Rural Financial Services in Ethiopia
Rural Financial Services and Financial Product Innovation in Ethiopia

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ABSTRACT

Many smallholder farmers in Ethiopia struggle to access financial services, and lack opportunities to improve their agricultural activities as a result. ICCO Cooperation’s STARS program aims to support smallholder farmers through the provision of financial support bundled with access to agricultural inputs, markets and skills training in order to break the cycle of poverty and food insecurity for rural smallholder farmers. To achieve this, the STARS program needs insight into the barriers and catalysts for smallholder farmers to access financial products, in order to tailor credit packages to best address their needs and capacities. The design of the STARS program reflects a wider shift in the rural finance sector from product-centred to client-centred services; founded on the increasing recognition of the heterogeneity of smallholder farmers’ needs, capacities and aspirations. Evidence suggests that customer centricity can increase value for both customers and businesses; enhancing both customer satisfaction and business performance.

It is therefore essential to recognise the heterogeneity of smallholder farmers, and accordingly this study was conducted to understand differences in smallholder farmers’ wealth and food security, current trends and practices in productivity, their use of products and services and access to markets and to finance. This study also explores farmers’ reasoning in selecting and accessing credit; comparing formal and informal sources. On this foundation, the program and participating MFIs enhanced their understanding of the client base: their needs, capacities, attitudes, strengths, weaknesses, barriers and catalysts and were able to adapt product features to match the needs of farmers.

The study revealed that participating smallholder farmers have diverse needs, capacities and aspirations with regards to both agricultural enterprises and financial credit. Farmer decision-making is guided by a range of catalysts and barriers, and there is a need for financial products that adapt to these conditions in order to attract and retain clients. Furthermore, this decision-making reflects the benefits and limitations associated with formal and informal sources of credit. Broadly speaking, smallholder farmers require appropriate loan sizes, flexible collateral requirements and flexible repayment periods; and these factors can be more influential than interest rates. However, financial products targeting this market should take into account the different profiles of smallholder farmers in terms of land size, crop type, market orientation, and tailor collateral options, loan sizes and repayment terms to individual farmer characteristics. Developing products based on client needs can lead to an increased uptake as well as enhancing client satisfaction; although these must be provided in a sustainable and responsible manner.
INTRODUCTION

Background

In Ethiopia only around 35 percent of adults have an active account at a formal financial institution used for payments, savings, and accessing credit (Demirguc-Kunt et al., 2018; Baza & Rao, 2017). Reasons for this financial exclusion include lack of money, distance to branch offices, costs, documentation requirements, lack of trust in financial institutes and religious beliefs (Baza and Rao, 2017).

Similarly, many smallholder farmers struggle to access financial services, and lack opportunities to improve their agricultural activities as a result. In particular, collateral requirements for credit can be prohibitive, and formal credit is mainly accessible to relatively wealthy people with good connections (Baza & Rao, 2017). For these reasons, many smallholders take informal loans from family and friends or informal savings clubs (Demirguc-Kunt et al., 2018).

Smallholder farmers often operate without substantial financial reserves, and require credit to purchase inputs and to finance their harvesting, processing and marketing activities. Importantly, farmers need more than just credit; also savings and payment services are essential to help them manage unstable income flows, mitigate risks and unlock the development potential of agricultural activities (World Bank, 2007). To summarise, developing the agricultural sector requires a well-functioning financial system; to support the adoption of modern production tools and techniques, to access competitive markets and to overcome shocks and unexpected challenges (IFC, 2014).

