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TAKING STOCK OF USAID'S RURAL AND AGRICULTURAL FINANCE INITIATIVES

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The author's views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

CONTENTS

I. INTRODUCTION 1
A. Background and Objectives of the Study 1
B. Key Research Questions 1
II. OVERVIEW OF USAID'S RECENT WORK IN RURAL FINANCE 2
A. Geographic Distribution of USAID's Work in Rural Finance 2
B. Focus of USAID's Work in Rural Finance 4
C. Range of Intervention Approaches in USAID's Work in Rural Finance 6
III. SELECTED PROJECTS IN AGRICULTURAL VALUE CHAIN FINANCE 10
A. Reducing Third Party Selling 10
B. Reducing Production, Price and Market Risks 11
C. Improving Fixed Asset Finance 11
D. Increasing Returns through Bulking and Selling 12
E. Integrating Poorer Farmers 13
F. Increasing Private Sector-Engagement and Competition 13
G. Increasing Access to Working Capital and Assessing Cash Flow 14
IV. SELECTED PROJECTS IN NON-FARM ENTERPRISE FINANCE 15
A. More Appropriate Collateral Requirements 15
B. Determining Capacity to Borrow 15
C. Improved Design Of Non-Farm Enterprise Services 16
V. SELECTED PROJECTS IN HOUSEHOLD FINANCE 17
A. Reducing Households' Vulnerability 17
B. Expanding Financial Institutions' Products to Meet Regular Household Needs 18
C. Improving Financial Institutions' Marketing and Outreach to Rural Areas 18
D. Improved Financial Education 18
VI. SELECTED PROJECTS IN ENABLING ENVIRONMENT 20
VII. CONCLUSIONS AND NEXT STEPS 21
APPENDIX 1: INFORMATION REQUEST FORM 22
APPENDIX 2: PROJECT DATABASE 24
APPENDIX 3: OBJECTIVES, BACKGROUND, METHODOLOGY 25
APPENDIX 4: STUDY APPROACH, SCOPE AND LIMITATIONS 26
APPENDIX 5: SELECTIVE QUOTES FROM RESPONDENTS, ORGANIZED BY TYPE OF CHALLENGE IDENTIFIED 28

ACRONYMS

ARIES	Agriculture, Rural Investment and Enterprise Strengthening
BNA	Central Bank of Angola
CBSPs	Community-Based Service Providers
CHAMP	Community Health and AIDS Mitigation Project
COMPETE	East Africa Competitiveness and Trade Expansion
DAI	Development Alternatives, Inc.
DCA	Development Credit Authority
DMS	Deepening the Microfinance Sector
DRC	Democratic Republic of Congo
FAIDA	Financial Access for Investing in the Development of Afghanistan
FIRM	Financial Inclusion for Rural Microenterprise
FSP	Financial Sector Program
GDP	Gross Domestic Product
I4	Index Insurance Innovation Initiative
IIFCs	Islamic Investment and Finance Cooperatives
M4P	Making Markets Work for the Poor
MABS	Microenterprise Access to Banking Services
MARKETS	Maximizing Agricultural Revenue and Key Enterprises in Target Sites
MATEP	Market Access, Trade and Enabling Policy
MFIs	Microfinance Institutions
MLI	Market Linkages Initiative
OIBM	Opportunity International Bank Malawi
OVC	Orphans and Vulnerable Children
PDA III	Peru Alternative Development Program
PROFIT	Production, Finance and Improved Technologies
PSCEP	Private Sector Competitiveness Enhancement Program
RAMP	Rebuilding Agricultural Markets Program
SMEs	Small and Medium-Sized Enterprises
SPEED	Savings Promotion and Enhancement of Enterprise Development
TSP	Tillage Service Providers
USAID	United States Agency for International Development
WRS	Warehouse Receipt Systems

I. INTRODUCTION

A. BACKGROUND AND OBJECTIVES OF THE STUDY

The United States Agency for International Development (USAID) mission in Senegal is working with local banks to make credit and savings services available to poor people in remote areas of the country. The mission in Peru is working towards the same goal, but has been taking a more value chain-centered approach. How can these missions find out what the other is doing, discover in what directions USAID as a whole is heading, and learn from each other's experience?

This report represents a first step towards addressing that question. As the report will explain, at least 40 USAID missions are, or recently have been, working to expand access to financial services in rural areas. Yet, many missions remain unaware of the broader trends in rural finance from recent years.

To remedy that situation, USAID's Office of Microenterprise Development commissioned a two-part study: one titled '*Rural and Agricultural Finance: Taking Stock of Five Years of Innovation,"* led by Jason Agar of Kadale Consultants, to catalogue innovations in rural finance; this study, carried out by Joe Dougherty and Keelyn Henderson at Cardno Emerging Markets USA Ltd., under subcontract to ACDI/VOCA, collected information on USAID's rural finance work from missions around the world as well as from USAID's headquarters in Washington, D.C.

B. KEY RESEARCH QUESTIONS

With those objectives in mind, the team identified three basic research questions that the study would attempt to answer, with a series of more specific questions under each primary question:

1. *How many recent and current USAID projects address the issue of rural finance?*
    - Where are the projects taking place?
    - What are the projects' timeframes and how large are they?
    - What aspects of rural finance do the projects address and whom do they aim to help?
2. *How are USAID projects expanding access to rural finance?*
    - What financial and non-financial 'tools' do the projects employ?
    - What challenges are the projects experiencing?
    - What results are the projects generating (so far)?
3. *What insights can USAID gain from these projects to inform its rural finance strategy?*
    - What approaches seem to be working and not working?
    - What needs and approaches have not been fully explored?
    - Where might further research or investment be needed?

II. OVERVIEW OF USAID'S RECENT WORK IN RURAL FINANCE

In January 2004 the Office of Agriculture within USAID's Bureau of Economic Growth, Agriculture and Trade issued a "Rural Finance Baseline Inventory" based on work that had been carried out by Development Alternatives, Inc. (DAI). That exercise sought to catalogue *all* of USAID's work in rural finance that took place between 1997 and 2003. The 2004 Baseline Inventory took a more summative approach than the present study, focusing on quantifying and categorizing USAID's investments in rural finance rather than delving into the details of any one particular project. Despite these differences, the 2004 Baseline Inventory offers a useful point of comparison for understanding how USAID's approach to rural finance has evolved over the past seven years and will be referred to periodically in the discussion below.

The most striking difference between our findings and the results of the 2004 Baseline Inventory is that most of USAID's work in rural finance now takes place in the context of integrated rural value chain development projects, as well as, in some cases, the context of broader projects focused on food security or vulnerable populations, rather than as stand-alone efforts. The 2004 Baseline Inventory found that 76 percent of USAID's investment in rural finance (by value) was in stand-alone rural finance projects, while only 24 percent was invested in rural finance components of larger projects. In contrast, only 10 of the 61 projects in our database focus exclusively on finance, and together they account for no more than about 8 percent of the total value of all the projects. Moreover, only two projects—the FIRM (Financial Inclusion for Rural Microenterprise) Project in Kenya implemented by DAI and the AgBiz Project in Macedonia implemented by Tetratech—focus explicitly and exclusively on *rural* finance. Others, such as the FAIDA (Financial Access for Investing in the Development of Afghanistan) Project implemented by Chemonics, the MABS (Microenterprise Access to Banking Services) Project in the Philippines also implemented by Chemonics, and the Financial Sector Project in Angola implemented by Cardno, are aimed at improving access to financial services for both rural and non-rural firms and households.

The 2004 Baseline Inventory found that USAID's investment in rural finance in 1997 through 2003 was about $270 million, not including Development Credit Authority (DCA) guarantees. Our database includes more than $1.5 billion in total project value, again not including DCA guarantees. It should be noted that we cannot determine how much of that amount was devoted exclusively to rural finance, rather than other activities. Therefore we are not able to say whether USAID's investment in rural finance has grown, declined or remained steady since 2003.

A. GEOGRAPHIC DISTRIBUTION OF USAID'S WORK IN RURAL FINANCE

Location of Projects: We *can* say, however, that the largest portion of USAID's rural finance work takes place in Africa. More than half of the 61 projects are located in sub-Saharan Africa, accounting for about 48 percent of total project value, as seen in the table below:

Region	Number of Projects	Aggregate Value
Sub-Saharan African	32 (52%)	$736,898,000 (48%)
Central Asia	5 (8%)	$332,380,000 (22%)
Latin America / Caribbean	8 (13%)	$252,753,000 (16%)
Europe and the Caucuses	7 (11%)	$109,500,000 (7%)
South and East Asia	5 (8%)	$78,400,000 (5%)
North Africa and Middle East	4 (8%)	$25,150,000 (2%)
Total	**61 (100%)**	**$1,535,081,000 (100%)**

Within sub-Saharan Africa, USAID's rural finance efforts seem to be concentrated in a relatively small number of countries. Our database includes four major projects in Kenya and four in Uganda, but none in Tanzania, for example.

Across all regions, about a quarter of the projects in the database are located in conflict-affected countries like Afghanistan, Pakistan and the Democratic Republic of Congo (DRC), representing about a third of the known total project value. Roughly 10 percent of the projects, representing about 15 percent of known total project value, are in natural disaster-affected countries such as Pakistan, Haiti and Bangladesh.

Country Characteristics: Interestingly, the countries in which USAID has chosen to invest in improving access to rural finance vary widely in terms of the degree of access to finance and the portion of people who live and work in rural areas. As a rough proxy for the degree of access to finance, the team used the World Bank's measurement of credit to the private sector as a percent of gross domestic product (GDP). USAID funds rural finance work in countries with very low ratios of credit-to-GDP, like Yemen (7.4 percent), the DRC (7.5 percent), and Afghanistan (9.1 percent), but it also funds rural finance work in a few countries with much higher credit-to-GDP ratios, such as Macedonia (44.3 percent), Bosnia (57.3 percent), and Ukraine (77.3 percent). In general, however, USAID's investments seem to be larger in countries with lower credit-to-GDP ratios and thus (one can assume) less access to finance, especially in rural areas.

