RURAL AND AGRICULTURAL
FINANCE

TAKING STOCK OF FIVE YEARS OF INNOVATIONS

microREPORT #181

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ACRONYMS

ASCA  Accumulating savings and credit association
ATM   Automated teller machine
BDS   Business development services
BMGF  Bill and Melinda Gates Foundation
CBSP  Community-based service provider
CGAP  Consultative Group to Assist the Poor
CLI   Credit life insurance
COMPETE Competitiveness and Trade Expansion project
FAST  Finance Alliance for Sustainable Trade
FDL   Fondo de Desarrollo Local (Nicaraguan MFI)
FI    Financial Institution
FIRM  Financial Inclusion for Rural Microenterprises project
FTF   Feed the Future
HF    Household Finance
I4    Index Insurance Innovation Initiative
ICT   Information and communication technology
IFC   International Finance Corporation
IIFC  Islamic investment and finance cooperative
ILO   International Labour Organisation
KFSDT Kenya Financial Sector Deepening Trust
M4P   Making Markets Work for the Poor
MFI   Microfinance Institution
MSEs  Micro and small enterprises
NFE   Non-Farm Enterprise
NFED  Non-Farm Enterprise Finance
NGO   Nongovernmental organization
OIBM  Opportunity International Bank of Malawi
ROSCA Rotating savings and credit association
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>SMEs</td>
<td>Small and medium enterprises</td>
</tr>
<tr>
<td>SMS</td>
<td>Short messaging service</td>
</tr>
<tr>
<td>TSP</td>
<td>Tillage service provider</td>
</tr>
<tr>
<td>UNCDF</td>
<td>United Nations Capital Development Fund</td>
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<tr>
<td>UNDP</td>
<td>United Nations Development Program</td>
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<td>USAID</td>
<td>United States Agency for International Development</td>
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<td>VCA</td>
<td>Value Chain Approach</td>
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<td>VCF</td>
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<tr>
<td>VS&amp;L</td>
<td>Village savings and loans</td>
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<tr>
<td>WRS</td>
<td>Warehouse receipt system</td>
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I. INTRODUCTION

Financial access can be critical to reducing hunger and poverty in three ways. First, financial access for agricultural value chain development is needed throughout the value chain to achieve broad-based economic growth that raises incomes for low-income households. Second, diversification out of agriculture is a hallmark of economic growth, but rural entrepreneurs require financial access in order to invest in non-farm enterprises (NFEs). Third, at the household level, access to financial services (including savings and other non-credit products) enables rural households to meet both regular and unexpected consumption and social demands, such as food, school fees, health care, and funeral expenses, without having to divert financing from investment opportunities. Given the fungibility of money, these three areas are closely interlinked.

This paper researches and categorizes the principal challenges facing the agricultural and rural sectors, and takes stock of the financial services initiatives around the world since 2006 that form part of the “innovations frontiers” in addressing these challenges.

In so doing, the paper attempts to accomplish three main objectives:

- **Define** a model for agricultural and rural finance that is inclusive of agricultural value chains, agribusiness firms and households, recognizing the money flows, interactions and inter-connections between and among agricultural value chain actors and households.

- **Frame** the rural/agricultural finance discussion from the perspective of demand for finance rather than the more common focus on supply (products, institutions and delivery mechanisms). Its starting point is the type of problem—either in the value chain, such as side-selling; in the non-farm firm, such as appropriate collateral requirements; or in the household, such as a need for “lump sums” at particular times of the year. Only after identifying the key relevant problems in agricultural and rural development does the paper turn to the solutions in terms of financial product, institutional and delivery responses to these problems. As a result of a demand side focus, the report highlights financial needs that have sometimes been overlooked.

- **Categorize** innovations that show promise in addressing the problems referred to above (in the value chain, in NFEs, or in the household), as well as those related to the policy environment, that affect the performance of the agricultural sectors and the wellbeing of rural households.
II. DEFINING AN INTEGRATED MODEL OF RURAL & AGRICULTURAL FINANCE

This paper’s integrated framework emphasizes the inter-relation between the agricultural value chain, the non-farm enterprise, and the rural household. The seasonal nature of cash needs and sources within these three entities and the fungible nature of cash make it imperative to think holistically about the ways that financial services can improve the efficiency and effectiveness of all three. By doing so, financial service providers and their partners have managed to introduce more flexible products and services that fit the needs of households, enable investment by these households as well as firms in the value chain, and thereby strengthen the competitiveness of value chains—while simultaneously lowering their own risk exposure. The paper also explores the enabling environment—not as a part of the integrated way in which cash and financial services flow in rural areas, but rather as an area in which innovations have been effective in removing the barriers to such services.

Agricultural value chains, and many of the firms in them, tend to have seasonal financial needs due to the nature of crop and livestock maturing, seasonal restrictions on fishing, etc. There is a period of investment in producing and then a period of selling within a cycle, which can range from weeks to several years.¹ Farmers are often cash-constrained, limiting their ability to make improvements or upgrades. Firms in the value chain, such as inputs dealers, buyers, traders and processors typically need considerable working capital for inputs, buying crop for onward sale or processing, arranging transport and for other service costs to produce and reach (distant) markets. With limited or no financial access, value chain actors face a zero-sum game in which investment and improvements at one level (such as production or inputs) can only be made at the expense of investments or improvements at another level (such as processing). As an example, some value chain firms (both buyers and inputs providers) provide advance payments or in-kind loans to producers or traders, limiting the capital available to them for their own investment and expansion. Thus providing liquidity to such firms can have positive spillover effects for producers as well. Likewise, providing financial access directly to farmers can free up much needed capital for buyers to make the investments needed to expand operations or enter into new markets.

With regard to NFEs, a substantial multiplication effect is achieved by improved value chain competitiveness. This can take the form of clusters of mutually supportive firms, service providers that spring up to respond to new needs in growing chains, and providers of basic goods and services to regions experiencing income gains and thus increased spending power.

The importance of the integrated vision of rural finance is seen most clearly at the household level, where all income and spending decisions are closely linked. Household expenditure and income are likely to be highly seasonal—particularly where agriculture is predominantly rain-fed—and this is accentuated by the seasonal nature of some non-business needs and expenditures such as education and medical costs. Understanding the rural household requires an understanding of the range of cash and non-cash needs (e.g. education, medical, consumption, loan repayment, housing, farm expenses, and non-farm business expenses) and sources (farm sales, trading, labor, remittances, pensions, sale of assets), and the timing and related imbalances of these. Given money’s fungibility, consumption and other non-business expenses can and do divert funds from farming, business, and investment needs, especially during “lean” times of year when income is low. Thus a financial service provider must view the rural household holistically,

¹ The same is true for manufacturing, but the investment-sale cycle is usually shorter than for agricultural production, and turns over more frequently.
rather than trying to isolate its agricultural finance from other finance needs. A financial needs analysis that is limited to the particular finance needs of the cash crop in question fails to address the integration of the rural household’s agricultural, NFE and household activities and cash flows. This can result in improperly designed products, low repayment rates, and perpetuation of the perception of rural producers as poor credit risks.
III. FRAMING RURAL & AGRICULTURAL FINANCE FROM THE DEMAND SIDE

Compared to cities and towns, rural areas by their nature tend to be physically more difficult to access, with dispersed populations having relatively limited purchasing power. They usually also have poorer infrastructure, such as roads, markets, water, telecommunications and electricity, and weak public and private services such as education, medical and retail services. As a result, rural areas are more difficult to reach with financial services and less attractive to financial institutions (FIs). This reality is reinforced by the fact that many FIs are disconnected from the agricultural economy (in many countries, private financial institutions pulled back from agricultural lending many years ago) and thus lack the knowledge they need to make informed lending decisions.

Aside from these structural challenges to expanding rural and agricultural finance, there are specific needs and challenges when viewed from the perspective of the actor(s) who rely on these financial services. In this section, we explore both the needs and challenges from the distinct perspectives of the value chain as a whole, the NFEs and the household. Under the “Enabling Environment” section, we explore—from a more systemic vantage point—the needs and challenges that are not unique to one of these three perspectives, but rather relate to broader obstacles to expanding and improving financial access in rural areas. Together these needs and challenges are the multi-dimensional “problem statement” that the innovations in the subsequent section attempt to address.

A. VALUE CHAIN-WIDE FINANCIAL NEEDS, SOURCES AND CHALLENGES

Looking back 20 to 30 years, many agricultural development interventions focused solely on farm-level assistance aimed at improving productivity, quality, and returns to farmers. This focus on production was found to be insufficient, however, as farmers faced an increasingly broad range of problems illustrated by limited access to markets and volatile prices. Although providing agricultural credit was recognized as essential, the inherent production, market and price risks frequently proved to be prohibitive. Interventions were typically piecemeal, uncoordinated, sometimes contradictory and often inappropriately designed.

1. CURRENT STATE OF AGRICULTURAL VALUE CHAIN FINANCE

Over the last 10 to 15 years, development partners, NGOs and private-sector players have increasingly recognized value chains as the key lens through which they understand production (or “farming”), processing and distribution to end user/consumption markets for a particular agricultural commodity. Consequently, agricultural interventions have sought to improve the competitiveness of value chains and to incorporate the value chain approach (VCA) more frequently. Improving access to finance along the value chain is now recognized as a crucial component of the VCA and critical to improving competitiveness.

For the purpose of this study, a value chain is defined as the range of activities and services required to bring a product or service from its conception to sale in its final markets. Value chains can be relatively simple, with a single agricultural commodity selling into a small number of end markets, or more complex, with several core commodities leading to multiple product outcomes for sale in a variety of end markets. These chains in turn are more or less integrated with other sets of services and non-agricultural value chains, such as transport, fertilizer, equipment and...

2 See USAID’s value chain wiki: www.microlinks.kdid.org/vcwiki
finance. They are also integrated with other agricultural value chains through intercropping, shared systems and services, common inputs, etc.

Agricultural value chains collectively have needs and challenges that supersede the needs of any single actor, some of which can be met or alleviated in part by improving access to financial services. For example, increased investment in processing plants and the use of improved inputs (seeds, fertilizers, irrigation, etc.) could increase the competitive positioning of the horticulture sector of a given country in national and export markets, thereby benefiting the entire chain. For this reason, it is important to understand how value chain relationships can be the starting point to implement financing arrangements that are profitable to the financial service provider but also result in financial benefit to the client (value chain actor) and the chain as a whole.

