2SCALE
Incubating and accelerating inclusive agribusiness in Africa

Thematic Strategy

Financial Inclusion

Implemented by

IFDC   BoP INNOVATION CENTER   SNV

Funded by

Ministry of Foreign Affairs of the Netherlands

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Author.

Abbreviations and Acronyms

2SCALE	Toward Sustainable Clusters in Agribusiness through Learning in Entrepreneurship
ABC	Agribusiness Cluster
BoP	Base of the Pyramid
BoPInc	Base of the Pyramid Innovation Center
BSS	Business Support Service
CASE	Competitive Agricultural Systems and Enterprises
D&D	Design & Diagnostic
CFC	Common Fund for Commodities
CS	Capacity strengthening
DGIS	Directorate-General for International Cooperation
EKN	Embassy of the Kingdom of the Netherlands
FBO	Farmer-based organization
FCU	Farmer cooperative Union
FI	Financial Institution
IFDC	International Fertilizer Development Center
IP	Impact Pathways
M&E	Monitoring and Evaluation
MFI	Micro-Finance Institution
M4C	Marks for Change
MSMEs	Micro-Small and Medium Enterprises
PO	Producer Organization
PPP	Public-Private Partnership
PrC	Partnership Resources Center
PF	Partnership Facilitator
RF	Rabobank Foundation
R&C	Review & Capitalization
SHF	Smallholder Farmer
SME	Small and Medium Enterprise
CTL	Country Team Leader
A2F	Access to Finance
TOC	Theory of Change
VLSAs	Villages Loans and Savings Associations
VC	Value Chains

1. Introduction

2SCALE worked between 2012 and 2018 to understand the demand for financial services at the level of the target value chain (VC), related agribusiness clusters (ABCs), to identify major financial gaps and priorities for intervention, and to try to match demand with supply.

In 2019 - 23, 2SCALE will continue, and where possible intensify, its efforts to identify relevant/ interested financial institutes/programs and investors and to bring financial and private partners together to bridge financial gaps. Specific attention will be given to access to finance (A2F) of vulnerable groups, e.g. to smallholder farmers (SHFs) and local small-scale entrepreneurs (MSMEs & SMEs), to the youth as farmer and/ or Agri-entrepreneur, and to women, both young and senior, involved in target VCs.

This document briefly outlines some of the major steps and building blocks of 2SCALE's financial inclusion strategy (2019-2023). This document will:

- Highlight some major issues that relate to financial inclusion
- Describe the major steps of 2SCALE's strategy to identify and address financial gaps/ challenges in target VCs and ABCs
- Present examples of typical financial arrangements (models) to finance ABC and/ or VC actors in agri-food industries; and in 2SCALE 2019-23, our financial inclusion plan will mainly build on (and mainstream) these examples.
- Propose a "way of working" to ensure that financial inclusion is properly addressed in all partnerships of the 2SCALE portfolio.
- Enlist some ideas to improve the supply of (adequate) financial services, through networking with likeminded programs, international/ regional financial service providers and/ or impact investors.

2. Financial Inclusion – some major issues

There is not one clear-cut definition of financial inclusion. We consider *financial inclusion* as *the delivery and use of a full range of (formal) financial services at affordable costs to all (bankable) companies and households, including the disadvantaged and low-income segments of society*. In 2SCALE we mainly focus on smallholder farmers and small- and medium-sized enterprise (SMEs) in our target VCs and ABCs. Financial inclusion of smallholder farmers and related target SMEs not only requires a thorough understanding of the dynamics of the agricultural sector, but also of their specific circumstances, capabilities and financial needs.

Financing needs arise when anticipated income does not match (planned) outlays; in addition, smallholder farmers are not only farming our target commodity, in addition they also run a household; as a result, there may be many partly overlapping streams of income, from farming and non-farming activities, and many different types of outlays, including for consumption, health and education. At the core, financing is just advancing money! However, as simple as this sounds, financing may become quite complicated. First of all, the financier (creditor) often needs to be informed about the purpose of the loan, he/ she probably would like to be convinced of the profitability of this purpose; due diligence procedures (to evaluate the credit-worthiness of the applicant) may be part of the process; agreements on guarantees and risk-management, payback schedule (deadlines), and monitoring and communication will often be included as well.

Not addressing financing needs may lead to postponement of outlays, under-investment and as a result reduced efficiency and income. Financial institutions however have been reluctant to invest in agriculture, and to smallholder farmers, and local SMEs, as a result of the (perceived) high riskiness of the sector, and the high transaction costs of dealing with many relatively small, largely unknown and sometimes illiterate, loan applicants. 2SCALE aims to overcome these “barriers” to entry by focusing both on the supply side (loan products that address the financial needs of target groups, and management systems and other accompanying measures that reduce risks and transaction costs) and on the demand side (e.g., by improving financial literacy, by maximizing savings and re-investment strategies to limit demand and reduce additional outlays on interest).