Finance trends in Ethiopia

Financial inclusion in Ethiopia remains limited. As much as 36% of all banks operate in or around Addis Ababa - leaving rural areas underserved - while rural savings and credit cooperatives are generally weak and unable to supply services sustainably (National Bank of Ethiopia, 2017). The Global Findex database tracks financial inclusion around the world, and provides insights into Ethiopia’s achievements and trajectory (Demirguc-Kunt et al., 2018). The percentage of adult account-holder has risen from 22% in 2014 to 35% in 2017, and 26% of adults now save at financial institutions (compared with only 14% in 2014) while 11% borrow from financial institutions (compared with only 7% in 2014). These figures are comparable to those presented by Baza and Rao (2017). The remainder borrowed from friends, family or savings clubs (Bessir, 2018). Furthermore, the Global Findex database found that women’s account ownership is increasing much slower than men’s in Ethiopia, with 41% of men and only 29% of women having an account; and less educated rural women are the most likely to remain unbanked. The poor, uneducated, youth, women and rural residents generally face greater constraints in accessing formal financial services (Demirguc-Kunt et al., 2018; Baza & Rao, 2017). Among the key challenges for improving financial inclusion are i) an underdeveloped financial infrastructure, ii) an inadequate supply of suitable financial products and services, iii) inadequate financial consumer protection, and iv) low levels of financial capability and awareness (National Bank of Ethiopia, 2017). In line with the second priority of the National Financial Inclusion Strategy, and the role for MFIs foreseen therein, ICCO Cooperation’s STARS
program works with MFIs to build their capacity and to develop suitable financial products to serve rural smallholder farmers following a client-centric approach.

A client-centric approach in agri-finance product development

According to Doug Leather, author of The Customer Centricity Blueprint (2013), customer centricity is a business model that operates in an ecosystem of customers, employees, suppliers, shareholders, and the communities that an organization serves. In this ecosystem, customers are at the centre of corporate strategy, decision making, organization design and operations.

Recognising that smallholder farmers are heterogeneous, a client-centric, or customer-focused approach requires:

- A granular understanding of customers;
- Financial solutions designed specifically for customer needs;
- Organizational commitment to delivery through a customer-centric business model.

This provides a fundamental shift away from the traditional product-focused approach, but it offers excellent returns. The CGAP customer-centric guide (2017) explored how customer centricity can contribute to the development of strategies and actions that lead to value for both businesses and customers. They noted that research has identified strong linkages between business performance and customer satisfaction. For example, Gupta and Zeithmal (2006) demonstrate that a 1% increase in customer satisfaction results in 2.4% growth in return on investment (ROI), while a 1% decrease in customer satisfaction results in a 5.1% decrease in ROI.

Thus, service providers must enhance their focus on customers, improve the customers’ experience and deliver value in order to assure good results. The customers want to reach their specific household goals in ways that fit easily in their cash flows and future needs (Christen & Anderson, 2013). As Collins et al. (2009) showed in their seminal work, poor households like those of rural smallholder farmers have unpredictable and irregular low incomes, making cash-flow management a necessity to meet the daily costs of living. In managing their small incomes these households have to aggregate usefully large sums of money to make investments in their farms or pay for big life events (like weddings), or to be able to deal with sudden shocks (like illness). For this, poor households need access to suitable financial tools to help them in money management, and having suitable payment, savings and credit products is a big part of that (Collins et al., 2009). But one first has to develop a good understanding of what farmers would consider suitable products, what attracts them to formal financial services and what barriers do they experience in accessing them?

Understanding smallholder farmers

Smallholder farmers are a heterogeneous group ranging from subsistence farmers struggling to survive, to emerging entrepreneurs who are successfully managing their farm as a business. According to the Agriculture Finance Support Facility (2015), client segmentation refers to the process of defining and subdividing a large, homogeneous market like agriculture finance into clearly identifiable segments having similar needs, demands and characteristics. The aim of this process is (i) to provide an optimization of profit for each individual segment, (ii) to create
understanding of the clients to provide them with the most suitable offer and (iii) to encourage the growth of a client towards an increased profitability by moving higher on the segmentation ladder.