The team also collected data (again from the World Bank) on the percent of the population of each country that works in agriculture. Unsurprisingly, USAID tends to invest more in rural finance (and in agricultural value chain development in general) in countries where a large portion of households rely on farming for their livelihoods. Most of the projects in our database are located in countries where well over half the workforce depends on agriculture, e.g., Senegal (78 percent), Afghanistan (79 percent), Ethiopia (85 percent) and Malawi (90 percent). There are, however, a few outliers. Fewer than 20 percent of workers in Colombia, Macedonia and Ukraine work in agriculture, but all three countries host significant USAID-funded rural finance efforts (the MIDAS, AgBIZ and AgroInvest projects, respectively). On the other hand, large majorities in countries like Angola (85 percent) and Sudan (80 percent) depend on agriculture, but USAID's investment in rural finance in those countries has been relatively modest.

It is interesting to note that among the countries in which USAID promotes rural finance, there seems to be a strong inverse correlation between the number of people employed in agriculture and the contribution of agriculture to the country's GDP. As a point of comparison, a little over 1 percent of the U.S. labor force works in agriculture, while agriculture accounts for a little over 1 percent of GDP, making agricultural workers about equally as productive as workers in other sectors. In Azerbaijan, agriculture accounts for 8 percent of GDP but employs 38 percent of workers. In Zambia, 85 percent of the workforce is employed in farming or livestock production, but those workers contribute less than 20 percent of GDP. Agriculture in those countries (and most others) is far less productive on a per-worker basis than other sectors in the same countries—mining, manufacturing or services for example—and therefore should not be a very attractive way to make a living for most households. The problem, of course, is that for most households there are few obvious alternatives to agriculture.

From the point of view of a donor agency like USAID, there are three possible responses to the low productivity of agriculture in developing countries. The first response is to try to make agriculture more productive, by enhancing the competitiveness of "high-potential" value chains, for example, or improving access to agricultural finance. As the next section will illustrate, this is the response that USAID most often seems to choose. The second response is to help poor, rural households move out of farming into other, more productive, activities by improving access to finance for non-farm rural enterprises, among other things. To a lesser extent, USAID has been working towards that objective as well, as the next section will also show. The third possible response would be to make it easier for the poor, especially those in rural areas, to find jobs with private companies in sectors other than agriculture, primarily by increasing the supply of jobs (by improving the business environment, for example, or promoting exports) but also by preparing the

rural poor to qualify for those jobs (through workforce development initiatives). The millions of people who have risen out of poverty in India, China and parts of Southeast Asia in recent years did so not by becoming better farmers or launching tiny enterprises, but largely by taking jobs with new and growing companies.

B. FOCUS OF USAID'S WORK IN RURAL FINANCE

Project Objectives: Respondents to our survey were asked to identify the *primary* goal of the rural finance components of their projects, and were given the following three choices:

1. Support agricultural production and/or processing
2. Promote development of non-farm enterprises
3. Support household consumption and emergency needs (income smoothing)

Respondents were asked to select more than one option *only* if they considered the selected options equally important. The majority, 37 of the 61 projects (61 percent), reported that they were exclusively focused on agricultural finance. Only 3 projects (5 percent) focused exclusively on non-farm enterprise finance and only 3 projects—all of which focus on orphans and vulnerable children (OVCs)—claimed household consumption alone as their primary goal.

Eighteen projects (30 percent) selected more than one "primary" focus area: all of those 18 included agricultural finance but only 8 included household finance among their multiple priorities. These findings are noteworthy for two reasons. First, they suggest that many people within USAID and its implementing organizations see "rural finance" as synonymous with "agricultural finance." Only 6 of the 61 projects did *not* include agricultural finance as a primary objective. Second, they suggest that many in the USAID community either do not associate "rural finance" with household (consumption) finance—and therefore did not guide the team towards household finance-focused projects that might have been included in the database—or, more likely, that many in the USAID community (or at least those associated with USAID's economic growth, agriculture and trade activities) perceive household finance and income-smoothing as less valuable or important than finance for production, particularly agricultural production.

This latter interpretation is supported by the fact that a few projects that are clearly focused on "support(ing) household consumption and emergency needs (income smoothing)" did not list that as a primary objective. For example, the Rural SPEED Project in Uganda (2004-2007), implemented by Chemonics, had the word "savings" in its title: "Savings Promotion and Enhancement of Enterprise Development." Savings promotion, almost by definition, focuses on smoothing incomes and supporting households' emergency needs. The Rural SPEED Project helped introduce 33 new or improved savings products to the market and encouraged more than 320,000 people to start saving money for the first time. Yet Rural SPEED listed only agricultural finance as its primary objective; it did not select household finance. The new FAIDA project in Afghanistan has a goal of increasing savings in USAID-assisted microfinance institutions by $3 million and, as a general financial sector development project in an extremely poor and war-torn country, might be expected to focus on income-smoothing and emergency-response finance as well as production finance. However, FAIDA also listed only "agricultural finance" as its primary objective. It, too, chose not to list household finance as an equally important objective.

Types of Financial Services Promoted: Just as agricultural finance dominated over the other categories, credit dominated over other types of financial services. As noted earlier, only 3 projects listed "supporting household consumption and emergency needs (income smoothing)"—which would suggest a focus on savings and/or insurance, rather than, or in addition to, credit—as its exclusive objective and only 11 projects listed it as one of their primary objectives.

Among the 61 projects in our database, 52 reported on their quantitative targets and/or results achieved to date. Of those projects, 17 (28 percent) had a target (or reported a result) related to increasing savings or developing new

savings products. Seven projects (11 percent) reported a target or result related to improving access to payments, transactions or other unspecified financial services (other than loans), but the only 3 projects known to have invested significantly in mobile transactions are the Haiti Multi-Year Assistance Program (implemented by World Vision), the Zambia PROFIT (Production, Finance and Improved Technologies) project (implemented by CLUSA and Cardno) and, most notably, the Philippines MABS project. Only one project (Haiti CHAMP— Community Health and AIDS Mitigation Project—implemented by FHI360 and Catholic Relief Services) reported any targets or results related to insurance, although Zambia PROFIT has explored options for supporting rural micro-insurance and the Bureau of Food Security is piloting various forms of index insurance in seven countries. (As noted, those pilots were not included in the database used as the basis for this quantitative overview.) Other than the index insurance programs, Zambia PROFIT, and Haiti CHAMP, which promotes formation of community-level insurance funds, the study did not find evidence of any other projects actively promoting rural insurance.

Even among the large majority of projects that focused exclusively on credit (rather than other financial services), there was surprisingly little variation. The majority of projects in the database worked exclusively with microfinance institutions (MFIs) and/or commercial banks to generate various types of credit, such as working capital loans secured by fixed assets, "social collateral" (in the case of some MFIs), warehouse receipts (less commonly) or, in one case, purchase orders. Only a handful of projects—AgVantage in Georgia implemented by ACDI/VOCA, PROFIT in Zambia, and ARIES (Agriculture, Rural Investment and Enterprise Strengthening) in Afghanistan implemented by AED, ACDI/VOCA and WOCCU—seem to have explored equipment leasing, but those projects all report promising results (see Section III). Finally, about 20 percent of projects promote self-financing through village savings-and-loan associations or similar mechanisms.

Fewer projects have experimented with hybrid or equity financing as an alternative (or complement) to debt financing. Chemonics' Afghanistan RAMP (Rebuilding Agricultural Markets Program) invested in the Afghan Renewal Fund in the early days of the country's transition and helped it make equity investments in several agricultural enterprises, apparently with disappointing results. In Azerbaijan, PSCEP (the Private Sector Competitiveness Enhancement Program), also implemented by Chemonics, worked with two investment companies, one state-owned and one private, to identify and evaluate investment opportunities in the agricultural sector. One of them ended up making a $6 million equity investment in a large agribusiness, as will be discussed in more detail later. Finally, Zambia PROFIT played a small role in helping a Zambian company, Mobile Transactions Zambia Ltd., attract an equity investment from the Grassroots Business Fund. The study found few other examples of USAID-funded projects actively helping to arrange third-party equity financing for agricultural or non-agricultural rural enterprises. In one example, Paraguay Productivo, (implemented by Carana and ACDI/VOCA) the project facilitated a multi-party financing deal for a cooperative sugar processing plant, which included national and international banks as well as local equity investors.

Finally, surprisingly few projects explicitly address the enabling environment-related constraints to rural finance. Only eight projects cited targets or results related to the enabling environment (financial sector policies, laws, regulation or supervision) or mentioned having addressed enabling environment issues related to rural finance.

This apparent lack of attention to constraints in the enabling environment is significant because most of the countries in which USAID funds rural finance initiatives have relatively weak enabling environments for financial services. Most of them perform quite poorly, for example, against the World Bank's Doing Business indicators for "ease of getting credit." The World Bank scores countries on the "strength of legal rights," as they pertain to credit transactions, on a scale of 1 to 10 (with 10 representing very strong legal rights). The average score for countries in which USAID is working in rural finance is 5.5, with more than a third of countries scoring a 4 or lower. The World Bank also assigns scores for "depth of credit information," measuring the rules that govern the availability of data on potential borrowers. On a scale of 0 to 6 (6 being the best score), the average score for countries in which USAID is working in rural finance is 2.8. Seven countries actually received a score of zero, including some countries in which USAID has

invested a great deal in rural finance and might therefore have significant leverage to push for reforms, like Afghanistan and Malawi. Improving the enabling environment can be difficult and time-consuming, and it does not often generate the quick, measurable and directly attributable results that USAID seeks. In some cases, this may be more a reflection of a given mission's real or perceived comparative advantage and where they feel their scarce resources would be best put to use given other actors' strengths (for example, a World Bank project with policy expertise). Nevertheless, the lack of focus on enabling environment reform might represent a missed opportunity for USAID to help bring about deeper and more sustainable improvements in access to rural finance.

