White Paper | Agrifinance | May 2009

Agrifinance—Reaching the Rest of Africa

For Limited Distribution

Objective

In 2008, Opportunity International made a strategic decision to significantly increase its banking services in the rural areas of all the African countries where Opportunity operates. Despite the disproportionate concentration of poverty in rural areas in Africa, Opportunity International (along with most financial institutions) has historically focused on urban areas, where clients could be more easily accessed and at lower cost. As the market for microfinance in urban areas (especially small-scale group business loans in these areas) matures, Opportunity is increasingly turning to the largely unbanked rural population, where the needs for microfinance are greatest.

The main key to Africa's rural regions is the agricultural industry, which will make up a significant percentage of Opportunity's rural loan portfolio. This paper will discuss Opportunity's effort to expand financial access to this difficult-to-serve industry. It will also highlight the challenges that we face and that have brought failure to previous attempts at developing sustainable rural microfinance models. Those obstacles include the complexity of farming operations, which are dependent on proper seed and farm inputs, farming techniques and infrastructure, access to markets and information and management of irregular income flows.

Finally, this paper will show how Opportunity International is seeking to overcome these obstacles through a strategic and holistic approach to agricultural lending, which we believe will help African farmers make great strides toward feeding the continent.

Context

With 65% of the Sub-Saharan African labor force employed in agriculture, which provides 32% of GDP growth, according to the World Bank, the importance of the sector to the economy is clear. Yet, the Bank finds that the region's agriculture industry receives

***Opportunity International** is one of the world's largest and oldest microfinance organizations, serving low-income families in Asia, Africa, Eastern Europe and Latin America.*

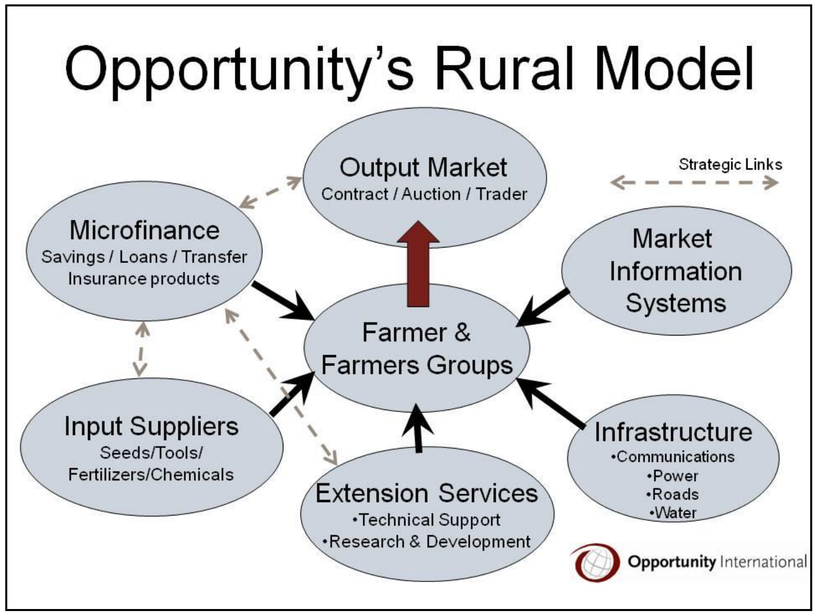
www.opportunity.net

just four percent of "official development assistance."[1] Opportunity International manages institutions in eight African countries and recognizes the need for and opportunities of agricultural financing in the rural regions of these countries. The percentage of the labor force involved in agriculture in these countries is as follows: Ghana (56%), Kenya (75%) Malawi (90%), Mozambique (81%), Rwanda (90%), South Africa (9%), Tanzania (80%), and Uganda (82%).[2]

Entry Strategies

In considering the provision of financial services to the rural populations in Africa, Opportunity quickly determined that it would represent a massive step forward to provide rural dwellers with easier access to deposit-taking, remittance and insurance services. However, a large number of potential clients, Opportunity expected, would seek access to loans as well. Hence Opportunity needed to be prepared to provide smaller loans within its holistic approach if it were to truly serve the needs of this largely disenfranchised and underserved client base. Opportunity recognized its approach would therefore involve lending to some of the poorest farmers on the continent who have never had access to financial services before and probably never dreamed of having such access.