The Consultative Group to Assist the Poor distinguishes three smallholder segments of decreasing size: noncommercial smallholders (or subsistence farmers), commercial smallholders in loose value chains, and commercial smallholders in tight value chains (Christen & Anderson, 2013). The farmers in these segments are likely to have very different needs and capacities, face distinct challenges and strive for different objectives. Given these broad client segments there are several different approaches to a better understanding of even a deeper segmentation of agricultural households. The process can be based on demographics (e.g. income, gender, age), psychographics (e.g. attitudes, aspirations and lifestyle), behaviour (e.g. product consumption), needs (similar needs across customers), commercialization or a blend of different indicators (Agriculture Finance Support Facility, 2015; Christen & Anderson, 2013).

The STARS program targets 210,000 farmers across four countries, of which 76,000 in Ethiopia, and we anticipate that these farmers will constitute a diverse range of rural smallholders. This range will consist of subsistence farmers up to emerging agri-entrepreneurs, therefore broadly covering the three segments identified by Christen & Anderson (2013). In order to understand and respond to client needs, it is necessary to develop a more sophisticated understanding of what motivates their actions and informs their decisions, allowing us to better understand and respond to their needs in a targeted way. Customer analysis therefore is a core aspect of the client-centred approach embraced by the STARS program.

**Objective of the study**

In order to better understand and respond to the needs of agricultural clients, we designed a deep dive study to run parallel to two pilot tests of newly designed agricultural credit products. This study will help us to gain insights into the following research questions:

1. What is the current state of wealth and food security of the smallholder farmers targeted by the new credit products?
2. What is their current state of farming in terms of productivity, use of products and services, access to markets, and access to finance?
3. What guides a farmer’s decision-making in taking a MFI loan and how do other credit products differ in their advantages and disadvantages to farmers?

The purpose of this customer analysis is to enhance our understanding of the smallholder client base: their needs, capacities, attitudes, strengths, weaknesses, barriers and catalysts. This could create a possibility to adapt product features to match the needs of farmers.
METHODOLOGY

Aiming to understand and enhance access to financial services, the STARS program in Ethiopia is working with MFIs in developing agriculture-specific credit products. One of these credit products is a vegetable loan, and for this study we will focus on vegetable producers in the Meki-Ziway area. This area is located in the East Shewa Zone of the Oromia region, in the Central Rift Valley in Ethiopia. The area is well known for vegetable production (horticulture) including tomato, onion, green pepper, green beans and cabbage. Vegetable is produced twice a year by irrigation and rainfed systems. Another credit product is a malt barley loan, and we will focus on producers in the Kersa area. This area is located in the Arsi Zone of the Oromia region. In this area farmers grow cereals like barley, wheat and teff, as well as sorghum and maize. Also pulses, potatoes, onions and some other vegetables are grown. Malt barley is harvested once per year and is a rainfed crop.

Data collection

The core research study on which this conference paper is based was conducted as a component of a four-country study during the pilot phase of new credit products launched in collaboration between the STARS program and participating MFIs. The study aimed to establish baseline levels of key indicators, including food security and income levels of participating farmers. It was also designed to investigate farmers’ access and attitudes to finance in the core intervention areas. This study was called the Credit Pilot Deep Dive (CPDD) study; and used a mixed quantitative and qualitative approach based on a quantitative household survey triangulated with focus group discussions. Additional findings are drawn from a case study intended to further identify reasons farmers continue to make use of informal sources of finance, despite the higher costs associated with these loans.

Sample

For the quantitative part of the CPDD study, a questionnaire was administered to 100 individual vegetable farmers in the Meki-Ziway area (where we worked with Busa Gonofa and Metemamen MFIs) and to another 100 individual farmers who predominantly grow malt barley in the Kersa area (where we worked with Harbu MFI). These farmers have been categorized in three strata:

- The Treatment group includes farmers who have taken the agri-credit through the MFIs linked to the program. Out of the 200 farmers sampled, 106 are in this category (56 in Meki-Ziway, 50 in Kersa).

- The Rejected group includes farmers who applied for the loan but their application was rejected by the MFIs. A total of 34 farmers were sampled in this category (14 in Meki-Ziway, and 20 in Kersa).