C. RANGE OF INTERVENTION APPROACHES IN USAID'S WORK IN RURAL FINANCE

Types of Interventions Used: After exploring *which* objectives the USAID projects are designed to achieve, the team asked *how* the projects go about achieving them. Fundamentally, a donor-funded project has a limited set of tools at its disposal and only so many ways in which it can go about pursuing its objectives, as illustrated in the table below:

"Non-Financial" Interventions	"Financial" Interventions
✓ Technical assistance	✓ Grants (cash or in-kind)
✓ Training and capacity building	✓ Guarantees (DCA or other)
✓ Market facilitation (brokering relationships)	✓ Loans or leases
✓ Advocacy and outreach (public awareness)	✓ Equity investments (and "repayable grants")

Most commonly, donor-funded projects offer technical assistance, providing local actors with consulting services, research or other forms of technical expertise. Moreover, most projects have a focus on capacity building for local actors, providing formal or informal training, either directly or through a third party. Projects that follow the Office of Microenterprise Development's value chain approach or a similar approach like Making Markets Work for the Poor (M4P) place a great deal of emphasis on market facilitation. This involves bringing various actors in and around a particular value chain together to take collaborative action, make joint investments, or "do deals." Finally, and less commonly, projects can promote their objectives by advocating for change (directly or indirectly) to public officials, specific stakeholders, or the public at large. What all of these approaches have in common is that they do not usually involve large sums of money, other than the project teams' salaries and general operating expenses. Therefore, in this study they are referred to as "non-financial" interventions.

All donor-funded projects, by definition, employ at least one of these interventions. Many augment their non-financial interventions with "financial interventions," which involve either making a significant expenditure (i.e., a grant) or incurring a significant liability (i.e., a credit guarantee or a direct loan or lease). It is important to note here that a loan, lease or other investment is considered a financial intervention only when the loan, lease or investment is originated directly by USAID or a USAID-funded project and *not* when the project facilitates a loan, lease or investment by a third party. For example, USAID provided $2 million in seed capital, through its MATEP (Market Access, Trade and Enabling Policy) project in Zambia, implemented by DAI, to a local (USAID-originated) NGO, ZATAC, which used the money to make loans to agribusinesses under MATEP's direction. Loans made directly by ZATAC to an agribusiness, using USAID's money, would be considered a "financial intervention" under this definition. A loan made to the same agribusiness by a commercial bank would not be considered a financial intervention, even if MATEP had brokered the relationship and provided technical assistance to the bank to evaluate the loan.

The team asked all of the USAID missions and implementing partners we contacted to list *all* of the non-financial and financial interventions the project employed and, where possible, to provide the value of the financial intervention(s).

First, as expected, the vast majority of projects employ more than one non-financial intervention, as seen in the following table:

Non-Financial Intervention	Percent of Projects Using Intervention
Technical Assistance	87%
Training	80%
Market Facilitation	75%
Advocacy and Outreach	43%

Only nine projects reported using only one type of intervention (technical assistance, mostly) and there is no apparent correlation between the size of the project and the number of intervention types it employs.

It is interesting to see that less than half the projects reported that they engage in advocacy or awareness-building, but the finding is not surprising given how few projects address the enabling environment for rural finance.

About 60 percent of the projects reported using one or more financial interventions in addition to their non-financial interventions. Almost 45 percent of the projects we surveyed include a grant component, and about two-thirds of those projects use grants as their only financial intervention. More than a quarter of all projects employ a credit guarantee. In most cases, the guarantees were issued by USAID's DCA in cooperation with the project. In a few cases, however, projects issued guarantees backed by their own funds. The Value Girls Project in Kenya, co-funded by USAID and the Nike Foundation and implemented by Cardno, is one current example. Integrated Initiatives for Economic Growth in Mali, implemented by Abt Associates, is another, which maintains a $2 million guarantee fund for loans to agricultural producers and processors.

At least four projects—Afghanistan ARIES, Georgia AgVantage, DRC Farmers-to-Market (implemented by Paul Carlson Partnership), and Zambia MATEP—used project funds to make loans or leases to rural borrowers, either directly (AgVantage and Farmers-to-Market) or indirectly through a local NGO set up for that purpose (ARIES and MATEP). Only one project, Afghanistan RAMP, used project funds to make equity investments in rural enterprises. RAMP provided grant funding to the Afghan Renewal Fund for that purpose, as mentioned earlier. The Agricultural Enterprise Finance Component of the Southern Sudan Agricultural Revitalization Program (implemented by Chemonics), which ended in 2008, created and funded the Sudan Microfinance Institution, but it did so (as many USAID projects have done over the past decades) through a grant rather than through an equity investment.

Among the 61 projects in our database, the average duration is just over 4 years, with the shortest project (Afghanistan FAIDA) lasting a little over one year and the longest project (Philippines MABS) more than 10 years. Fifty-six of the 61 projects began in 2010 or earlier, so nearly all of them have had enough time to generate at least preliminary results and thus provide useful feedback on the challenges they have faced, the lessons they have learned and the impact they have achieved so far. The following paragraphs address these topics.

Challenges Encountered: Projects were asked to list the challenges they faced as they deployed these interventions. Thirty-eight projects responded. Based on the range of responses received, the challenges are organized into five categories, as seen in the table below:

Challenge	Description	Percent
Supply	• Limited willingness / ability of financial institutions to lend / provide services in rural areas	*33%*

	• Poor understanding of agricultural risks, returns and cash cycles • Low level of competitive pressure within banking industry	
Demand	• Inherent risks in agriculture, especially among smallholders—reliance on weather, lack of insurance, etc.—along with limited adoption of improved farming techniques • Lack of financial literacy and poor record-keeping among rural enterprises / households	*30%*
Systems	• Prohibitive legal/regulatory framework or unclear/inconsistent policies • Unpredictable intervention in markets by governments, making investment more risky • Lack of financial market infrastructure, e.g., credit information systems and insurance	*21%*
Other	• Unpredictable and severe weather patterns • High rates of turnover among financial institutions' staff • Excessive intervention by donor agencies, perverting incentives and price mechanisms	*11%*
USAID	• Inappropriate DCA guarantee structures or targets, limiting utilization of guarantees • Onerous and irrelevant grant disbursement and reporting requirements • Excessive focus on short-term results instead of longer-term, systemic changes	*7%*

The numbers in the right-hand column add up to more than 100 percent because about half of the projects that responded cited more than one challenge. It is interesting to note that supply and demand appear with almost equal frequency among the most commonly cited challenges. Appendix 5 lists some of the specific challenges or issues cited by individual projects.

Strengths and Lessons Learned: The strengths and lessons learned reported by most projects were relatively common: understand value chains before intervening in them, offer "demand-driven" technical assistance, establish buy-in and support among stakeholders, and build local capacity. The handful of more specific strengths and lessons learned that were cited correspond to the challenges outlined above. Most projects, for example, cited their "integrated nature" as a strength—their ability, in other words, to address supply-side and demand-side constraints at the same time. Many projects in the database seem to work with those actors demanding services, such as borrowers and savers, to increase their financial literacy, improve their record-keeping practices, and enhance their creditworthiness; all while working with actors providing financial services, such as financial institutions, to develop new products, evaluate loan applications, or build their basic understanding of the agricultural sector.

Several projects cited as a key strength their ability to provide sector- or commodity-level market information to financial institutions, to help them understand the risks and opportunities inherent in certain agricultural markets as well as the specific needs of farmers, processors and traders in those markets. The Deepening the Microfinance Sector (DMS) project in Malawi (implemented by Chemonics), for example, believed that certain MFIs were doing a poor job of identifying and assessing risk in agriculture, and were therefore "overly cautious, when they could safely lend more." To address this issue, the DMS project carried out a series of sector studies explaining the underlying economics, risks and opportunities for specific crops and made the results available to MFIs. The Maximizing Agricultural Revenue and Key Enterprises in Target Sites (MARKETS) Project in Nigeria (also implemented by Chemonics) studied the maize and sorghum markets in cooperation with farmers and processors, and was thus able to explain to financial institutions why the risks and cash cycles in each market were different and required specialized

financial products. DAI's FIRM Project in Kenya is in the process of establishing a Value Chain Finance Center (which is discussed in more detail in Section III) to provide up-to-date information on agricultural markets to financial institutions, including risks, opportunities, financing needs and ideas for new or tailored products. These three projects, among others, stressed the need to continually update information on targeted sectors, as agricultural markets are dynamic and their risks and requirements change often.

In terms of lessons learned, several projects helpfully pointed out that it is important to consider income and expenses associated with *all* of a rural household's activities, not just its farming activities, when assessing its borrowing needs and repayment capacity. This approach has, in fact, become standard practice among the best rural lending institutions. On a related note, a few projects cited the need to encourage rural households to diversify their income sources in order to reduce their vulnerability to bad weather and volatile prices.

Performance Targets and Results: Among the projects that reported their targets and results, the vast majority reported that they have met or exceeded their targets. Only three projects reported instances in which they failed to meet a target indicator. There are, of course, a number of ways in which this finding might be interpreted.