2. CURRENT AGRICULTURAL VALUE CHAIN FINANCE CHALLENGES

From a demand-side perspective, farmers and firms in agricultural value chains must address some key challenges in order to improve their individual and collective performances and to achieve sustainable results. Thus, innovations in value chain finance (VCF) have typically focused on the following:

1. **Third-party selling** is common particularly where the nature of the commodity means it can easily be sold to one of several buyers.
2. Considerable **production, market and price risks** remain for farmers and consequentially for finance providers.
3. There is limited **finance for fixed assets (equipment) for smallholder farmers**, as providers focus on working capital for inputs.
4. Farmers are often unable to take advantage of **temporal price gains** in the value of their produce due to **poor access to warehousing and storage**.
5. **Integrating the poorest farming households** remains challenging; FIs have focused on better-off farming households as they are easier to reach.
6. **Limited private-sector engagement and competition** affects many smallholder farmers, meaning high producer dependence on particular buyers (for inputs, agronomy and markets) and poor returns; part of the dependence is due to weak farmer organizations.
7. Access to working capital has increased, but there is still room for improvement: few financial providers have effective ways of **assessing cashflow needs**, and provision does not often match actual needs.

B. FIRM-LEVEL RURAL FINANCIAL NEEDS, SOURCES AND CHALLENGES

Economic growth resulting from value chain development generates multiplication effects, which, in turn, spawn new enterprises that serve the needs of value chain firms and the households that benefit from growth. As growth accelerates, so does the emergence of input outlets, equipment leasing services, tractor services, restaurants, hair salons, and hardware stores.

The resulting non-farm enterprises (NFEs) play a vital role in the rural economy and can range from large, internationally owned agricultural conglomerates operating estates or farms to an agri-input retailer with a single small shop. Dimensions such as the nature and locus of ownership (domestic or international, scale of operation, market focus, etc.) all impact the firm’s financial needs and potential sources. International farming companies usually have a wide range of needs, but also access to national and international finance options, perhaps through their parent firm. At the other extreme, small-scale family-owned firms may not differ much in needs and sources of finance from the household-level enterprises.
1. CURRENT STATE OF NON-FARM ENTERPRISE FINANCE

Given the predominance of agriculture in rural areas as the core enterprise activity for most rural firms and households, it is unsurprising that there has been less attention to rural non-farm enterprise finance (NFEF). FIs generally saw rural areas primarily as places for agricultural finance. Since that often proved difficult and expensive due to losses and poor access in the past, rural areas were often neglected and FIs’ interest in NFEs was resultantly mainly confined to urban areas.

Although the major portion of many rural households’ resources goes towards farming for much of the year, there are opportunities for micro-NFEs, particularly seasonally. Seasonal NFEs take advantage of farming downtime periods and the boost in the rural cash economy post-harvest and post-sale of produce. Anecdotal evidence suggests there are many opportunities for micro, small and medium sized firms in “off-farm” enterprises such as trading or processing farm produce, and “non-farm” enterprises that, for instance, supply household with goods and services.

Part of the reluctance to reach out to rural areas has been a general view among FIs that rural inhabitants, other than commercial farmers, are poor and consequently unattractive as clients. That generalized thinking is falling away, as FIs see that there are opportunities for non-agricultural finance and that rural areas are not uniformly poor. The opportunities lie in NFEs (this section), as well as in products targeting household activities (see section IV-C).

Support to farmers and firms through value chains also creates spin-off NFE opportunities, partly through increased consumption in rural areas, but also to provide NFEF products to value chain actors, such as in Kenya through the construction of beehives (K-Rep Development Agency). With radical changes in the way FIs can access dispersed and physically remote clients, opportunities to reach rural NFEs have also increased commensurately.

As a result of little interest in the past by commercial FIs in rural markets, much of the rural market was ceded to NGOs and government agencies/schemes. For a long time both of these groups failed to make rural finance work. NGO microfinance was most successful in urban and peri-urban areas (with the exception of countries with densely populated rural areas), while government programs and NGOs not specialized in finance (e.g., relief-oriented NGOs) faced poor repayment rates, weak systems, inappropriately designed products, political and ideological interference and ongoing heavy subsidy, all contributing to overall poor performance. That poor performance reinforced the commercial FIs’ view that rural markets were not viable; it also fostered a view among the interested few that it would be difficult to operate successfully due to past rural finance market distortions.

2. CURRENT NON-FARM ENTERPRISE FINANCE CHALLENGES

In order for NFEs to grow and generate jobs, a number of bottlenecks need to be addressed. Innovations are built around mitigating the following constraints:

1. **Collateral requirements** are inappropriate given the nature of the rural enterprise.
2. It is difficult to determine rural NFE clients’ **capacity to borrow** and repay credit.
3. **Financial products**, particularly savings and insurance, are often **inappropriately designed**.

C. HOUSEHOLD-LEVEL RURAL FINANCIAL NEEDS, SOURCES AND CHALLENGES

Analysis of rural finance has tended to focus on FIs, categories of products (credit, savings, insurance and transmission), financing mechanisms (e.g., outgrowing) and financial market development. In addition to these different analytical foci, the widespread adoption of value chain analysis has more clearly placed farmers within a wider set of linkages. There has been insufficient emphasis on rural finance from the household demand perspective. To clarify, there has been analysis of finance flows and needs based on particular aspects of rural life, such as understanding agricultural finance needs or livelihood finance opportunities, but these have often been narrowly focused. However, there needs to be a more unified model of inter-linked rural household financial needs and flows.
I. CURRENT STATE OF HOUSEHOLD FINANCE

Poor infrastructure and limited accessibility to finance service points compounds the physical isolation of rural households. The initiatives of FIs to increase outreach are very significant for household finance since the platforms and products created are useful for both livelihood and household financial needs. However, there are specific aspects of household finance needs that financial products must take into account.

Historically, microfinance institutions (MFIs) have been reluctant to provide credit for (non-productive) household activities; rather they have sought to lend for productive purposes on the basis that this is necessary to ensure repayment. Such thinking is based on a “silo” mentality, in which resources for agriculture, NFE and household activities are seen as separate, and it ignores the reality of an integrated set of household sources and needs. Potential responses to this issue include teaching people to minimize the mixing of household and economic resources; recognizing that household needs should be addressed within the financing package; or developing products for non-productive household needs as a separate category, recognizing that it is better to design products with the real uses in mind.

In response to specific household finance needs, to date there has been particular emphasis on savings and insurance products. Indigenous models of savings and credit, initially overlooked by the development community, have long existed, such as the Tontines of West Africa. USAID undertook early work on solidarity groups in the Dominican Republic and Costa Rica in 1981-82, with subsequent work by CARE in Niger in 1991 on village savings and loans (VS&L). Others worked on rotating savings and credit associations (ROSCAs), and accumulating savings and credit associations (ASCAs). Such groups play a major role in making funds available for household-level farming, NFEs and consumption spending, and are generally perceived to be a well-proven model. Because this study is primarily about innovation, we thus focus mainly on scale-up efforts in VS&L and ROSCAs. VS&L is promoted in Africa, Asia, Latin America and the Caribbean, claiming at least 3 million users; CARE Malawi, supported by the Bill and Melinda Gates Foundation (BMGF), aims to reach 400,000 rural people with VS&L. Savings and credit groups are also promoted for other purposes; for example, Oxfam works in Mali to improve soil fertility management and agricultural production for 300,000 ROSCA members.

Considerable attention is being paid to designing innovative savings products within more formal financial institutions, such as the efforts of Ecofuturo and Innovation for Poverty Action in Bolivia. These efforts aim to provide lockboxes to savers, with a daily (or weekly) alarm that can only be turned off by depositing money. Remittances from urban areas and abroad can be important as a form of intra-family cash transfers. Mechanisms like M-Pesa are a major improvement on previous formal sector finance arrangements in efficiency, convenience and cost. These are covered in section IV-D.

As the provision of microfinance services has exploded in recent years, some suggest that expansion may have come at the expense of financial inclusion. However, some MFIs have decided explicitly to increase their emphasis on the social aspects of their services. Red Financiera Rural of Ecuador, AMK of Cambodia, Prodesarrollo of Mexico, and other microfinance associations (facilitated in many cases by the SEEP Network) have introduced social responsibility and “codes of conduct” as core tenets of their lending practices.

Finally, there has been increased acknowledgement that financial education should play a big role if financial access and responsible use are to be improved. Technology has also played a role with more scope for innovation in media to increase reach, improve the quality and consistency of the messages, improve impact, and reduce delivery costs. The continued problem with financial education is finding someone willing to pay for it.

2. CURRENT HOUSEHOLD FINANCE CHALLENGES

The innovation frontier in household finance (HF) has generally been focused on addressing four key challenges:

1. Rural households are particularly vulnerable to shocks.
2. FIs have limited products to meet regular health, education, pension and housing needs.
3. Rural households have limited knowledge of potentially useful financial products because of difficulty in reaching rural clients with promotional messages.
4. Many rural households lack understanding and demonstrate inappropriate use of financial services due to poor financial education.

D. ENABLING ENVIRONMENT NEEDS AND CHALLENGES
In addition to the three categories covered above, there are structural challenges that create obstacles to expanded rural financial access. In particular, the geographic dispersion and low population density of rural areas and the non-enabling regulatory environments have historically been major impediments to cost-effective and sustainable financial delivery. This has highlighted a need for supporting market infrastructure, including more efficient platforms from which the above categories of products can be brought within reach of the relatively remote, dispersed rural population. Thus the need for innovation in delivery platforms becomes particularly significant, as they the delivery of a range of traditional, previously unavailable services. Such innovation is integral to the way FIs are re-appraising opportunities in rural areas that are now potentially serviceable (physical issue) and viable (cost issue).

As those platforms become more readily available, the challenge evolves into addressing the gap between these technological advances and non-dynamic legal/regulatory environments that can stifle their roll-out. Thus other enabling environment challenges relate to the need for enabling legislation and for increasing MFI capacity and developing new partnerships.

I. CURRENT STATE OF ENABLING ENVIRONMENT ISSUES
This section mainly focuses on issues relating to FI outreach innovations such as cellular and mobile banking,3 even if those services are also used for agriculture and household-related finance activities. This is because much of the impetus for this area of innovation came from FIs seeking to move beyond their urban bases where services were predominantly focused on NFE finance.

Perhaps the most exciting development of recent years is the use of increasingly innovative ways to provide financial services to rural households in which access to fixed-branch financial services was particularly limited. This has been through new forms of physical reach and presence and in the application of technology. Increased physical outreach has been based on three main strands: use of mobile services (mobile banks and teams), new forms of outlets (container units, kiosks, etc.), and working with new categories of partners that have rural outlets to provide cash-in and cash-out services.

The last decade has seen major innovations around the use of cellular phones for financial services. SMART money (2000) and G-Cash (2004) in the Philippines were early pioneers, followed by Safaricom’s Sambaza, which was subsequently replaced by M-Pesa (2007) in Kenya, and Wizzit (2005) in South Africa. All of these built on the ability to transfer credits by cell phone to other users, which stimulated an informal trade in credits that started to be accepted for payment of goods and services. With the addition of cash-out services, recipients of credit can receive money from a remote sender and convert this into cash. These models are now maturing into large-scale networks for financial transfers and payments, and are providing mechanisms for temporary saving (unused/uncashed credits) and platforms for loan disbursement and repayment. In that respect they are no longer innovative (and are not noted in the following section) because they have become part of mainstream thinking, even if they are still to be applied in many countries. However, cellular banking continues to spawn new ideas and services are still evolving.