- The Control group includes farmers who have not applied for a loan from the MFIs. There was a total of 60 farmers in this category (30 from each of the two zones).
This stratified approach facilitates the analysis of similarities and differences between the groups; revealing the demographic and motivational differences between farmers selected and rejected for credit, and those who chose not to apply for credit. Farmers who agreed to participate in the study were categorized into one of the three groups according to their experience with the pilot MFI loans.

For the qualitative component of the CPDD study, focus group discussions (FGDs) were conducted. A total of 9 FGDs were conducted (6 in Meki-Ziway, and 3 in Kersa) with an average of eight participants per group. These FGDs followed a structured format though which core topics were systematically investigated in depth. The case study collected information through semi-structured interviews with two MFI branch managers and 19 MFI clients; including men, women and youth.

**Data analysis**

The quantitative data collected through the survey included demographic information, wealth and food security data and additional questions around access and attitudes to finance. The wealth of participating households was assessed through the following characteristics: land size in hectare (converted from the local unit *qert*), the Tropical Livestock Unit (TLU) index which aggregates the total number of livestock owned based on animal weights (Chilonda & Otte, 2006), and finally by using the Poverty Probability Index (PPI) of the household compared with the national poverty line. The resulting PPI score estimates the poverty rate of the sampled population (Schreiner, 2016). To understand better how food security changes over the course of the year, the tool Months of Adequate Household Food Provisioning (MAHFP) was employed (Bilinsky & Swindale, 2010). This tool identifies the months of the year during which the respondent does not have enough food to meet the family's needs. The survey data were statistically analysed to identify patterns and trends.

During the FGDs and case study, rich qualitative data were collected around attitudes to and experiences with finance, as well as catalysts and barriers influencing participants’ decision-making. The FGD data were transcribed and then analysed using thematic content analysis based on text coding for the central themes of this study.
RESULTS

The smallholder farmers in this study

Wealth levels among the targeted farmers differ slightly between the two areas (see Table 1). Farmers in East Shewa area on average have more land, fewer animals and a lower poverty rate than farmers in Arsi.

Table 1. Wealth indicators in Arsi and East Shewa

<table>
<thead>
<tr>
<th>Area</th>
<th>Land size (ha)</th>
<th>Livestock (TLU)</th>
<th>Poverty rate (PPI 100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arsi</td>
<td>2.13</td>
<td>4.76</td>
<td>25.75</td>
</tr>
<tr>
<td>East Shewa</td>
<td>2.27</td>
<td>3.42</td>
<td>19.94</td>
</tr>
</tbody>
</table>

With respect to the three farmer strata, the survey data suggest that on average the farmers who received the loan are wealthier than farmers who never applied, with the rejected applicants taking on average the intermediate position (Table 2).

Table 2. Wealth indicators per farmer grouping

<table>
<thead>
<tr>
<th>Stratum</th>
<th>Land size (ha)</th>
<th>Livestock (TLU)</th>
<th>Poverty rate (PPI 100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Received</td>
<td>2.37</td>
<td>4.21</td>
<td>22.94</td>
</tr>
<tr>
<td>Rejected</td>
<td>2.30</td>
<td>3.87</td>
<td>20.37</td>
</tr>
<tr>
<td>Not applied</td>
<td>1.84</td>
<td>4.01</td>
<td>24.07</td>
</tr>
</tbody>
</table>

Wealth levels are an important factor affecting access to finance. This is likely related to the requirement to provide collateral as a security on formal loans, but could also entrench the cycle of poverty if poorer farmers are unable to access credit. However, it is important to note that recruitment into the agri-credit pilot favored the more eligible existing MFI clients, which will to some extent explain these wealth differences between the farmer groupings.

