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February 16, 2012

Viewing Value Chain and Household Finance From a Demand Perspective

Geoffrey Chalmers
ACDI/VOCA

Jason Agar
Kadale Consultants Limited

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Innovations in rural and agricultural finance, from a demand perspective

Geoffrey Chalmers
ACDI/VOCA

Jason Agar,
Kadale Consultants

A demand side approach ...

... focuses on firm and household finance needs and uses, not products and providers

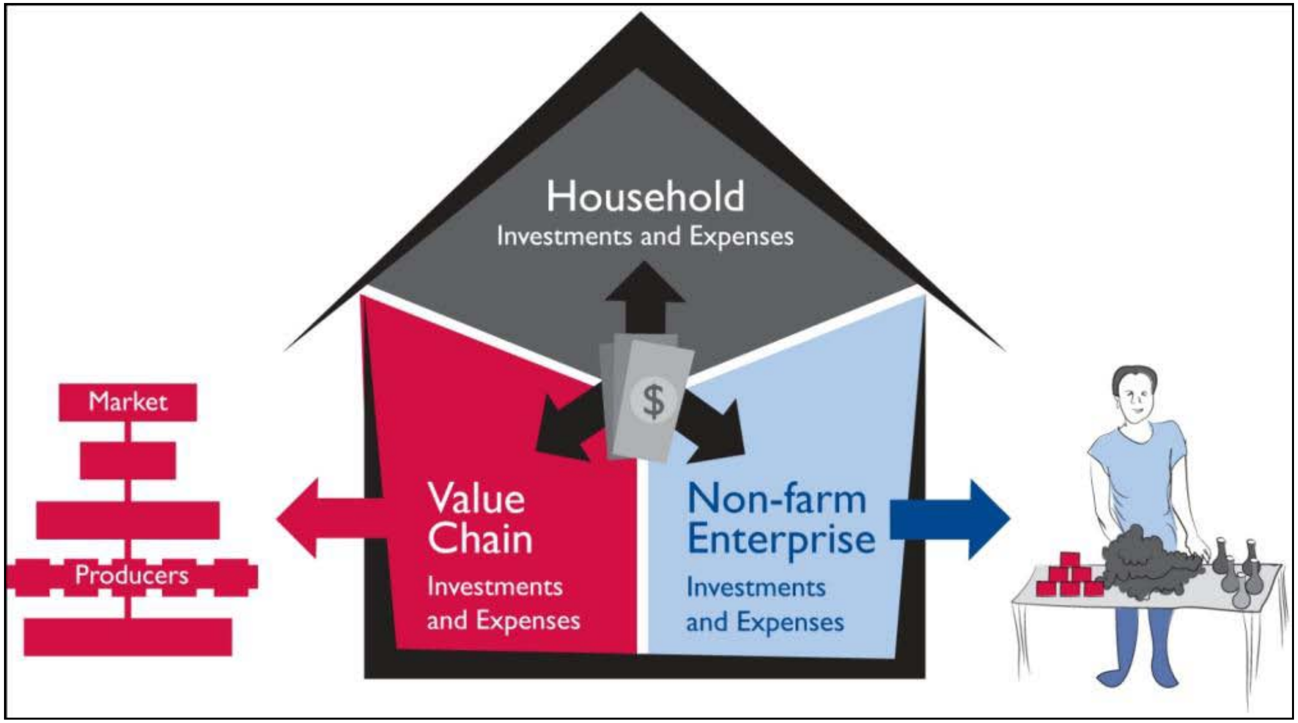
1. Agricultural Value-Chain Finance
2. ‘Non-farm’ Enterprise Finance
3. Household Finance
4. Enabling environment: macro- & meso-, legislation/ regulation, hard/soft infrastructure

Source: “Rural & Agricultural Finance: Taking Stock of Five years of Innovation” by Jason Agar, Kadale Consultants

Many shared challenges at value-chain, enterprise & household levels

- Rural enterprises and households (HHs) face common challenges - remote, dispersed population, poor infrastructure
- Seasonality a significant factor especially where agriculture is rain-fed
- FI perception of rural risk is high and generalized
- Products, services often evolved from urban
- Unequal access based on size and level of connectedness
- But it's changing… commercial motivation, technological means, increased collaboration

