases agricultural productivity and food and nutrition security in several ways (CGAP, 2016). Access to credit increases the likelihood that farmers will invest in productivity-enhancing measures, such as buying quality inputs and hiring labor. Higher productivity leads to improved access to food, and higher return on investment enhances household food consumption. The study also discusses insurance, which emboldens farmers to make additional and longer term (potentially risky) investments, and saving mechanisms/services, which increase farmers' capacity to bridge financing gaps and make larger investments.

Despite these obvious benefits, only 8% of adults in rural areas in developing countries have borrowed from formal financial institutions, and only 48% have bank accounts (World Bank, 2014). All sources of finance, together, provide only 20% of the $33 billion needed for smallholder borrowing in sub-Saharan Africa (Rural and Agricultural Finance Learning Lab, 2016).

To improve financial literacy and access to finance, a number of challenges must be overcome:

- Smallholder farmers incur most of their operational expenses (labor for land preparation, seed, fertilizer, etc.) before sowing, but they earn most of their income at harvest. After harvest, farmers must provide for consumption and urgent needs, substantially reducing the money available to prepare for the next growing season. Most smallholder farmers, living at the edge of survival, find it hard to manage cash flows; **financial gaps** are the rule, not the exception. How can we bridge the gap between required investment and available income (at the required moment)? Can we facilitate tailor-made financial products and solutions?
- Financial institutions see farming as a **risky business** (volatile markets, crop failures, drought risk, etc.), and farmers tend to lack assets that can serve as collateral. The same situation exists for most small and medium enterprises (SMEs) that work with these farmers. How can we reduce the perceived riskiness of rural/agricultural financing?

- Financial institutions bear **high transaction costs** of screening/due diligence and of implementing and monitoring numerous (small) loans with farmers who are often located in remote or scattered locations. Working with groups of farmers, rather than individuals, can reduce these costs, but this approach has its own challenges. What can we do to reduce transaction costs and support financial institutions to engage efficiently and more sustainably with larger numbers of smallholder farmers and local agri-enterprises?
- Many smallholder farmers are not literate, let alone financially literate. How can we improve this situation without putting excessive program resources into grassroots education on **financial literacy**?
- Companies that source produce from smallholder farmers would like the farmers to invest more in equipment, agro-inputs, and labor, to produce more or better-quality produce, and/or to smoothen supply over the year. However, most of these companies are unwilling or unable to provide the necessary funding. How can these **companies be supportive** in increasing access to finance for farmers, without becoming financiers themselves, or bearing too much of the related costs and risks?
- Slowly but steadily, more micro-insurance products are being offered in 2SCALE countries, and farmers increasingly have access to these services. Most farmers, however, are not willing to pay the premium for insurance because they do not see the direct benefit. Similarly, high premiums and ambiguously defined policies (what risks are really insured and how much will be paid) may also explain smallholder farmers' reluctance. Are there ways to **improve insurance services** for smallholder farmers, for instance, by tying insurance to loans for specific agro-inputs and the risks related to their use?
- **Lack of information:** Banks do not have the capacity to truly understand each and every smallholder farmer or local SME. They may have some understanding of the industries and markets in which they operate, but they often have limited insight into farming systems, production and processing cycles, and related financial needs. On the other hand, farmers lack awareness of bank products and procedures. They lack knowledge about the meaning, usefulness, or mechanics of saving and loan products, insurance services, and money transfers.
- Lack of understanding may also lead to **unfit loan terms and conditions** and, if a loan is approved, to ineffective disbursement. It also affects loan monitoring by the financial institution and can therefore result in high default risk.
- Financial service providers are sometimes unwilling or unable to develop tailor-made financial products for special groups (e.g., women and youth). The traditional procedures and complex steps used by many financial service providers tend to discourage or even disqualify the intended beneficiaries.
- Stringent, uncoordinated, and constantly changing government policies and other constraining regulations for agribusiness have hampered access to finance. Subsidies, withdrawal of subsidies, protection from or exposure to external markets – these and other policy changes have left farmers vulnerable and risk-averse.

This document describes how these and other questions have been progressively addressed by 2SCALE. Key concepts of A2F in agricultural value chains are reviewed in Chapter 2. Chapter 3 describes 2SCALE's approach and methodology to mainstreaming A2F in its interventions. Chapter 4 provides examples of A2F activities at the cluster and value chain levels, selected from 2SCALE partnerships. Building on previous sections, Chapter 5 includes recommendations and lessons learned with an emphasis on next steps and, in particular, how to further develop and expand A2F interventions in agricultural value chains.

Financial training has helped strengthen producer groups; more than 3,000 farmers have received small loans, mostly for input purchases.

A2F IN AGRICULTURAL VALUE CHAINS: KEY CONCEPTS

2.1 What is Financial Inclusion?

The term "financial inclusion" has gained importance since the 2000s. There is no clear-cut definition of the term. Financial inclusion often relates to microfinance but also involves a range of other products and services. In this paper, we consider financial inclusion as the delivery and effective use of a full range of formal financial services at affordable costs to all bankable households, including the disadvantaged and low-income segments of society. This is based on definitions from the Alliance for Financial Inclusion and the Global Partnership for Financial Inclusion.

Financial inclusion of smallholder farmers and agribusiness SMEs requires not only a thorough understanding of the dynamics of the agriculture sector and the particular value chain but also their specific circumstances, capabilities, and financial needs.

2.2 Understanding the Financial Needs of Smallholder Farmers and Agribusiness SMEs

As with any other business, the financial needs of a smallholder farmer are specific to the characteristics of the farming system and the target commodity. Seasonality and the general context (ecosystem, location, value chain) play important roles. Because smallholder farmers usually have to pay their operational expenses before sowing and do not earn income until after harvest, they often experience a financial gap at the time when investment is needed, particularly if they had to spend money during the off-season, i.e., the period between harvest and the next sowing. Financing needs arise when anticipated income (and cash flows as a result of expenditures on consumption and non-farm activities) does not match planned outlays for farming. For smallholder farmers, even small amounts of cash required to buy seeds and other inputs may constitute a challenge because these expenses must be met at a specific time, during a period when money is scarce.

The crop cycle (and hence the investment cycle) depends on the commodity and the ecosystem. Pineapples, for instance, take about 18 months to mature; the farmer will get no income from his investments during that time. A starting dairy farmer may even have to wait a few years before her cows begin to yield milk. Staple crops maize, sorghum, or millet take three to four months to grow and are produced only once a year unless the farmer has irrigation or there are two rainy seasons. High-value, irrigated crops can be grown in multiple cycles within one year. It is important to differentiate between two kinds of financing needs: working capital (operational expenditures for one production cycle) and investments such as equipment or infrastructure (irrigation kits, stables, etc.) where the benefits accrue over a number of years. Understanding these specificities is crucial to quantify farmers' financial needs and to develop appropriate financial products and delivery channels.

Similarly for SMEs, financial needs are often linked to working capital (to buy raw materials, hire labor, pay for transport and other services) and investment capital to buy equipment for value addition, such as processing, packaging, etc. Also, the seasonality of the agriculture sector and the dynamic nature of the agri-food industry determine the financial needs of SMEs.

2.3 Why Are Financial Institutions Reluctant to Serve Farmers?

To promote inclusive business, we need to overcome the most critical financial gaps of bankable rural households and SMEs in our partnerships. This cannot be achieved without the involvement of formal financial institutions; this is why financial inclusion specifically targets the delivery of formal financial services to poor and disadvantaged segments of society. According to research by the Rural and Agricultural Finance Learning Lab (2016), formal financial institutions need to double their projected annual growth rates (from 7% to 14%) in lending to smallholder farmers in order to meet half the need for smallholder finance by 2025. However, financial institutions face a number of challenges that limit their capacity to increase lending at the required pace (IFC, 2013; IFC, 2015; Dalberg Global Development Advisors, 2012). These include the following:

- Key constraints are lack of familiarity with the needs of the agriculture sector (and smallholder farmers in particular) and lack of tailored products and processes to respond to these needs. The agriculture sector is very diverse, and understanding the patterns and risks in different value chains and farming systems requires an investment that few financial institutions are willing to make. This lack of understanding leads to a high perceived risk, often higher than reality warrants.
- Low population density in rural areas and the small size of most financial transactions lead to high transaction costs. Innovations in mobile banking and IT platforms can substantially reduce transaction costs, but these innovations come at a cost and appear to be less relevant for other financial services, such as savings and insurance.
- Few farmers can pledge the required collateral to access loans. Most financial institutions (particularly banks) have difficulty working without collateral. The alternative offered by microfinance institutions – peer pressure through group lending – while practical in some instances, has a number of limitations.
- Many SMEs, particularly small or local enterprises, have a low level of (formal) organization and are therefore unable to meet the bank's requirements.