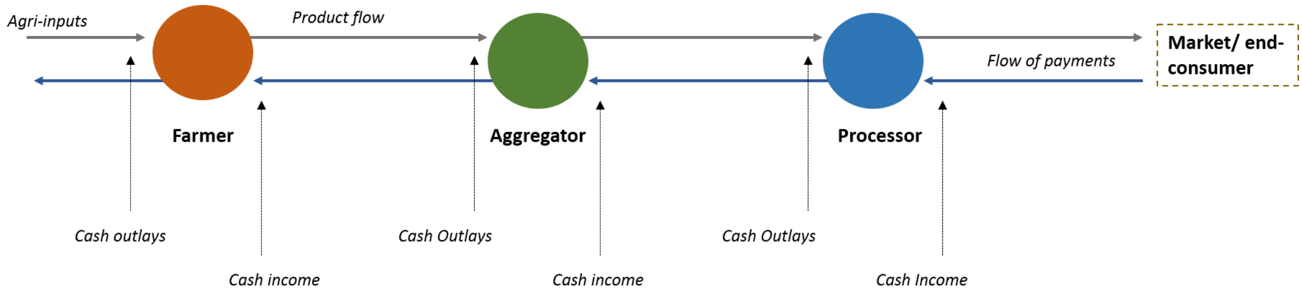


Figure 1: Stylized example of product and financial flow in an agri-food value chain

2SCALE’s financial inclusion strategy therefore does not look solely at access to formal services; it also looks at savings and capitalization strategies. Informal systems, like village saving and loan associations are considered as well. Other sources of informal financing, e.g., through moneylenders, etc. will not be considered. These amounts are often small, and entirely dependent on relations between the receiver (debtor) and the moneylender. Informal financing (often called pre-financing, even though all financing, if not a gift, is pre-financing) through VC agents (e.g., input-dealers supplying inputs on credit; and aggregators/ buyers, pre-financing inputs on behalf of target farmers), while not without risks, will be addressed.

Financial services finally are not limited to credit (loan). Deposits/ savings, and insurance products are considered financial services as well. Systems to manage financial services (e.g., to make payments, to reimburse, to ensure adequate monitoring and communication) and related risks, while themselves not a financial service, range from ICT, to organizational arrangements (e.g., like in group lending). Innovations in financing are often triggered through changes in technologies, including mobile phone applications.

3. Steps to Accelerate/ Ensure Financial Inclusion in 2SCALE

Table 1: The major steps to identify and address financial gaps in 2SCALE's PPPs:

Step 1	Assessment of profitability (actual/ potential) along target VC**:** **Profitability:** (income – outlays, incl. of investments) > 0; unit production cost (over the whole VC) should be lower/ equal than that of competitors; profitability per unit of labor should also be higher than alternative income generating activities.
Step 2	Identification of major financing challenges: **Financial gaps**: period & amount of negative income (outlays, no income) for each actor in the VC. (Finance = Advance Money) Note: financial gaps in VCs have two major reasons: (1) costs are born way before income comes in – as a result of production (or investment) cycles; (2) – as a result of delayed payments (as other downward VC actors also have gaps and may need time before they have the money to pay for the raw materials). Delayed payments do not happen in spot markets; they should also be considered as a financial arrangement (i.e., the farmer waiting to be paid by the aggregator, is pre-financing the aggregator).

Step 3	Assess strategies to close (major) financial gaps: a) Savings and re-investment (e.g., farmer putting money aside to buy inputs for the next growing season) b) Financial support: through own community (VSLAs); through informal loans (e.g., community moneylenders); through financial institutions (bilateral loans); through another VC actor (e.g., aggregator/ buyer for the farmer, or through the buyer for the aggregator) directly or indirectly (e.g., when the buyer funds the aggregator, who in turn funds the farmer); or through this actor, but as part of a tripartite (or even more complex) financial arrangement, involving a financial institution.
Step 4	Design **pilot** / conduct pilot/ evaluate pilot (if needed)
Step 5	Precisely, they are roads to nowhere!

We will come back on these steps in the next chapters, we will first present some typical models of financial arrangements that 2SCALE has been working on over the past few years. These models will be – as much as possible – replicated and strengthened in 2019-2023 (while at the same time some innovations may be tested, through pilots; like the case of DODORE's Agri-wallets in Kenya to assist farmers to put money aside for next season's Agri-inputs).