It is also important to highlight the position of female-headed households (FHH) in terms of their wealth level. Although only 15 FHHs were reached in our sample, our findings suggest that they are poorer than the other households, see Table 3.
Table 3. Wealth indicators for FHHs compared to the other households

<table>
<thead>
<tr>
<th>HH type</th>
<th>Land size (ha)</th>
<th>Livestock (TLU)</th>
<th>Poverty rate (PPI 100%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FHHs</td>
<td>1.93</td>
<td>3.34</td>
<td>24.87</td>
</tr>
<tr>
<td>Other HHs</td>
<td>2.22</td>
<td>4.15</td>
<td>22.68</td>
</tr>
</tbody>
</table>

To gain further insights into the wealth levels and the cash flow needs over a longer period of time, we surveyed during which months of the year the households experience food shortages. This period is termed the lean season, and it is characterised as a period during which households harvest little or nothing, and need cash to buy food, or face hunger. As Figure 1 shows, the lean season in Arsi peaks in September and October, but food shortages begin to rise significantly in June. In East Shewa a lean season is not so well defined. Food shortages peak from June to August, but this peak is less defined and less severe compared to Arsi.

![Figure 1. Months of Adequate Household Food Provisioning (MAHFP) in the two study sites.](image)

When comparing the regional results, 56% of the households in Arsi report food shortages at some point during the year, compared with 47% of households in East Shewa. This suggests that around half of the participating farmers have sufficient funds to buy food during the lean season. Among households reporting experiencing food insecurity, on average participants in Arsi experience food shortages for 2.2 months per year, compared with 1.9 months in Arsi. It is also important to note that the lean season generally occurs close to the planting season, so there can be a dual need for cash during this period: both for investing in the next crop and for buying food. The agricultural calendar is the determinant of the timing of this need for cash (or credit).

**Smallholder farmers as agri-business actors**

**Agricultural production**

In order to enhance our understanding of the current state of farming and the factors influencing harvest sizes, farmers were asked to compare the size of their most recent harvest
to the two previous seasons, and to identify the main reason for any observed differences. Overall, a high number of farmers reported improved harvests (71%) although there was a difference between barley (85%) and vegetable farmers (56%). Examining the reasons for improved harvests, barley farmers were most likely to attribute these improvements to new seeds (27%), followed by climate (21%) and improved farming practices (19%) (Figure 2). For vegetable farmers, climate was the main reason for improved harvests (18%), but 11% of vegetable farmers attributed the improvements to improved farming practices and to the use of fertilizers or chemicals.

![Figure 2. Number of farmers having indicated improved harvest citing the main factor associated with the improvement.](image)

Overall, these results highlight the effects of climate as a particularly influential factor for vegetable farmers, while for barley producers, new seeds are popularly associated with improved harvests. In fact, farmers even applied for a loan just to be able to access the new seeds available through the MFI.

**Access to financial services**

To increase our understanding of participating farmers’ previous access to financial services, their loan history and the sources of these loan were surveyed. Around 70% of all participating farmers have at some point taken out a loan. Sources of loans that were mentioned are MFIs, SACCOs, informal money lenders, ‘equb’¹, as well as family and friends. Moreover, the survey data suggest that previous access to credit correlates with the current access to the piloted

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¹ The equb is a form of a rotating savings and credit association (ROSCA). Such instruments can blur the distinction between loans and savings, see Collins et al. (2009).
STARS agri-loans. All 106 farmers in our sample that applied for and received the new agri-loan, had previous experience with credit. In contrast, of the group that applied and was rejected, only 41% had previous experience with credit. In the group that did not apply for credit, only 32% had previous experience with credit. Thus, loan history seems important in determining subsequent access to finance. It may be hypothesized that the farmers who were rejected, or did not apply for credit, are unable to meet the collateral requirements, or it may be that MFIs select loan recipients based on their previous relationship and history in successfully repaying loans.

**Differences in financial needs and aspirations**

Participating farmers, like smallholders in general, are not a homogeneous group but have a multitude of different capacities, needs and aspirations. This can also be seen in their differences in risk appetites. Looking at the farmer group as a whole, 64% would risk losing their investment if there was a possibility of a high return, while 28% would accept some risk in return for a higher return on investment, and 8% would accept only a low return on an investment and not take a risk. Female-headed households reported more conservative responses, which were corroborated by the FGDs during which it was often mentioned that women are more prudent money managers.