2.4 The Importance of Financial Literacy

Smallholder farmers have little or no financial buffer. Any cash shortfall can have a major impact on household welfare and on potential future income. Most smallholders have limited experience with managing their finances and do not keep detailed financial records, making it harder to access formal financial services. Farmers unskilled in keeping records and planning expenses are risky clients. Limited financial literacy reduces their capacity to repay or to follow the terms and conditions of a loan. It increases the risk that loans are mismanaged, i.e., not properly used, and may lead to multiple borrowing and over-indebtedness.

This highlights the danger of promoting A2F without fostering some understanding of saving and loan products. Financial literacy is therefore a critical aspect of capacity strengthening for farmers and enterprises (even for small financial institutions). We should aim to ensure that loan applicants are able to manage their business efficiently, increase savings to invest and have a buffer, and use credit productively. Also, if farmers are able to demonstrate basic financial skills, such as record keeping, lenders are more likely to consider them as "bankable."

2.5 The Paradox of Informal Lending

Because smallholders find it difficult to borrow from financial institutions, they often rely on informal financing, borrowing from family, friends, neighbors, or informal money lenders. This type of financing is usually more easily available than formal lending and has much lower thresholds and less need for formal contracts. One would therefore expect informal lending to be smallholder farmers' preferred method, but it is often not. Informal finance carries heavy costs, such as the "social" costs of borrowing from family or friends and the high financial costs of borrowing from informal money lenders.

There are other challenges as well. Informal lending is often only a short-term solution (informal lenders want a quick return on their money) that does not match the seasonality of a farmer's needs. Also, the loan amount is often too low to cover the full requirement.

2.6 Strengths and Limitations of Semi-Formal Finance Solutions

Semi-formal financial providers are becoming increasingly common in Africa. Examples include

A start-up dairy farmer must wait several years before reaching profitability; finance can help bridge cash flow gaps.

Village Savings and Loan Associations (VSLAs), Community Savings and Loan Associations (CSLAs), and Rotating Savings and Credit Associations (ROSCAs). Essentially, these are groups of around 25-30 farmers who save together on a weekly or fortnightly basis and take small loans against their savings. The activities of the group often run in cycles; at the end of a cycle, the accumulated savings and the loan profits are distributed back to members. The purpose is to provide simple, easily accessible savings and loan facilities in communities that do not have easy access to formal financial services. This often serves as an alternative to inaccessible formal lending and the high costs of informal loans.

However, semi-formal services have limitations. They only provide a basic credit and savings approach, without interest (at least no interest on the savings), rarely offer long-term loans, which farmers need for equipment, and are unable to accommodate larger loans because they function in closed environments, operating only with the limited money available within the group at any one time. However, the presence or creation of such financing alternatives paves the way for access to more formal financial services. These groups can be connected to formal institutions, improving financial inclusion. Lending risks are reduced because the group's funds are leveraged; this allows the formal lender to offer loans at lower interest.

2.7 Financial Inclusion – More than Access to Credit

Much of the discussion on financial inclusion revolves around getting access to credit: what type of credit or loan would someone need and what are the conditions for that loan. However, in addition to access to credit, many smallholder farmers and local SMEs benefit significantly from access to other financial and non-financial services. These are services that help mitigate risks and reduce transaction costs, not only for the farmers or SMEs that buy and make use of these financial services, but also for financial institutions.

There is a difference between financial and non-financial services within the broader goal of financial inclusion.

Financial services

- Savings accounts can help households put aside money for large farm and non-farm expenses as well as regular household expenses and emergencies. Savings – and capitalization strategies to maximize savings for business use – are critical to optimize (i.e., limit) demand for financial services, particularly when interest rates are high, to demonstrate bankability, and to manage risks.
- Different types of insurance (e.g., health, agriculture) can help farmers protect their farm investments or overcome unexpected shocks such as drought or crop failure. Research on micro-insurance has found positive impacts on investment in inputs, household income, and household resilience to health-related consumption shocks (Initiative for Smallholder Finance, 2016).

Non-financial services

- Digital services, such as the use of mobile money and mobile banking (saving via mobile phone), reduce the transaction costs of lending to rural areas and enable farmers to receive payments from buyers and manage their cash flow. The availability of such services also enables pay-as-you-go solutions for assets such as irrigation pumps and cold storage facilities.
- Technical assistance and information services can reduce financing risks by strengthening farming and business skills (including financial literacy), by promoting innovation and collective action, and by improving coordination in the value chain. This includes technical assistance to improve access and correctly use farm inputs, training on farming and post-harvest practices, and access to market information. Information on land cultivated and quantities produced and/or delivered often plays a crucial role in triggering A2F. Finally, data on farmers' collective performance and credit history – essential for lenders – can be collected more efficiently using these tools rather than conventional and costly credit-scoring exercises.

2.8 Value Chain Financing

Value chain financing is an integrated solution to achieving financial inclusion. It is based on the relationship between two or more actors in the value chain, either directly (one actor provides credit to the other) or indirectly (one actor obtains credit from a financial institution based on a sales relationship with another actor). Value chain financing does not focus specifically on formal financial services, even though financial institutions are usually involved. It encompasses both informal and formal services – informal financial relations between actors within the value chain, and more formal services in which one of the value chain actors has relations with a formal financial institution. Value chain financing looks at financing from the broad perspective of the target value chain, not from the perspective of a specific target group (e.g., smallholder farmers) or a particular type of finance (e.g., microfinance). Rather, it includes all actors in the value chain and all types of financing.

Internal value chain finance

Participants down the value chain provide loans to smallholders with or without the involvement of financial institutions. Transactions could include aggregator credit, input supplier credit, marketing

Risks of Value Chain Financing and Mitigation Measures

Risk	Description	Mitigation measure
Reduced yield	Due to unforeseen reasons, yield is lower than expected	Combining a credit product with crop insurance does make the financial product more expensive, but it can ensure that financial institutions will have guaranteed access to at least part of the insurance pay-out.
Market price fluctuation	Market prices can change from year to year or even during the season	Contracts with flexible price arrangements, allowing for price adjustments throughout the season, mitigate the risk of price-induced defaults that often accompany fixed-price contracts. But such contracts might also result in cash flow challenges, either for the lead firm (when prices go up) or for farmers (when prices go down). Choosing a modest pre-financing percentage or structuring trade contracts with a mix of fixed-priced and flexible-priced volumes can mitigate this risk and ensure that loans are repaid.
Financial weaknesses	Farmers or SMEs have inadequate financial literacy to properly manage finance	A standard procedure should be to assess the financial strength of the SME (including access to credit it may need to pay farmers) or farmer. Companies with a strategic interest in their supply chain may be willing to guarantee farmers' loans, giving an additional financing option. The financial institution may require debtor insurance on the company to mitigate default risk.
Defaults	For numerous reasons, the farmer or SME might be unable to repay the loan	Trade disputes are less likely to occur, or likely to be resolved amicably, if the company and farmer have a long-standing relationship. When considering giving a loan, the financial institution may require a positive trading record to mitigate the risk of trade disputes. Additionally, purchase contracts should not require farmers to sell 100% of their harvest to the buyer and should include detailed quality standards specified by the buyer.