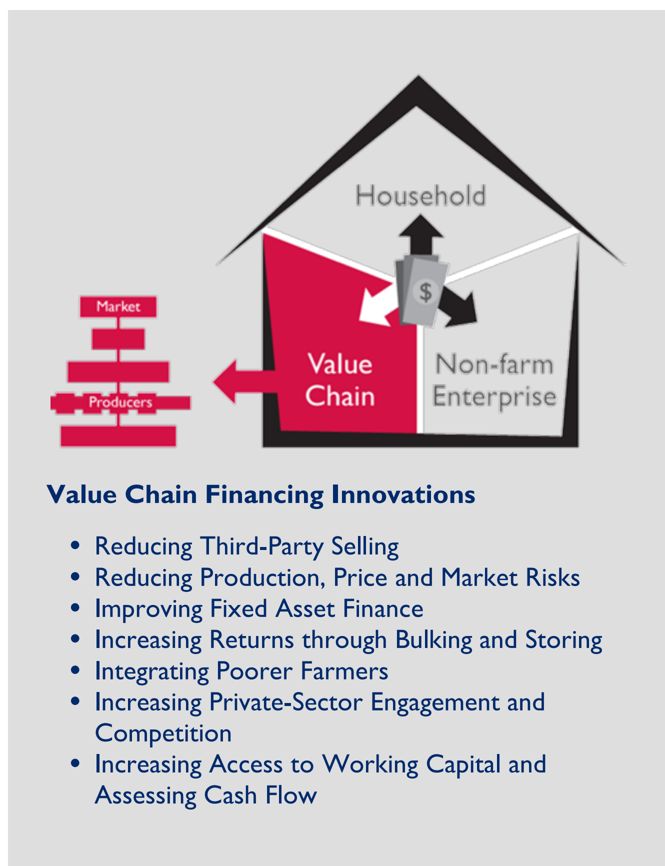
As noted earlier, most projects' targets focused on credit rather than savings or other financial services. Only 17 projects reported having a target (or reported a result) related to savings. Only seven projects reported a target or result related to improving access to payments, transactions or other financial services. In contrast, 35 projects (two-thirds of all projects reporting targets or results) aimed to increase the volume and/or number of new loans disbursed by assisted financial institutions. Troublingly, however, only six projects cited some measure of loan performance, such as portfolio at risk or loan delinquency rate, as a target or result and only two projects listed targets related to improving the overall sustainability or profitability of financial institutions. This suggests that USAID-funded rural finance projects are focusing exclusively—and dangerously—on short-term results (as measured by loans disbursed) to the detriment of longer-term sustainability (as measured by loan repayment rates and institutions' overall financial performance). Some of these projects might be pushing financial institutions to make loans that should not be made and are unlikely to be repaid.

It is also interesting to note that only five projects mentioned research among their targets and results, despite the "lesson learned" about the value of providing useful market information to financial institutions and others. Similarly, only about a quarter of projects listed a target or result related to training, despite USAID's focus on capacity building. Admittedly, it is quite possible that more projects had targets in these areas, but simply failed to mention them in the survey forms. Nevertheless, the mere fact that so many projects focused exclusively on generating new loans, while so few mentioned loan quality or financial institutions' overall performance, suggests that too many projects see long-term sustainability as less important than short-term results. The fact that so many projects focus on loan growth without mentioning targets for savings, payments, insurance or enabling environment reform, suggests an overly-narrow focus on credit.

A few projects claim to have achieved truly eye-popping results. A project in Uganda, for example, evidently helped generate *$31 billion* in new agricultural loans in just three years. A project in Malawi takes credit for *doubling* the total amount of microloans outstanding in the country over a single year. A project in Ghana assisted nearly 3,000 producer groups and trained 129,000 people within five years, while a project in Mali has directly benefitted more than 12,000 households in just 18 months. The sheer magnitude of these numbers, along with the short time in which they were achieved, might suggest that some of USAID's rural finance programs should adopt more rigorous results measurement and attribution techniques.

III. SELECTED PROJECTS IN AGRICULTURAL VALUE CHAIN FINANCE

The preceding section presented a "macro-level" view of our database of projects, which represents a substantial portion of USAID's portfolio of recent and current work in rural finance. The following sections provide a window into a "micro-level" view, delving into the details of selected projects in order to highlight approaches that appear to be particularly unique, innovative, promising and/or successful.



As noted earlier, 37 of the projects in our database listed agricultural value chain finance as their *only* objective. Another 18 projects cited agricultural value chain finance as *one of several* objectives. Only 6 projects—fewer than 10 percent—did *not* list agricultural value chain finance as an objective. This reinforces the perception that, for many of USAID's implementing partners, "rural finance" is synonymous with "agriculture finance."

There are a number of ways in which financial services can improve the productivity and efficiency of agricultural value chains. The companion piece to this report, *Rural and Agricultural Finance: Taking Stock of Five Years of Innovations*, organized rural finance innovations according to the problem or constraint they seek to address, as shown in the figure on right.

The following pages provide examples of USAID projects from our database that seek to address each of these seven concerns in turn.

A. REDUCING THIRD PARTY SELLING

Third-party (or side-) selling is when farmers who are contracted or otherwise obligated to sell to a particular buyer, from whom they have received financial, technical or other support, sell to a different buyer. The review of rural finance innovations found side-selling to be a significant problem facing outgrowing and contract farming arrangements. It can be costly and impractical for a buyer to enforce contracts with smallholder farmers and, in some cases, attempting to do so can be politically sensitive. Different approaches are being tried, including attempts to police and prevent sales to third parties, offering incentives to sell to the original buyer, and greater integration of operations. USAID's work in this area includes the following:

- The PROFIT project in Zambia facilitated the launch of a secure, mobile phone-based platform to link Dunavant Cotton, one of Zambia's largest buyers of smallholder-grown cotton, and its suppliers. Mobile

Transactions Zambia Ltd.'s platform helped reduce side-selling by Dunavant's outgrowers, since the outgrowers appreciated that they were paid immediately (and *not* in cash, reducing pressure from family members for support). The platform's unique personal identification number, which served as a receipt for payment at authorized agents (village kiosks), means that each payee does not need to own a mobile phone.

- In Bolivia, FIE (a Bolivian MFI) introduced purchase order finance to the dairy and coffee value chains. USAID, through the ARCO project, provided technical assistance and start-up support to FIE (without any guarantee or loan subsidy). Through this model, the buyer places a purchase order to small producers through a broker or processor, and the producers then request a loan from FIE; accounts receivable are transferred to FIE, which receives payment directly from the buyers at a later point. The long-term commercial relationship between the bank's client (the supplier) and the buyer diminish risk for all parties involved. The arrangement is thought to reduce third-party selling since the producers' ability to access finance is directly linked to their contracts with buyers.

B. REDUCING PRODUCTION, PRICE AND MARKET RISKS

Agricultural production is a risky business. Farmers face a variety of risks that make their incomes unpredictable from year to year. Outgrowing provides a mechanism to reduce some price and market risks. By providing access to the right amounts of inputs and technical support, outgrowing can also reduce production risks. Insurance is another key mechanism through which the risks associated with agricultural production can be mitigated, and credit can be unlocked by reducing the risk of default due to uncontrollable events. However, private insurers have historically been reluctant to insure crop and livestock yields due to moral hazard and inadequate risk assessment information. Worse, the high frequency and covariant nature of certain agricultural production risks potentially expose insurers to large payouts. Crop insurance has been rare or prohibitively expensive, often leaving it to government agencies to provide some form of insurance for farmers. An emerging alternative is index insurance**,** which uses an identified objective index (such as rainfall) with reliable data that is highly correlated to local yields as a proxy for actual loss. This removes the need for the insurer to make costly in-field assessments of actual losses. Crucially, it also opens the door for re-insurance.

- USAID's Bureau of Food Security has been sponsoring a collaborative research program called the Index Insurance Innovation Initiative (I4), in which U.S. universities partner with developing country research institutions to develop, pilot-test and evaluate index insurance products designed for the needs of small-scale farmers in each country. In Bangladesh, for example, I4 partnered with a local insurance company to offer flood insurance to small-scale farmers; in Ethiopia, farmers can insure themselves against both drought and frost.

C. IMPROVING FIXED ASSET FINANCE

Much of the credit available through value chains has been for working capital needs, which has been a key gap for smallholders, but there is also a need for fixed asset finance. One alternative for financing fixed assets is financial leasing. This is a close substitute for loans, and offers several advantages for providers and clients: farmers do not need to have a strong asset base or pay large initial cash deposits, with the inherent value of the purchased asset acting as the collateral. For the financial institution, leasing offers a particular advantage in developing and middle-income countries where enforcing creditors' rights is difficult and/or costly. The use of financial leases for farm machinery is not new or innovative, but such leasing packages are for equipment beyond the reach of most smallholders. Evidence of participation in the leasing market for lower-value agricultural-related capital investments remains relatively scarce.

- In Georgia, the USAID AgVantage project helped agribusinesses gain access to fixed asset financing by developing a leasing sector as an alternative to inaccessible term loans with prohibitive collateral

requirements. AgVantage created a specialized Leasing Unit to facilitate the provision of long-term equipment financing from Georgian leasing companies, with support from a credit guarantee program. The Leasing Unit's capacity building efforts ensured that Georgian leasing companies had the management and operational know-how to ensure sustainable provision of leasing services in the future.

- USAID's PROFIT project worked with the Zambian Conservation Farming Union and others to cultivate tillage service providers (TSPs)—farmers who would till the fields of other farmers for a fee. To overcome aspiring TSPs' liquidity constraint, PROFIT turned to Dunavant Cotton, who agreed (with a modest initial guarantee) to purchase a tractor and lease it to one of its trusted outgrowers who was interested in becoming a TSP. Dunavant went on to purchase and lease out ten more tractors, without any guarantee from PROFIT.

