Financial Inclusion

P4P Experiences in Systemic Change

Limited access to finance is a major challenge for smallholder farmers around the globe. Smallholder farmers face constraints in accessing credit, such as limited financial literacy and financial management skills. Financial institutions tend not to see smallholder farmers as desirable clients due to the risky nature of agricultural production—particularly given changing climatic patterns—and a lack of assets for farmers to use as collateral.

P4P and Financial Inclusion

Under Purchase for Progress (P4P), it became clear that promoting financial inclusion for smallholder farmers can catalyse economic growth and poverty alleviation. Financial constraints severely limited the ability of FOs to aggregate, process, transport and store members' crops.

Low income smallholder farmers need ongoing access to financial services to invest in their production and reach formal markets. By increasing the availability of financial services, P4P fostered engagement in local value chains by farmers and FOs, and enabled them to: invest in productive assets; aggregate crops for sale; and smooth out consumption patterns after harvest.

Highlights

- Despite ongoing support from P4P, providing financial services for agriculture in rural areas at the right conditions is extremely challenging, specifically in the case of staple food crops. Furthermore, widespread financial inclusion for low income farmers still remains a challenge in most countries, and there is no single solution that fits all the different country situations.

Forward Delivery Contracts (FDC)

- When smallholder farmers' organizations hold a formal purchase agreement guaranteed by reputable institutional buyer, this can help encourage financial institutions to provide them with credit. For this purpose, P4P tested the use of forward delivery contracts signed either before planting or harvest. With FDCs, FOs could leverage contracts as collateral for loans from financial institutions. Oftentimes, payment on the contract was made directly to the FO account with the lending institution, enabling them to automatically withdraw repayment on the loan. FDCs proved an important tool for mitigating risk for both smallholder suppliers, buyers, and financial service providers.

Achievements

- In Rwanda, loans to P4P-supported farmers' cooperatives increased from **US$56,000 in 2010 to US$790,000 in 2013**.
- Over five years of the pilot, P4P engaged in **19 partnerships with financial institutions** with far-reaching results.
- Working with P4P has enabled farmers' organizations to access loans at lowered interest rates. For example, in **Burkina Faso farmers' organizations could access credit at 9.5 percent** against the prevailing 12 to 14 percent.
- In Latin America, more than **12,000 farmers accessed credit through revolving funds**, many of whom for the first time.
- In Uganda, P4P has strengthened the capacity of **747 Village Savings and Loans Associations** with US$866,352 directly mobilized by farmers under supervision of the partners.
- At the end of 2015, four banks in Malawi **disbursed US$16 million in credit to farmers** through the warehouse receipt system.

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Revolving funds

- In El Salvador, Honduras and Nicaragua, WFP tested revolving funds with a number of FOs as a possible solution to help FOs access credit for agricultural production. WFP provided start-up capital for revolving funds, and supported the provision of capacity development to increase smallholder farmers' financial literacy and business capacities. This model proved successful, however, in some cases it was challenging for FOs to manage revolving funds, and many require further capacity development to ensure sustainability of the model.

Warehouse receipt systems (WRS)

- Supporting the expansion of inventory credit, such as warehouse receipt financing, can facilitate commodity trading by converting agricultural commodities into tradable devices guaranteed by warehouse operators. This model creates an opportunity for financial institutions to stipulate agreements with warehouse operators (who act as collateral managers) expanding the delivery of financial services to WRS users. These agreements enable receipt holders to engage directly with financial service providers to obtain short-term loans. P4P has supported WRS and warrantage schemes in Burkina Faso, Ghana, Kenya, Malawi and Uganda.

Capacity development

- It is necessary to build smallholders' capacity in financial literacy and management, including by strengthening community-based savings and credit schemes. In Rwanda, P4P collaborated with the Rabobank Foundation to provide farmers' cooperatives with financial literacy training to assist them in understanding how to manage their finances.

