Re-imagining Rural Financial Services

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Across Africa only 4% of the supply of smallholder finance comes from financial institutions. Over decades there have been multiple responses to this challenge. Special purpose institutions – development banks and agricultural finance corporations. Risk sharing mechanisms – credit guarantees. There have been government schemes providing subsidised credit.

Today, there are new initiatives under the rubric of blended finance, which combine public and private finance in innovative ways – for example challenge funds – such as that run by the MasterCard Fund for Rural Prosperity, which have financed innovations in agricultural finance. And yet, still the supply of credit for smallholder farmers still comes mainly from the informal sector.

So, what is going to make the difference? Re-imagining rural financial services. We need to make a better business proposition of agriculture and reduce the risks inherent in rural finance. This implies a range of initiatives that could be undertaken:

a) Repurpose channels – reducing costs
b) Digitise the loan process
c) Digitise user interfaces and user experiences and successfully onboarding farmers
d) Increase funds available through increased rural deposit mobilisation
e) Apply risk weighted pricing to loans
f) Diversify sources of finance through formalising and scaling informal finance mechanisms
g) Digitise value chains where feasible
h) Identify and developing schemes to manage covariant risks which are difficult to predict and manage

Re-imagining Rural Finance

Fortunately, the digital finance revolution combined with the advent of agricultural technologies and innovations are making significant strides forward. Thinking through these points:

Reducing the cost of provision of rural financial services

Reduced costs of provision, improves the profit margin for financial institutions and their willingness to invest:

- Use agent banking to reduce branch infrastructure costs – use shared agents where appropriate
- Develop app-based services for farmers to reduce their needs for branch-based services ○ Work with and through partnerships with rural finance institutions and associations to test and scale services
- Digitise the loan cycle to improve decisioning, speed decisions, reduce lending costs and reduce loan losses

Digitising the loan process

Digitising loan processing enables loans to be processed faster, more accurately and with improved decisioning. User interfaces, apps, enable the integration of value-added services for farmer and can provide data for improved decisions on loans.

- Loan application: This includes digital KYC and application scorecards linked into credit reference bureaus
- Loan processing: Field based applications for loan officers linked into collateral registries ○ Loan decisioning: Direct data acquisition through apps, use of third-party datasets. Pre-scoring regular customers
- Loan distribution: Direct into accounts, special purpose wallets, direct payment of suppliers

Digitising the user experience

Initial products from Safaricom - Digifarm, and Kenya Commercial Bank - Mobigrow show that considerable steps can be taken to digitise user experiences. They also point to challenges in usage and adoption which need to be carefully addressed, through product design, pilot testing and implementation.

- Loan application: Digital applications, digital KYC and provision of initial data for lending ○ Information services: Provision of best practice information, advice on agricultural technology ○ Value added services: E-commerce for farmers using approved suppliers, sourcing inputs, and equipment, farmer to market services
- Agent banking and mobile money: For loan distribution and repayment

However, the typical Kenyan farmer is 56 years old, with moderate education, but is likely to be familiar with M-Pesa. This implies that digital services require pilot testing with early adopters, and ongoing support through agents, farmers' groups and targeted campaigns through social media and through media outlets.

Managing Farmer Risks

Processes and services that help farmers to manage risks are designed into services offered, these could include:

- Farmer appraisal based on evidence of the application of best farming practices and access to farmer support services
- Information services providing advice to farmers ○ E-commerce services facilitating the best inputs and marketing ○ Added value through incorporation of agricultural technologies ○ Incorporation of insurance services

Apply risk-based pricing

Risk based pricing means that farmers who are judged at greater risk pay higher interest rates, but critically can access credit. This implies:

- Access to credit reference bureaus acknowledging that many farmers will have an incomplete formal record
- Assessing farmers for use of best practices
- Use of own data, collected data, and third-party data sets with data analytics

Understand emerging agricultural technologies

Understand emerging agricultural technologies which can reduce risks, improve yields or returns, for farmers throughout the agricultural cycle, including - planting, irrigation, fertiliser, pest management, harvesting, storage, distribution, marketing, and post-harvest production.

○ Adjust products, scorecards, and risk weightings according to use of emerging technologies ○ Incorporate into app development and information services, where appropriate

Integrate into digitising value chains

Specific value chains can be targeted for digitisation. These value chains are often those which generate frequent transactions through regular harvesting, or production, this includes dairy farming, coffee, tea, fisheries. Products can be designed for specific value chains such as invoice discounting for dairy farmers. In this example, information from farmers or their cooperatives, on yields, fat content and bacterial testing is used to calculate receipts due to the farmer and an appropriate discount factor is applied against the timing of the anticipated payment.

Rural deposit mobilisation

Rural deposit mobilisation helps to fund agricultural lending and helps to cover the cost of rural channels:

- Agent banking services designed for rural areas
- Provision of G2P services including subsidy programs which support rural populations ○ Apps offering improved savings products, and financial planning built around rural lifestyles ○ Deposit mobilisation focused on supporting rural businesses, through cash management, merchant services, and digitisation targeting rural SMEs
- Seasonally focused campaigns and products which reflect the availability of deposits in agricultural communities

Diversify sources of finance for farmers

Diversify risk through matching existing sources of finance for farmers, where collateral is retained by the financial institution to cover their risks. This could include:

- Partnerships with agricultural cooperatives and SACCOs ○ Partnerships with savings groups
- Partnerships with crowdfunding platforms specialising in agricultural lending

Manage co-variant risks

Covariant risks occur through drought or pestilence and can have a dramatic impact on portfolios. It can be difficult to design products which can accommodate co-variant risk. However, this is where reinsurance and government subsidy schemes can apply to share co-variant risk. Managing co-variant risks is important to change deep seated perceptions within the financial sector as to the profitability of agricultural finance.

Partnerships and networks

Scaling up agricultural finance is no longer only about direct relationships with farmers. It is about an ecosystem of partnerships:

- Finance partnerships: To leverage funds that are available and explore new ways to share financial risks
- Technology partnerships: Leveraging financial and agricultural technologies to improve all aspects of loan processing, decisioning and delivery and to provide value added services for rural communities
- Data partnerships: To facilitate improved decision making and to pre-score clients where possible
- Farmer support partnerships: To recognise additional support already provided to farmers.
- Digital value chain partnerships: To explore how digital finance can be provided through value chains
- Risk partnerships: To incorporate risk management mechanisms for farmers into product and app design and to offset covariant risks to the extent possible, which provides confidence to go to scale

This blog is one of a series of blogs, should you wish to sign up to receive additional blogs, please write to David Cracknell at david@firstprinciples.consulting

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