4. Models of Financial Inclusion – 2SCALE's Experience so Far

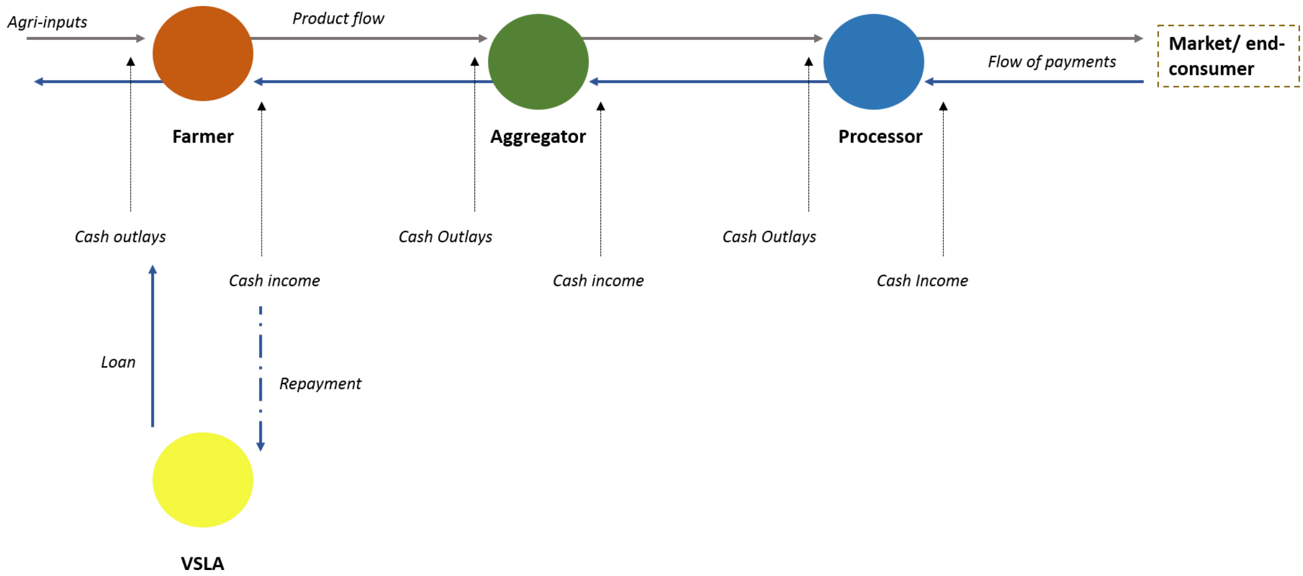
This Chapter presents 4-5 typical financial models, promoted through 2SCALE to strengthen access to finance (A2F) for smallholder farmers and (local) SMEs.

Two warnings first:

1) We present – on purpose some highly stylized examples. Every specific case has its own characteristics. The models also do not tell the whole story, as they focus just on the financial flows, not on details of risk management and securitization of loan products or monitoring and communication systems.
2) We focus here on financial arrangements from village saving and loan associations (VSLAs) to VC financing. This does not mean that we under-value savings and re-investment by the agent her - or himself. On the contrary, savings and re-investment strategies should be explored first (we will insist on this in the next Chapter again), for the smallholder farmers. Loan conditions

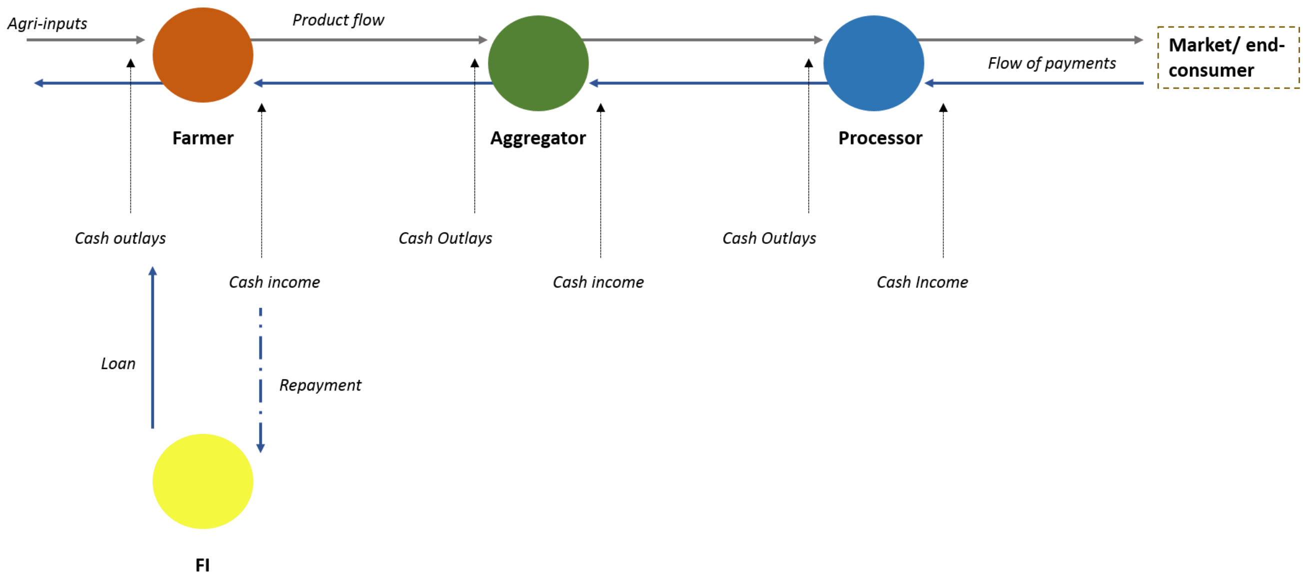
may not always be easy; and (high) interest rates may reduce profitability levels significantly …. Saving strategies are under-rated in many programs, and often also by the private partners themselves – for good, and sometimes very bad (e.g., when loans are easy money coming from a "stranger" [a project]) reasons!