- Aside from leasing, several USAID projects have approached the fixed asset financing problem through equity rather than debt. In particular, the Rebuilding Agricultural Markets Program provided funding and assistance to the Afghanistan Renewal Fund, Afghanistan's first venture capital fund, which invested in small and medium enterprises (SMEs) along the agribusiness value chain. However, the project reported problems with "investor follow-through," and project management suggested that it might have been more effective to invest directly in SMEs rather than going through a third-party investment vehicle.

- USAID's Private Sector Competitiveness Enhancement Program assisted in the identification and analysis of opportunities to facilitate investment by the Azerbaijan Government's equity investment company and a privately owned equity fund called Caspian International Investment Company. The $6.8 million investment in NAA (an agribusiness) helped improve its cold storage, greenhouse and packaging capabilities, thus leveraging limited project funds to achieve larger investments that benefit an entire sector.

D. INCREASING RETURNS THROUGH BULKING AND SELLING

Since harvesting is seasonal in a particular locality, there is a relative abundance of local produce at that time and limited availability between harvests. There are significant potential value gains through delayed sale of the crop, but the problem for most farmers is that they need some release of their capital tied up in the product to meet immediate obligations or invest in a seasonal business as early as possible. One solution to this problem, warehouse receipt systems (WRS), has been promoted for many years, yet the evidence of success is still limited, particularly in terms of benefits to smallholder farmers.

Reasons for difficulties in operating WRS include the need for reliable, certified warehouse infrastructure, links to a transparent price discovery mechanism, and lenders' willingness to lend against stored crop (often their hesitancy relates to the lack of reliable warehouses and trustworthy warehouse managers): it takes many years to get all of these working at the same time. The upfront cost of moving small quantities of a commodity to a warehouse at some distance is a deterrent to many smallholders with limited cash resources, but more in line with the resources and role of traders. Because most of the constraints to WRS-based financing relate to a lack of underlying infrastructure, information and regulation, the issue is better approached from outside the remit of "rural finance" per se:

- The Market Linkages Initiative (MLI) in Malawi, implemented by Carana Corporation, does not have an explicit rural finance component, nor did it set out purposely to enhance access to finance. Instead, MLI worked with farmers and other value chain actors to improve productivity by improving physical and technological infrastructure, among other means. But MLI has found that its interventions have brought about an unintended, but welcome, increase in interest among financial institutions in lending to farmers. For example, MLI provided a grant to fund 50 percent of the cost of building a new warehouse for a grain bulking operation. Partly because of MLI's investment and the confidence it demonstrated in the enterprise's prospects, a local financial institution (Opportunity International Bank Malawi, or OIBM) was, at the time of

writing, set to provide the operation with a $1 million loan. OIBM is also reportedly working with MLI to leverage Esoko, a mobile agricultural market information system developed with MLI's support, to identify, assess and approach potential new borrowers among smallholder farmers with specific, trustworthy warehouse operators.

E. INTEGRATING POORER FARMERS

Where value chain projects have included smallholders, they have most often targeted those with land and sufficient resources to enter into a commercial transaction. Subsistence farmers have mostly been neglected, as have the poorest, vulnerable and destitute households. To integrate such farmers and households into commercial opportunities, many donors have used "push-pull" strategies: a "push" of direct subsidized support to households to stabilize their asset base, accompanied by more sustainable market opportunities and loans designed to "pull" them up into commercial relationships.

- In Kenya, the Nike Foundation's Value Girls Program, co-funded by USAID, is facilitating access to finance and education for young women who are beginning to undertake vegetable and poultry production but lack assets and national identification cards. The program also provides the women with access to technical, agronomic support and has facilitated commercial links with input providers and local markets.
- The Farmers-to-Market Project in the DRC, lends tools and seeds to farmers, sells bicycles on credit to transporters, and provides credit to wholesalers to purchase the produce the farmers have grown and the transporters have brought to market, thus seeking to create a small value chain where none previously existed.
- The One Acre Fund, which received a grant from USAID's East Africa Competitiveness and Trade Expansion (COMPETE) project implemented by Chemonics, provides a "market bundle" of agricultural training, bulk selling services, in-kind loans of seeds and fertilizer, and crop insurance to smallholders in Kenya and Rwanda. The in-kind nature of the loan ensures that funds are used for the intended purposes, although it might limit each farmer's ability to select his or her unique optimal mix of inputs. Farmers choose their own repayment schedules, which avoids any mismatch between repayment terms and cash flow cycles.

F. INCREASING PRIVATE SECTOR-ENGAGEMENT AND COMPETITION

A close relationship between producer and buyer can be beneficial, for example, by allowing stability as well as a transfer of knowledge or practices from buyer to producer. However, in some cases this can also lead to high dependence and an excessive capture of profits by dominant firms in certain value chains with large outgrowing arrangements and a tendency towards exploitative or rent-seeking behavior. In such cases there is a need to increase marketing options and reduce the farmers' dependence. One strategy to do this is to strengthen farmer groups' capacity so that the groups can either work with several buyers or can better negotiate for the farmers with a single buyer. In some instances, independent access to credit from a financial institution can free the farmer to choose the buyer(s) with the most attractive terms, and help balance the power relations between famers and buyers. Access to independent business development services, extension, external finance and other linkages are also common approaches to addressing this challenge. Nevertheless, there may still be benefits in contracting to a particular buyer to get access to certain markets, specialized inputs or technologies.

- In Paraguay, three-way lending arrangements between Financiera el Comercio, large buyers and small-scale producers engage the private-sector actor to reduce information asymmetries, and thus the risk of lending. For example, Financiera el Comercio provided loans to 2,000 small cassava producers backed by the recommendation of CODIPSA, the buyer. USAID's Paraguay Productivo project, links the multiple actors and helps improve the producers' creditworthiness through training and market linkages

G. INCREASING ACCESS TO WORKING CAPITAL AND ASSESSING CASH FLOW

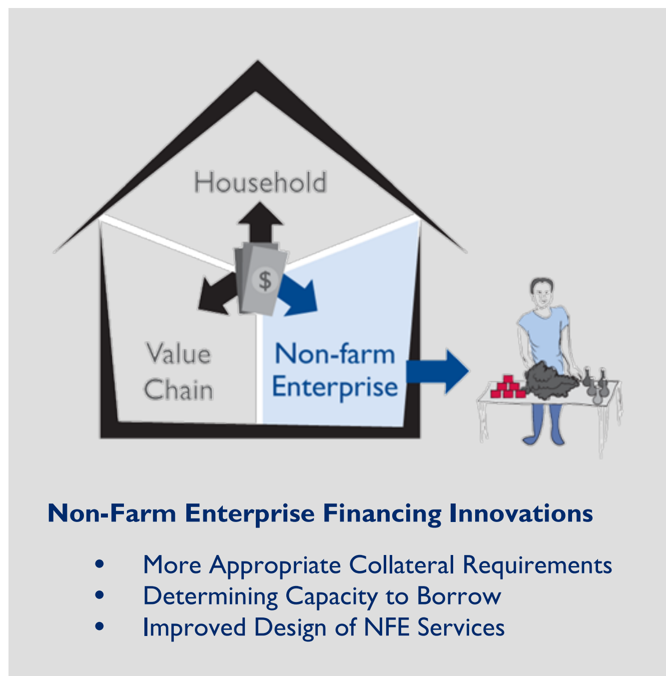
Access to working capital is a prerequisite for participation in any value chain, and is necessary for all actors in the chain. Innovative recent models adapt measures long used in developed economies to minimize or eliminate the window between delivery of product and payment. One straightforward way to increase access to working capital for small-scale farmers and other cash-constrained value chain actors is for lenders to develop appropriate products and lending methods. A distinct agriculture lending product is typically built around the unique realities of farming families, and draws lessons from both microfinance (use of alternative collateral mechanisms, consideration of the entire household's income and expenses) as well as traditional agricultural lending (longer terms, infrequent repayments).

- USAID's AFIRMA project in Mexico, implemented by DAI, helped Financiera Súmate, an MFI that focused primarily on peri-urban lending, to design and implement a lending program based on smallholder farmers' cash flow. Súmate piloted the product in two rural branches, and later expanded it to six branches.
- USAID's FIRM project in Kenya has encouraged the country's banks to enter the agricultural sector. With help from the project, Kenya Commercial Bank has committed $30 million to structure and staff a stand-alone profit center in which all agricultural financial services will be housed. FIRM hopes to create competitive pressure on other financial institutions to sharpen their focus on agriculture.

IV. SELECTED PROJECTS IN NON-FARM ENTERPRISE FINANCE

As noted earlier, only 3 projects out of the 61 in our database (5 percent) focused exclusively on non-farm enterprise finance. Another 8 projects included household finance among their multiple priorities, for a total of 11 projects concerned with helping rural households start or expand non-agricultural income generating activities.

Despite the relative lack of development in this area, there is recent evidence of banks and MFIs reaching out into the rural market to lend to non-farm enterprises as their core urban markets become more saturated. Some of this is based on their organizational missions, particularly in cases where banks evolved out of MFIs, such as Equity Bank in Kenya, Centenary Rural Development Bank, Uganda and others. The innovations report identified three issues addressed by non-farm enterprise finance as shown in the figure on right.



Non-Farm Enterprise Financing Innovations

- More Appropriate Collateral Requirements
- Determining Capacity to Borrow
- Improved Design of NFE Services

A. MORE APPROPRIATE COLLATERAL REQUIREMENTS

A key credit theme over recent years has been changing collateral requirements. For many years, there was a major emphasis on land registration so that farmers could use their land for borrowing, particularly but not exclusively for agriculture. Perhaps because of the unattractiveness of small plots of rural land as collateral, thinking has shifted to moveable collateral and so-called soft collateral based on contracts (although this seems to be most promising with agricultural contracts). While not widely practiced in rural areas yet, attempts to use moveable property on a wider scale play a significant role in the business climate reform agenda in developing countries. None of the projects in our database reported any significant activity related to changing lenders' collateral requirements.