Source: Incofin Investment Management. 2015. Insights on Credit Risk and Agriculture Value Chain Finance.

company credit, and "lead firm" financing (out-grower schemes). This firm may borrow from a financial institution, but there is no formal connection between the financial institution and upstream value chain participants. While internal value chain finance offers the advantage of utilizing relationships and transaction mechanisms already in place, there are also drawbacks. Working capital is tied up in finance; farmers may not understand the costs of finance as it is deducted from payments or hidden in price discounts; and agribusinesses must allocate resources to financing suppliers rather than to their core business.

External value chain finance

Actors outside the value chain, such as financial institutions, provide finance to the value chain based on relationships within the chain. For example, a bank provides a loan to a producer based on a contract with a buyer. This can benefit all value chain participants: buyers do not need to use working capital to lend to producers; producers can access finance without collateral; and banks can enter profitable new markets without the risk and transaction costs associated with lending to smallholders.

Several 2SCALE initiatives involve forms of value chain financing ranging from simple tripartite arrangements to reverse factoring or invoice discounting. Tripartite arrangements involve the farmer, the lead firm buying from the farmer, and the financial institution. Off-take contracts are used as collateral, allowing the farmer to obtain a loan for agro-inputs. Another approach is inventory-based credit (warehouse receipting), in which produce stored in specified warehouses provides the collateral for loans, allowing the farmer to meet consumption expenses. In reverse factoring/invoice discounting, financial institutions take over the invoice or provide credit to the lead firm but pay directly to the supplier (mainly the smallholder farmer).

Value chain financing first requires trust and connectedness. That is why most partnerships begin with a loyalty program to build relations and progressively develop more complex, integrated arrangements. Loyalty programs often start with technical assistance and access to inputs, such as seeds or fertilizer, and sometimes include support to local seed producers. These programs may expand into financial arrangements based on savings/credit and innovative ways to manage risks, including insurance, to ensure timely access to inputs and services, such as tractor rental for land preparation or crop spraying to control pests.

Value chain financing is not always possible and does not necessarily eliminate the various risks (physical, market, social) of financing. 2SCALE experience has provided insights on how to manage these risks. The major insights are summarized in the table on page 7.

Despite these risks, value chain financing is an appropriate approach for 2SCALE for the following reasons:

- *Leveraging existing information inside the value chain reduces credit risk for financial service providers and other value chain actors.* Information on where value is added in the chain and what value is added, identification of key participants and intermediate and ultimate markets, and understanding of customer demand help financial institutions make better informed decisions. Information also provides insight to the financial institution to adjust or review loan disbursement and recovery mechanisms and develop a good risk mitigation plan to avoid loan default. Information has the potential to substantially lower costs of lending and other financial services. In addition, vale chain relationships between companies and farmers may be leveraged to enable financial institutions to organize their services to farmers more efficiently or to channel these (at least partly) through the company. Information helps farmers pool small individual financial needs to discuss a larger combined need for finance that can be reviewed with financial institutions. For example, in Saboba, Ghana, soybean farmers meet with tractor service providers before the cropping season to discuss operational plans and pricing of services. Based on that, a loan application is developed and submitted to the local financial institution.
- *Bundling of finance with other services, such as input supply, extension services, and off-take contracts, reduces credit risks.* This avoids loan diversion and also ensures that farmers have timely access to services while sharing risks among all actors. Off-take contracts between farmers and buyers comfort financial institutions on the risk of default; they can also help to accelerate payments and thus reduce financial gaps. For example, in Benin, pineapple processor Promo Fruits secured a credit facility of 700,000 FCFA from Oikocredit to purchase plastic mulch on behalf of its outgrowers; mulching significantly reduced weeding costs and increased yields (see Chapter 4).
- *Since agribusiness companies make their profits not from lending but from their commercial activities, they may tolerate higher levels of loan default than financial institutions* (Agrifin, 2016; IFC, 2015). Some companies that rely on a steady flow of good quality products prioritize a loyal relationship with the farmers that supply them (see Chapter 4). For example, in Mali, sesame processor PROSEMA is experimenting with alternative approaches to develop farmer loyalty. These include providing its outgrowers with inputs on credit, to be repaid through deductions from payments at harvest, and pre-financing of local agents to ensure quicker payment to farmers.

A2F IN 2SCALE: APPROACH, METHODOLOGY, AND BEST PRACTICES

3.1 The A2F Approach

The development of sustainable relationships with financial institutions is an important part of the 2SCALE approach. For each of the 50-plus partnerships in the portfolio, the project developed specific interventions that increase the accessibility, affordability, and appropriateness of financial services for smallholder farmers and SMEs. Interventions targeted both recipients (farmers, SMEs) and providers (financial institutions).

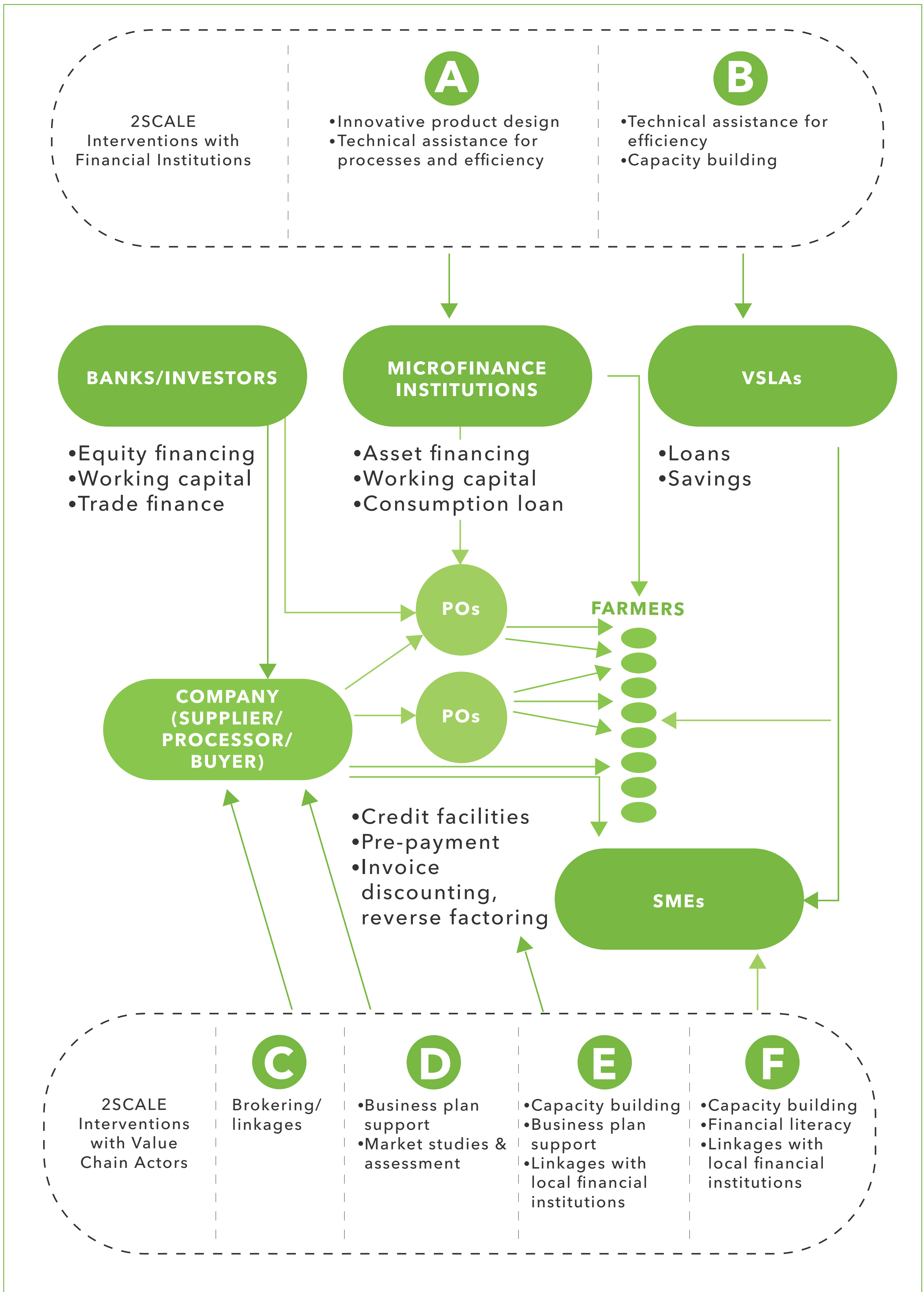
The position of A2F specialist was created, providing dedicated capacity and embedding A2F within the program. Two A2F specialists, based in Kenya and Ghana for logistical reasons, support partnerships and field teams in various ways – advice, brokering, training, and other activities required to design, pilot, monitor, and mainstream A2F interventions.