Model 1 **Village Savings and Loan Associations (VSLAs)**



VSLAs will all have specific conditions to manage savings and loan applications. VSLAs will by their very nature not be capable to provide loans at the same time to all farmers; on the other hand, VSLAs in the 2SCALE partnerships often succeed to open a bank account with a formal financial institution (FI); their savings and demonstrated capacity and competence in managing money, may be seen as an argument/ foundation for additional credit.

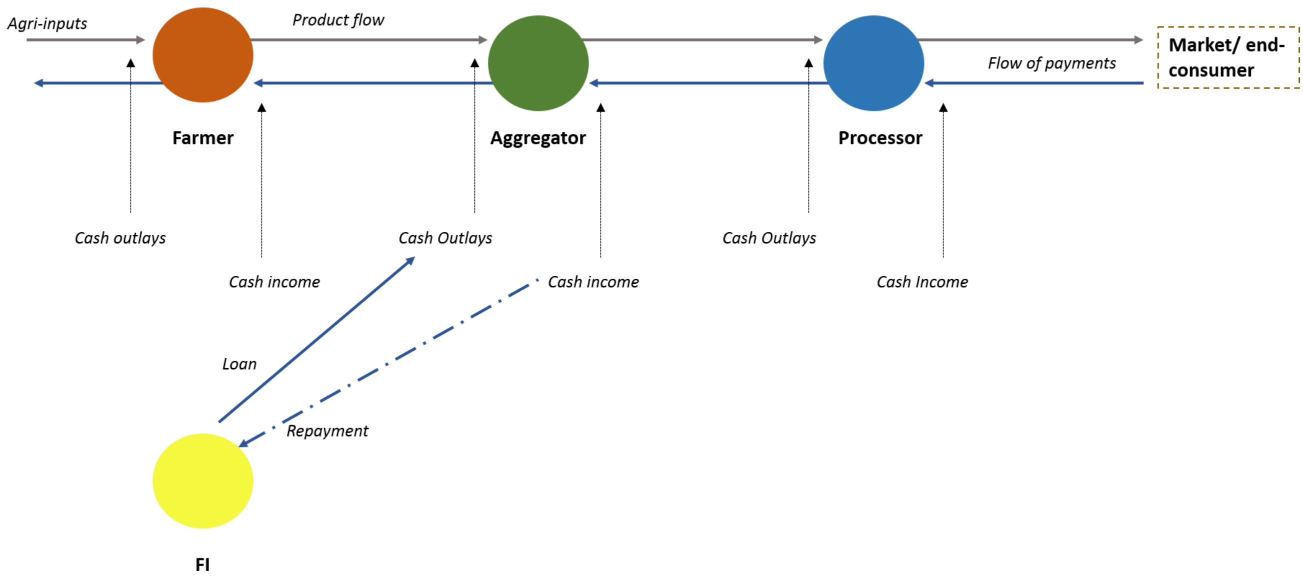
Model 2 **Bilateral Agreement Financial Institution and Farmer/ PO**



Please note that a loan also involves conditions: including demonstrated profitability of the proposed business; guarantees/ collateral, monitoring/ communication lines. Collateral may be partly based on savings (savings account with FI); group lending & peer pressure may partly overcome collateral requirements; an offtake contract may serve as a guarantee (in case the aggregator/ processor is intimately involved in the loan – it becomes a "light" version of VC financing).

Inventory credit systems, including simple warehouse receipt systems (co-managed by farmers and the FI), are based on inventories (of existing or anticipated stocks) as collateral.