B. DETERMINING CAPACITY TO BORROW

Lenders seek to establish the capacity of potential borrowers to repay a loan. Early attempts using business plans and other credit tools had limited success. Because credit checking is difficult in rural areas where many people do not have a formal identity, methodologies changed to find other ways to determine creditworthiness. This was typically through cautious initial lending followed by progressive increases in loan sizes. Now, at least in urban areas, credit reference bureaus are becoming more prevalent as a means of assessing the credit risk associated with a given borrower.

- The Nepal Economic, Agriculture and Trade Activity, implemented by Chemonics, was at the time of writing planning to investigate the possibility of establishing a private credit reference bureau for microfinance institutions that would allow them to check the creditworthiness of small-scale borrowers in rural areas. This would steer MFIs toward borrowers with good credit histories and away from borrowers with multiple

outstanding loans that are already overextended.

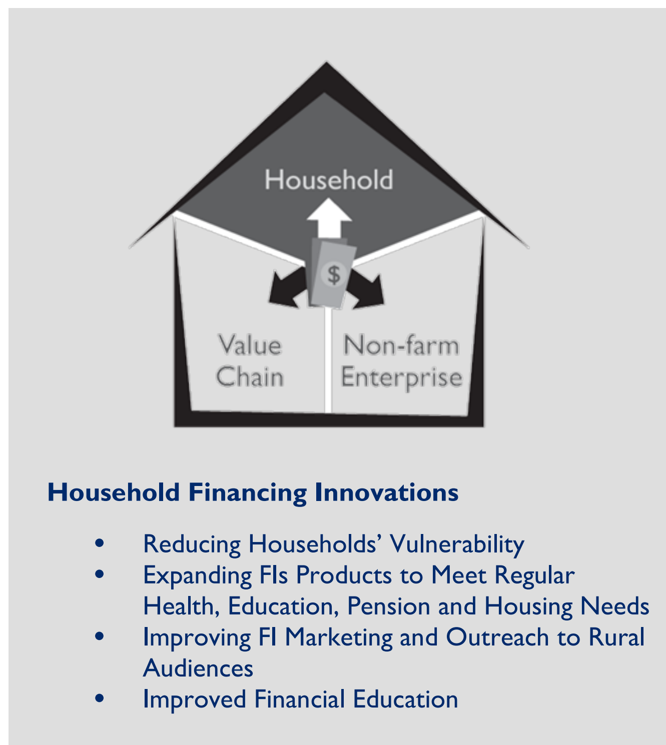
C. IMPROVED DESIGN OF NON-FARM ENTERPRISE SERVICES

Inappropriate product design has been a contributing factor to the relatively poor uptake of certain financial services, namely enterprise-focused savings and insurance.

- In Afghanistan, the USAID-funded Rural Finance and Cooperative Development Program is working with Islamic investment and finance cooperatives (IIFCs), or credit unions, to test a new hybrid loan product that will combine financial leasing and lines of credit to offer larger and longer-term loans to small businesses in the rural Helmand province. The IIFCs are the first and only cooperative financial institutions in the country to offer products and services compliant with Islamic Law. Since helping the first two Afghan IIFCs open their doors in 2005, WOCCU has worked with the Afghan people in 14 provinces to establish a total of 40 IIFCs and points of service, 25 of which are located in the conflict-ridden southern and eastern provinces.

V. SELECTED PROJECTS IN HOUSEHOLD FINANCE

This section covers areas of household finance that are not directly related to enterprise activity. This is potentially a far-ranging category that includes financial services for consumption, housing, education, medical needs, life events and household assets. This is primarily an expenditure area with limited or no income inflows. Eleven of the 61 projects in our database listed household (i.e., consumption) finance as a primary goal, but only 3 of those projects listed it as their only goal. The framework used to categorize activities in household finance is shown in the figure on right.



Household Financing Innovations

- Reducing Households' Vulnerability
- Expanding FIs Products to Meet Regular Health, Education, Pension and Housing Needs
- Improving FI Marketing and Outreach to Rural Audiences
- Improved Financial Education

A. REDUCING HOUSEHOLDS' VULNERABILITY

When faced with a shock such as an illness or funeral that requires expenditures greater than available cash resources, the household has to find a way to finance the shortfall. Traditional coping strategies such as withdrawing working capital from the farm or non-farm enterprise activity, distressed sale of assets or food supplies and informal borrowing, can prove costly in the short-, medium- and long-term. These shocks provide opportunities for financial services ranging from short-term credit to savings, insurance and transmission of funds to meet household needs in ways that significantly reduce the impact of such events on rural households.

- USAID's Post-Cyclone Sidr Livelihoods Reconstruction Program in Bangladesh helped cyclone-affected poor households organize into informal groups to mobilize savings that were deposited in the local bank; it also established a Group Disaster Fund coupled with training in financial literacy that helped to increase their resiliency to future shocks. With likely increasing incidences of disasters from climate change, this is an area in which innovation is required to fully integrate the financial sector responses with other disaster and post-disaster responses. In particular, savings—including ROSCA-based systems and credit unions—serve as a traditional buffer for meeting emergency needs.

- The CHAMP project in Haiti works to improve the livelihoods of people living with HIV/AIDS as well as OVCs. It does so through an integrated "package" of assistance consisting of vocational education, in-kind grants, and training and facilitation of "MUSOs" (social security/savings groups). CHAMP has found that integrating the formation and development of savings groups into a broader program of support has helped reduce household vulnerability to shocks and allows very poor households to begin investing in income-generating activities.

B. EXPANDING FINANCIAL INSTITUTIONS' PRODUCTS TO MEET REGULAR HOUSEHOLD NEEDS

Rural households' regular needs for cash include four categories: predictable regular non-enterprise expenditures, notably education; commonly-needed services, such as health, of which the exact timing is not predictable; irregular but significant needs such as housing and life events (weddings, funerals, births, cultural and religious events); and the costs of retirement.

- The MABS project in the Philippines has pioneered a whole range of innovations in mobile financial services over the past decade. For example, in 2004, Globe Telecom launched a mobile money service called GCASH, which could offer payments, phone-to-phone transfers and domestic money transfer services, all through SMS. MABS recognized the opportunity to apply mobile money solutions to improve efficiency and reduce the costs of collecting and administering loans provided to microenterprise borrowers of rural banks. Because such platforms greatly increase the ease and flexibility of withdrawing and depositing funds, it represents an improvement in a household's cash flow management.

C. IMPROVING FINANCIAL INSTITUTIONS' MARKETING AND OUTREACH TO RURAL AREAS

Financial institutions have found it difficult to reach dispersed rural populations with their promotional messages due to limited access to television and print media. While radio has traditionally been the most important broadcast media, new approaches are being adopted.

- In Afghanistan, where the challenge of rural outreach is related to the risk and costs associated with the security situation, USAID/Afghanistan's Rural Finance and Cooperative Development program supports 30 IIFCs, or credit unions, in providing shariah-compliant loans to 8,000 small business owners and farmers. To penetrate high-risk provinces, IIFCs depend on shura, or community councils, to travel into previously unserved areas and introduce the IIFC to groups of small farmers and business owners. They use female officers to reach out to women's groups in the area.

- The Peru Alternative Development Program (PDA III), implemented by WOCCU, supports alternative livelihoods to discourage farmers from growing coca. After identifying the lack of access to finance as a binding constraint on the transition to alternative means of generating income, PDA III explored further and found that the financial institutions' simple lack of a physical presence in remote coca-growing areas was a serious obstacle to improving access to finance. To address this challenge, PDA III worked with a private bank, Caja Luren, which demonstrated interest in serving rural communities but lacked physical infrastructure in those communities. PDA III negotiated an arrangement with state-owned Banco de la Nacion, which has an extensive branch network, whereby Caja Luren borrowers could perform banking transactions at Banco de la Nacion offices.

D. IMPROVED FINANCIAL EDUCATION

Financial education differs from promotion, as the latter is seeking to attract new clients or persuade existing clients of an institution to purchase its products. There is a recognized need for rural populations with little education and previously limited access to financial products to receive some degree of financial education to be able to assess and make better financial decisions in relation to all aspects of their lives.

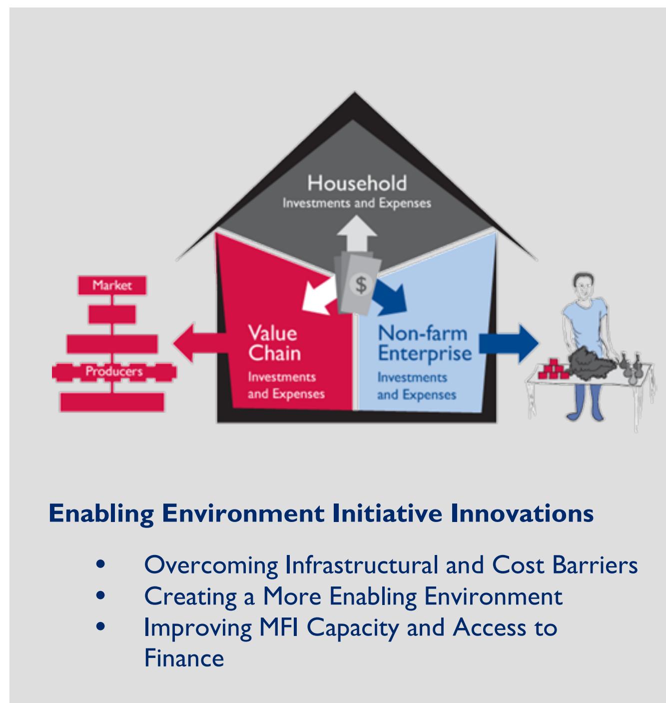
- USAID's YAJEENDE Project in Senegal, implemented by CLUSA, was launched in late 2010 and plans to address not only low levels of financial literacy but more broadly the problem of limited creditworthiness, by

linking producer groups to MFIs and banks through community-based service providers (CBSPs). These CBSPs are entrepreneurs elected by the local community to represent them vis-à-vis the private sector. CBSPs help entrepreneurs identify the appropriate lender, apply for credit, and manage their credit through business skills building and on-farm technical assistance.