Opportunity recognizes that there are very few success stories of rural lending in a sustainable way and that there is a need to develop a robust approach. In our effort to develop such a strategy, Opportunity has been piloting microfinance services and products adapted to the rural sector. We believe we are now ready to expand these pilot operations further and eventually throughout our operations in Africa's rural regions.



The primary entry strategy into rural areas will be via the provision of basic savings, money transfer, cash-back and insurance products, which will help households set up financial safety nets. The need for savings is amplified in the rural areas in order to smooth seasonal agriculture cycles and support the household until the next harvest. The seasonal flows add complications for the banks whereby, at planting season, they may see their deposit base (which is used to fund lending) reduced as farmers withdraw their savings to invest in their land. This withdrawal of funds will come at a time when the need to lend is at its highest.

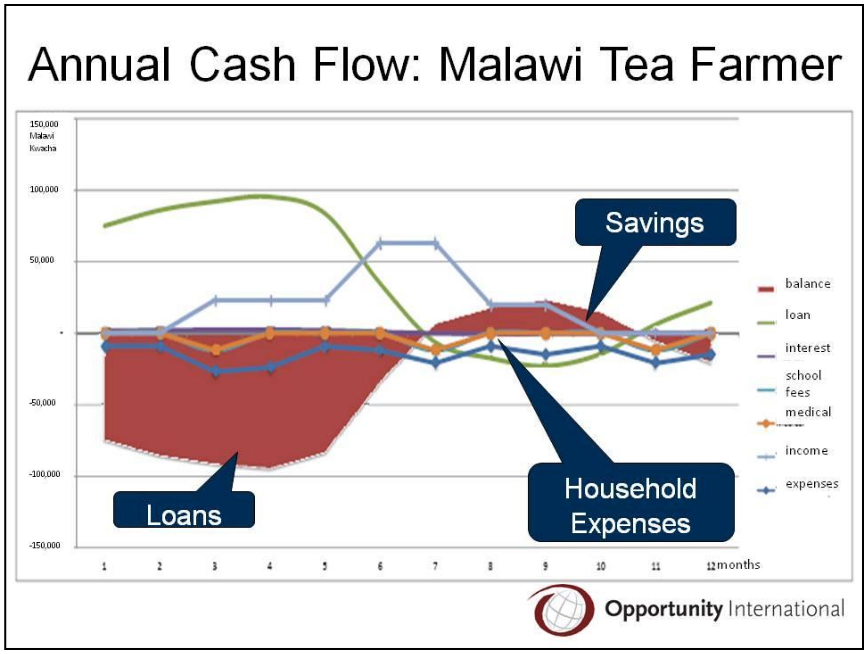
Opportunity estimates that 80-85% of our rural clients will access savings and insurance services, as studies have shown that rural farmers are highly desirous of formal savings opportunities. We believe more clients will want to use loan products once they become familiar with Opportunity and the services we offer, and this should, in turn, increase the sustainability of our rural operations.

---

1 The World Bank; *World Development Report 2008: Agriculture for Development*; Washington, D.C; 2008; http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/EXTWDR2008/0,,menuPK:2795178~pagePK:64167702~piPK:64167676~theSitePK:2795143,00.html, accessed April 30, 2009

2 Statistics come from the U.S. CIA's *The World Factbook*.

Accordingly, after entering an area with basic savings and banking services, an agriculture loan portfolio will gradually be introduced.



Developing such a portfolio in the rural areas requires modifying some of the proven strategies within traditional microfinance along with incorporating relevant technical knowledge of agriculture and agricultural value chains. This approach will involve a multitude of risks and challenges some of which we can foresee and others we cannot. Some of those we can foresee in developing this agriculture-focused microfinance model are:

- **High transaction costs** and high monitoring costs due to low population density in the rural areas and poor infrastructure (roads and communication).