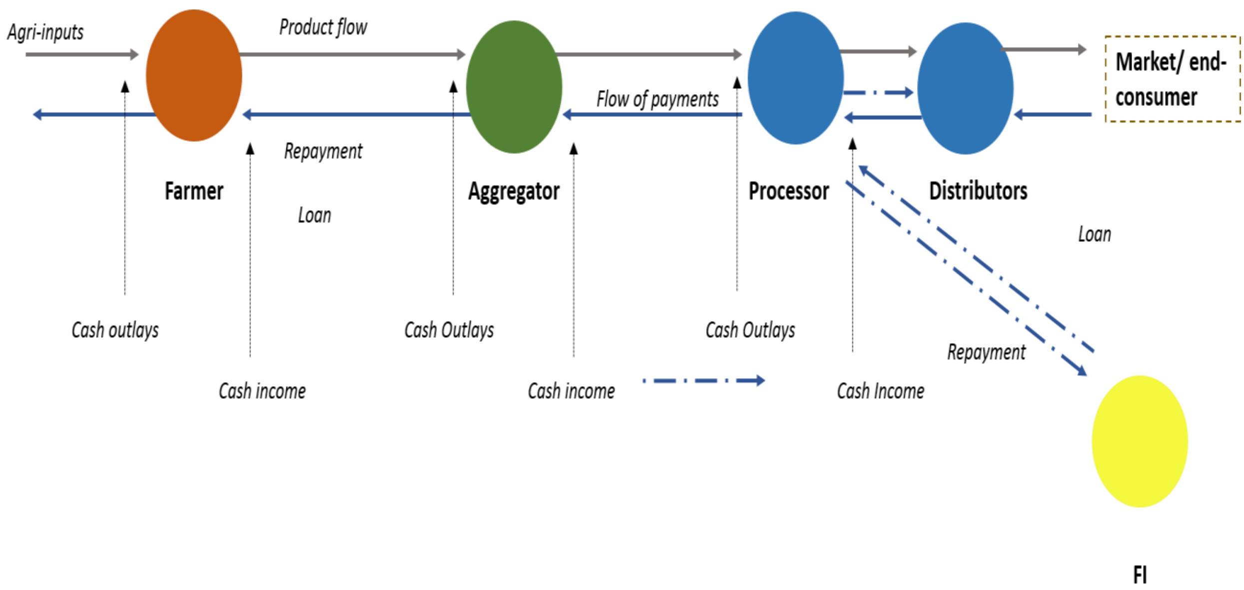
Model 3 Bilateral Agreement Financial Institution and SME



Bilateral arrangements between a FI and SME (aggregator in this example but could also be the processor) follow similar steps as with all bilateral financing. The FI looks at the track record (character/ competence), capital/ collateral, and business proposal of the SME, evaluates risks, and decides to fund or not.

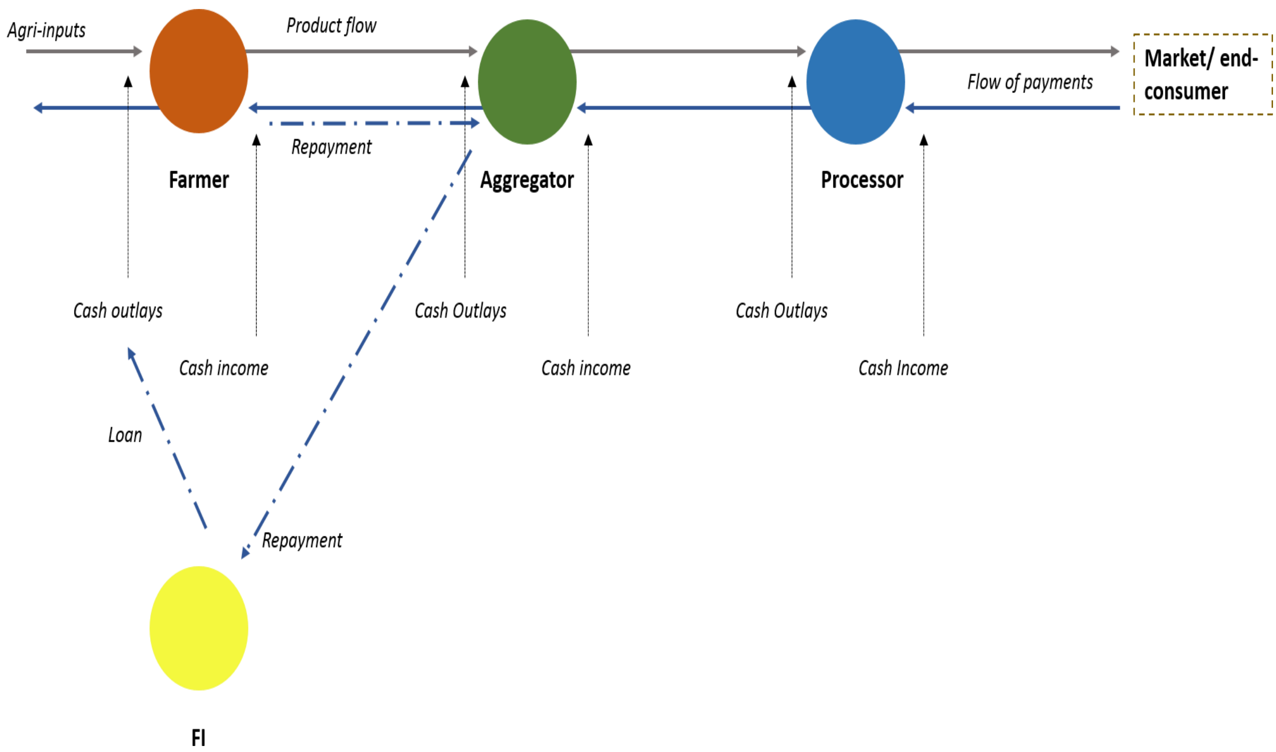
SMEs require bilateral loans either for their ***working capital*** (e.g., to provide inputs on credit to farmers; to pay staff/ agents; to pay suppliers, including farmers; to provide stocks on credit to distributors) or ***investments***. The latter can be of interest, if a new processing line helps to upgrade the capacity (scale) of the aggregator and increases volumes of goods that flow through the target VC; or when the processing line (or other things, like trucks etc.) is needed to develop new products/ markets. 2SCALE has been relatively successful ensuring loans for investments of lead partners (i.e., SMEs, like Shalem in Kenya); this often involves quite a bit of work, including technical assistance to develop or improve investment plans and in financial intermediation. The leverage however may be substantial, as with one bigger loan to a SME the whole VC gets a boost.