- In Ecuador, USAID's Local Business Development program (locally knows as PRODEL, for Programa de Desarrollo Económico Local)—implemented by ACDI/VOCA under FHI360's FIELD-Support Leader with Associates award—seeks to impede the spread of the narco-economy in northern border regions. . PRODEL works with cooperating financial institutions to provide structured loan products for smallholder farmers linked to the program's network of 43 anchor firms, as well as to transfer a financial literacy training program as part of their outreach and marketing strategy to reach a greater number of producers.
- The TIPCEE Project in Ghana, implemented by Chemonics, worked alongside the country's Ministry of Finance to develop nationwide financial literacy programs.
- More recently, the Financial Sector Program in Angola designed and piloted a financial literacy campaign under the auspices of the central bank.

VI. SELECTED PROJECTS IN ENABLING ENVIRONMENT

The *Rural and Agricultural Finance: Taking Stock of Five Years of Innovations* report explicitly sought out and examined interventions designed to improve the enabling environment for rural finance in developing countries. This report did not do so. "Improve the enabling environment" was not listed among the potential choices for primary objective and, even if it had been, the responses suggest that few—if any—USAID projects would have listed it is a key objective. Nevertheless, several projects have taken steps to address the enabling environment for rural finance as one of several constraints:



Enabling Environment Initiative Innovations

- Overcoming Infrastructural and Cost Barriers
- Creating a More Enabling Environment
- Improving MFI Capacity and Access to Finance

- The Financial Sector Program (FSP) in Angola provides economic opportunities for SMEs and rural farmers by working with the Central Bank of Angola (Banco Nacional de Angola-BNA) to draft regulations around mobile banking, ensuring banks, bank agents and other retailers are allowed the appropriate flexibility and guidance on management and growth of their mobile banking products. Through the Financial Education Program, FSP teaches low-income households and rural families about the importance of saving, budgeting and using credit wisely. The program has a goal to reach 20 percent of the population by 2012.

- The DMS project in Malawi worked with microfinance institutions to build their capacity to assess risk more accurately and thus issue more loans safely. DMS believed that the MFIs were doing a poor job of assessing risk, leading them to be overly cautious, when they could safely lend more. The project's capacity building specialist held numerous trainings with the governing bodies and management teams of the MFIs, and worked with the overarching Malawi Microfinance Network. Specifically, DMS worked to eliminate "information asymmetries" by carrying out detailed sector studies in coffee, tea and cotton and sharing the results with MFIs. The studies helped the MFIs understand the risks as well as the potential returns in those sectors and design more appropriate credit products.

- Similarly, the AFIRMA project in Mexico also conducted value chain-specific studies (for example, mangos) that identified constraints and targets of opportunities for financing in the chain, which they shared with all financial institutions.

- USAID's COMPETE project has established the East African Agricultural Finance Network, which it describes as "a one-stop location for agricultural finance systems, methods, training materials, case studies and templates for lending to agriculture…", in order to help financial institutions across the region learn from each other's experience as they build their agricultural portfolios. COMPETE has also provided support to the East African Community ITC Task Force's efforts to harmonize the technical protocols and regulatory treatment of mobile money transfers across the region.

VII. CONCLUSIONS AND NEXT STEPS

While by no means comprehensive, this study provides a meaningful snapshot of USAID's recent and ongoing work in rural finance. Among its more significant findings are the following:

- The vast majority of USAID's work in rural finance takes place within the context of larger, integrated projects aimed at improving agricultural value chains or, in some cases, household economic strengthening for those affected by HIV/AIDS or other vulnerable populations. This is a significant change from 2004, when most of USAID's investment in rural finance was through stand-alone financial sector development or rural finance projects.
- More than half of the projects surveyed equate "rural finance" with "agricultural finance" and only a small minority focuses exclusively (or even strongly) on non-farm enterprise finance or household finance (income-smoothing). Also, few projects explicitly aim to improve the enabling environment for rural finance.
- The majority of USAID's rural finance projects appear to focus exclusively or almost exclusively on extending formal credit to farmers through banks or microfinance institutions. Few projects seem to have attempted to support supplier or purchaser credit, or any kind of non-credit financing (e.g., equity or leasing). Of the 61 projects in the database, only 15 or so mention a focus on savings—and the vast majority of those are projects aimed at the very poor or AIDS-affected OVCs. Only about five projects report any work related to payment systems, and fewer appear to have promoted rural insurance of any kind.
- Among the large majority of projects that aim to extend credit in rural areas, few report any targets or results related to long-term sustainability, i.e., low levels of non-performing loans, etc. This suggests that some of these projects may be overly—and inappropriately—focused on short-term results to the detriment of long-term, systemic change.

This report was designed to provide a first step towards greater sharing of knowledge and experience across USAID missions involved in rural finance. Appendix 2 provides summary information on all of the projects that were included in this report, along with contact information for each of them. The team hopes that this information will serve as a platform from which rural finance specialists across USAID and among its implementing partners can learn from each other's experience and avoid repeating each other's mistakes. We also hope that USAID will consider the results of this study and the companion *Innovations* report as it designs new rural finance interventions and explores new approaches to expanding access to finance for farmers and rural families.

APPENDIX 1: INFORMATION REQUEST FORM

<table>
<tr><td>Country:</td><td></td></tr>
<tr><td>Project Name:</td><td></td></tr>
<tr><td>Project Start and End Dates:</td><td></td></tr>
<tr><td>CTO or COTR name and e-mail:</td><td></td></tr>
<tr><td>Approximate Project Budget:</td><td></td></tr>
<tr><td>Name of Implementing Partner:</td><td></td></tr>
<tr><td>Chief of Party or Relevant Component Leader (and e-mail):</td><td></td></tr>
<tr><td colspan="2"></td></tr>
<tr><td colspan="2">Please provide a brief description of the project's rural finance activities, including the apparent problem or obstacle, the approach to overcoming it, and the intended outcome:</td></tr>
<tr><td colspan="2"></td></tr>
<tr><td>Please select the primary goal of the rural finance initiative:
Choose more than one goal only if they are <u>equally</u> important</td><td>1. Support agricultural production and/or processing
2. Promote development of non-farm enterprises
3. Support household consumption and emergency needs (income smoothing)</td></tr>
<tr><td>Please select all forms of non-financial intervention used and indicate which one is used most often or is most important:</td><td>1. Technical assistance to market participants
2. Training (including study tours, etc.)
3. Market facilitation / brokering relationships
4. Outreach and/or public awareness</td></tr>
<tr><td>Please indicate whether the rural finance initiative involves a financial intervention funded by USAID, e.g. guarantee, loan or line of credit, grant, equity investment or other subsidy:</td><td>YES NO</td></tr>
<tr><td colspan="2"></td></tr>
<tr><td colspan="2">If you answered 'yes' to the question above, please provide a brief description of the financial intervention(s), including type, amount, recipients and objective:</td></tr>
</table>

Please list any *quantitative targets* which the rural finance initiative is designed to achieve:
Please list any *quantitative results* which the rural finance initiative has already achieved:
Please briefly describe any unexpected challenges encountered –internal as well as external – and the main 'lessons learned' as well as the initiative's strengths and weaknesses, and finally any particular innovations the initiative has developed or tested:

Please return the completed form to Joe.Dougherty@CardnoEM.com and please also attach the most recent quarterly report, annual report and/or other documents which describe the project's rural and agricultural finance activities.

THANK YOU VERY MUCH for your assistance with this important initiative.

APPENDIX 2: PROJECT DATABASE

Please see related excel charts.

APPENDIX 3: OBJECTIVES, BACKGROUND, METHODOLOGY

This report is the result of the "USAID-only" portion of the two-part study on rural and agricultural finance commissioned by USAID's Office of Microenterprise Development. Jeanne Downing and Anicca Jansen, both from the Office of Microenterprise Development, provided valuable guidance and insight into the process while Geoff Chalmers from ACDI/VOCA directed and supervised the assignment.

The overall objective of the Knowledge and Practice II contracting mechanism is to "generate and disseminate knowledge to improve practice in value chain development." Within the context of that objective, the Rural Finance Stocktaking and Strategy Development assignment seeks to "better understand how projects focused on developing agricultural value chains and ensuring food security can effectively address the financial constraints to reducing hunger and poverty." To help achieve that objective, this report takes stock of USAID's recent and ongoing efforts in rural finance around the world. It addresses quantitative questions: how many USAID projects are working in rural finance, in which countries? How many projects focus exclusively on credit and how many incorporate savings or other financial services? The report also seeks to answer qualitative questions: how successful has USAID been in promoting leasing as a way to finance agricultural equipment for small farmers? To what extent are guarantees, grants or other "financial interventions" used in leveraging technical assistance and other "non-financial interventions" to expand access to rural finance? While the report's answers to these and similar questions are necessarily indicative rather than definitive, we hope they provide useful insights that USAID can incorporate into its rural finance strategy. We also hope the report acts as a conversation starter—a foundation from which USAID missions around the world can launch a series of discussions to learn from each other's experience and thus achieve ever more impressive results in expanding access to rural financial services.

