



# Case Study:

# **AFR's Agricultural Credit Units Project**

The ACU project was designed to address existing market failures on the supply and demand sides of the agricultural finance market which have resulted in agricultural loans comprising only 6% of outstanding loans in Rwanda. At the time of project inception, existing agricultural credit products were weak and inappropriate to farmers' needs while financial service providers faced challenges with high non-performing loan rates of agricultural portfolios. To address these market failures in agricultural finance, the ACU project was designed with the purpose of increasing access to financial services for poor rural and urban people (especially women and youth) that engage in agricultural activities and micro, small, and medium agribusiness enterprises (MSMEs).



# Introduction



Access to Finance Rwanda (AFR) launched the two-year Agricultural Credit Units (ACU) project in collaboration with Unguka Bank (UB) and Umutanguha Finance Company (UFC) in 2017, to improve the quality and delivery of financial products and services to the agricultural sector.<sup>1</sup> The project enabled the two financial institutions (FIs) to efficiently provide credit to agricultural clients and thus expand and sustainably diversify their agricultural portfolios, by supporting them to de-risk agricultural credit. Ultimately, the project was expected to improve the liquidity, productivity and output levels of agricultural value chains through increased investment and to encourage others to follow a similar model.<sup>2</sup> By the end of the project, AFR support had enabled both of the participating financial institutions to:

					
<b>Set up agricultural credit units within their organisations</b>	<b>Develop four agricultural credit products</b>	<b>Adopt new policies and procedures for agricultural lending</b>	<b>Significantly increase farmer access and use of good quality agricultural loans</b>	<b>Extend their outreach to rural areas</b>	<b>Reach over 34,000 cumulative borrowers, 51% of which were women</b>

The FIs performance since project end suggests that the improvements to agricultural lending practices will be sustained into the future. In addition to this, the project has provided several lessons for the industry on the design and implementation of initiatives to expand access to agricultural finance.

## Implementing Partners

AFR partnered with two local microfinance FIs and brought in a technical assistance provider to implement the project and to strengthen the capacity of the FIs to efficiently deliver relevant financial products and services for the agricultural sector.

	<b>UFC</b> is a microfinance institution established in 2003 and licensed as a limited finance company since 2013. At the start of the project, UFC had 10 branches, with eight in rural areas, in addition to outlets and agents or points of sale (POS), and it was looking to expand the branch network. UFC was already offering an agricultural loan.
	<b>UB</b> , founded in 2005, transitioned to a licensed microfinance bank in 2011. UB had 19 branches, 15 in rural areas in late 2017, and it was present in three provinces (north, west, south) and 14 districts.

Although both banks had existing agricultural loan products, their agricultural finance programmes faced several challenges. The ACU project addressed these challenges directly.

<sup>1</sup> Undertaken from 2017 through 2018, and costing USD 481,510.

<sup>2</sup> This briefing note is based on a final evaluation of AFR's Institutional Support for the Establishment of Agricultural Credit Units at UFC and UB project conducted by Nathan Associates London Ltd in late 2019.

## Project Activities

### Project activities:



Training



Grants for an increased outreach



Market research studies



Establishment of agricultural credit units

A capacity building component addressed inadequate agribusiness lending skills which hampered the existing agricultural lending businesses. Critically, the capacity building was delivered to two sets of staff: senior leadership and board members, and all field-based staff.

Starting with the senior level, training of the FI leaders focused on decision making and policies for effective agricultural lending. This was intended to instil a broader institutional understanding of the agricultural lending challenges, risks and opportunities; and to ensure collective ownership of the functions and outputs of the agriculture finance unit. Buy-in at this level was critical for establishing policies that can facilitate effective agricultural financial services.

Field-based staff including all loan officers, regional managers and the agricultural finance manager, who are responsible for the delivery and management of the agricultural financial services, were trained to understand the unique dynamics of the agribusiness value chains to strengthen agricultural credit portfolios. Staff were trained to appraise agricultural loan applications, to monitor and supervisor agricultural loan borrowers, to understand the risks of agricultural lending and to mitigate those risks through diversifying the loan portfolio. The capacity building also equipped staff with the necessary agricultural lending tools and methodologies.