An integrated model of rural finance



VC Finance: Challenges from a demand side perspective

1. Side-selling a disruption for agricultural value chains

2. Enterprises & HHs face production, price & market risks

3. Fixed asset finance hard to obtain

4. Farmers lose value through forced early sale

5. Poorer farmers excluded

6. Power relations between producers & buyers can be exploitative

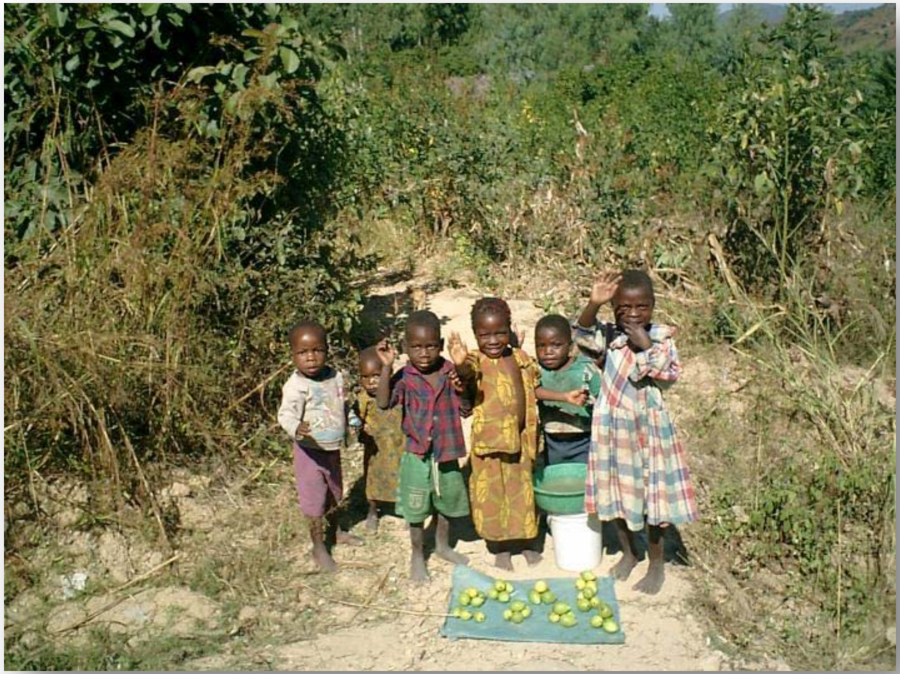
7. Working capital and cashflow weak

HH Finance: Challenges from a demand side perspective

1. HHs vulnerable to shocks – considerable innovation in disaster response, insurance & savings

2. Unmet predictable needs: education, health, life events - considerable innovation

3. Rural HHs harder to reach with promotion – new approaches to marketing and outreach



4. HHs limited knowledge and understanding of finance – integrate with services

NFEF Finance: Challenges from a demand side perspective

1. Lender risk reduction has relied on (inappropriate) collateral requirements - now showing more flexibility

2. Weak ability to determine borrowing capacity results in overly conservative lending – new approaches used

3. Product design not tailored to rural needs + too much focus on credit – product innovation occurring

EE Challenges

1. Cost of rural access has deterred FIs – innovations in outlets, partners and technology have changed the game

2. Regs & Legs based on inappropriate modes of (rural) operation – change opens up opportunities for serving rural

3. MFI capacity weak with insufficient access to capital – measures to strengthen MFIs and increase capital access

Multi-dimensional VCF challenges require appreciation of integrated cashflow.

Some examples:

1. Reducing side selling

2. Reducing production, price & market risks

1. Reducing side selling

– The problem, from the VC competitiveness perspective
  - Under-investment
  - Caused by breakdown of trust
  - Stems from focus on maximizing returns this season
– The problem, from the household perspective
  - Urgent outweighs important
  - Cashflow constraints lead to sub-optimal decision making

- The solutions are multi-dimensional, not just financial
  - Can come from **within** VC or from **outside** but requires understanding of integrated household cashflow.

1. Reducing side selling

– Innovations that respond to this challenge: Malawi

- Prevalence of side selling depends on VC governance structure: open (market based) vs. closed (directed)
- In open marketed crops: substantial, integrated support package (and monitoring by buyer) helped reduce side selling
- Innovations such as “Hungry season payments” helped farmers meet household demands for food, school fees at times of low income inflow etc.

1. Reducing side selling

– Innovations that respond to this challenge: Nicaragua

  - UCPCO (union of cooperatives) in partnership FDL (local MFI)
  - Improved liquidity in the value chain through FDL loan
  - To reduce side-selling (and thus default risk for FDL), UCPCO and FDL supervised the harvest, provided additional services

1. Reducing side selling

– Links to other VC challenges, such as "increasing access to working capital"

  - Ag commitment savings: same goal as hungry season payments - can reduce side selling.
  - NB: the "selecting in" made the difference – not actual tying of the hands

2. Reducing production, price & market risks

– The problem, from the VC competitiveness perspective
  - Excessive risk (or perception) leads to reluctance to invest

– The problem, from household perspective:
  - Without mitigation tools, risk minimization is only option
  - Risk minimization effective for “treading water”, less for moving out of poverty

2. Reducing production, price & market risks

- Innovations that respond to this challenge from within (mostly) the VC: Outgrowing in Ethiopia, Kenya, etc.

- Price and market risks alleviated through (informal or formal) contract, fixed price or bands
- Production risk alleviated through access to proper inputs package and TA

2. Reducing production, price & market risks

- Innovations that respond to this challenge from outside the VC: index based insurance products in Bangladesh, India, Philippines, Tanzania, Malawi, others

- Address production risk primarily
- Overcomes moral hazard & selection bias
  - Result: increased supply of insurance -> increased investment -> improved VC competitiveness
- Overcomes high claims investigation cost
  - Result: lowers risk for household by making coverage more accessible

To read the report mentioned in today's presentation:

"Rural and Agricultural Finance: Taking Stock of Five Years of Innovations"

Please visit http://bit.ly/wz6Xk8

Geoffrey Chalmers
gchalmers@acdivoca.org

Jason Agar
jason.agar@kadale.com

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Microlinks and the After Hours series are products of Knowledge-Driven Microenterprise Development Project (KDMD), funded by USAID's Microenterprise Development office.