

Financial Services Help Build Resilience

By Robert Fries

Achieving food security is a complex challenge. Its dimensions are technical, involving issues from nutrition to agronomy, as well as economic, including market distortions and price volatility. They are also financial. With limited liquidity in rural areas and limited access to financial services, smallholder farmers are constrained in their ability to grow food.

Our beneficiaries' financial challenges are linked to the reality of life in rural areas. Rural areas typically face high transaction costs compared to urban areas, because clients are more dispersed, infrastructure is less developed and branch networks are more expensive to maintain. It is difficult and expensive to get the information necessary to assess a borrower's ability and willingness to repay a loan. Collateral is more limited and often less documented, and it is more difficult to liquidate, increasing provisioning and foreclosure costs for financial institutions. Financing agriculture creates an additional set of costs and risks, from its seasonality and requirements for longer terms, to the fact that many borrowers will face the same production and price risks and thus collectively pose a problem to the lender. For these reasons, banks are reluctant to extend credit to small farmers, leaving them vulnerable to food insecurity.

To address these challenges, we have helped launch financial institutions committed to serving rural customers. We tap nonfinancial institutions to expand farmer access to credit. And we help build systems that allow farmers to use their stored products as collateral for financing that can help sustain their family budgets until the next production cycle.

New Financial Institutions with a Rural Mission

ACDI/VOCA's founders included members of the U.S. farm credit system—associations and cooperative banks with a history of serving rural communities and farmers on a consistent and reliable basis. Throughout its history, ACDI/VOCA has created and supported financial institutions that share this commitment to rural and agricultural finance. Over the past two decades,



Above, representatives from Financiera de Cooperativas Agropecuarias, Ltda, (FINACCOOP) pose in front of the microfinance institution's office. Located in Honduras and supported by ACDI/VOCA, FINACCOOP's motto is "nosotros creemos en los negocios rurales," or, "we believe in rural businesses."

ACDI/VOCA has launched a number of financial institutions that emphasize services to small farmers and rural residents to help them manage their cash flow constraints and invest in expanded production that allows their families to become food secure.

These entities take on a number of legal structures, including nonprofit foundations, credit

cooperative systems and for-profit finance companies. Regardless of the legal structure, institutions with a strong commitment to serving small farmers can grow and thrive with products and practices that meet their customers' needs while managing risk effectively.

For example, in 2000 ACDI/VOCA established Bai Tushum Financial Foundation in Kyrgyzstan with \$2 million in initial loan capital from the U.S. government and Swiss Caritas. Its objective was to establish a permanent local financial institution to facilitate access to financial services for farmers, agroprocessors and rural entrepreneurs. After three years, Bai Tushum was profitable, had three branches and 10 suboffices throughout Kyrgyzstan, and had an outstanding loan portfolio of \$5.6 million extended to nearly 3,000 borrowers. It now has seven branches and 29 suboffices serving more than 26,000 borrowers with a \$40 million loan portfolio.

Three more examples of institutions that were formed to meet the financial needs of rural families, farmers and small enterprises, and that have grown to significant scale, include CredAgro in Azerbaijan, a finance company with over 18,000 borrowers and \$50 million in loans; Agrocapi, a foundation in Bolivia with over \$25 million in loans to 20,000 borrowers; and a network of credit cooperatives in Russia serving 500 farmers with \$11 million in loans. Each filled a void in rural financial services. Through their growth, and competition these organizations inspired over time, small farmers' access to loans has increased dramatically in these countries.

Partnering with Nonfinancial Entities

ACDI/VOCA also has learned that financial services to small farmers can be expanded by part-

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nering with nonfinancial institutions. Two examples of its current work in Honduras, under an MCA-funded Access to Credit Activity, illustrate this well. Small farmers seeking to begin or upgrade their horticultural production had limited access to credit for the more expensive inputs this value chain required. Input providers who were interested in expanding sales operated with 30-day credit. We worked with them to adapt their loan terms to reflect the crops being financed. As a result, some of the input providers introduced a line of credit to preferred customers, extending their loan terms from the traditional 30 days to 90 and 180 days. Credit line applications were analyzed using a cash flow analysis tool that reduced credit risks by linking loan sizes, disbursements and repayments to realistic cash flow projections. In one year, 11 input providers introduced this new product to nearly 1,000 smallholder farmers in Honduras.

A second example illustrates how, through **strategic alliances**, a group of partners can provide services to small farmers they would not otherwise reach. The relationship makes the services more efficient, reducing transaction costs and risks. In Honduras a bank, a supermarket chain and an NGO have formed a joint venture in which the bank disburses loans to producers who have contracts with a supermarket chain. The supermarket repays outstanding loan balances before making final payments to the farmers. The NGO provides technical assistance and marketing services, and helps the bank identify and screen new clients. In three cycles, the joint venture has doubled the number of borrowers with each new round.

Warehouse Receipts

Another product that builds collaboration across multiple actors and offers potential for small farmers to enhance their food security is warehouse receipts. How do warehouse receipts work? Produc-

ers, traders and processors deposit commodities at a warehouse. The warehouse promises secure and safe storage and issues a receipt to the depositor, certifying that it is in possession of a specific quantity of a particular commodity that meets specified standards. The depositor can then use that receipt as a pledge to secure a loan from a bank or other lender. The lender places a lien on the commodity so that it cannot be sold without the proceeds first being used to repay the outstanding loan. A depositor can also transfer the receipt to a buyer, who in turn can take delivery of the commodity at the warehouse.

This system has many significant benefits. Producers and traders gain increased access to reliable storage. Reliable storage can contribute to food security because it increases both the effective yields (by lowering post-harvest losses) and the average prices producers receive for their product, because they can participate in bulk sales and sell their product over time, rather than just at harvest time when prices are low. An efficient and reliable system that participants trust also increases the depositor’s creditworthiness. Deposits can serve as a source of collateral, and warehouse records allow depositors to build a transaction history. Lenders are able to reduce screening, monitoring and transaction costs because many of these are built into the receipt system.

Furthermore, the value chain as a whole benefits, making trade of the commodity more efficient. Buyers worry less about product availability and timely delivery. Consistent standards are developed, and their incorporation into receipts allows buyers and sellers more symmetrical knowledge of product quality and quantity. With consistent standards, buyers can purchase commodities without having to sample the product of individual producers, which allows them to buy the commodity and resell it *in situ*. This significantly reduces handling



costs and additional transportation charges. All of these benefits serve to reduce the costs and risks associated with transactions, and to upgrade the marketing process so that increased value is generated by the chain. Finally, with increased access to financing, smallholder farmers can invest in the next season’s inputs and preparation without being forced to sell their commodity.

The mechanisms we have highlighted here, from strategic alliances to warehouse receipt systems, are often identified with larger players. However, these same mechanisms can build on existing relationships and assets that help small farmers, like larger players, manage risks better, allowing them to diversify their production and sources of income and reduce vulnerability.

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