Women's access to finance

- Legal barriers, socio-cultural norms, lack of access to assets to use as collateral and high illiteracy levels prevent women farmers from accessing financial services. Farmers' organizations, particularly women, struggling to access credit through formal institutions, may access credit through informal financial mechanisms such as village-based cooperatives, credit unions and saving schemes. For instance, in Ethiopia, Uganda and Rwanda, P4P provided women's groups with space and income needed to create groups savings to obtain credit for urgent cash needs or reinvestment in agricultural businesses.

Further reading

- Publication: The P4P Story, Chapter 1
- Publication: Reflections on the P4P Pilot, Chapter 5
- Article: Empowering smallholders with innovative purchasing models

The Commercial Bank of Ethiopia (CBE), WFP and cooperative unions signed an agreement allowing cooperatives to obtain loans to purchase and aggregate maize directly from farmers.

"Not only did this loan allow us to buy maize and increase our sales to WFP from 400 metric tons last year to 2,500 metric tons this year, it also helped to create market access for these farmers and train us about quality and storage of the grains," said Kalifa Ossero, manager of the Melik Cooperative Union in Warabie town, in the Silti zone of SNNPR.

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Forward Delivery Contracts

A contract with a reputable organization like WFP can go a long way in helping smallholders obtain credit from financial institutions. Forward delivery contracts (FDC) have been used to give smallholder farmers the ability to plan in advance as well as to leverage credit at favourable conditions.

FDCs are an innovative procurement modality that strengthen farmers' financial inclusion. With FDCs, FOs could leverage contracts as collateral for loans from financial institutions. Oftentimes, payment on the contract was made directly to the FO account with the lending institution, enabling them to automatically withdraw repayment on the loan.

- Financial institutions are more likely to provide FOs with credit at favourable conditions if they hold an FDC.
- FDCs are most effective at generating credit for smallholder farmers when WFP actively engages with other stakeholders to develop smallholder-specific solutions for farmers' access to credit.
- FDCs can be complex and therefore FOs require substantial capacity development to ensure they understand the mechanism.
- For buyers to use FDCs, they must be able to designate funds up to a year in advance in order to provide farmers with the collateral they need.

Case study: Maize Alliance in Ethiopia

The Maize Alliance in Ethiopia represents the most successful example of collaborative efforts to link smallholder farmers to financial institutions using FDCs. The Maize Alliance is a tripartite agreement between WFP, the state-owned Commercial Bank of Ethiopia (CBE) and various cooperative unions (CUs).

In four consecutive seasons, WFP was able to purchase 82,800 mt of commodities directly from CUs, for a total value of US$25.4 million. These contracts allowed eight CUs to access over US$10 million in output credit, at a subsidized interest rate of 7.5 percent.

This occurred thanks to a combination of factors. The availability of multi-year funding for pro-smallholder procurement enabled WFP to plan its procurement more effectively. CBE was able to modify its statutory requirements to make P4P-supported CUs eligible for credit. Finally, targeted support from supply-side partners was instrumental in developing key capacities in FOs and facilitating the loan application procedures. Positive performance on FDCs helped FOs strengthen their financial position, by allowing them to repay outstanding loans, start building a credit history, and develop relations with lending institutions.

Achievements

- FDCs have yielded positive results, both in terms of procurement achievements and in unlocking access to financial institutions for smallholder farmers.
- So far, **WFP has contracted almost 120,000 mt** food commodities using the FDC modality in seven countries.
- WFP signed **340 forward delivery contracts** in seven countries.
- In Burkina Faso, WFP has partnered with the *Federacion du Caisses Populaire du Burkina* and the National Federation of Agricultural Producers to allow farmers' organizations **to access credit at lower interest rates** (9.5 percent against prevailing rates of 12 to 14 percent).
- In 2011, Diedougou Farmers' Union in Mali was enabled to take out a loan of **US$155,000 by leveraging the FDCs** with WFP.

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