With the support of ICRA, these specialists also developed Training of Trainers (ToT) modules on financial literacy and A2F in 2012 and 2013, soon after 2SCALE was launched. 2SCALE staff as well as agribusiness coaches (who work directly with farmers) were trained on different A2F mechanisms. This approach ensured that all 2SCALE staff working on a partnership were able to use an "A2F lens" in all activities they undertook.

The initial training helped develop broad commitment and involvement within 2SCALE. Next, a series of interventions was developed by the specialists together with field teams (see figure on page 11):

- Finance between value chain actors (farmers, SMEs, suppliers, etc.) or direct value chain finance, as indicated by the horizontal arrows in the diagram
- Relations with external financiers (banks, microfinance, etc.) or indirect value chain finance, as indicated by the vertical arrows in the diagram
- Capacity building of farmers and SMEs, as shown in the lower box
- Capacity building of financial institutions, as shown in the upper box
- Networking and linkages between local actors and financiers (members of the agribusiness cluster)

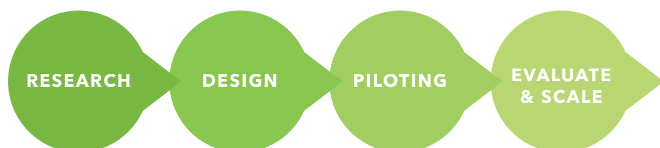
2SCALE Interventions with Financial Institutions and Value Chain Actors



Source: Yohann Formont, ENCLUDE

3.2 Shaping A2F Interventions in the Field

To provide a more structured approach to A2F, the two specialists, together with local 2SCALE staff and agribusiness coaches, developed interventions following a structured four-step approach.



- *Research to understand beneficiaries' needs and lenders' perspectives:* Interventions must be based on a good understanding of the financial needs of smallholder farmers and SMEs and the barriers seen by local financial institutions – hence, the importance of research. For farmers and SMEs, this includes a detailed inventory of demand and supply (currently or potentially available) of financial services, and analysis of the level of financial literacy among smallholders, the extent to which they have and use their own savings, and the organizational capabilities of producer organizations (POs) and SMEs. Assessment of the financial literacy level is critical as this is a prerequisite for the success of any A2F intervention.

  Assessment of financial needs was based on a sound understanding of the business model and the flow of funds within each target value chain. Based on the activities of each actor in the value chain, the research focused on better understanding each actor's activity cash flow cycle. The cash flow cycle might be based on a cost of production analysis, especially for smallholder farmers engaged in one crop or in very seasonal production. In general, they have limited financial needs for inputs, working capital, and equipment. For more complex businesses, such as agroprocessors, aggregators, and seed companies, 2SCALE provided assistance to develop a comprehensive business plan.

  Following the needs assessment, 2SCALE staff conducted a market survey to identify potential financial institution partners. The market survey was conducted first with financial institutions that have collaborated with IFDC in the past, then for others involved in the same or related value chains. These interactions also helped to better understand the barriers that financial institutions faced while delivering services to farmers and SMEs.

  Several criteria influenced the choice of partner financial institutions: their mission, vision, core values, experience in financing rural and agricultural businesses, and availability and willingness to increase outreach and impact.

  Finally, in a number of cases, methodologies developed by the development organization SCOPEinsight were used to better understand finance needs and capabilities and also to facilitate the "scoring" of farmers and farmer groups. Scores were used in discussions with finance institutions to better understand the financial situation of the farmer groups seeking loans.

- *Design of financial instruments and approaches:* Financial instruments or approaches must be tailored to the particular crop and/or value chain. While addressing the needs of farmers and SMEs, they must also be acceptable to the financial institution. Design of such instruments involves optimizing the type of loan, duration, interest, repayment installments, mechanism of disbursement, etc. The first step, therefore, was to organize dedicated business or finance forums where farmers, companies, financial institutions, and other stakeholders shared ideas and experiences and provided input on the design of financial instruments or approaches to pilot. These forums also increased local financial capabilities and awareness. For many farmers and SMEs, it was their first interaction with banks (and vice versa, for some banks). The design phase included further negotiations with target groups (farmers, SMEs), other value chain agents, and financial institutions to develop a concrete plan to improve financial literacy, savings, and re-investment capabilities, and expand both formal and informal financial services.

  In parallel, 2SCALE teams worked with financial institutions to identify the most suitable product available and also to develop savings options that loan beneficiaries could use, reducing the risk of default. Numerous products are available: input finance, equity finance, asset finance, warrantage (inventory credit), working capital finance, reverse factoring, index-based insurance, drought insurance, poultry insurance, bank savings, and savings and loan associations, among others.

- *Pilot implementation:* The design phase led to financial products or approaches that were new to some or to all of the stakeholders involved. These products/approaches were piloted on a limited scale before being offered to a larger audience. Facilitating A2F often involves the design of financial product pilots – development and testing of financial services tailored to the target group. All pilots were designed in close partnership with financial institutions. 2SCALE's financial specialists were careful with screening and due diligence to ensure that the partner financial

Training on financial literacy led to the formation of VSLAs in multiple countries, enabling farmers to save for investments.

institution believed in the product and was willing to scale up successful pilots, taking some business risks if required. In practice, this meant that risk management measures funded or in some way "backed" by 2SCALE during the pilot phase were taken over by borrowers or the lender.

- *Scale-out of successful pilots:* Results of the pilots were carefully evaluated. For successful pilots, 2SCALE teams worked with farmers, SMEs, and (where relevant) financial institutions to plan how to scale out the new financial product/approach. Scaling often involved expanding capacity building through training of trainers and coaching, building local skills, enlarging or strengthening the financial network, and in some cases setting up a monitoring and evaluation system.

Scaling is not as straightforward as it sounds. Financial institutes may have capital or staffing constraints and hence are unable to expand to the number of clients. Newly engaged farmers may live in other areas and may have different characteristics and financial priorities. As a result, awareness campaigns and close monitoring are required. Monitoring data can also help to adapt existing products to specific circumstances.

3.3 Implementing A2F Interventions

A variety of A2F interventions have been implemented in nine countries. These interventions fall under three broad categories: financial literacy, brokering linkages with financial institutions, and development of new products or services.

3.4 Financial Literacy

Financial literacy is a cornerstone of financial inclusion. Farmers often have limited education and lack the skills to evaluate how big a loan to take or the costs and benefits of the loan. It is not uncommon to see farmers paying more interest than the additional profit generated with the loan. Financial literacy helps farmers understand their production and household cash flow cycles and improve financial planning. It encourages farmers to save, making them less vulnerable to shocks and more likely to receive loans. It allows farmers to compare offers from different financial institutions and choose what is best for them. Financial literacy can ensure that better A2F leads to higher income, not over-indebtedness.

Workshops on financial literacy were, for instance, organized in many 2SCALE partnerships. For example, in Ghana, we worked with FYSSO Ghana to conduct workshops for rice, soybean, and vegetable farmers. Twenty lead farmers and agribusiness coaches from each partnership were trained, and they later trained other farmers in their groups.

Following the training, participants were able to assess income and outlays, identify financial needs and sources of finance, understand the conditions and risks of taking a loan, and develop a loan application. If farmers had previously received financial training from other projects, 2SCALE built on this previous experience and

provided more in-depth information on specific topics. For instance, in Uganda, a needs assessment indicated that soybean farmers from the Masindi District Farmers Association (MADFA) required more capacity building on savings. Over 6,000 MADFA farmers, in groups of 15-20, received dedicated training, which led to the establishment of Village Savings and Loan Associations to accumulate, pool, and leverage savings.