APPENDIX 4: STUDY APPROACH, SCOPE AND LIMITATIONS

In order to answer the study's key research questions, the team gathered and analyzed information in five stages, as follows:

1. Solicited input from the Office of Microenterprise Development and other sources within USAID/Washington with whom missions and implementing partners were likely to be working (or to have worked recently) in rural finance.

2. Sent an information request form (see Appendix 1) to all of the USAID missions and implementing partners that had been identified in Stage 1. Requests were sent to more than 30 missions and 20 implementing partners, not all of whom responded. When responses were not received, the team sent e-mails or made phone calls to follow up. Overall, the team requested information on rural finance work in more than 50 countries.

3. Reviewed the responses as they were received and logged the information into a database (see Appendix 2) in order to compare across projects and aggregate the information. The team also collected pertinent data on the agricultural and financial sectors for each of the countries in which rural finance projects were taking place. This data included credit as a percent of GDP, the country's World Bank Doing Business score for ease of getting credit, size of the agricultural sector in terms of GDP and share of the labor force, GDP per capita, and net development assistance per capita.

4. Selected, from about 60 information request forms that had been returned, projects with a particularly successful, innovative or unusual approach to rural finance (as well as projects for which some piece of basic information was missing) and contacted the relevant mission and/or implementing partner to request further information. At the same time, the team looked for more detail on the selected projects from USAID's Development Experience Clearinghouse and other on-line sources. The team then conducted phone or e-mail interviews with Chiefs of Party, Contracting (or Agreement) Officer's Technical Representative and other interested parties.

5. Reviewed the draft report prepared by Jason Agar and Kadale Consultants to identify promising innovations in rural finance sponsored by organizations other than USAID and to compare USAID approaches with approaches that are being explored by others.

In parallel with these activities, the team also provided information on selected USAID-sponsored innovations to ACDI/VOCA for inclusion in a synthesized (USAID and non-USAID) report title *Rural and Agricultural Finance: Taking Stock of Five Years of Innovations*, which was released in December 2011.

Finally, after completing these five stages of information gathering and analysis, the team issued a draft report in order to share findings with interested stakeholders and, at the same time, solicit feedback and additional information on USAID's work in rural finance—all of which has been incorporated into this final report.

As noted earlier, the quantitative information and qualitative insights that this report offers are necessarily indicative rather than definitive. The stocktaking exercise was not meant to be comprehensive. It does not presume to include *all* of USAID's recent or current activities in rural finance, nor does it provide complete information for every project. As with any effort of this nature, the final product is limited by the amount and quality of information that our sources—USAID missions and implementing partners—were willing or able to provide.

Despite these limitations, the team is confident that the report covers a meaningful portion of USAID's rural finance work, with 61 projects in 40 countries. The study only includes projects that are current or that ended within the last five years. All but two of the projects in the study are either ongoing or ended after January 2008.

The study includes projects that focus on agricultural (i.e., value chain) finance, non-farm enterprise finance and/or rural household finance (which includes savings as well as credit for consumption, rather than revenue generation). It does not include projects aimed at broad financial sector reform unless they explicitly address obstacles to *rural* finance. (USAID's recently-ended Financial Sector Deepening Project in Armenia, for example, was excluded for that reason.) The study interprets "rural finance" to mean "rural financial services"—in other words, not just credit, but also savings, insurance and payment or transaction services.

This stocktaking exercise focused on "projects" as traditionally defined by USAID and its contractors and awardees—typically, multi-year efforts involving an on-site team that are designed to achieve measurable improvements in access to rural financial services. Most of the projects are funded by USAID missions, but several are centrally funded. We did not investigate "pure" research on rural finance (i.e., efforts like this study), nor did we include stand-alone guarantees issued by USAID's DCA (i.e., guarantees that are not associated with or overseen by a particular project). These activities were excluded because the study's objective is to collect and disseminate useful information that would otherwise not be readily available to USAID mission staff. The results of any USAID-sponsored research on rural finance are likely to be available already through the Office of Microenterprise Development's Microlinks website or another central site like FS Share, while information on USAID's credit guarantees is centrally available through the DCA office.

Finally, the level of detail available varied somewhat from project to project. In a few cases, we have not been able to find the total value of the project. Among projects that included a "financial intervention" (i.e., grant, guarantee, loan or equity investment), only about 60 percent listed the value of the intervention and in some cases the team estimated the value through independent research. Also, there are several important rural finance initiatives, such as the Bureau of Food Security's pilot programs in index insurance, for which we have not collected certain information such as start and end dates, total project value, etc. For that reason, the quantitative analyses discussed in Section II are based on a slightly different population of projects than the qualitative findings discussed in Sections III-VI. Section II describes a population of 61 projects for which we had basic information regarding timing, size and scope. Section III also draws on those 61 projects, but makes reference to others (such as the index insurance pilots) that were not included in the quantitative analysis.

The study team assembled a database of 61 USAID projects for which we were able to gather certain basic facts, such as start and end dates, budget, whether or not the project provided grants or guarantees, etc. The database is not entirely complete: a few projects did not report their total budget or are otherwise missing bits of information. Nevertheless, the team believes that the sample size is large enough to allow for meaningful observations regarding USAID's global work in rural finance over the past five years.

APPENDIX 5: SELECTIVE QUOTES FROM RESPONDENTS, ORGANIZED BY TYPE OF CHALLENGE IDENTIFIED

Challenge	Description
Supply	"Agriculture is risky… other opportunities are more secure and banks can't be blamed for taking them." "The financial sector has to be addressed as a market system itself. Pushing services without understanding the internal relationships and rules within the financial sector will not result in sustainable access…" "The main challenge is slow uptake (of DCA guarantees) because banks are reluctant to experiment with new clients…they would rather continue to deal with their existing customers." "Credit demand surpasses the processing capacity of MFIs since most of the credit needs arrive at the same time according to the agricultural calendar. MFIs cannot afford to hire new personnel only for that season." "MFIs lack flexibility to meet the urgent needs of applicants; MFIs argue that they have to secure their credit." "Banks lacked agricultural lending staff, or even if we trained there was high turnover." "Lengthy bank processes sometimes make it difficult for the (borrowers) to access their loans in time…" "Financial institutions do not have adequate information to enable them to make financing decisions to participants within agricultural value chains."
Demand	"The leasing companies had difficulty finding qualified agricultural borrowers." "The financial sophistication of the agricultural sector was a significant problem… Many agricultural customers did not keep financial records… Customers lacked financial management skills and managed their business solely on intuition rather than developed business strategies and financial plans." "We underestimated the lack of trust within the private sector. The difficulty in finding win-win situations among exporters, among producers, and between producers and buyers was formidable, and continues to hinder development of the sector." "A key challenge has been in finding… innovative, "serious" businesses and producers among the targeted value chains who can provide a reliable supply chain and produce quality and competitive market goods." "Agriculture remains risky—weather, pests and diseases, market price fluctuations…." "Some investments, like improved seeds, fertilizers, and crop protection chemicals had high marginal

	rates of return, yet smallholders were still reluctant to treat farming as a business and invest." "Not all borrowers are honest. One has to secure everything they own, and still do follow-up." "Problems have been seen with low recovery rates, high transaction costs, high price risk to be competitive and sell their product, political intervention of local government and others." "The low level of literacy among members had slowed down progress in the strengthening of Savings Groups. As the program did not have an adult literacy component, this issue remains." "There are still challenges with gender mainstreaming; women's participation (in savings groups) is on the increase but they still have not broken the glass ceiling in terms of representation and leadership positions."
Systems	"There were no collateral laws in place in case the bank needed to seize collateral." "The progress for clarification of the tax code and advocacy for the lease law was slow and at times stalled. However, the Leasing Association's efforts succeeded in reaching the minister level for an open dialogue." "Policy changes take longer to manifest and measure, especially when several government institutions are involved. Achieving buy-in and building sustainable capacity to analyze and implement numerous policy reforms takes time. True impact is often achieved years after a new law or procedure is implemented." "Unpredictable government market intervention creates a high risk financing environment for agriculture." "The lack of insurance continues to present a barrier to finance for farmers and for financial institutions."
USAID	"It was hard to remain focused and not be sidetracked by our donor with other project objectives." "DCA characteristics did not match the needs of the agricultural community; most importantly, loans could not be used for working capital." "DCA guarantees were not well utilized. This was because the criteria for the grain sector, including small loan limits, did not match the banks' current business strategies. Additionally, the nature of trade finance requires rapid and multiple transactions per borrowers. The structure of the DCA, however, required each individual transaction to be booked as an individual loan as opposed to under a line of credit which was the preferred arrangement by the banks. Finally, the banks believed the grain sector to be so disorganized that even with a 50 percent guarantee on principal, the loans remained too risky." "Donors are dangerous. Donor funds are very dangerous when applied into a financial sector without understanding how incentives have to align in order to see ag and rural market segments as an opportunity." "Too many donors with too many different packages—we tried to have everyone adopt a unified approach. But many recipients sat back and waited for grants or freebies." "Indicators indicate. They do not define success. Defining targets without understanding how those numbers would evolve without donor assistance is harmful, and dogmatic focus on achieving

	operational targets like number of loans is outright dangerous. Success or sustainability is never defined/achieved by a transaction that does not result in both parties wanting to repeat the transactions."
Other	"Identifying, training and retaining qualified staff was difficult." "Text boxes, computers and other high technology are merely a means to an end—delivering rural financial services—and not the end itself. At times, project staff, partner financial institutions, and even consultants became overly focused on making technology function from a technical perspective in this difficult environment. As a result, they lost sight of the real goal—and real challenges—of making technology work for people in their daily lives. Market needs must remain the driver of efforts to harness new technology to deliver rural financial services."