Grants from AFR allowed the two FIs to enhance their relatively limited rural outreach. This was an important element of the design which allowed the institutions to better serve farmer clients. The institutions purchased motorcycles that improved staffs' abilities to raise farmers' awareness of new agricultural products and to more closely serve and monitor rural borrowers.<sup>3</sup>

Market research studies were conducted to address the lack of understanding of agricultural value chain actor's needs and to remedy the existing weak agricultural products, which were unsuitable for those needs. With guidance from Friends Consult, the institutions collected information from value chain actors in selected commodities, including farmers, on their financing needs and preferences.<sup>4</sup> This allowed the institutions to both acquire new market research skills and to develop four new agricultural products. The market research informed the design of loans for production, for asset or equipment purchases, for input supply purchases and post-harvest uses. The new products positioned the institutions to diversify their agricultural portfolios to better mitigate risk.

Additionally, the ACU project supported the establishment of Agricultural Credit Units within each institution. The staff of these units, which included an Agricultural Credit Manager and two others, led the agricultural lending activities and oversaw the adoption of new agricultural lending policies introduced by the project.

<sup>3</sup> Grant Agreement - UB (2016) AFR; Grant Agreement - UFC (2017) AFR.

<sup>4</sup> Market Research Report - UB (August 2017) Friends Consult; Market Research Report - UFC (July 2017) Friends Consult.

## Project Results

The financial institutions reported that they had experienced the positive impacts that the project intended. As one stakeholder put it:



*"First we improved our products. We improved our service to farmers. We increased our portfolio and the number of our clients significantly, ... and we increased our profits. It also increased the skills and knowledge of our staff."*

The project resulted in both institutions growing the client bases for agricultural loan products and significantly expanding the loan portfolios devoted to agriculture (see the table below). The impact of the project on the quality of agricultural portfolios was mixed.

### Financial Institution Performance against Target, 2017-2018

	UB <sup>5</sup>			UFC		
	Target	2017	2018	Target	2017	2018
<b>Institutional</b>						
Number of trainings	2	2		2	2	
Number of employees trained	25	53	-	30	40	-
Number of agricultural products revised/developed/promoted	3	4	-	3	-	4
<b>Agricultural Portfolio</b>						
Value of agricultural loans disbursed (USD) in the year	NA	1,656,018	2,766,787	NA	1,821,115	3,056,831
Growth in agricultural loan portfolio (since beginning) (%)	20%	71%	181%	27%	129%	295%
% of Loan Portfolio in Agriculture Loans	NA	7.4%	13.8%	NA	28.6%	37.9%
Agriculture portfolio at risk (PAR>30 days)	<5%	7.2%	5.1%	<5%	1.8%	4.9%
Number of people accessing and using agricultural finance products (cumulative)	15,000	3,452	15,026	10,000	7,923	19,100
Number of women accessing and using agricultural finance products (cumulative)	9,000	1,775	7,024	6,000	4,072	11,142
Women as percent of total clients	60%	51%	47%	50%	51%	58%

<sup>5</sup> UB's overall performance during the project period was challenged by internal and external factors including institutional restructuring and the loss of branch staff who had been trained under this program and the resignation of the ACU Manager resulting in a loss of skills which the bank believes negatively affected the quality and growth of the agricultural portfolio implementation for a short time. While all of these factors slowed progress in the second half of the project period, the institution-wide capacity building provided enabled the bank to maintain the agricultural finance offerings even after these staff losses.



Calculated from data provided in the quarterly performance spreadsheets. The project at UB started in the second quarter of 2017. Therefore, the data for the year 2017 for UB only contains three quarters of data. In comparison, UFC started the beginning of 2017 so the annual data for 2017 contains four quarters of data. All data presented for both institutions is for the calendar years 2017 or 2018.