3 Although cellular banking is often referred to as mobile banking, this terminology is potentially confusing due to the parallel developments in vehicular mounted banking services, also termed mobile banking. Throughout this paper, mobile banking will be used to refer to vehicular banking, and cellular banking to the use of mobile or cellular phones for banking services.
There has also been increased attention to improving the **legislative and regulatory environment**. This includes recognizing the need to incorporate MFIs and other non-traditional, non-bank FIs into the regulatory framework, and to recognize new forms of delivery such as those mentioned above. A key part of the success of M-Pesa is attributed to the Central Bank of Kenya’s willingness to let developments occur that were not explicitly covered under the legislation, keeping them under review rather than blocking them.

### 2. CURRENT ENABLING ENVIRONMENT CHALLENGES

The innovation frontier in enabling environment has generally focused on addressing three key challenges:

1. **High costs** and physical difficulties remain for FIs wishing to reach more rural households.

2. **Legislation and regulation** often does not explicitly enable innovations based on new forms of delivery, new products and use of technologies.

3. Limited improvements in **MFI capacity** persist despite considerable technical assistance.
IV. CATEGORIZING RURAL FINANCE INNOVATIONS

This section highlights the four categories of innovations: agricultural or value chain finance (VCF), non-farm enterprise finance (NFEF), household finance (HF) and enabling environment (EE). It first summarizes the characteristics of each of the four focus areas, then details the areas or categories of innovation that are being implemented, making observations and drawing parallels between efforts to address common problems. The points at which unresolved problems are being addressed by “innovative” responses are termed the “innovation frontiers.”

For this stocktaking exercise, innovation was considered in relation to: products and services, delivery methods and channels (reach and cost), excluded target groups, providers, partnerships, promotion methods, financial education, and enabling environment and infrastructure. Some of these innovations have already shown positive results, been sustained, achieved substantial coverage, and are being adopted and replicated by others, while others show potential but are too new to judge. More detail of each of the 160 initiatives is included in Annex III with links to a contact point or source material where further information is available.

A. AGRICULTURAL VALUE CHAIN FINANCE

From the review of innovations, it is clear that agricultural interventions by development partners, NGOs and private-sector players increasingly use (at least partially) the value chain approach and seek to facilitate the improved functioning of value chains. An important recent trend has been the recognition that improving access to finance along the value chain is a crucial part of the value chain approach. Many of the initiatives considered in this paper are based on comprehensive research of the whole value chain and include interventions at multiple points to overcome bottlenecks. Projects analyze relative power along the chain, particularly the situation and position of marginalized groups such as women, and their particular needs. In order to improve creditworthiness, such efforts often link financial interventions to agronomic support and seek partnerships and alliances (including outgrowing) between FIs and commercial actors.

The challenges listed in section III-A have served as foci for many of the successful innovations in the area of VCF and represent the framework for categorizing the following frontiers of innovations:

- VCF 1: Reducing Third-Party Selling
- VCF 2: Reducing Production, Price and Market Risks
- VCF 3: Improving Fixed Asset Finance
- VCF 4: Increasing Returns through Bulking and Storing
- VCF 5: Integrating Poorer Farmers
- VCF 6: Increasing Private-Sector Engagement and Competition
- VCF 7: Assessing Cash Flow
INNOVATION FRONTIER VCF 1: REDUCING THIRD-PARTY SELLING
Third-party (or side-) selling is when farmers who are contracted or otherwise obligated to sell to a particular buyer based on having received financial, technical and/or other support sell to a different buyer. This is a significant problem facing outgrowing and contract farming arrangements, according to this review. It is difficult for a buyer to enforce contracts with smallholder farmers because in most cases it is too costly and impractical, as well as potentially politically sensitive. Different approaches are being tried, which include attempts to police and prevent sales to third parties, offering incentives to sell to the original buyer, and greater integration of operations.

A study on contract farming in Malawi for the World Bank analyzed “open marketed crops,” which are transportable and not perishable, such as tobacco, paprika and cotton, and “closed marketed crops” that are perishable and not easily transportable such as green leaf (tea) and sugar cane. It found that the operational need for immediate processing and proximate locations had resulted in stronger relationships, reduced opportunity for side-selling, and increased opportunity for finance flows along the value chain. It even led to profit sharing arrangements in the case of closed marketed crops (green leaf and sugar cane). The study also found that it was possible to reduce side-selling for an open marketed crop, in this case burley tobacco, through a substantial, integrated support package, as the farmers did not want to lose the package for future years, and through very close monitoring by the buyer.

Innovations included “hungry season payments” prior to the food harvest that helped farmers to meet household cash demands for food, school fees and medical bills, which could only otherwise have been met by side-selling or by taking loans from informal lenders.

USAID’s PROFIT project in Zambia facilitated the launch of a secure, mobile phone-based platform to link Dunavant Cotton, one of Zambia’s largest buyers of smallholder-grown cotton, and its suppliers. Mobile Transactions Zambia Ltd.’s platform helped reduce side-selling by Dunavant’s outgrowers, since the outgrowers appreciated that they were paid immediately (and not in cash, reducing pressure from family members). The platform’s unique personal identification number, which served as a receipt for payment at authorized agents (village kiosks), means that each payee does not need to own a mobile phone.

In Nicaragua, UCPCO, a union of six village-level cooperatives growing organic coffee has a partnership with the local rural microfinance institution Fondo de Desarrollo Local (FDL) to improve liquidity in the value chain. To reduce side-selling (and thus the default risk for FDL), UCPCO and FDL supervised the harvest, offered competitive prices, and provided additional client services, thereby reinforcing the contract.

INNOVATION FRONTIER VCF 2: REDUCING PRODUCTION, PRICE AND MARKET RISKS
Agricultural production is potentially a risky business for farmers and therefore for those who buy from and finance them. Farmers face a variety of price, yield and resource risks that make their incomes unstable and unpredictable from year to year. In addition, there is the constant fear that catastrophe may strike. Outgrowing provides a mechanism to reduce some price and market risks. By providing access to the right amounts of inputs (and financing for these) and access to technical support, outgrowing can also reduce production risks. Examples of technical support arrangements include Facilitator for Change and Harbu’s (Ethiopia) support to finance the soya bean chain and K-Rep Development Agency’s (Kenya) support to the honey chain. In the latter case, K-REP Development has combined strengthening of producer organizations and improving market linkages with access to micro-credit and micro-factoring for working capital, and micro-leasing for fixed capital purchasing.

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4 Agar, Contract Farming in Malawi, 2008.
Insurance is another key mechanism through which the risks associated with agricultural production can be mitigated, and credit can be unlocked by reducing the risk of default due to uncontrollable events. However, private insurers have historically been reluctant to insure crop and livestock yields due to moral hazard and inadequate risk assessment information. Worse, the high frequency and covariant nature of certain agricultural production risks potentially expose insurers to large payouts. Crop insurance has been rare or prohibitively expensive, often leaving it to government agencies to provide some form of insurance for farmers. In China, central and provincial governments have provided premium subsidies for a national multi-peril crop insurance program—yet these face the same problems of moral hazard and related high verification costs.

Some organizations have focused on improving verification as a way of bringing premiums down and making insurance for smallholder farmers more appealing for both the farmer and the insurer. In India, to improve the identification of animals and prevent fraud, MicroEnsure, the Centre for Insurance and Risk Management and IFFCO-TOKIO General Insurance Company have used radio frequency identification technology to reduce fraudulent claims since 2009. Land O'Lakes (Malawi) and NICO General (insurer) focused instead on formal animal registration and an independent expert partner to verify animal loss.

Despite such efforts, much of the focus in recent years has been on developing an alternative mechanism through which agricultural goods can be insured in a way that would substantially reduce moral hazard and verification costs. The solution most commonly pursued is index insurance, which uses an identified objective index (such as rainfall) with reliable data that is highly correlated to local yields as a proxy for actual loss. This removes the need for the insurer to make costly in-field assessments of actual losses. Crucially, it also opens the door for re-insurance.

While index insurance has been used in developed countries for decades, its application in developing countries is still relatively new. Some early work on weather-based index insurance was conducted by Opportunity International Bank of Malawi (OIBM) supported by the World Bank; examples have since proliferated. In Mongolia, agriculture is dominated by livestock, so in partnership with the World Bank, Global AgRisk used two complementary Index-Based Livestock Insurance products: a standard index policy based on a district’s combined mortality rate, and a complementary disaster response product funded by the government.

USAID’s Bureau of Food Security has been sponsoring a collaborative research program called the Index Insurance Innovation Initiative (I4), in which U.S. universities partner with developing country research institutions to develop, pilot-test and evaluate index insurance products designed for the needs of small farmers in each country. In Bangladesh, for example, I4 partnered with a local insurance company to offer flood insurance to small farmers; in Ethiopia, farmers can insure themselves against both drought and frost.

To target the problem of farmers selling assets prematurely in response to natural disasters, the World Bank and the World Food Program in Ethiopia developed rainfall-indexed drought insurance for emergency food aid and cash payments. Other index products have been designed by Global AgRisk for Vietnam, covering floods in the Mekong Delta (with Ford Foundation) and drought in the Central Highlands (with Asian Development Bank); and in Ukraine by Credo-Classic Insurance Company and IFC/World Bank.

Weather insurance has yet to gain significant penetration of the rural agricultural market and it is not without its downsides, as there can be high costs associated with research and development of a suitable index. The limited distribution of reliable weather stations has proven to be a limitation to uptake. An interesting alternative to weather station data collection is the use of satellite imagery by the International Livestock Research Institute to monitor pasture in arid Marsabit, Kenya. From this data it is possible to calculate the risk that animals will die and so trigger compensation payments to the owners. Another alternative is the Dry Day Weather Insurance product offered by MicroEnsure and its local partners in Tanzania, Rwanda, India, and the Philippines, in which payments are triggered depending on how many days a crop has not been replenished by rain. Furthermore, insurance is a new concept to
many rural households and even to some FI and partner staff. SANASA in Sri Lanka seeks to increase consumer awareness and understanding using approaches pioneered by BASIX in India, which is providing technical assistance.

OIBM (Malawi) automatically bundles weather insurance with its agricultural loans to tobacco farmers for contract farming schemes that are within 20 kilometers of a reliable weather station. Bundling emphasizes the link between the supply of agricultural credit and weather insurances—indeed, FIs may eventually require weather insurance or build it into the credit package. For example, also in Malawi, NICO is offering an insurance package that covers a range of risks for tobacco farmers such as excessive rainfall, fire (in storage/transit) and theft. The insurance is rolled out as a complement to agricultural loans to tobacco farmers.