3.5 Linking Farmer Organizations to Financial Institutions

Farmers have traditionally relied on family savings, relatives, local savings groups, and local informal lenders. Because most farmers are located outside towns and business centers, they know little about formal financial institutions if those institutions do not reach out to them.

2SCALE provides farmers with information on which financial institutions might be suitable for them and how to access their products. 2SCALE also facilitates direct interactions by organizing business forums to bring financial institutions and farmer groups together, understand each other's requirements, and explore whether new, tailor-made products are required or can be developed.

In the cassava partnership in Nigeria, lead firm Psaltry purchases cassava from 700 small-scale outgrowers. A needs assessment indicated that farmers lack input financing to buy cassava stems and fertilizer as well as working capital to hire tractors and labor.

2SCALE identified three financial institutions, Central Bank of Nigeria, First City Monument Bank (FCMB), and Excel Microfinance Bank, and facilitated meetings and field visits by bank staff. The banks were largely unfamiliar with outgrower schemes but now have an understanding of the opportunities and risks of lending to smallholder outgrowers. The discussions also explored ways to mitigate risks – including technical assistance from 2SCALE experts to bank staff and farmers.

The brokering proved successful – FCMB began disbursing low-interest loans (9% per annum). The loans are guaranteed by the Central Bank through the Anchor Borrowers Programme. FCMB has also introduced crop insurance for cassava, in collaboration with the Nigerian Agricultural Insurance Corporation. Insurance is part of the loan package, protecting farmers against crop failure at affordable premiums.

3.6 Developing New Financial Products and Services

A loan is the culmination of a sometimes lengthy or complex process: application forms and procedures, screening and due diligence on applicants, disbursement schedule, repayment plan, etc. While designing a tailored financial product for smallholder farmers, several things must be considered. First, the anticipated cash flow should be assessed, i.e., when should inputs be bought, and at what prices; what other cash outlays are needed and when; how much income will be generated and when.

Market and environment risks must be evaluated and factored into cash outlay and income projections. Risk mitigation measures need to be assessed, including the farmer's own financial capacity, amount of savings, etc. Financial institutions often need technical assistance to design appropriate products and staff training to roll out new products.

An interesting example of a new financial product comes from the sorghum partnership in Kenya. The needs assessment revealed that the 7,000 farmers supplying to lead firm Shalem needed input financing but had little to no access to formal sources of credit. 2SCALE brokered meetings between the farmers and local financial institutions.

Equity Bank was initially interested, but after the first months of collaboration, it became clear that Equity's products did not match farmers' needs. We then approached microfinance provider Capital Savings and Credit Cooperative. Its product range was not suitable either, but 2SCALE facilitated discussions between Capital and the farmers to create a new loan product that took into account both the farmers' and the bank's preferences. All parties agreed on conditions:

- Loans will be for a maximum of six months.
- Farmers will borrow in groups; members of a group co-guarantee each other.
- Shalem will contract farmers and give irrevocable orders to the bank, as the main security for the loans.
- The loan will include insurance against crop failure (insurance provided by UAP).
- Disbursement will be in the form of vouchers, not as cash.

This product was piloted in two branches, and the repayment was 100%. Capital has now rolled out the product to four additional branches, with inputs being distributed by another partner, Meru Farmers Ltd.

Another example comes from the soybean partnership in Uganda. 2SCALE worked with MADFA to develop a warehouse receipt system. MADFA farmers store their harvest in specified warehouses. They can store and wait for more favorable prices and also use the stored grain as collateral to obtain loans to pay for household expenses or to prepare for the next season.

- Farmers store their maize and soybean harvests in the warehouse, for a fee. The farmer receives a receipt for the quantity deposited. The receipt information is also shared with MADFA's Savings and Credit Cooperative (SACCO).
- If the farmer needs a loan, she takes the receipt to the SACCO, which can advance 75% of the value of the stored produce (calculated using current market prices).
- The grain is stored until prices are favorable. The warehouse manages the sale and remits the proceeds to the SACCO, which pays the farmer after deducting the advance.

In the design of new financial products, it sometimes helps to involve other actors that can guarantee a certain level of risk. Sometimes, even institutions such as the Dutch Embassy in Benin (see box) are involved to build dedicated financial products or services.

3.7 Building Financial Capacity of Producer Organizations and Processors

Many rural SMEs and farmer groups lack business skills and experience. 2SCALE helps both groups build their financial capacity. Senior staff from SMEs are offered coaching to develop a clear vision and a business development plan. Producer organizations receive similar support to streamline their activities, meet good accounting standards, and thus improve their ability to access loans from the formal market.

3.8 Innovative Financial Models in the Value Chain

As indicated previously, value chain financing can offer a good alternative when bilateral financing (i.e., direct financing of the farmer by the financial institutions) is considered too costly or too risky. Value chain finance is based on the relationship between two or more actors in the value chain, who either directly finance each other (e.g., aggregator advances money to farmer for input purchase) or support each other to obtain external finance – for example, one actor obtains credit from a financial institution based on a sales relationship with another actor. 2SCALE facilitates several of these external value chain financing models, which have proved highly effective in the smallholder setting.

One example is the pineapple sector in Benin. 2SCALE helped connect several players: juice processor Promo Fruits, farmer cooperatives supplying Promo Fruits, financial institution FECECAM, and two input dealers. Previously, FECECAM did not work with pineapple farmers; they only lent to the cotton sector.
2SCALE helped broker a multi-partner agreement. The farmer cooperative received a working capital loan from FECECAM, "guaranteed" by Promo Fruits. The money was paid not to farmers but to the input dealers, who supplied inputs to farmers. Repayments were coordinated by the cooperative through deductions from payment for pineapples supplied to Promo Fruits.

3.9 Village Savings and Loan Associations

Smallholder farmers tend not to save – and this makes financial institutions even more reluctant to lend. 2SCALE promotes Village Savings and Loan Associations (VSLAs) that encourage savings and investment and makes farmers more credit-worthy to banks. VSLAs also create opportunities for farmers to pool and leverage these savings to obtain larger loans.

A VSLA is a group of farmers who save together and take small loans from those savings. The activities of the group run in one-year cycles. After each cycle, the accumulated savings and the loan profits are distributed back to members.

GUARANTEE FUNDS

The Dutch Embassy in Benin supports a guarantee fund to bolster A2F for farmers. The fund is co-managed by two Netherlands-funded projects, 2SCALE and ACMA, and administered on their behalf by local microfinance nongovernmental organization (NGO) ALIDé. The guarantee fund has resulted in:

- Lower interest rates.
- Reduction of the loan screening fee.
- Faster and less bureaucratic procedures.
- Flexible loans that match the crop and market cycle.

Six tailored financial products have been developed. To date, group and individual loans of €1.8 million have been disbursed to 1,400 farmers, processors, and traders.

Simple innovations such as "savings boxes" have helped protect group savings and encourage transparency in accounting and use.

2SCALE supports farmers to design efficient savings models specifically for financing farm operations. Interventions include sensitization, training of farmer groups on how to set up the governance structure for a VSLA, introduction of physical savings boxes to start saving, and capacity strengthening in bookkeeping (often linked to broader financial literacy training.

In total, more than 1,400 VSLAs were established in 2016 in Benin, Ghana, Kenya, and Uganda. In Benin alone, in the first season of operation, savings amounted to 1.3 million FCFA, while 650,000 FCFA were disbursed as loans to 46 women.

A number of VSLAs have created a substantial financial base of their own. These VSLAs are now being linked to financial institutions. The expectation is that the VSLAs' capital base and financial track record will attract additional capital from banks. For example, in Ghana, 45 VSLAs were set up, involving 1,350 rice farmers. Accumulated savings grew to 877,500 Cedi – too large to keep in physical boxes. Therefore, 40 of the 45 VSLAs opened savings accounts with Unity and other local banks. Their savings were more secure and earned interest. They have also encouraged the banks to offer other financial services to the farmer groups.

PROMOTING FINANCIAL INCLUSION: EXAMPLES FROM 2SCALE PARTNERSHIPS

4.1 Types of A2F Interventions

Financial inclusion is an important element in each of the 52 partnerships that 2SCALE supports. A range of A2F interventions has been implemented, depending on the business environment and the needs of value chain actors. This chapter highlights examples from 2SCALE's portfolio.