Farmers differed in the time needed to get a return on their investment. Among the farmers in the survey sample, more than half (52%) report that they would need to get their investment back in one harvest cycle, indicative of limited savings and a subsistence level household economy. However, 44% of sampled farmers report that they could wait up to four harvest cycles to get a return on their investment, while only 4% could wait longer than four cycles.

Religious beliefs were also found to inform farmers’ aspirations and needs related to financial inclusion. In this study most farmers are Christians (62.5%) or Muslims (36.5%). Interestingly, access to loans is higher among Muslims (75%) compared to the other religious groups, despite the religious restrictions on interest-bearing loans according to the principles of the Islamic faith. During the study, researchers noted that some Muslims take loans covertly, while for others the decision not to take a loan is explicitly linked to their religious principles. This can call for a need of a specific financial product.

**What guides the decision making in taking out a loan?**

Recognizing the differences in smallholder farmers, it is essential to find ways to serve these heterogeneous clients and to address the various catalysts and barriers affecting their access to finance.

**Credit catalysts**

During the FGDs, participating farmers identified the factors that encourage them to access MFIs’ credit products. The next part highlights a number of these core catalysts:

- **Credit combined with farm inputs or training.** Farmers reported that they prefer combined packages of credit loans and quality agro-inputs, or packages including training. This is likely to be particularly critical in the areas where inputs that are available in open markets are of inconsistent or poor quality.

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2 The remaining one percent practice the local Waqefeta faith.
Credit meeting farmers’ actual financial needs. Farmers reported that they avoid small loans, which are insufficient for their needs, in order to avoid having to secure loans from multiple sources. This is the case even when the interest rates are low.

Flexible repayments. Farmers prefer flexible repayment options, which allow them to make repayments according to their harvest cycles and cash flow.

Credit availability during critical periods. Farmers are more attracted to loans when credit appraisal is rapid, and when loans are available during key periods during which farmers need to purchase inputs.

Respectful treatment. The study findings suggest that poor or disrespectful treatment by formal and informal credit providers inform farmers’ assessments of the credit product.

Importantly, the findings suggest that the conditions described above, such as access to inputs or access to loans at appropriate times, are widely considered more important than interest rates.

Credit barriers

Participants identified two types of credit barrier during the study; some conditions contribute to farmers’ inability to access credit, while others contribute to their reluctance to access credit.

Examining first the factors associated with an inability to access credit, the findings suggest that certain demographic groups are less able to access formal credit, particularly women and youth. The farmers are unable to access loans when they cannot meet requirements of service providers, and may be constrained by a range of characteristics:

- **Social networks are needed to access both formal and informal loans.** For formal loans, a guarantor is needed. For informal loans, effective networking is critical to establish relationships with money lenders.

- **Collateral is needed to secure a loan.** For young, female or impoverished farmers, it may be impossible to provide sufficient collateral to secure a loan from a formal source such as an MFI. Collateral size and loan size are also reported to often be out of proportion.

- **Some MFI loans are provided to groups rather than to individuals.** Group membership is therefore a prerequisite of accessing such a loan. The study findings suggest that young people are less able to join groups and apply for group loans, and some farmers want smaller groups or more individual loan options.

- **Farmers are unable to secure loans if another member of the household already has a loan.** In cases where households share financial decision-making this may be less relevant, but the findings suggest that some women may be unable to access credit for themselves or make decisions about loans secured by their households, due to a lack of permission from their husband.

Then there are factors associated with a reluctance to access formal credit. Participants noted that risk averse farmers are unwilling to risk over-indebtedness, reputational harm and loss of collateral (both those of the recipient household and the guarantor household), which could occur if loans are not repaid on time. Some farmers are also afraid of ‘institutional’ financial
services if they do not understand the terms and conditions, and fear exploitation. Rather, the farmers might be more familiar with informal money lender modalities, even though terms are generally less favorable.