Returning to the early efforts in China at state-funded universal coverage, an alternative means of counteracting agricultural risk lies in meso-level insurance not aimed at individual smallholder farmers. One approach has been to provide index insurance to lenders to mitigate risks in their agricultural lending portfolios. A pilot in Peru by La Positiva, PartnerRe and Global AgRisk aims to help mitigate the risks associated with El Nino.5 It is aimed at risk aggregators such as FIs and businesses dependent on local agricultural production for their value added. Meso-level insurance also provides a mechanism for governments to mitigate risks that have catastrophic consequences for agricultural production. In Bangladesh, the Centre for Insurance and Risk Management (based in India) and the Institute of Water Modeling have been collaborating with Oxfam UK to provide a meso-level index-based catastrophic flood insurance product for the government, but sold through banks, MFIs or other agents. In Mexico, the government-owned AGROASEMEX operates an index insurance product for drought or excess rainfall, and then transfers the risk to the international reinsurance market. This coverage is sold to federal and state governments, enabling them to provide payments to farmers in the wake of disasters.

As discussed above, considerable innovation is taking place in the production risk frontier; in contrast, there has been limited innovation in the areas of price and market risk.

**INNOVATION FRONTIER VCF 3: IMPROVING FIXED ASSET FINANCE**

Much of the credit available through value chains has been for working capital needs, which has been a key gap for smallholders, but there is also a need for fixed asset finance. One alternative for financing fixed assets is financial leases. These are close substitutes for loans, and offer several advantages for providers and clients: farmers do not need to have a strong asset base or pay large initial cash deposits, with the inherent value of the purchased asset acting as the collateral. For the FI, leasing offers a further major advantage in developing and middle income countries where enforcing creditors’ rights is difficult and/or costly. The use of financial leases for machinery in the agricultural setting is not new or innovative, but such leasing packages are for equipment beyond the reach of most smallholders. Evidence of participation in the leasing market for lower-value agricultural-related capital investments remains relatively scarce.

In Georgia, the USAID AgVantage project helped agribusinesses gain access to fixed asset financing by developing a leasing sector as an alternative to inaccessible term loans with prohibitive collateral requirements. AgVantage created a specialized Leasing Unit to facilitate the provision of long-term equipment financing from Georgian leasing companies, with support from a credit guarantee program. The Leasing Unit’s capacity building efforts ensured that Georgian leasing companies had the management and operational know-how to ensure sustainable provision of leasing services in the future.

USAID’s PROFIT project worked with the Zambian Conservation Farming Union and others to cultivate tillage service providers (TSPs)—farmers who would till the fields of other farmers for a fee. To overcome aspiring TSPs’ liquidity constraint, PROFIT turned to Dunavant Cotton, who agreed (with a modest initial guarantee) to purchase a

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5 UNDP provided funding for a similar product more tailored to household level to be created and piloted.
tractor and lease it to one of its trusted outgrowers who was interested in becoming a TSP. Dunavant went on to purchase and lease out ten more tractors, without any guarantee from PROFIT.

In Pakistan, Network Leasing Corporation Ltd. provides leases for both new and used assets, including donkey pull carts and livestock, valued between US$17 and $1,760, with rural leases available in the areas surrounding major urban locations. In Bolivia, the National Ecumenical Development Association has offered an innovative leasing product that targets poor groups—as well as other agricultural value chain actors—without guarantees, based only on a 25% deposit required and a lien over the machinery. Lease amounts range from US$300-$20,000.

In Mongolia, recent efforts have sought to improve outreach to herders. One product piloted by the Centre for Policy Research helped a herding community purchase a mobile dipping bath for small livestock through a micro-lease, enabling the community to pay for the bath via user fees. Elsewhere leasing is used to purchase processing equipment by farmer organizations and buyers to increase value addition in the chain. Examples include FCE and Harbu (Ethiopia) that financed a women’s association to process soymilk. There are Islamic banking variants, like Al Amal Microfinance Bank experimenting with Islamic micro-leasing products in Yemen.

Aside from leasing, several USAID projects have approached the fixed asset financing problem through equity rather than debt. In particular, the Rebuilding Agricultural Markets Program provided funding and assistance to the Afghanistan Renewal Fund, Afghanistan’s first venture capital fund, which invested in small and medium enterprises (SMEs) along the agribusiness value chain. However, the project reported problems with “investor follow-through,” and project management suggested that it might have been more effective to invest directly in SMEs rather than going through a third-party investment vehicle.

USAID’s Private Sector Competitiveness Enhancement Program assisted in the identification and analysis of opportunities to facilitate investment by the Azerbaijan Government’s equity investment company and a privately owned equity fund called Caspian International Investment Company. The US$6.8 million investment in NAA (an agri-business) helped improve its cold storage, greenhouse and packaging capabilities, thus leveraging limited project funds to achieve larger investments that benefit an entire sector.

**INNOVATION FRONTIER VCF 4: INCREASING RETURNS THROUGH BULKING AND STORING**

Since harvesting is seasonal in a particular locality, there is a relative abundance of local produce at that time and limited availability between harvests. There are significant potential value gains through delayed sale of the crop, but the problem for most farmers is that they need some release of their capital tied up in the product to meet immediate obligations or invest in a seasonal business as early as possible. One solution to this problem, warehouse receipt systems (WRS), has been promoted for many years, yet the evidence of success is still limited—in particular, in terms of benefits to smallholder farmers. One example that stands out is in India, where the National Bulk Handling Corporation has (since 2005) been the largest warehouse receipt financing company in the country and possibly the world. Operating out of around 3,500 warehouses, at peak season it organizes US$2 billion of finance for agricultural commodities on behalf of bank agents. A farmer deposits the commodity in the warehouse, and money is credited to his or her account by the next day using smart cards and mobile phone cards. The electronic, cashless nature of the system adds further efficiency gains to the process.

Other recent successful examples of WRS were scarce, though there is some optimism that efforts are starting to gain momentum in Zambia, Ghana and East Africa. Reasons for difficulties in operating WRS include the need for reliable certified warehouse infrastructure, links to a transparent price discovery mechanism, and lenders’ willingness to lend against stored crop (often their hesitancy relates to the lack of reliable warehouses and trustworthy warehouse managers): it takes many years to get all of these working at the same time. The upfront cost of moving small quantities of a commodity to a warehouse at some distance is a deterrent to many smallholders with limited cash resources, but more in line with the resources and role of traders.
A similar concept is the “micro-warrant” scheme used since 2003 by the Foundation of Communal Development in Bolivia. A micro-warrant is a certificate of deposit for the crop, in this case rice (and later expanded to maize, coffee, quinoa and chili peppers) that can be used as collateral for a loan through a “pledge bond.” The farmer is then able to sell the crop at a later date at 30-60 percent higher prices and use the proceeds to clear the loan. This has provided farmers with off-farm storage services and enabled them to benefit from the price differential, and is an innovative form of guarantee attractive to both debtor and creditor. Other Bolivian groups such as PROFIN foundation have established similar initiatives, illustrating a demonstration effect.

There were several other variants to enable advance payments to farmers for crops deposited in a warehouse or sent to a processor. Typically, the farmer gets a percentage (up to 70 percent) in advance from a FI or farmer organization, which may also be borrowing from a FI against the future sale of the crop. Examples include Rice Producer Cooperative and Caisse des Affaires Financieres in Rwanda, and Bio-re with cotton farmers in Tanzania. Arrangements short of full WRS have been more commonly implemented and may provide more of an incremental way forward.

**INNOVATION FRONTIER VCF 5: INTEGRATING POORER FARMERS**

Where value chain projects have included smallholders, they have most often targeted those with land and sufficient resources to enter into a commercial transaction. Subsistence farmers have mostly been neglected, as have the poorest, vulnerable and destitute households. To integrate such farmers and households into commercial opportunities, many donors have used “push-pull” strategies: a “push” of direct subsidized support to households to stabilize their asset base, accompanied by more sustainable market opportunities and loans designed to “pull” them up into commercial relationships.

The Consultative Group to Assist the Poor (CGAP) and The Ford Foundation have been implementing a global initiative since 2006 to “graduate” the poor so that they can get to a level at which FIs are willing to provide services to them. This is referred to as the “graduation model,” building on the pioneering work of BRAC in Bangladesh, which from 2004-09 reached 800,000 “ultra poor” to help them become food secure and develop sustainable livelihoods. The graduation model consists of a sequence of development services targeted at the poorest households: first, consumption support that provides “breathing space” by stabilizing their consumption; followed by savings accounts and skills training and a subsidized asset transfer to jump-start economic activity. Finally, the project identifies sustainable livelihood options in value chains that can absorb new entrants. This sequencing of interventions is meant to enable beneficiaries to “graduate” from extreme poverty and welfare support. Examples are found in Ethiopia (Relief Society of Tigray), Haiti (Fonkoze), Honduras (Odef and Plan), India (SKS, Trickle Up and Bandhan), Pakistan (Pakistan Poverty Alleviation Fund), Peru (Association Arawiwa and Plan) and Yemen (Social Fund for Development and Social Welfare Fund).

In Kenya, the Nike Foundation’s Value Girls Program, co-funded by USAID, is facilitating access to finance and education for young women who are beginning to undertake vegetable and poultry production but lack assets and national identification cards. The One Acre Fund, which received a grant from USAID’s East Africa Competitiveness and Trade Expansion (COMPETE) project, provides a “market bundle” of agricultural training, bulk selling services, in-kind loans of seeds and fertilizer, and crop insurance to smallholder farmers in Kenya and Rwanda. The in-kind nature of the loan ensures that funds are used for the intended purposes, although it might limit each farmer’s ability to select his or her unique optimal mix of inputs. Farmers choose their own repayment schedules, which avoids any mismatch between repayment terms and agricultural cash flow cycles.

**INNOVATION FRONTIER VCF 6: INCREASING PRIVATE-SECTOR ENGAGEMENT & COMPETITION**

A close relationship between producer and buyer can be beneficial, for example, by allowing stability as well as a transfer of knowledge or practices from buyer to producer. However, in some cases this can also lead to high dependence and an excessive capture of profits by dominant private-sector firms in certain value chains with large
outgrowing arrangements and a tendency towards exploitative or rent-seeking behavior. In such cases there is a need to increase marketing options and reduce the farmers’ dependence. One strategy to do this is to strengthen farmer groups’ capacity so that the groups can either work with several buyers or can better negotiate for the farmers with a single buyer. In some instances, independent access to credit from a FI can “free” the farmer to choose the buyer(s) with the most attractive terms, and help balance the power relations between farmers and buyers. Access to independent business development services (BDS), extension, external finance, and other linkages are also common approaches to addressing this challenge. Nevertheless, there may still be benefits in contracting to a particular buyer to get access to particular markets, specialized inputs or technologies.

More positively, in Paraguay, three-way lending arrangements between Financiera el Comercio, large buyers and small-scale producers engage the private-sector actor to reduce information asymmetries, and thus the risk of lending. For example, Financiera el Comercio provided loans to 2,000 small cassava producers backed by the recommendation of CODIPSA, the buyer. USAID’s Paraguay Productivo project plays a facilitation role linking the multiple actors and improving the producers’ creditworthiness through training and market linkages.