Interventions can be classified as follows:

- Support to financial institutes to design and test services for specific target industries or beneficiary groups.
- Support to SMEs (aggregators, processors, wholesalers, retailers) for business planning.
- Support to smallholder farmers and other cluster actors (local SMEs) to improve financial literacy.
- Value chain analysis (profitability, cash flow) and financial needs assessments along the value chain; prioritization of financial needs.
- Financial intermediation for working capital: mostly bilateral, between financial institution and borrower (farmers or SME).
- Financial intermediation for investments, mainly for producer organizations and SMEs.
- Financial intermediation for working capital, focusing on value chain arrangements (interventions involving financial institution and at least two value chain actors).
- Financial intermediation to strengthen value chain, specifically to reduce delayed payment: introduction of tools such as invoice discounting, reverse factoring.
- Support to build capitalization strategies of farmers and SMEs to reduce need for external financing. This includes support to establish VSLAs.

In some partnerships, the use of ICT tools has helped reduce transaction costs or the costs of information sharing, thus strengthening financial inclusion. For example, supply chain management systems can record and share detailed information on every farmer in a large outgrower network. Mobile phone platforms can accelerate payment and greatly reduce transaction costs.

4.2 Financial Inclusion in Different Value Chains

Benin: Rabbit meat

This partnership, centered in and around the capital Cotonou, focuses on youth organized in small producer groups. 2SCALE support has helped develop the rabbit meat value chain, from production to distribution and marketing of rabbit meat. In

addition to more than 1,000 producers, numerous young entrepreneurs are involved: traders, veterinarians, and slaughterhouse and restaurant operators.

Intervention

Financial literacy, input finance, direct/bilateral financing, guarantee fund (ALIDé).

Impact

15 producer groups were linked to microfinance institutions, including ALIDé. They opened bank accounts, developed business plans, established relations with potential buyers, and were able to access loans for both working capital and small investments. To date, 30 smallholder farmers have received loans of $4,680.

Benin: Pineapples

This partnership with juice processor Promo Fruits involves more than 3,400 smallholder farmers and 4,000 laborers. It aims to professionalize the pineapple sector in Benin and to develop national and regional markets for pineapple juice. Farmers have been supported to improve production and productivity. Promo Fruits was supported to build an extension system and to upgrade their business strategy. A pilot program was implemented to supply juice to local markets, targeting schoolchildren.

Intervention

Financial literacy, input finance, value chain financing, guarantee fund (Alidé) for farmer groups, bilateral financing for Promo Fruits for capital investment.

Impact

Promo Fruits was able to secure access to finance for the majority of Promo Fruits farmers. The farmers have A2F for inputs, including technology innovations such as plastic mulch. Several financial institutions are involved, including FECECAM, ALIDé, and Oikocredit, which funded part of the equipment and working capital needs of Promo Fruits. The partnership involves 3,500 farmers (750 women). Over $2.5 million has been disbursed, mostly to Promo Fruits but also small loans to 242 farmers.

Benin: Soybeans

This partnership specifically targets women processors (46 SMEs), helping them improve the quality and marketing of their soy-based products. The women produce and sell soya kebabs, goussi, milk, and cheese on local markets, as meat substitutes for low-income consumers. The partnership also involves more than 2,000 farmers (690 women) who supply the processors.

Intervention

Financial literacy, input finance, bilateral financing for processors.

Impact

Financial literacy and business skills have improved. Several processors have obtained funds to purchase equipment or raw material (soya grain) through ALIDé and other finance providers. Loans of $23,000 have

Bank credit to Promo Fruit, facilitated by 2SCALE, helped finance capital investments to increase processing capacity, and impact on more than 7,000 farmers and laborers.

Benin: Vegetables

This partnership aims to strengthen the vegetable sector by improving farmers' access to quality seeds and by strengthening marketing and distribution channels to reach consumers in Benin, Nigeria, and Togo. Over 30,000 farmers (7,500 women) and 182 SMEs are involved.

Intervention

Financial literacy, bilateral financing for farmers, guarantee funds (ALIDé).

Impact

Farmers were supported to assess financial needs and develop business plans. Several financial institutions have provided farmers with funds for inputs, labor, and services; disbursements have reached several hundred farmers. Loans of $1.2 million have been disbursed to 520 smallholder farmers (140 women).

Ghana: Citrus

This partnership supports 3,800 citrus farmers (1,200 women) to develop the competencies needed to supply to export-oriented aggregators/processors, such as Fruittiland and Pinora. The final buyers (Fair Trade Original and Verbruggen Juice) are also involved and provide technical advice and training materials.

Intervention

External value chain financing, working capital, input finance.

Impact

Producer organizations were able to obtain credit facilities for inputs, labor, and farm management. Funds

were provided to professional (certified) producer organizations and backed by supply contracts with the processor. Loans of $188,000 have been disbursed to 415 smallholder farmers (65 women) for inputs and farm operations.

Ghana: Soybeans

This partnership targets the cooking oil industry and women processors (over 30 SMEs). Project support to Yedent Agro, the lead firm, includes business strategy and especially marketing innovations. Support to processors has helped improve the quality and marketing of their soy-based products. The partnership involves 12,670 farmers (5,500 women) and 94 SMEs.

Intervention
Financial literacy, input finance, VSLA formation, bilateral financing for women processors, investment loan for Yedent.

Impact
Farmers' financial literacy and processors' business skills have improved significantly; 200 women have established a VSLA. Women processors have obtained working capital loans from local financial institutions. Yedent is negotiating for an investment loan with the Common Fund for Commodities. Loans of over $160,000 have been disbursed to 3,256 smallholder farmers (1,338 women).

Kenya: Dairy

This partnership aims to improve milk yields and production by improving dairy farmers' access to feed and fodder, backed by interlocked contracts from the dairy industry. More than 23,000 farmers (5,700 women) and 50 SMEs are involved. The two lead firms – milk aggregator Feska and dairy producer Eldoville – purchase from smallholder farmers and assist in capacity building programs. 2SCALE support helped Eldoville introduce Kenya's first commercial whey product, Whey Cool.

Intervention
Value chain finance, equity financing, supply chain financing, invoice discounting, livestock insurance, financial literacy.

Impact
Financing enabled smallholder dairy farmers to substantially improve milk production and quality. Feska increased milk collection by 50%, from an average of 8,000 liters to 12,000 liters per day. Eldoville raised $2 million in equity financing. Loans of over $3 million have been disbursed to 1,200 farmers. More than 300 farmers have enrolled for livestock insurance.

Kenya: Sorghum

This partnership supports sorghum trader/processor Shalem and its smallholder farmer-suppliers. Support to smallholder farmers includes technology innovations, extension support, and services, including A2F for purchase of inputs to improve yields and production. 2SCALE support also helps Shalem to strengthen

Financial linkages to help vegetable farmers in Benin invest in new technologies to increase productivity; loans of more than $1.2 million have been disbursed to 2SCALE clusters.

its relations with agents and farmers and to develop alternative markets (e.g., processed sorghum-based foods) to reduce its dependency on the beer industry. The partnership involves more than 28,000 farmers (17,000 women) and 55 SMEs.

Intervention
Value chain finance, capital investment, crop insurance, financial literacy.

Impact
Shalem raised $1.14 million in asset finance and installed a new production line producing fortified porridge for low-income families. Loans of $400,000 have been disbursed to 3,700 farmers. More than 1,200 farmers have enrolled for crop insurance. 2SCALE's A2F model is now being scaled out by Kenyan banks and microfinance providers.

Kenya: Potatoes

This partnership aims to improve farmers' access to quality (certified) potato seed and to strengthen the potato industry through farmer training, organizational strengthening, and development of coordinated value chains. The latter includes, for example, packed and graded products for low-income consumers. Interventions are led by Kevian, a large national food company keen to expand its presence in the potato sector. The partnership involves more than 20,000 farmers (10,000 women) and 24 SMEs.