**Comparing formal and informal loans**

As highlighted above, farmers can be reluctant to access formal credit. Therefore, farmers may prefer to take an informal loan. Among farmers participating in the case study, many chose to take an informal loan from traders to cover their production costs. These farmers do not pay interest on this loan but instead, after the sale of crops, they repay the loan amount and share the profits equally with the trader. In contrast, the formal MFI agri-loan comes with an interest rate and a service fee, but all profits are retained by the farmer. A further comparison between the features of MFI and trader loans from the farmers’ perspective is presented in Table 4.

**Table 4. Comparison of loan features between an MFI loan and a trader loan from farmers’ perspective.**

<table>
<thead>
<tr>
<th>MFI AGRI-LOAN</th>
<th>INFORMAL TRADER LOAN</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Attractive features</strong></td>
<td><strong>Attractive features</strong></td>
</tr>
<tr>
<td>A low interest rate (annually 18-24%) and a high profit margin for the farmer</td>
<td>Cash is accessible in adequate amounts</td>
</tr>
<tr>
<td>Freedom to run your farm as you wish</td>
<td>No collateral requirement</td>
</tr>
<tr>
<td></td>
<td>No monthly payments, flexible conditions</td>
</tr>
<tr>
<td></td>
<td>Loan is rescheduled in case of default</td>
</tr>
<tr>
<td><strong>Unattractive features</strong></td>
<td><strong>Unattractive features</strong></td>
</tr>
<tr>
<td>Inadequate loan size</td>
<td>High costs (50% profit sharing) and low profit margin for the farmer</td>
</tr>
<tr>
<td>High collateral requirement</td>
<td>Lack of freedom to run your farm as you wish</td>
</tr>
<tr>
<td>Fixed repayment period, no flexible conditions</td>
<td>Trust issues between farmer and trader around the selling price received by the trader</td>
</tr>
</tbody>
</table>

As the overview shows, there are advantages and disadvantages to both loan types from a farmer’s perspective. The case study identified a range of reasons that inform a farmer’s decision, including inadequate loan sizes, collateral requirements and repayment options. For those farmers unable or unwilling to secure an MFI loan, an informal loan can provide a viable alternative. Another possibility can be to shift to a low value crop that requires less investment (and thus a lower need for credit). In this case study we found evidence that some farmers indeed followed this strategy. From an MFI perspective however, given the objective of developing appropriate products for poor clients, these results further indicate that rural farmers need an appropriate loan size, flexible collateral requirements, flexible repayment periods and a grace period on the repayment in case of a default.
DISCUSSION AND CONCLUSION

The STARS program, through the vegetable and malt barley loans, has outreach with all three main smallholder segments (non-commercial subsistence farmers, commercial farmers in loose value chains, and commercial farmers in tight value chains) identified by Christen & Anderson (2013). These segments most likely form a gradually changing continuum, rather than consisting of strictly separate and static groups. As demonstrated by Collins et al. (2009), rural households have many different expenses. Some expenses are small and to some extent unpredictable (like buying daily household items on credit when money runs out), some are large and unpredictable (like costs of burials), while others are large and predictable (like investing in the next agricultural season). Therefore farmers need a choice of financial products to manage these different expenses. No single product will cover all needs and farmers in Ethiopia use multiple sources of credit, including MFIs, SACCOs, ROSCAs, informal money lenders, and family and friends. All of these sources potentially satisfy some of the households’ financing needs.