INNOVATION FRONTIER VCF 7: INCREASING ACCESS TO WORKING CAPITAL AND ASSESSING CASH FLOW REALITIES

Access to working capital is a prerequisite for participation in any value chain, and is necessary for all actors in the chain. Innovative recent models adapt measures long used in developed economies to minimize or eliminate the window between delivery of product and payment. In Bolivia, FIE (a Bolivian MFI) introduced purchase order finance to the dairy and coffee value chains. USAID, through the ARCO project, provided technical assistance and start-up support to FIE (without any guarantee or loan subsidy). Through this model, the buyer places a purchase order to small producers through a broker or processor, and the producers then request a loan from FIE; accounts receivable are transferred to FIE, which receives payment directly from the buyers at a later point. The long-term commercial relationship between the bank’s client (the supplier) and the buyer diminish risk for all parties involved.

Factoring and its variants are another innovative way to release working capital. Factoring is an arrangement in which a supplier sells its accounts receivables to a third party (called a factor) at a discount in exchange for immediate cash. Such arrangements are common in more developed economies and with larger firms. Recent innovations with smaller firms in developing countries include Biashara Factors for tea smallholders and K-REP Development Agency for honey producers (both in Kenya). Another variant on releasing value is Root Capital, which works in multiple countries and uses future contracts for coffee as collateral. Root Capital advances payment to suppliers (usually cooperatives), and then deducts interest and principal from payments received from the ultimate buyers. In Bolivia, Irupana is a private export company that has formed a joint venture company with a trader to fund the purchase of quinoa from farmers, sharing the profits from this arrangement, and ensuring farmers are paid in cash on delivery. In Ghana and Mali, InVenture is also providing investments with revenue sharing rather than micro-loans. Although for quite different reasons, this is also the basic model adopted for Islamic finance, such as Al Amal Microfinance Bank in Yemen, and Tanzania eco-Volunteerism’s Islamic Finance Project targeting honey producers.

One straightforward way to increase access to working capital for small farmers and other cash-constrained value chain actors is for lenders to develop appropriate products and lending methods. A distinct agriculture lending product is typically built around the unique realities of farming families, and draws lessons from both microfinance (use of alternative collateral mechanisms, consideration of the entire household’s income and expenses) as well as traditional agricultural lending (longer terms, infrequent repayments). USAID’s AFIRMA project in Mexico, from 2004 to 2009, assisted Financiera Súmate, an MFI that focused primarily on peri-urban lending, to design and implement a lending program based on small farmers’ cash flow. Súmate piloted the product in two rural branches, and later expanded it to six branches. In Honduras, local MFI FUNED has used a cash flow analysis tool developed under the Farmers Access to Credit project to analyze and record all the potential clients’ income and expenses, with a particular focus on the timing of such flows, and recommends loan terms tailored to the individual case.
USAID’s new Financial Inclusion for Rural Microenterprises (FIRM) project in Kenya has encouraged the country’s commercial banks to enter the agricultural sector. With help from the project, Kenya Commercial Bank has committed US$30 million to structure and staff a stand-alone profit center in which all agricultural financial services will be housed. FIRM hopes to create competitive pressure on other private financial institutions to sharpen their focus on agriculture.

One other area of innovation has been commitment savings through Michigan State University’s work with OIBM and World Bank in Malawi. OIBM offers farmers the chance to deposit money from crop proceeds immediately on receipt of funds. The farmer specifies the period for which he or she would like to lock the funds away—typically until he or she needs to purchase farm inputs. The funds are then released on that date, along with the interest earned. An alternative approach has been adopted by Innovations for Poverty Action/Kenya, which offers farmers the opportunity to purchase vouchers for future fertilizer, which is then delivered by the NGO at the time of planting. Both of these help to reduce farmer dependence on buyers that provide inputs.

B. NON-FARM ENTERPRISE FINANCE

Despite the relative lack of development of NFEF, there is recent evidence of banks and MFIs reaching out into the rural market to lend to NFEs as their core urban markets become more saturated. Some of this is based on their organizational missions, particularly in cases where banks evolved out of MFIs, such as Equity Bank in Kenya, Centenary Rural Development Bank, Uganda and OIBM in Malawi. But it is also related to their view of the opportunities, such as in the case of Standard Bank, NedBank, First National Bank and ABSA in South Africa, which collaborated on the development of a common account (branded “Mzansi”), a low-cost basic service account targeting the unbanked. The innovations in NFEF, based on the challenges identified in section III, include:

- NFEF 1: More Appropriate Collateral Requirements
- NFEF 2: Determining Capacity to Borrow
- NFEF 3: Improved Design of NFE Services

INNOVATION FRONTIER NFEF 1: MORE APPROPRIATE COLLATERAL REQUIREMENTS

A key credit theme over recent years has been changing collateral requirements. For many years, there was a major emphasis on land registration so that farmers could use their land for borrowing, particularly but not exclusively for agriculture. Perhaps because of the unattractiveness of small plots of rural land as collateral, thinking has shifted to moveable collateral and so-called soft collateral based on contracts (although this seems to be most promising with agricultural contracts). Whilst not widely practiced in rural areas yet, attempts to use moveable property on a wider scale play a significant role in the business climate reform agenda in developing countries. In China, an online registry has been created by the People’s Bank of Credit Information Center for pledges of receivables, thus creating a modern movable collateral registry. Similar efforts have also been initiated in Vietnam.
INNOVATION FRONTIER NFEF 2: DETERMINING CAPACITY TO BORROW AND REPAY CREDIT

Lenders seek to establish the capacity of potential borrowers to repay a loan. Early attempts using business plans and other credit tools had limited success. Because credit checking is difficult in rural areas where many people do not have a formal identity, methodologies changed to find other ways to determine creditworthiness. This was typically through cautious initial lending followed by progressive increases in loan sizes. Now, at least in urban areas, credit reference bureaus are becoming more prevalent as a means of assessing the credit risk associated with a given borrower. While it will take time for this to expand in rural areas, and for likely clients of microfinance, some interesting steps are being taken. KGFS’ rural branches in India have been using a “financial wellbeing report” to better understand households’ financial needs and flows as the basis for offering credit and other products to them. In Guatemala, Ethiopia, Kenya and Uganda, Fore Finance is providing a credit scoring service to assess the operational and financial performance of producers, thus reducing the problem of adverse selection for lenders.

The Harvard Centre for International Development is carrying out research on the potential to apply psychometric scoring through its Entrepreneurial Finance Lab Research Initiative. Psychometric screening tools measure future upside potential rather than traditional risk management tools used by banks for debt contracts, which only measure downside risk. While it is not restricted to rural and agricultural finance, this innovation is part of a wider trend to re-examine methods of assessing client potential.

INNOVATION FRONTIER NFEF 3: IMPROVED DESIGN OF NFE SERVICES

Inappropriate product design has been a contributing factor to the relatively poor uptake of certain financial services, namely enterprise-focused savings and insurance. In response, the Centre for Innovative Financial Design has piloted a product in Uttarkhand, India that seeks to break the debt cycle through lending. The financial product offers a series of loans and a commitment-saving account to existing bank customers. To help people start-up a poultry business, a loan is given to cover initial start-up costs, with proceeds used to repay the loan and also make savings contributions. The rate of savings is such that once the loan is repaid, producers will have accumulated sufficient funds to continue their poultry production without the need of further loans.

For insurance products, product acceptance has been much lower than for savings. One major method for addressing this has been the bundling of products. For example, credit life insurance (CLI) has become a relatively standard product built into a credit offer, but it is often hidden in practice from the borrower. Bundling with other products combined with cross-selling to existing and potential customers provides a useful avenue for spreading the use of insurance. These products and bundles are discussed in more detail in section IV-A where they relate to agriculture and section IV-C where they relate to households. There appears to have been limited work on insurance for NFEs, beyond the general adoption of CLI.

Given increasing attention to climate change, some development agencies are trying to use microfinance services to promote clean energy solutions in rural areas. Micro-Energy International and ADA Microfinance Expertise have used microcredit in Peru to increase access to sustainable energy services for vulnerable populations by supporting the integration of energy products (such as solar dryers and improved efficiency ovens) in MFI portfolios. Similarly, Arc Finance has partnered with MFIs to design loan products relevant for a variety of small-scale renewable energy applications. In Nicaragua, CEPRODELI has provided credit for financing water storage tanks and access to low-cost energy. Meanwhile PlaNet Finance has worked with the Tong Wei Rural Development Association to use microfinance to increase access to renewable energy in rural areas.

The innovations in outreach described below in section IV-D (Enabling Environment Initiatives) have opened up considerable opportunities for product improvement and reach. It is likely that this will spur more innovation around NFEs, as FIs seek to maximize returns from increased rural outreach by offering products targeting the relatively unmet areas of household and NFE finance. Lower cost structures will help in that process.
C. HOUSEHOLD FINANCE

This section covers areas of household finance that are not directly related to enterprise activity. This is potentially a far-ranging category that includes financial services for consumption, housing, education, medical needs, life events and household assets. This is primarily an expenditure area with limited or no income inflows. The section also covers promotion of financial services, as this is also driven (partly) by the need to reach new client groups, and issues related to financial education. The framework used to categorize innovations in household finance is as follows:

- HF 1: Reducing Households’ Vulnerability
- HF 2: Expanding FIs Products to meet regular health, education, pension and housing needs.
- HF 3: Improving FI Marketing and Outreach to Rural Audiences
- HF 4: Improved Financial Education

INNOVATION FRONTIER HF 1: REDUCING HOUSEHOLD VULNERABILITY TO SHOCKS

When faced with a shock such as an illness or funeral that requires expenditures greater than available cash resources, the household has to find a way to finance the shortfall. Traditional coping strategies such as withdrawing working capital from the farm or NFE activity, distressed sale of assets or food supplies and informal borrowing, can prove costly in the short-, medium- and long-term. These are opportunities for financial services ranging from short-term credit to savings, insurances and transmission of funds to meet household finance needs in ways that significantly reduce the shock of such events to rural households.

Perhaps the most extreme example of this role for microfinance is in response to disasters resulting in devastation for entire communities. Recently there has also been increased interest in using microfinance (with only minor adjustments to traditional methodologies) to help rebuild in post-conflict situations. One such example is the Microfinance Investment Support Facility in Afghanistan, set up in 2003 to coordinate donor efforts in channeling technical assistance and funding to build Afghanistan’s microfinance sector.