- **Poor credit culture** and high level of default. Government and donor support and interference can have a detrimental effect on other stakeholders. Supplying free inputs, for example, can damage the local input dealer.

- **No established track record.** When such support as above disappears, the smallholder farmer has no financial track record, no access to microfinance and no input dealer from which to get supplies.

- **New lending methodology** that is based on anticipated crop production rather than current cash flow. As a result, the lender takes the risk of natural disasters, disease, decline in market prices, unexpectedly low yields and other production risks.

- **Long loan periods** with bullet repayments, leaving little chance to develop repayment discipline, as farmers do not receive a regular monthly income.

- **Price risk** due to volatile and weak output markets.

- **Less collateral** than the little that urban microfinance clients offer and far less recourse to property rights due to traditional land ownership in rural areas.

A Two-Pronged Approach

Opportunity has developed a series of strategies to manage these risks and provide maximum support to our rural clients. First, Opportunity seeks to manage the entire value chain. Second, Opportunity will keep a close watch on household cash flow.

Managing the value chain
The most important aspect of Opportunity's strategy is a clear understanding that microfinance is just one of the stakeholders within the rural model and that identifying the other stakeholders and their specific roles in

supporting the smallholder farmer is key. In traditional microfinance, the financial provider does not need to understand or manage the entire value chain for a client's business. However, the key for the development of a successful agriculture microfinance program, we believe, is a deep understanding of the entire value chain and a tight control by Opportunity of each link in that chain.

A key component in this is that Opportunity has real 'skin in the game' and more to lose if our approach goes wrong. In contrast, similar programs in the past have been led by contracted program managers or technical assistance providers, who do not have the same long-term incentives. This, over and above our commitment to long term, sustainable support to improving the lives of the poor, will incentivise us to get the approach right.

To manage this value chain, Opportunity's strategy is to develop strategic alliances with agribusinesses, farmer groups and associations and other partners to ensure each link in the value chain is carefully managed in a cost-effective manner. The agribusinesses will enter into contractual arrangements with the farmers to buy their crops. This will reduce price risk, enhance production quality and help reduce the risk of poor repayment. As repayment will flow from the agribusiness through Opportunity to the farmer, Opportunity can be more assured that repayments for the loan will not be diverted.

Throughout the process, Opportunity will work with extension services that are providing farmers technical assistance with the objective of maximizing the output of the farm. This, in itself, reduces our repayment risk.

Working with farmer groups and associations, Opportunity will benefit from existing client data and hence reduce our analysis and selection costs. Working with such groups will also enhance farmer access to well-organized agriculture inputs and markets. As it is expensive to create these partnerships and tightly manage the value chain, Opportunity will seek to work with farmer groups co-ordinated through the extension services into associations of 500 to 5,000 farmers.

In addition, Opportunity has developed the following strategies to ensure a profitable and well-managed agriculture microfinance program:

- **Traditional microfinance character-based lending techniques will be combined** with technical criteria, such as expected crop costs and yields, in selecting borrowers, setting loan terms and enforcing repayment.

- **Insurance will be incorporated into loans** to enhance the household safety net. Weather index-based insurance, where available, will protect against the risk of excessive or deficit rainfall. Credit life insurance will be included in all loans.

- **Savings will be a critical component** of all loans, so that farmers can manage their cash flows.

- **Education will be provided** about savings as well as borrowing, cash flow and basic business disciplines to farmers groups and extension services.

- **Loan terms and conditions will accommodate** cyclical cash flows and bulky investments for individual crops.

- **High-quality technical assistance will assist clients** in the form of agriculture extension services in an effort to improve land management and hence yields.

- **A Farm Management Handbook (to be developed) will provide farmers** and other stakeholders in each country with a single resource to access information for all the inputs (seed, labor, finance) required to produce any crop along with its expected yield and market value.

- **Portfolio risk will be diversified** across a variety of sectors, crops and geographic areas to reduce concentration risk.