There were other positive impacts on the financial institutions. Increased loan portfolios improved the ability of loan officers to earn performance-based income incentives. The increased confidence of FI staff in their agricultural lending abilities, enabled the FIs to consider expanding lending to new value chains.

The results of the ACU project have persisted since the project ended in late 2018. Both institutions have committed to agricultural finance, maintained the ACUs and are continuing to offer new agricultural products. At UFC the agricultural loan portfolio outstanding and the number of new borrowers continue to grow while at UB, the agricultural loan portfolio one year later is still twice as high as it was a project start.

UB credits the ACU project with enabling them to “professionalise” their agricultural finance offerings, while both FIs are now able to innovate and expand lending to new agricultural value chains. UFC, for example, worked in Irish potatoes, maize and vegetables during the project and is now in the process of expanding to the rice value chain.



# ACU Project Results for Women, Youth and People Living with Disabilities

The ACU project aimed to increase access to agricultural credit for women, youth and people living with disabilities with the specific objective that 60% of all agricultural loan borrowers were to be women. No specific targets were set for youth or people living with disabilities.

## Outreach to Women and Youth

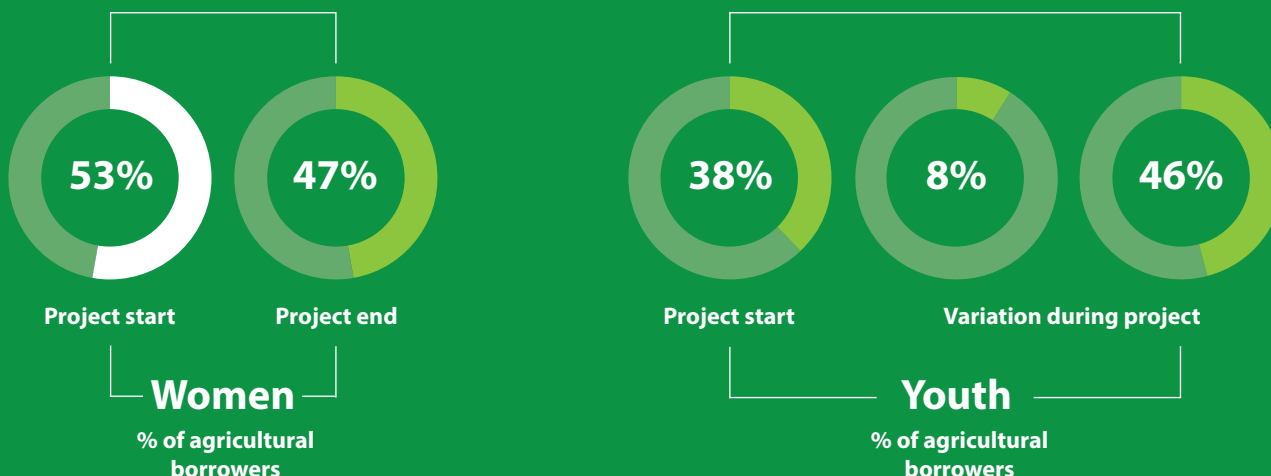
The two FIs had mixed results with increasing access to finance for women and youth. No data was available on outreach to clients with disabilities.

**Perceptions of Women and Youth Clients:** Farmers reported that women and men enjoy equal rights and treatment at both FIs and there is no special gender-based treatment. Yet the outcomes for each group are not equal. At both FIs, women and youth are more likely to use loans to hire farm land as they lack access to land.