There has also been increased interest in applying traditional microfinance to a disaster context. This was seen partially in the context of agricultural insurance in section IV-A. MFIs were heavily involved in the short- and medium-term responses to the devastating 2005 tsunami in Indonesia, Sri Lanka and India. Another example is USAID’s Post-Cyclone Sidr Livelihoods Reconstruction Program in Bangladesh, which helped cyclone-affected poor households organize into informal groups to mobilize savings that were deposited in the local bank; it also established a Group Disaster Fund coupled with training in financial literacy that helped to increase their resiliency to future shocks. With likely increasing incidences of disasters from climate change, this is an area in which innovation is required to fully integrate the financial sector responses with other disaster and post-disaster responses. In particular, savings—including ROSCA-based systems and credit unions—serve as a traditional buffer for meeting emergency needs.
Health and medical expenses are likely to be regularly incurred, though the timing and scale of these can be unpredictable. For the purpose of this analysis, they are covered in the “HF 2” case below, which deals with the more regular life cycle expenses, rather than this section which deals with major shocks.

**Insurance** is particularly suited for meeting shocks. **Funeral insurance** is increasingly prevalent, often offered with life insurance products. Burial micro-insurance has been offered by Alternativa Solidaria in Mexico since 2001 in partnership with Zurich Insurance. It collects small weekly premiums and often sells to groups to make it more affordable to savings and credit clients. In Haiti, the Alternative Insurance Company has launched funeral insurance on a wide scale in partnership with Banque National de Credit, smaller MFIs and a network of funeral homes. Partnerships are important to achieving scale rapidly. The Mthandizi savings account by OIBM Malawi offers a deposit savings account that provides funeral insurance if a minimum deposit of US$67 is maintained.

**Group life insurance** with funeral benefit and personal accident double indemnity insurance has recently been launched by Great Pacific Life Insurance Corporation in the Philippines. Life insurance is also emerging as a product available to rural households through the mobile network. For example Mi-life is an insurance service offered to clients through MTN’s Mobile Money network in Ghana. The client can buy insurance as well as initiate claims, seek answers to queries and make premium payments over the network.

A key problem for life and other insurances is collecting insurance premiums. Union des Assurances du Burkina Vie in Burkina Faso uses Cauri d’or automated daily collection of micro-insurance premiums. The initiative consists of a combination of savings account and insurance, and targets micro-entrepreneurs from local markets. Insurance covers life and disability. Another example of bundling insurance products is PROFIN (Bolivia). Its “Vida Agricola” product is a composite providing protection for agriculture, life and property.

Cellular phone provider TIGO (Ghana) gives its customers an amount of life insurance cover proportional to how much airtime was used the previous month. Although not an FI and not seeking to promote life insurance, clearly this is perceived by the company to be a strong promotional hook for clients to increase or maintain their usage, or to switch to TIGO. The response rate has been very high, suggesting that the cover is of considerable interest to clients (urban and rural), and an unmet financial opportunity.

**INNOVATION FRONTIER HF 2: IMPROVED PRODUCTS TO MEET REGULAR NEEDS**

Rural households’ regular needs for cash include four categories: predictable regular non-enterprise expenditures, notably education; commonly needed services, such as health, of which the exact timing is not predictable; irregular but significant needs such as housing and life events (weddings, funerals, births, cultural and religious events); and the costs of retirement from an active, full-time working life.

Although primary education is generally free, there are associated costs and fees, and in many cases secondary education still does carry charges. In Malawi, OIBM is offering Tsogolo Langa, an education savings account from which no withdrawals can be made, with funds paid directly to the school. In Tanzania, Plan is using ROSCAs to promote savings for education amongst young people. In Mongolia, XacBank has introduced a children’s savings account that cannot be touched until the child is 18, when the account transfers to a regular adult savings account at the bank. In a similar vein, Proyecto FCF in Peru is providing children with piggy banks and giving prizes if they can fill them within a certain time period.

Several other innovations reviewed seek to use microfinance to improve health provision in rural areas. Medical and health costs can be significant, especially when related to the HIV/AIDS pandemic. Although there are public health systems in place in most countries, their limited reach and low quality of care often force rural households to rely on private provision or subsidized provision from NGOs. A program run by the Social Development and Environmental Conservation Forum is working with the Centre for Microfinance and Medicins du Monde France in...
Nepal to bundle microfinance provision with reproductive health awareness classes. Similarly, the Micro Credit Summit Campaign and Freedom from Hunger have trained local MFI workers in India to deliver health lessons to women’s credit groups. The Bharat Integrated Social Welfare Network has piloted self-help groups across villages in India’s Orissa province to buy insecticide-treated bed nets through cash or credit contracts. In 2010, the Centre for Innovative Financial Design launched a savings plus loan pilot program aimed at facilitating access to childbirth services with Cooperative Banks in Andhra Pradesh and Rajasthan. Planned savings are promoted, with loans near the expected delivery date to make up for shortfalls.

Cambodia is a site of innovation, with GRET experimenting with health insurance to provide primary health care to both children and adults, including free medical check-ups and the provision of cash payments for some secondary care such as childbirth and certain surgical procedures. The National Bank for Agriculture and Rural Development in India offers low-cost in-patient insurance to 600,000 farmer households at US$10 per year for a family of four, with no need for up-front payments. The Co-operative Insurance Company and the National Hospital Insurance Fund of Kenya offer Bima ya Jamii, a comprehensive low-cost package with in-patient insurance covering hospitalization, compensation loss during hospitalization, personal accident, and funeral expense insurance. In Tanzania, the Kilimanjaro Native Cooperative Union offers members a package for in- and out-patients, which is bought only if the majority votes for the insurance at their annual meeting. In Malawi, CUMO Microfinance is piloting hospitalization insurance, covering medical costs, pre-determined hospitalization support, and payment of loan installments during the period of hospitalization. The Oriental Insurance Company has partnered with Swasth India Services to improve healthcare access by pooling members’ savings to create a self-sustaining Community Health Fund for high-cost health events. Aga Khan Agency for Microfinance has developed cashless health insurance in Pakistan, while MicroEnsure’s cashless insurance is implemented through local partners in India and the Philippines. These policies attempt to overcome the barrier of up-front payments, and even provide a transport allowance in the policy; they count on a network of hospitals and third-party administrators to reduce costs and improve outreach.

There are also innovative partnerships between international insurance companies and local partners. Building on their initial work in Bolivia, Zurich Insurance Group entered into a partnership with the ILO and COSUDE (Swiss Agency for Development & Cooperation) in 2007 to increase micro-insurance provision worldwide. In 2009, MicroEnsure began the world’s first “virtual cell captive” (purchasing a shareholding in a risk insurance company, allowing the owner of the “cell” to raise finance to cover risk exposure) with Hollard Insurance Group. The virtual cell captive will use Hollard’s balance sheet to underwrite a range of health, life and weather index risks across Asia and Africa.

There has been innovation also in the provision of pension products, recognizing improving longevity, as well as changes in traditional family and social obligations (though more so in urban than rural populations). Grameen Bank in Bangladesh offered pension products as far back as 2001. Invest India Micro Pension Services Limited offers micro-pension accounts to both the rural and urban poor. India’s national Pension Fund Regulatory and Development Authority has recently launched “National Pension System Lite (sic),” to be offered through aggregators such as NGOs and MFIs that already work with economically disadvantaged communities. Pensions are deliverable on an individual level thanks to the reduction in administrative costs of using a group platform.

There has also been increased focus on the provision of housing finance in rural areas in recent years. Housing represents a major cost for building, extension, repair and maintenance. A home improvement loan was launched for low income rural clients in 2010 by First Micro-Finance Bank Tajikistan and the Microfinance Centre for Central and Eastern European and Newly Independent States. This project has targeted remittance recipients, seeking to steer such transfers towards investments in home improvements. In Armenia, Habitat for Humanity is providing rural households with long-term affordable loans to improve their housing conditions. Kalaignar Veedu Vazhangum Thittam, a state welfare scheme, is comprised of a grant per house, with both cash and material components, delivered...
in four tranches. Disbursements are based on completion of a stage of construction. The MFI provides loans to enable clients to ensure completion of each stage and thus trigger the next tranche of the grant.

**INNOVATION FRONTIER HF 3: IMPROVING FI MARKETING AND OUTREACH TO RURAL AUDIENCES**

FIs have found it difficult to reach dispersed rural populations with their promotional messages due to limited access to television and print media. While radio has traditionally been the most important broadcast media, new approaches are being adopted. In South Africa, Wizzit mobilized a sales force composed of 3,000 Wizzkids, generally formerly unemployed students, to promote its services, rather than investing in costly advertising. Standard Bank (South Africa) sales teams board mini-buses and speak to travelers about their products until the end of the journey, and sign up new customers. In Azerbaijan and Georgia, the Microfinance Centre for Central and Eastern Europe and Newly Independent States works with four local banks to provide “educators” who intercept remittance recipients in branches and provide them with targeted educational sessions including offering additional services, such as savings accounts that may be of benefit to the (unbanked) recipient.

In Afghanistan, where the challenge of rural outreach is related to the risk and costs associated with the security situation, USAID/Afghanistan’s Rural Finance and Cooperative Development program supports 30 Islamic investment and finance cooperatives (IIFCs), or credit unions, in providing shariah-compliant loans to 8,000 small business owners and farmers. To penetrate high-risk provinces, IIFCs depend on shura, or community councils, to travel into previously unserved areas and introduce the IIFC to groups of small farmers and business owners. They use female officers to reach out to women’s groups in the area.

FINCA, in collaboration with Innovation for Poverty Action, is piloting schemes that help people to “remember to save” in Ecuador, Peru, Bolivia and the Philippines. This includes testing to see whether short messaging service (SMS) reminders can encourage savings. Finance Alliance for Sustainable Trade (FAST) is promoting a financial fair event and a financial marketplace website in East Africa. These seek to create one-to-one meetings between producers and financial institutions, usually held alongside other major events that producers might be attending. FAST provides the matching and scheduling of meetings.

**INNOVATION FRONTIER HF 4: IMPROVED FINANCIAL EDUCATION**

Financial education differs from promotion, as the latter is seeking to attract new clients or persuade existing clients of an FI to purchase its products. There is a recognized need for rural populations with little education and previously limited access to financial products to receive some degree of financial education to be able to assess and make better financial decisions in relation to all aspects of their lives. Health Micro Insurance Consumer Education, promoted by Freedom from Hunger in Ghana, is an educational tool that targets the poor and vulnerable groups in need of health insurance due to poor health. In Kazakhstan, AMFOK has established Local Advisory Points with local organizations to engage in the provision of financial education to low-income people in rural areas. Some organizations focus financial education programs on youth groups. This has been a key tenet of the AIM Youth program being piloted in Ecuador and Mali by Freedom from Hunger with funding from the Mastercard Foundation, focused on youth between the ages of 13 and 24. AIM Youth also builds the capacity of microfinance providers to offer youth-appropriate products and services.