Intervention
Value chain finance, inventory financing, financial literacy, business planning, financial modeling,

Impact
Microfinance partner Smart Champions SACCO raised $74,000 and introduced inventory financing for farmer groups. Processing firm Sereni Fries raised $140,000 for business expansion. Loans of $306,000 were disbursed to smallholder farmers; 36 producer organizations were trained on finacial management.

Mali: Sesame

This partnership aims to support smallholder farmers' access to information and financial services through long-term contracts/relations with the lead firm PROSEMA, one of the country's largest sesame processors. The partnership involves nearly 37,000 farmers (10,000 women) as well as farm laborers, agents, and 35 local SMEs.

Intervention
Models for internal value chain financing, insurance, logistics services.

Impact
PROSEMA improved its business model for local sourcing, increasing its emphasis on pre-financing inputs to its contracted farmer-suppliers, directly or through agents. 2SCALE helped PROSEMA design and roll out a stepwise loyalty program to reduce side-selling. Farmers were also introduced to a weather-index based insurance program; about 1,000 farmers have subscribed. Loans of $3.9 million were disbursed, mostly for capital investment by PROSEMA, but also to 1,575 farmers (489 women).

Mali: Maize

This partnership aims to promote yellow maize production by cotton farmers, helping them diversify their farming system and incomes. The lead firm, SONAF (aggregator/trader), offers a guaranteed market with contracts and production-related services to enable farmers to expand production. SONAF contracts also allow farmers to participate in an insurance scheme. The partnership involves more than 30,000 farmers (8,000 women) and 37 SMEs.

Intervention
Financial literacy, loyalty programs, internal value chain financing, crop insurance, and bilateral financing for farmers (working capital) and SONAF (investment).

Impact
SONAF provided producer organizations with funding for inputs, to be deducted after harvest. "Teething troubles" (this was the first such initiative for maize) are being overcome. Financial literacy has been strengthened. Some farmers were also able to access input loans through Soroyiriwaso, a local financial institution, with support from Oikocredit. 2SCALE staff helped SONAF obtain financing for a new processing line (2SCALE helped develop the business plan). Loans of $687,000 have been disbursed to SONAF and to 1,270 farmers (240 women).

Nigeria: Cassava

This partnership aims to develop a viable business model for local sourcing from smallholder farmers. The lead firm, Psaltry, processes cassava into starch, sold mostly to Nigerian Breweries (Heineken subsidiary). Psaltry also provides farmer training, extension services, pre-financing of inputs, and support for the introduction of new cassava varieties. The partnership involves 1,400 farmers (327 women) and 28 SMEs.

Intervention
Value chain finance, input finance, financial literacy.

Impact
Availability of input finance has enabled farmers to increase cassava yields from 9 tons to 15.6 tons per hectare. Farmer groups are now part of the the Anchor Borrowers Programme; low-interest loans of nearly $400,000 were disbursed in 2017 alone. Crop insurance is available for cassava for the first time.

Financial innovations championed by PROSEMA have impacted nearly 37,000 farmers and many others involved in the sesame value chain in Mali.

Nigeria: Groundnuts

This partnership supports farmers (mostly women) and local women processors to improve output and quality and to access wider markets. 2SCALE support has helped processors upgrade the quality of groundnut paste and establish business networks involving supplier-farmers and other supporting SMEs. A pilot was successfully concluded, test-marketing Tom Brown porridge mix to low-income consumers. The partnership involves more than 2,000 farmers (662 women) and six SMEs.

Intervention
Value chain finance, input finance, financial literacy.

Impact
New financial products have accelerated growth in production, processing, and trade. Tractor rentals have allowed farmers to reduce production costs by 19%. Women processors have introduced multiple new package sizes for groundnut oil. Loans of $178,000 have been disbursed to 30 farmers and processors (15 women).

Nigeria: Vegetables

This partnership aims to strengthen the vegetable sector by improving access to quality seeds and by strengthening marketing and distribution channels to tap consumer markets, including the low-income segment. Lead firm AACE Foods purchases vegetables and herbs (peppers, ginger, etc.) from 2SCALE clusters for processing, packaging, and resale. The partnership involves 23,000 farmers (7,500 women) and 80 SMEs.

Intervention
Value chain finance, input finance, financial literacy.

Impact
Loans of $292,000 have been disbursed to farmers and agri-enterprises; beneficiaries included 415 farmers (130 women).

Uganda: Soybeans

This partnership focuses on sustainable sourcing, by strengthening farmer capacity to improve yield and quality; by supporting the MADFA cooperative to multiply quality seeds; and by linking farmer groups to the lead firm RECO Industries. RECO is a large processor, mainly supplying wholesalers and institutional markets, and provides extension services to its farmer-suppliers. The partnership involves 23,000 farmers (11,000 women) and 12 SMEs.

Intervention
Value chain finance, inputs finance, financial literacy, warehouse receipt system.

Impact
More than 6,000 have been trained in financial literacy; farmer groups are now saving collectively, using “box banks” introduced by 2SCALE. More than 5,600 farners have opened accounts with a microfinance partner. Loans of $158,000 were disbursed to 3,400 farmers. Masindi SACCO has disbursed $205,000 through inventory financing; the warehouse recepting portfolio has grown to $32,000, with nearly 1,000 users.

5 LESSONS LEARNED

Many of the approaches described in Chapters 3 and 4 were new for most of the stakeholders involved. Implementation – successes and failures – has provided experiences and lessons that can be applied in the future by 2SCALE and other development programs.

Lesson 1: Integrate functional and technical capacity development

- The participatory initial assessment may take slightly longer to conduct, but it is important. It helps SMEs and producer organizations reflect on their own business model and situation. Even in successful SMEs, senior management often needs technical assistance for identifying and tapping external funders.

2SCALE carried out a market study on small-scale dairy farmers in Kenya, at the request of processor Eldoville Dairies. The findings (farm size, production, production costs, etc.) provided the basis for designing a loan product with a local microfinance provider. The survey also identified farmers' needs for extension services and training and highlighted the fact that farmers were, somewhat unexpectedly, willing to pay part of the costs.

Insights from a study on crop insurance in Uganda led to a partnership with insurance company UAP. Findings from the study convinced UAP to roll out micro-insurance for sorghum and soybean farmers. To encourage adoption, premiums were reduced by 50%. A growing number of farmers have purchased insurance, and government agencies plan to replicate the model in selected areas.

- Consider using an external assessment methodology like SCOPEinsight. External assessments may be more costly and time consuming, but they provide a structure and attention to detail that can be extremely useful for farmer groups and SMEs, especially those that are large or vertically integrated.

For example, in Benin, five pineapple cooperatives linked to Promo Fruits were assessed with the SCOPEinsight assessment tool (three to seven lead farmers from each cooperative attended each assessment). The assessments provided insights on financial management in the cooperative; the cooperative took action, based on the findings, to improve accounting and record keeping. The assessments also uncovered hidden conflicts in management. The findings suggested that the cooperative be split to improve management efficiency; this was agreed together with the management teams and is being implemented.

Conducting a formal SCOPEinsight-type assessment also makes the farmer group or SMEs appear more credible to future financiers. It also speeds up their due diligence process, especially when financial institutions are familiar with the methodology (which is the case in several 2SCALE countries, especially in East Africa) and consider it a trustworthy way of assessing the credibility of loan applicants.

- A detailed plan should be prepared immediately after the initial assessment, spelling out objectives, activities, and quantified targets for financial inclusion in the partnership.

This was done in most partnerships and helped cement commitments made or agreements reached informally. In a few partnerships where this was not done, A2F interventions did not yield the expected results.

Lesson 2: Understanding specific value chain dynamics and the specific needs of each farmer segment

- It is critical for banks to understand the specifics of crop or livestock production and the implications for A2F.

To meet the strict high-quality standards of buyer/processor Promo Fruits, farmers need to use a fertilizer that is more expensive than the one usually used on pineapple – significantly increasing their financing requirements. Understanding these details is key for financial institutions to properly assess loan requests. 2SCALE worked directly with financial institutions to ensure that they understood the value chain well enough to feel confident in lending to farmers.

- Farmer groups are not a homogenous group – it is important to understand the different dynamics and farmer needs within the group.