The example below follows the same model, but now the arrangement is between the FI and processor.



The arrangement now focuses on the processor, who uses bilateral funding to establish a distribution/ distributor network. In this example, the FI provides working capital to the processor, who lends it (or part of it) to last-mile distributors (e.g., in-cash for equipment/ materials, and in-kind by giving them their products on credit). When last-mile distributors have sold the products, they repay the buyer (often before getting new stock).

<u>Model 4</u> **VC financing**



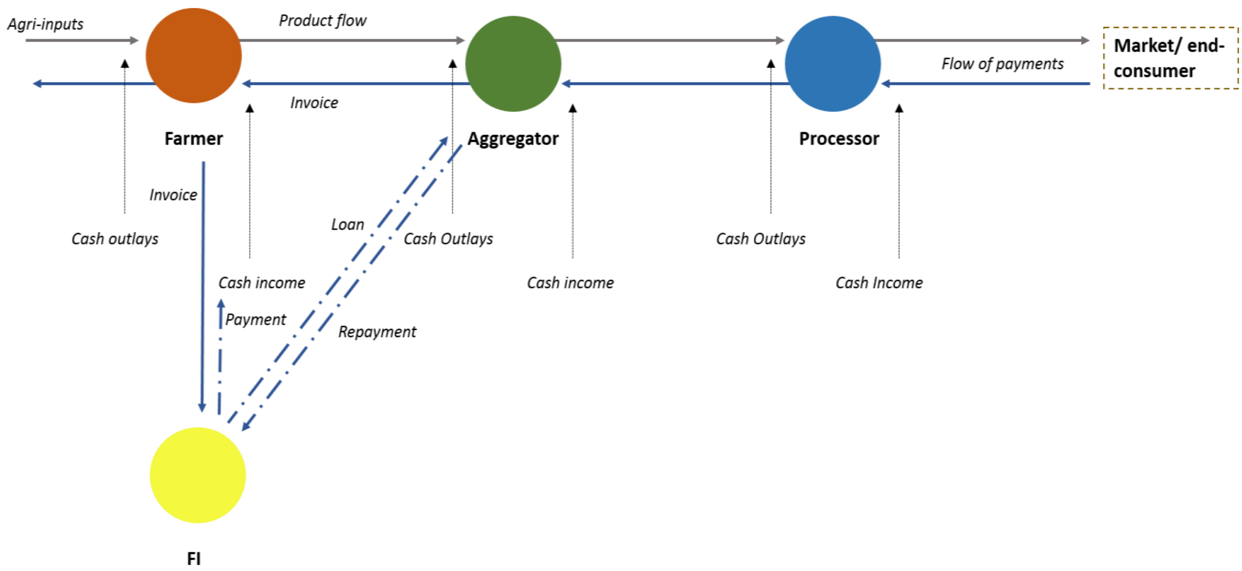
In this arrangement the FI provides finance to the farmers (with a guarantee from the aggregator) to buy inputs (the finance can also be given directly to the input suppliers, who then supply the inputs to the designated farmers). When farmers deliver the product (part or all of the harvest, as per the conditions of the contract between farmers and aggregator), the input credit (total costs, including negotiated interest levels) is deducted from the final payment; the latter can be done by the aggregator, who then repays the FI (as in the diagram), or by the FI, when the payments to the farmers are made through bank accounts managed by the FI.