- **A robust and sophisticated management information system will ensure** we have constant real-time information on the status of the agriculture loans within the portfolio.

- **Prudent risk management** that limits sector concentrations and caps the institution's loan portfolio as a percentage of the bank's capital base. Risk management will also include a rigorous credit approval process subject to the oversight of the relevant boards and bank management.

With the rural model strategic partners in place, the next phase of the Opportunity approach is to develop a series of support strategies to improve its knowledge regarding how the household is operating throughout the year and reduce the risks that result from the bursts of income around periods of harvest and lack of income for the rest of the season.

Household mapping

When attempting to manage a large number of smallholder farmers, the typical approach is to treat them as if they all worked the same land area, with the same number of family members, family labor, type and depth of skills and expected yields. This is far from the reality however, and therefore the level of support and funding should reflect individual needs.

Opportunity will cost-effectively discover and meet the individual needs of its smallholder loan clients by gathering specific data. GPS mapping will be used to locate the household and the land available for production. This will be combined with a simple household questionnaire to identify the demographics and other basic information in

Mapping and Profiling:
Sample Smallholder Farmers in Malawi

Area	Farmer ID	Age	Gender	Family Members	Kg / house (200)	Hectares (ha)	Maize / 5000kg/ha (5,000)	Production vs. Consumption at 5000kg/ha
Kutsamba	16	31	M	3	600	0.05	231	38%
Matchado	19	41	M	5	1,000	0.12	605	60%
Mwandama	9	25	F	3	600	0.08	388	65%
Nyozani	13	36	M	5	1,000	0.18	876	88%
Nyozani	11	50	M	5	1,000	0.21	1,028	103%
Kamlo	6	31	F	7	1,400	0.29	1,446	103%
Nyozani	12	36	F	4	800	0.23	1,157	145%
Matchado	20	53	M	6	1,200	0.36	1,809	161%
Mwandama	7	68	F	7	1,400	0.66	3,280	234%
Kutsamba	15	47	F	3	600	0.34	1,713	285%
Matchado	17	42	F	4	800	0.54	2,696	337%
Kamalo	5		M	2	400	0.27	1,362	341%
Kamalo	1	37	M	7	1,400	1.00	4,988	356%
Matchado	18	28	M	4	800	0.57	2,860	358%
Kutsamba	14	28	F	3	600	0.46	2,278	380%
Mwandama	8	72	F	3	600	0.47	2,368	395%
Mwandama	10		M	1	200	0.19	947	474%
Kamalo	4	59	M	2	400	0.38	1,906	477%
Kamalo	3	40	F	4	800	2.11	10,535	1317%
Kamalo	2	71	M	3	600	1.63	8,161	1360%

200kg maize per person = food security; 30% of sample are food insecure as indicated by yellow boxes.
5,000kg maize/ha productivity = financially vulnerable 10% (blue) of sample.

order to create a profile of each household.

Household profiling
From this profiling data it is possible to make objective decisions to:

- Optimize the cropping mix and land use for household food security and commercial production.
- Maximize production for household food security to release land for other productive enterprises.
- Collect production data to determine the type and amount of technical assistance needed.
- Identify vulnerable households – both for food security and provision of loans.
- Determine the need for paid labor or mechanization to crop the available land.

Even if the smallholder producer is maximizing production and the crop profile and mapping/household data indicate that they are able to repay the loans, it is important to utilize the household profile to identify the non-productive costs and financial pressures on the family.

Throughout Africa, low-scale, rural farmers struggle to balance annual expenditure requirements with limited seasonal income, sometimes resulting in the urgent need for cash to cover medical, school fees and even food. Smallholders, in such circumstances, will resort to moneylenders and similar intermediaries and either sell their crop before harvest (at up to 60% discount) or borrow money at non-commercial rates (up to 50% per month) to address the short-term need. This can mean the diversion of the crop away from the organized markets, reduce the potential income to the family and impact repayment to Opportunity.