USAID’s YAJEENDE Project in Senegal, which was launched in late 2010, plans to address not only low levels of financial literacy but more broadly the problem of limited creditworthiness, by linking producer groups to MFIs and banks through community-based service providers (CBSPs). These CBSPs are entrepreneurs elected by the local community to represent them vis-à-vis the private sector. CBSPs help entrepreneurs identify the appropriate lender, apply for credit, and manage their credit through business skills building and on-farm technical assistance.
D. ENABLING ENVIRONMENT INITIATIVES

This section explores innovations that aim to improve the underlying market infrastructure, platforms and policies that enable the provision of the products and services in the previous three sections. In particular, this section highlights efforts that overcome longstanding barriers to rural and agricultural finance, such as the high cost of rural delivery and lower levels of human capital in rural areas. The framework used to categorize enabling environment innovations is as follows:

EE 1: Overcoming infrastructural and cost barriers
EE 2: Creating a more enabling environment
EE 3: Improving MFI capacity and access to finance

INNOVATION FRONTIER EE 1: OVERCOMING INFRASTRUCTURAL AND COST BARRIERS TO REACH RURAL CLIENTS

Three main approaches have been used to expand rural outreach by combining new ways to increase physical presence and using cellular phone technologies as the basis of a new generation of products available to the increasing rural population with cellular access.

The first approach to increasing outreach beyond the traditional branch network is the use of physical outlets that are not full branches. For example, Standard Bank (South Africa) uses refurbished shipping containers as mini-branches that can be dropped at a target location to test the market for a more permanent outlet. In Georgia, the Constanta Foundation used CGAP funds to develop a flexible lower-cost strategy based on a mobile team in satellite offices on certain days of the week. In Mongolia, XacBank has worked in partnership with local savings and credit cooperatives to build their capacity to act as franchise partners. This offers clients in rural areas the safety of a bank with the convenience of a locally based cooperative, at a cost that enables the bank to reach rural clients on a sustainable basis.

A second approach to expanding a physical presence has been to establish mobile (vehicular) banking units that effectively provide multiple and flexible outlet points. This is not new or innovative in itself, but there has been further adaptation in using vehicles that can reach beyond the main roads, since full armored mobile banks are often too heavy and large to reach far out. In Malawi, OIBM converts the ubiquitous bakki (pickup trucks) to potentially bring all rural locations within reach. Other examples include the “Bank on Wheels” used by HDFC bank in India. This was launched in 13 states to capture more of the retail market, facilitating access to financial services at affordable costs at people’s doorsteps using mobile biometric (e.g. fingerprint recognition) automated teller machines (ATMs). A jointly funded program by the European Union and Microsoft in China has sought to train “barefoot bankers” to become computer literate, then travel to villages to share knowledge and sign up clients before returning to digital hubs in more developed areas to process the information.

The final main method to establish a physical presence, sometimes known as the “correspondent model” has been to use existing rurally accessible outlets as non-traditional service points such as retailers and government outlets (post offices, shops, etc.). This strategy is attractive to FIs since the core infrastructure is provided at the partner’s cost, and outlets are already known and established, so it is quicker to scale up. For the partner with the outlets, in addition to receiving a fee, the arrangement is beneficial since it increases visits by existing and new customers who have access to cash that they might spend in the outlet. The partner thus improves outlet viability.
Diconsa, a Mexican government agency, manages a network of more than 22,000 community-owned stores, selling food and other necessities in remote areas. With funding from the BMGF, a pilot program was launched in 2008 to deliver government cash benefits through Diconsa stores, significantly reducing travel time and associated costs for the rural poor. There have been startup delays and challenges with this model, but other examples in Mexico are also exploring agent partnerships, like the pharmacy chain Farmacias del Ahorro and Te Creemos, a private MFI. Other examples include the partnership between the First Microfinance Bank and Pakistan Post, which has 13,000 postal offices across the country, even in the most remote areas of Pakistan. Similarly, in China, the Postal Savings Bank is using branches in villages and rural areas to move into microfinance, with initial capital support coming from monthly deposits by the central government.

Much of the pioneering work on correspondent models occurred in Brazil. More than 32,000 “corresponding banking outlets” were added from 2000-04, most of them retailers ranging from lottery kiosks to construction goods stores. This model is now being widely used in India, with banks partnering with a range of actors already present in rural areas to add thousands of customers. These initiatives have been made possible by the technological revolution that has reduced transaction costs and made a decentralized approach to rural financial service provision possible.

INNOVATION FRONTIER EE 2: CREATING A MORE ENABLING ENVIRONMENT
Many of the above approaches have met challenges with regulators who are used to sanctioning traditional fixed full branch models. In some cases it has meant adapting or changing the rules, while in others, there has been sufficient flexibility by regulators to allow for change within the spirit and principles of the rules. In Brazil, any legal entity is now permitted to be an agent; in Kenya, agents are required to be for-profit actors; while in India the largest MFIs are explicitly excluded.

As global experience deepens, some countries have relaxed initial restrictions. The Reserve Bank of India initially restricted agents to non-profits, post offices and cooperatives, which was widely viewed as a contributing factor to a slower than expected launch of branchless banking. Revisions have since expanded eligibility. In Kenya, KFSDT facilitated a revision of the legislation to allow retailers to act as agents, so that they can receive deposits as well as provide cash-out. In Bolivia, the Superintendent of Banks and Financial Entities has been proactive in amending the rules regarding mandates for financial brokerage.

Looking into the finer details of regulation, it is clear that the key issue is perhaps not who can act as an agent, but what roles agents are allowed to play—account opening, cash-in and cash-out services, payment and transfer services and potentially even credit underwriting. Regulation therefore is important in balancing the demand for increased financial inclusion and concerns over the reliability, security and competence of such third parties. Some regulators are considering different categories of agents based on the services they wish to offer, so that those involved simply in cash-in and cash-out services may reasonably face less stringent eligibility standards.

The issue of identity needs to be addressed, as it is more difficult to establish an identity for a rural illiterate person than the generally educated, employed and recorded urban populace. Many FIs, particularly banks that are “downscaling,” have reviewed their product requirements such as minimum balances and charges for savings accounts (see Mzansi, South Africa), as well as identity and reference requirements for savings and credit products.

Pushing against this accepted need to relax unnecessary identity requirements has been a counter-trend based on stricter money laundering and terrorism-related regulations. As a result there has been pressure on FIs around Know Your Customer requirements that are not well-suited to dealing with unregistered enterprises and people lacking official identify cards. This has also included requirements to monitor transactions, which potentially creates

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* A wealth of more specific country information is available on the CGAP Regulation Center website, found at http://www.cgap.org/p/site/c/regulation_center/.
difficulties in tracking transactions by such groups. There have been initiatives using biometric smart cards (cards with electronic chips that store data, such as Malswitch, Malawi and many types in India) to address this concern. With the advent of better telecommunications networks enabling remote access to a central database and identification at a much lower cost (magstripe cards plus pin), biometric and smart cards have been partly sidelined as unnecessarily costly solutions. The core problem is that establishing a reliable identity system in developing countries is very difficult due to the cost of establishing initial identities in the absence of comprehensive birth certification and registration.

At the regional level, USAID’s COMPETE project has provided support to the East African Community ICT Task Force’s efforts to harmonize the technical protocols and regulatory treatment of mobile money transfers across the region.

INNOVATION FRONTIER EE 3: IMPROVING OVERALL MFI CAPACITY AND ACCESS TO FINANCE

Considerable efforts have been made to build the capacity of MFIs and improve their operations. Approaches have included broad support to the micro and/or rural finance sector of a given country, direct technical assistance to retail MFIs, new product development and innovations, support to improving the enabling environment, and support to “meso” level support institutions, associations, local universities, etc. Examples include UNCDF’s MicroStart program, which draws on high-level micro-finance expertise. The Africa Microfinance Growth Centre, supported by KFSDT and UNITUS, runs an innovative leadership program for chief executives and senior staff of MFIs in Kenya and Tanzania. USAID has over many decades funded a wide range of projects to improve MFI capacity, but recently projects have focused (exclusively or partially) on rural and/or agricultural finance. Examples include AFIRMA (Mexico), Deepening the Microfinance Sector (Malawi), CAMFA (Central Asia) and Rural SPEED (Uganda). In addition to targeting rural institutions for capacity building, many of these projects built strategic alliances with non-financial actors, and worked to eliminate “information asymmetries” by carrying out detailed sector studies (coffee, tea and cotton in Malawi; mangos in Mexico) and sharing the results with interested financial institutions.

Several initiatives seek to improve MFI access to banking services through shared platforms. In Senegal and with users and programmers around the world, Grameen Foundation’s open source software platform, MIFOS, provides MFIs with a cost-effective Management Information System and taps into a growing worldwide open source community. Given the cost and challenges of proprietary software, platforms that are more readily available to MFIs in their early stages of development could be of considerable assistance.

In addition to the decentralization that technology has facilitated, the provision of centralized information and communication technology (ICT) systems to those involved in rural finance has also had a substantial impact in improving their capacity to function both efficiently and effectively in rural areas. In India, the Government of Andhra Pradesh is working with CGAP and the World Bank to enable real-time accounting for 800,000 informal savings and credit groups. Elsewhere in India, FINO is providing a remote data-capture device combined with a back-office banking solution. Similarly, in Nepal the Centre for Microfinance has been working with 60 MFIs to provide a cost-effective microfinance platform; in Ecuador, Red Financiera Rural has been using CGAP funds to provide a shared technology platform to MFIs, credit unions and cooperatives in rural areas. Bansefi, a government-owned savings bank in Mexico, also provides a centralized platform and access to remittance and payment/transfer services for MFIs and credit unions. The creation of a new apex bank in Indonesia, Bank Andara, was accompanied by a standard back-office solution for data management at client MFIs. In Zimbabwe, PayG Solutions is implementing the Kopesha Cloud MFI application that gives MFIs and savings and credit cooperatives the ability to access cellular banking, branchless banking, ATMs, and other services using established cellular networks. All of these examples allow small MFIs to access a more sound and robust system than they could afford on their own, facilitating interbank transactions and connections with other payment systems. The World Bank has gone as far as to describe this as “a
new paradigm for introducing technology in … microfinance,”7 and is encouraging similar centralized ICT platforms in developing and middle income countries around the world.

There have also been initiatives to promote access to finance for MFIs. Incofin Investment Management is operating a Rural Impulse Fund (I & II) globally. This is a commercial microfinance fund to link private capital with sustainable rural MFIs. Other funds are also emerging to provide capital for the sector, such as Agora in the UK.

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7 “Linking up and Reaching out in Bangladesh: Information and Communications Technology for Microfinance”, World Bank 2010
V. CONCLUSIONS AND FURTHER RESOURCES

This study has reinforced that rural household financial needs and sources need to be seen in an integrated manner as there is considerable overlap and connection between agricultural, non-farm livelihood and household finance needs.

Firms and farmers are interconnected with each other and so constraints on one set of firms will impact other firms within the value chain and also in the wider local and national economy. It is also apparent that households do not separate their resources into the three categories, but rather they prioritize resources according to the time of year and their regular, irregular and emergency commitments. As a consequence, they draw on available resources in one category to meet needs in another category. Recognizing this interconnectedness of sources and needs, and understanding how it is impacted by seasonality and cash flow demands, will continue to be central to innovation in rural and agricultural finance.