Note: the distinction between a VC arrangement, and a bilateral loan to a SME (aggregator) to supply inputs (on credit) to farmers is not always very clear-cut. As soon as farmers (or their organization) become part of the financial contract with the FI, we will use the term VC financing.

Model 5 **Reverse Factoring**

In this arrangement the FI either provides funds to the aggregator (or to the processor, who then lends it to the aggregator/ agents) to pay farmers for their produce (preferably upon delivery) or pays the farmers directly upon delivery of produce. In the latter case, the FI collects the invoices of the farmers; the total sum of these invoices is seen as a loan to the aggregator/ buyer. Reverse factoring is usually considered a "low risk" adventure for financial institutes; the payments are only made after delivery of the good at the aggregator's factory; and the aggregator pays the FI as soon as he/ she gets income from his buyers/ processors (as production cycles of processors are much shorter than farmers, the time involved is much smaller).

NB. When quality is checked at the factory gate in a transparent manner, invoices could specify volumes, quality & calculate the total price based on negotiated prices for each quality category.



Reverse factoring is – in essence – not very different from the example of VC financing (model 4); it is however commonly seen as a low risk type of financial arrangement; the produce is already in, and checked by the aggregator; the loan is between the FI and the aggregator; and the farmers are paid in time (in fact: reverse factoring helps to avoid delayed payments to farmers, a form of – often – "hidden" financing from the farmer to the aggregator).

5. Way forward

In this Chapter we focus only on what needs to be done to strengthen financial inclusion in each of the 2SCALE PPPs; and how this will be achieved. In the first table below some of PPPs (per country) are presented, including some information on the planned (by PFs) financial intervention. The identification of the financial gaps will be decided at the partnership level during the D&Ds, including holding some bilateral discussions with prospective financial partners.

In 2019 training will also be designed and implemented to strengthen internal (staff) capacity. This training will offer examples of solutions to the challenges experienced during 2012-18 and provided opportunities for replication. A survey to capture the opinions of the staff and external experts may also be implemented. The objective will be helping to develop a skilled, flexible team that can effectively address financial inclusion challenges during 2019- 23.

In countries/areas where banks might remain geographically inaccessible to smallholders, 2SCALE will focus on developing financial inclusion partnerships between financial institutions, governments, NGOs, and other players. The objective will be to leverage on technology (fintech institutions) to develop investments schemes in remote rural areas. One model, for example, is the successful pilot, which was established in Kenya between 2SCALE, and Dodore limited (Agri-wallet) - a fintech company in which farmers in remote areas were able to access loans at a low-interest rates for inputs purchase. Such activities will promote and support establishment of demand driven-grassroots special groups (SHFs, MSMEs, SMEs) that will leverage on technology lending schemes from commodity (aggregator) markets through establishment of management contracts with off-take markets. This will increase the autonomy, efficiency and participation of farmers in the management of savings and loans. To help develop and roll-out this strategy we will sometimes outsource/external support - consultancies focusing on this and the following:

1. Collateral management – with a view to have a feasibility study on African collateral company that could be set up, collectively, by African /Dutch banks/financial institutions having an inclusive business agenda.
2. Mapping studies – to provide an overview of best practices, including on the use of associated tools (fintech) such as mobile money technologies and risk management instruments (e.g., guarantee funds, group lending, crowdfunding arrangements) for enhancing target VCs and ABCs financing.
3. Financial Inclusion studies – to identify opportunities for intra-African trade VC financing which can be exploited by Financial Institutions, leading to new business opportunities, larger transaction volumes and greater efficiency.

Generally, this strategy will be implemented to influence change for Financial Inclusion for rural prosperity through 2SCALE tailored support activities in the three interdependent value chain levels as follows;

1. Farmer Level: to improve livelihoods and incomes through building their capabilities to access and use financial services.
2. Institutional Level: to support Financial Services Providers and agribusinesses to develop and expand access and partnerships for SHFs.
3. Sector Level: to support systematic change in Agri-finance by strengthening networks to attract other influential actors and supporting innovations.

Table 2: Priority financial challenges/ opportunities per partnership

(NB. *Some known pilots are included as well; they may be supported as soon as financial arrangements are defined as a priority)*

Country	**PPPs Code**	**Partner**	**Related PPP**	**Financial institution identified/ involved**	**Identified financial intervention**	**Status**
Burkina Faso	**? TBD**					
Cote d' Ivoire	CI05	POs	vegetables			
	CI08	POs	Groundnuts			
Ethiopia	ET06	POs (Tsehay FCU)	Indigenous oil seed	(RF/CFC	Working capital	financed.
	ET08	? TBD				
	ET09	Robi Berg Liben FCU	Potato	? TBD		
	ET10	FCUs (Setit /Dansha)	Sorghum	RF/Agrittera	Working capital	Financed
Ghana	GH04	Wienco	Rice			
	GH08	SFMC	Soybeans			
	GH09	Faranaya	Sorghum			
	GH11	Youth groups	Vegetables			
Kenya	KE06	Shalem	Sorghum	RF/CFC	Working/investment capital	Post loan monitoring
	KE11	KDPL	Dairy	Taifa SACCO	VLSAs: Financial literacy	Planned
	KE12	Mhogo Foods	Cassava			
	KE13	Dodore	Mobile digital savings			
Mali	ML04	Doun Ka Fa	Digital layaway agro-inputs			
	ML05	Services Commercial Silvain (SCS)	Vegetables			
	ML06	Enterprise Kady Traore (EKT)	Soybeans			