The agri-loans developed by Busa Gonofa, Metemamen and Harbu, with the support of the STARS program, specifically address the need for agricultural solutions. Many farmers in our study were looking for (timely) access to good agricultural inputs and suitable financial products to manage their irregular cash flows. From the client perspective, a suitable financial product is one that is affordable, convenient, flexible and reliable (Collins et al., 2009). In designing loan products, the MFIs participating in this study consider the economic profile of the target market, and adapt general parameters like product features, delivery methodology and collateral options to the needs of the targeted segment. However, client segmentation and customer centricity are limited to broader sectoral parameters. For instance, most of the loans are delivered through the group solidarity lending modality. Adapting financial products to more entrepreneurial and graduating farmer segments is still underdeveloped. In addition, the agricultural loan does not yet take into account the different profiles of smallholder farmers in terms of land size, crop type, market orientation, etc. Similarly collateral options, loan sizes and repayment terms are not yet tailored to individual farmer characteristics, which is echoed by the smallholders in our study. Furthermore, this study found that loans combined with agri-inputs are highly appreciated, as are the lower interest rates compared with interest rates associated with informal loans.

Thus, market assessments are crucial to understand the complex landscape of financial service providers, different financial products and the various needs of (the different segments of) smallholder farmers. Based on these assessments, products can be designed that serve the needs of (a certain segment of) smallholder farmers. Farmers in this study highlighted particularly attractive characteristics of credit packages; specifically when they experience respectful treatment from lenders and credit provided in combination with training or farm inputs. Furthermore, it is essential that credit is sufficient to meet farmers’ investment needs, has flexible repayment options aligned with the agricultural calendar, and is timely in providing disbursements and any associated trainings and inputs. Overall, these characteristics are considered more important than the interest rate.
Developing products based on client needs can lead to an increased uptake as well as enhancing client satisfaction. At the same time, it is also important to consider the perspective of the MFI in order to develop sustainable financial services. Therefore, the client-centric approach needs to be balanced with a strategy to sustainably manage the MFI’s loan portfolio. For example:

- An MFI that is too heavily invested in a rural, agricultural portfolio runs the risk of large-scale defaulting in case of major environmental shocks like droughts or floods. This happened for example to the microfinance pioneer Grameen bank after flooding devastated crops, plunging them into a crisis (Collins et al., 2009).

- An MFI can decide to bundle access to finance with the provision of seeds or agro-chemicals, as this is highly appreciated by farmers. However, if the MFI inadvertently provides seeds of poor quality due to a lack of agronomic expertise, or delivers agro-chemicals too late due to problems with imports, the MFI may be held responsible and the ensuing poor yields may cause risks for the loan portfolio as a whole.

It is therefore important to consider the risks that the MFIs face in this client-centric approach. Currently, the participating MFIs have no strong, proactive risk mitigation strategies in place. More than 60% of their portfolios are concentrated on agriculture. One strategy that is applied is area selection for opening new branches; nevertheless most MFI clients are affected by one or more climatic shocks like floods, drought and frost, which can result in the risk of widespread defaults. As a result, the portfolio at risk (PAR30) can be above a sustainable level. In turn, this can lead MFI loan officers to practice aggressive default management; including demanding that joint liability group members repay the loan, taking compulsory savings, forcing clients to pay from other income sources, and even court cases as a last resort. Few MFIs practise the rescheduling of loans, and the use of these aggressive practices appear misaligned with the client-centric approach.

In conclusion, it is important to balance the attractiveness of credit packages from the client’s perspective and the need for sustainability and risk mitigation from the MFIs perspective. Providing attractive credit packages which align with client needs must be balanced with appropriate policies and practices within the MFI. These are likely to reflect their risk appetite and the strength of existing risk management systems, the level of decentralization and delegation of authority around portfolio and loan risks, the MIS system to keep track of them, and the capacity of MFI staff to understand and adapt product features. Prior to bundling financial with agronomic services, MFIs should ensure that they have sufficient in-house expertise on agricultural practices, trends and markets, and distribute only high quality inputs in a timely fashion to avoid reputational harm.

In order to break the cycle of poverty and support the development of the rural sector, it is essential to facilitate access to suitable financial modalities for smallholder farmers; a client centred approach requires enhanced understanding of the customer base, financial packages tailored to their needs, and an organisational commitment to delivering customer-centred services to enhance both customer satisfaction and business performance.
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