2SCALE worked with a large financial institution in Kenya to develop loans tailored to the needs of sorghum farmers supplying aggregator Shalem. Initially, the product took off rather quickly with a large number of farmers applying for a loan, but then it stagnated. Further assessment showed that a large share of the farmers – the smallest farmers – were barely included in the success. 2SCALE therefore engaged with an additional partner, a microfinance provider that had a much more explicit focus on small farmers.

Lesson 3: Benefits of value chain finance

- Value chain financing is not limited to tripartite agreements (farmers, aggregator, financier), but can include other downstream partners.

When negotiating with financial institutions, involvement of a larger buyer further downstream in the value chain can be a big plus. This was exemplified in the cassava partnership in Nigeria, which involved farmers, processor Psaltry, and its main client, Heineken subsidiary Nigerian Breweries. Being a recognized supplier to large company, Psaltry found it easier to obtain investment capital, part of it even pre-financed by Nigerian Breweries. Irrevocable supply agreements between Psaltry and the farmers, in turn, allowed farmers to access loans from local financial institutions.

- Input suppliers are more likely to offer credit when they are part of the partnership and involved in capacity strengthening activities.

Being part of cluster activities leads to ownership and buy-in. Suppliers are thus more likely to take the long-term view and offer goods on credit to their fellow cluster actors. This approach works best when there is a tripartite agreement involving the buyer, rather than a situation in which farmers negotiate directly with the input supplier. A good example is the arrangement in the pineapple partnership in Benin (see Chapter 3).

- A good outgrower scheme requires a long-standing relationship, trust, and honest communication.

Creation of platforms that connect existing farmer groups can facilitate outgrower and similar schemes. These platforms are created through selected lead farmers or “opinion leaders” who can lead discussions with other actors on behalf of the group. 2SCALE used this approach in Kenya when working with sorghum farmers and aggregator Shalem Investment. It proved to be successful in reducing side-selling, increasing volumes, and strengthening farmers’ relationships with Shalem and its agents. These relationships built credibility of th,e entire chain in the eyes of financial institutions.

- It is important to constantly look for ways to minimize costs in value chain financing.

Smallholder farmers face transaction costs – for example, transport to the bank, even when it is part of the partnership and has a branch in the area. Direct value chain financing (i.e., through the buyer/processor) is often the most convenient option for farmers, limiting their transaction costs. Of course, this will only work when there is a trusted relationship with the buyer/processor.

Lesson 4: The importance of facilitating linkages

- Farmers and processors/buyers often need help navigating through the terms and conditions set by the lender; 2SCALE and other partners can provide assistance.

2SCALE, and particularly the agribusiness coaches in each partnership, can help to identify, assess, and understand these conditions. In Benin, for instance, 2SCALE linked Promo Fruits to FECECAM (local finance provider) and Oikocredit, an international investor. 2SCALE further facilitated the process by supporting Promo Fruits to understand Oikocredit's lending criteria and develop a business plan, and by providing Oikocredit with insights on the pineapple value chain in Benin.

- Lenders are aware of the challenges in establishing strong supply chains; they value relationships between farmers and upstream processors.

Lenders are more likely to lend to partnerships where farmers have close relationships not only with local support services (e.g., inputs) but also with upstream processors. The strength of such relationships should be highlighted during A2F negotiations. For example, in Nigeria, the strong relationship between cassava processor Psaltry and its farmers (which underpins Psaltry's outgrower scheme) was a key element in convincing Nigerian Breweries to invest in Psaltry and in convincing the Central Bank of Nigeria to provide guarantee capital to local banks, which in turn enabled them to provide financing to the outgrowers at substantially lowered interest rates.

- Even successful SMEs can face difficulties in preparing a good loan application. 2SCALE assistance in this area is important.

One example is Shalem in Kenya. 2SCALE support helped the firm develop a solid business model. Based on this model, Shalem was able to secure substantial funding from Root Capital, Rabobank, and the Common Fund for Commodities.

Lesson 5: Using ICT and other tools to support A2F innovations

Working with smallholder farmers generally involves high transaction costs and financing risks. Both can be minimized by making use of ICT and other new technologies. A number of these technologies were tested in 2SCALE.

Often, borrowers and lenders know very little about each other; the costs of acquiring this information can be prohibitive, certainly for financial institutions, making it difficult for them to assess loan applicants. IT-based systems can close many of these information gaps at relatively low cost. In Nigeria, 2SCALE helped introduce the FarmForce platform, which allows cassava processor Psaltry to log and store information on each farmer: volumes produced, inputs used, training received, etc. This information is also shared with farmers. The transparency and analytical capacity of this system was a key factor in decisions by local financial institutions to lend to Psaltry farmers.

IT solutions can also directly improve A2F. For example, in Kenya, 2SCALE teamed up with dairy firm Eldoville, Equity Bank, and financial intermediary Umati Capital.

Citrus harvest in Ghana: access to finance has helped smallholder farmers deliver consistent, quality supplies of fresh fruit; loans of nearly $200,000 have been disbursed.

Farmers delivered milk to Eldoville daily but were paid only after 30 days. Umati introduced an IT platform to accelerate payment. When milk is delivered, Eldoville logs it into the system and immediately shares data with Umati, which then processes small loans to farmers, worth up to 80% of the value of the milk supplied. Eldoville's payments to farmers are channeled through Umati, which deducts loans and advances and pays farmers via the mobile money transfer service M-Pesa. The system ensures that farmers have easy access to finance with minimal transaction costs.

Lesson 6: Importance of pilot testing new financial products and services

New financial products or services, and new delivery models for these, are first tested in a pilot program with the service provider, target farmers, and other relevant stakeholders. This ensures that the product or service meets the needs of the beneficiary group and is feasible to implement for the financial institution. Pilots enable all parties to overcome challenges before a full-scale rollout.

An example of how things should **not** be done was the introduction of a loan product in Kenya, designed with Equity Bank for sorghum farmers. The new loan product was launched without full pilot testing. It quickly became evident that the bank's collateral requirements were beyond farmers' capacity or willingness. This experience shows that even with large and experienced financial institutions, a pilot phase is essential.

In Uganda, 2SCALE partnered with Masindi SACCO and insurance company UAP to pilot crop insurance for soybean farmers. The pilot included assessment of risks, cost structure, and margins of various categories of farmers in the value chain. The results were used to determine the premium level. However, the pilot also showed that farmers considered the premiums too high. These insights were shared with the Ugandan government, leading to a temporary government subsidy of 50% of the premium. This subsidy has helped launch and expand the insurance scheme and promote the concept of tying insurance to credit provision.

Lesson 7: Building financial literacy

- Financial literacy training must be tailored to the real needs of the target group.

Capacity strengthening is a prerequisite for financial inclusion, because most small-scale farmers do not fully understand their own cash flows and are unable to accurately project their credit needs. Financial literacy training is therefore a key component in almost all 2SCALE partnerships. However, this training must be tailored to farmers' real needs. An important starting point is the needs assessment done at the beginning of the A2F intervention. For example, in Ghana, following a needs assessment, financial literacy training for rice farmers was focused on how farmer groups could set up a VSLA.

- Financial institutions should be involved from the start in designing and implementing the training.

Financial institutions have the expertise; having their staff lead or support will ensure that the training fits closely with the financial institution's own lending criteria and procedures. It is also convenient, because during training, bank staff also "market" the products and services that the bank has to offer. These interactions also help build relationships between farmers and financial institutions. For instance, in Kenya, staff from Equity Bank are actively involved in developing financial literacy training for sorghum farmers.

For farmers, and particularly for SMEs, it is important to understand the costs and risks of borrowing. Credit may not be the only solution – or even the best solution – to every financial challenge. Farmers and SMEs that understand the costs of external financing might be triggered to consider financing at least part of their business through their own savings from farming or off-farm income.

Financial literacy is not merely understanding profit margins and cash flows on the farm or being able to prepare a loan application. It goes much further. 2SCALE's goal is to empower smallholder farmers to run their farm as a business; to understand what financial products and services are available and how to compare different alternatives; and to access and wisely use finance to improve profits and sustainability.

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