Niger	? TBD			-		
Nigeria	NG01	FrieslandsCampina	Dairy	FMO- Massif	Working capital	Deliberations
	NG09	Aggregators	Sorghum			
	NG11	Artee Group/Spar	Vegetables			
	NG12	Tays foods (TFL)	Onions			
	NG13	Kwara youth cooperative	Soybeans			
South Sudan	? TBD		TBD	-		

The PFs will first complete the above Table and ensure that all relevant information of financing strategies appears. Missing information to identify best-bet financing strategies (saving/ reinvestment; VSLAs; bilateral financing for SHFs/ POs; bilateral financing for SMEs for working capital, or investment; VC financing, with or without external financial service providers) will be identified as well. This will be a continuous process till maximum PPPs are achieved.

What we will do after this, will depend on the priority activities identified during the D&D workshop and subsequent TOC/M4C and impact pathways. In principle all partnerships should go through a cycle as described in Table 2. In the meantime, attention will be given to support/ advise the on-going PPPs (including in the coming days for sorghum/Niger seed, in Ethiopia and the Friesland Campina in Nigeria …).

Table 3: A systematic (cyclical) series of steps to address financial gaps in PPPs

Step 1	Partnership facilitator to present the VC/ analyze profit-cost structure of the VC (including risks as a result of climate/ market-price/ alignment-opportunism, etc.)	Q: do SHFs and local SMEs need support to understand profitability issues at their segment, and for the VC as a whole?	Financial literacy (budgeting/ record keeping/ VC cost structure)
Step 2	Partnership facilitator to identify major financing gaps - in consultation with VC stakeholders & (when needed Fin. Incl. Expert)	Q: do SHFs and local SMEs need support to understand their financing gaps?	Financial literacy (financing, loan/ credit management)
Step 3	Priority setting (consult Fin. Incl. expert): = Strategy for top (1 or 2) financial issues 1) Savings possible? 2) Bilateral loan with FI possible? 3) Tripartite financial arrangement possible? - What needs to be done with FI - What needs to be done with VC actors	R: identify leverage points, i.e., areas where you can achieve the highest impact. Working capital: for Agri-inputs (SHFs), packaging and other materials (SMEs etc.); timely payment for supplies (e.g., aggregator to SHF) … Investments: trucks/ processing lines (SMEs); equipment/ tractors (SHFs) → consider also leasing/ rental options, for SHFs, but maybe also for SMEs	VSLA Bilateral Financing VC financing (including reverse factoring)

Step 4	- Pilot (with Fin. Incl expert) - Design (including monitoring system/ communication) - Implementation Go/ No Go (with relevant stakeholders)	Proposed (in the meantime): savings, digitizing gender financial literacy, working capital	Ethiopia: Feasibility study (Agri-wallet) Yielder app – FACTs – reverse factoring
Step 5	Mainstream in target VC/ ABCs		PFs to reduce risks

6. The Supply-Side of Access to Finance/ Financial Inclusion

2SCALE essentially works through partnerships to pilot-test, develop and prepare inclusive business models for scaling/ mainstreaming. What we are aiming for in the end, are empowered local actors (ABCs) effectively integrated (inclusion) in commercially viable VCs, and lead partners that are inspiring examples of inclusive business. Wherever possible, financial institutions should be linked to target ABCs and VCs; and new financial institutes/programs (IDH-Farm Fit, ICCO, FAO Massif etc.,) including impact investors (Rabobank-Rural Fund, Oikocredit, etc.), should be aligned. New donor-funded programs (like SDGP/FDOV (facility for sustainable Entrepreneurship and food security), or Embassy-funded trade and investment type of programs) could follow up as well in future.

Part of the work of the 2SCALE Financial Inclusion Specialist therefore goes beyond just the individual partnerships, or the 2SCALE portfolio, to identify financial institutions that are willing/ committed to make a difference in the agricultural sector, and in agri-food industries; and to create awareness in the financing industry on the potentials of inclusive agribusiness in Africa. Some of these institutions may become interested to finance lead partners; such institutions include CFC Rabobank Foundation, Oikocredit, other impact investors and entrepreneurial challenge / competitive funds.

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