The recent past has seen some significant breakthroughs at the “innovation frontiers,” where unresolved problems are being addressed in diverse ways. Many of the most notable breakthroughs involve new alliances and technological developments such as the rapid spread of cellular phones; many are supporting constructive developments in the enabling environment, such as more flexible responses of regulators.

Overall, the study has found a wide range of organizations seeking innovative ways to more effectively reach and sustainably service more segments of the rural market with a more relevant, targeted and generally better-integrated product range. Rural finance has now moved well beyond agricultural credit delivered by large formal FIs to commercial farmers, to an increasingly diverse range of products and services serving increasingly diverse and segmented rural client groups. Within that increased reach and diversity of offering and target groups, there has been a welcome increased focus on poorer groups and a better understanding of their needs. Perhaps the most exciting aspect of this study is that innovation has yielded considerable benefits to many rural people, and that the innovations captured in this stocktaking are a stepping stone in a continuum of innovation. In five years, many of these innovations will have been consolidated, some will have fallen away, and new ones will have emerged.

Annex III provides a summary of the initiatives reviewed and brief profiles of all the innovations detailed in the report, as well as others that may also be of interest. More than 400 organizations and initiatives were reviewed, from which over 160 innovative rural finance initiatives have been listed. Reference to these is made throughout the report, as appropriate.
ANNEX I: METHODOLOGY AND LIMITATIONS

This report represents the culmination and combination of two team’s efforts. The first team consisted of Jason Agar and Harry Davies of Kadale Consultants, who identified promising innovations in rural finance sponsored by organizations other than USAID. The second team, consisting of Joe Dougherty and Keelyn Henderson from Cardno Emerging Markets USA Ltd., took stock of recent and current work in rural finance funded by USAID and selected particularly innovative USAID projects for inclusion in this report. (The broader results of the USAID stocktaking are covered in a separate report.) Both teams worked under the leadership of Geoff Chalmers from ACDI/VOCA, with guidance and support from Jeanne Downing and Anicca Jansen of USAID’s Office of Microenterprise Development.

There were no geographic limitations, but there was a particular focus on those countries that form part of Feed the Future (FTF), the U.S. global hunger and food security initiative, which includes relatively poor countries in Africa, Asia and Latin America and the Caribbean. All FTF countries were included in the review. However, examples from other countries are critical to an understanding of what does and does not have potential for FTF countries. For this reason, this review covered all FTF countries, as well as selected innovations from non-FTF countries.

The consultants do not claim to have reviewed all possible candidates, or to have definitively and accurately assessed opportunities to be truly innovative. The rural finance “territory” covering all developing countries is vast and complex, making comprehensiveness impossible.

Because the two teams had different objectives, they employed different approaches. The “Innovations Team” sought to identify the most unique and promising innovations being explored by a broad range of donors, governments, nonprofit organizations and financial institutions. The Innovations Team used three main methods to identify (potentially) innovative rural finance initiatives.

1. The first method involved extensive web-searching, first by countries and then by themes. This included searching organizational websites and documents about their own initiatives, and also searching independent organizations and sources for commentaries on other organizations’ initiatives. This dual referencing enabled an initial view to be taken of what is claimed to be (by sponsoring organizations), and found to be (by independent commentators) “innovative.”
2. The second method used key source persons to obtain their views on organizations and initiatives that they regard as innovative to generate a list of peer-identified innovation leads that were then also researched using the first method.
3. The third method was to use supplementary sources, such as the shortlisted proposals for the “Cracking the Nut” Conference, key leads provided by USAID, ACDI/VOCA and others, as well as leads from the consultant’s own information.

The “USAID-Only Team” sought to capture as many USAID-funded rural finance initiatives as possible from the last five years, regardless of how “innovative” those initiatives might be. The team followed a five-step approach:

1. Solicited input from the Office of Microenterprise Development and other sources within USAID on which USAID country missions were likely to be working in rural finance.
2. Sent an information request to all the USAID Missions that had been identified in Step 1. Requests were sent to more than 30 missions and 15 implementing partners, not all of whom responded. When responses were not received, the team sent e-mails or made phone calls to follow up. Overall, the team requested information on rural finance work in nearly 40 countries.
3. Reviewed the responses as they were received and logged the information into a database in order to compare across projects and aggregate the information.

4. Selected, from about 50 information request forms that had been returned, projects with a particularly successful, innovative or unusual approach to rural finance and contacted the relevant mission and/or implementing partner to request further information. At the same time, the team looked for more detail on the selected projects from USAID’s Development Experience Clearinghouse. The team then conducted phone or e-mail interviews with chiefs of party, USAID Contracts Officer’s Technical Representatives and Agreement Officer’s Technical Representatives, as well as other sources.

5. Drafted brief descriptions on 15 of the most promising and/or unique USAID-sponsored innovations for inclusion in this report.
ANNEX II: SCOPE AND DEFINITIONS

This section reviews what is included in rural finance and discusses and defines innovation in this context. Although this may appear relatively unimportant, it reveals key issues about how rural financial innovation can be seen and characterized.

The stocktaking exercise covers innovations in rural finance. The interest in rural finance is both in terms of its implications for rural households, of which a majority are likely to be classed as poor or amongst the poorest, and its implications for growth in economies where there is a strong agrarian component. Many of the least developed and developing economies have a relatively high proportion of the economy based on agriculture and related activities. Therefore improving the flow, access and relevance of rural finance will disproportionately impact on the overall growth of these economies. It will also have an indirect and direct impact on poverty and related food and livelihood security.

Furthermore, the study reviews initiatives that directly impact the poor, as well as those with a more indirect impact, such as financing for large, medium and small firms when this enables them to improve the growth potential of the value chains in which the poor participate.

In terms of rural households, it is not assumed that all of these are farming households or that all are poor. However, it should be noted that the vast majority of rural households in least developed and developing economies partake in smallholder farming. No attempt is made to delimit this focal group, as what constitutes a smallholder and rural household varies considerably, particularly across continents. Rather than try to quantify or parse these differences, the review makes general observations about approaches that are effective in addressing the key problems facing rural and poor households, firms and agricultural sectors.

The finance field is heavily influenced by development partner initiatives and funding, but not exclusively, as the commercial sector is also operating and becoming more important. This partly reflects the deliberate approaches of many development partners to work with and through them. In contrast to development partner initiatives, larger, commercial FIs have traditionally been more focused on large- and medium-scale commercial farmers. However, this narrow focus is changing with recognition that other rural groups represent a large and potentially viable market, particularly as changes in delivery platforms for services have reduced the cost and difficulty of reaching them, and changes in methodology have reduced the risk in lending to them.

Differentiating between those innovations funded by USAID on one hand, and other donors or investors on the other, was necessary to enable sufficient focus on each source by the two separate consulting teams. However, in quite a number of cases, innovation was not being funded by a donor or development partner but was “self-funded” by the implementing organization or partnership. This was particularly the case with private-sector value chain players, such as processors and buyers, who were often making up for the lack of formal finance sources and limited interest from development partners.

INNOVATION

A term such as “innovative” is inevitably elastic in its definition with no universally agreed upon criteria by which to judge. The innovative label is regularly over-used and over-claimed by both donors and implementers. Good candidates for innovative examples may have been overlooked or wrongly excluded; and poor candidates may have been wrongly included. This is therefore more of a summary of innovative initiatives for wider discussion and debate: a starting not an end point. After all, innovation is by nature continuous.

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8 The term firm is used to refer to a legally constituted business (formal), as differentiated from an individual or household business activity (informal business).
“Innovation” usually has positive connotations and so promoters of initiatives, products and organizations like to have “innovative” attached to what they are promoting. As a result, the term “innovative” has been overly (and often wrongly) applied and claimed. There are several dimensions of “innovation” that can be extracted:

1. It is something that is new (invented) and/or being newly applied.

2. It relates to things, ideas, methods, systems and more.

To fall within the scope of this exercise, the author took the view that innovation had to be more than just new for the organization and the country. It also had to be more than applying relatively well-established approaches (such as using a value chain approach) to new crops. These can be worthy and indeed innovative at the organizational and national levels, but not necessarily of note beyond these boundaries.

Part of the power of innovative ideas is that they spread rapidly and are imitated, expanded, adapted or applied in a new context. The stocktaking includes variants and adaptations of innovations, but does not attempt to define where innovations were first introduced or which organization could stake a claim to be the first. Therefore, because an innovation is listed in this study does not imply it is necessarily the first application of the idea, product or approach.

For this stocktaking exercise, innovation was considered in relation to:

1. **Products and services** – new products, variants, new applications, new combinations with other financial products (“bundling”) and unbundling

2. **Delivery** – methods and channels (reach and cost), types of organizations (non-traditional suppliers), new or existing technologies applied to microfinance, and changes in back-office support

3. **Excluded Target Groups** – targeting products to different demographic and economic groups that were previously excluded or not reached

4. **Providers** – new types and categories of providers becoming involved in rural finance, usually in some new way

5. **Partnerships** – new categories of partnerships across the public sector, private sector, NGOs, communities and development partners

6. **Promotion** – new methods of reaching new and potential clients

7. **Financial education** – new ways to educate individuals and households on how to manage their finances. This may be in support of a particular product, but is distinguished from products because it may be a generic campaign by an independent body to educate particular groups about the use of financial products and services

8. **Enabling environment and infrastructure** – enabling regulation/legislation, provision of public goods, and provision of necessary financial-sector infrastructure platforms

Overall, we selected as “innovations” any new, unique and/or particularly promising approaches to expanding rural financial services. Some of these innovations have already shown positive results (G-Cash in the Philippines and M-Pesa in Kenya, for example, are innovations that have established an operational track record, been sustained, have

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9 Generally, products and services are treated as the same. Although many financial products are not “tangible,” the term “product” is used in the marketing sense of the tangible product or intangible service that is supplied to a customer.

10 There is now more emphasis on financially excluded groups, including research and analysis to understand who is excluded, how and why. This focus now drives innovation in products, delivery (reducing cost and increasing access), promotion and partnerships.
substantial and growing coverage, and are being adopted and replicated by others), while others show potential but are too new to judge.

In this report, the term “innovation frontiers” has been coined to refer to these problems/areas/points. As the innovation frontiers became apparent in the review process, the consultants used these to group the identified initiatives to build a picture of how different stakeholders were responding to a common problem. These innovation frontiers have been used to group the innovations under the four main category headings of agricultural value chain finance, non-farm enterprise finance, household finance and enabling environment.
ANNEX III: LIST OF INNOVATIONS

See Excel sheets—these can be searched by country, initiative name, category of innovation, etc. to find a particular innovation initiative or groups of innovation initiatives that share one or more common characteristics.