It is important to recognize this financial pressure on the household to reduce both the loss of income to the family and the risk to Opportunity. This understanding also serves to highlight the need for savings and properly structured loan facilities to provide income-smoothing options to the rural client.

Conclusion

To address this critical need alongside the provision of traditional financial services, Opportunity has developed an innovative, exciting and holistic approach to provide loans to smallholder farmers that combines the best of traditional microfinance with a rigorous understanding of the unique factors associated with smallholder agriculture in Africa.

Opportunity is seeking partnerships and funding support to speed the deployment of agricultural financing. Please see Appendix A for a list of specific items that need additional resources.

We know there are many lessons still to be learned in this sector—even money to be lost—but our experience to date suggests that this key market and our new methods will prove to be financially viable and add an important new component to Opportunity's work in Africa.

Of greater importance, Opportunity's agrifinance model has the potential to transform the lives of Africa's smallholder farmers, which in turn, can move the continent toward becoming a self-sustaining food producer.

Africa has potential to be the breadbasket of the world, yet it is a net food importer. Rural Africa holds the continent's poorest families. Commercializing the agricultural economy by transforming farmers from subsistence growers to cash crop producers has great potential to move families out of poverty and feed a continent.

Opportunity International

Opportunity International has nearly $600 million in assets serving poor families with micro loans, savings, insurance and training in 26 countries in Africa, Asia, Eastern Europe and Latin America. Opportunity builds, owns and operates microfinance banks and the first wholly-owned microinsurance company, MicroEnsure. With Supporting Partners in Australia, Canada, Germany, the United Kingdom, and the United States, Opportunity manages investment divisions and a Loan Guarantee Fund.

Our Mission is to provide opportunities for people in chronic poverty to transform their lives.

Our Commitment is motivated by Jesus Christ's call to serve the poor.

Our Vision is to see millions lifted out of poverty permanently.

Our Core Values are respect, commitment to the poor, integrity, and stewardship.

We Serve women and men of all faiths and no faith.

Contributions & Acknowledgements

The World Bank*; World Development Report 2008: Agriculture for Development*; Washington, D.C; 2008; http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/EXTWDRS/EXTWDR2008/0,,menuPK:2795178~pagePK:64167702~piPK:64167676~theSitePK:2795143,00.html, accessed April 30, 2009

Christen, Robert Peck and Pearce, Douglas; *Managing Risks and Designing Products for Agricultural Microfinance: Features of an Emerging Model*; August, 2005; Consultative Group to Assist the Poor; Washington, D.C; 2008; http://collab2.cgap.org/gm/document-1.9.2705/OccasionalPaper_11.pdf, accessed April 30, 2009

Author Bio

John Magnay, Opportunity Agricultural Advisor
John was born and raised on a large farming estate in the United Kingdom. He studied agriculture management at the University of London, Wye College. John's 32 years of living in Uganda include 2 years with the Uganda government as a dairy advisor and 30 years in the private sector. John has worked in agro processing and input supply as well as a regional grain trader. He spent 20 years as a buyer of output crops for food, seed and agro processing while working with smallholder farmers and traders. John has served as a consultant to the United Nations World Food Programme, the Food and Agriculture Organization, the European Union, the World Bank and USAID. He has specialized in agribusiness and market development in East and Southern Africa.
johnmagnay@gmail.com

Editorial Input

Richard Marney, Senior Vice President for Product Management
rmarney@opportunity.net

Colin McCormack, Managing Director Africa
cmccormack@opportunity.net

Claudia McKay, Director of Product Development
cmckay@opportunity.net

Rob Moll, Strategic Communications Manager
rmoll@opportunity.net

Appendix 1: Partnerships and Funding Support

Opportunity is seeking partnerships:

- to identify and support farmers through farmers' groups,
- to expand the Weather Index Insurance scheme by increasing the coverage area through added weather stations.

and funding support

- to begin mapping and household profiling,
- for Opportunity staff, training and infrastructure,
- for loan funds and loan guarantees,
- to produce the Farm Handbook.