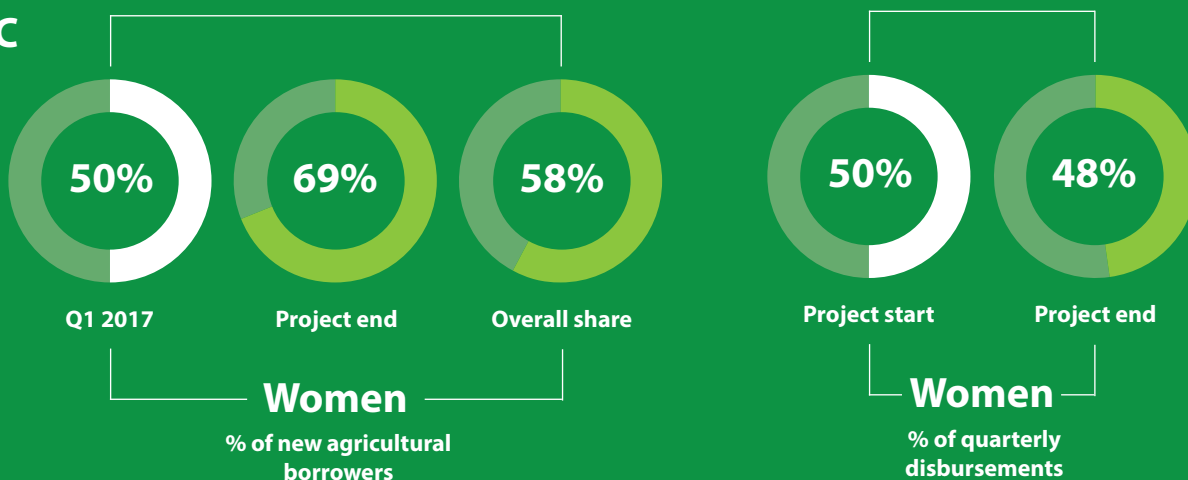
The FIs have tried to address some of the barriers that women and youth face in accessing loans. They allow these clients to form solidarity groups which lowers the need for traditional collateral. Youth are also supported by UB by the acceptance of collateral from their parents.

Discussions with women and youth reveal that under this project they are having more difficulty in accessing loans because the institutions have tightened the criteria for solidarity groups from five members to 10. This change was one of the new lending policies adopted to reduce the risks of agricultural lending. Farmers report this is a serious barrier as it is hard find 10 people they trust. Additionally, youth reported that loan processing time was longer due to new requirements. Some of the experienced women borrowers at UB reported being demotivated by the change and were unsure whether they would continue borrowing.



**UB**

Although the share of women accessing loans was not far from the target, the amounts women access are on average significantly smaller than amounts men access. The share of the total amount disbursed that was borrowed by women was 36% at the end of Q1, 2018 (the first quarter for which data is available) and it was 32% by the end of that year.

**UFC**

## Outreach to People living with Disabilities

In addition to a lack of targets, the FIs had difficulties with the mandate to prioritize people living with disabilities. A critical challenge was that the stigma attached to disability which makes the institutions reluctant to try to identify those with disabilities. It is recommended that in the future, the financial institutions partner with organizations that already work with this sub-group.

## Lessons Learned

Neither FI developed effective strategies for enhancing outreach to women, youth or people living with disabilities. This is an area where more work needs to be done in the future. Recommendations for improving outreach in the future are:

- 1** The FIs should partner with organisations that already work with these vulnerable groups.
- 2** AFR could provide challenge grants to allow FSPs to pilot solutions for sustainably increasing access to agricultural finance for women, youth and people living with disabilities. Innovations around collateral alternatives for women and youth would be particularly helpful in expanding outreach of agricultural finance for these groups.

## Results and Benefits Experienced by Farmers

The project resulted in a significant expansion of credit to farmers across both institutions. Before the inception of the ACU project<sup>6</sup>, a total of Rwf 1.392 billion was in agricultural portfolios across both institutions. By the end of 2018, this total had risen to Rwf 4.572 billion. A total of 34,126 cumulative borrowers were reached with loans during the two years.

A mix of farmers<sup>7</sup> from Gahunga and Byangabo (Musanze District) in the northern province and Mahoko and Kora in the Western province were asked about their experience with the new agricultural loan services. Key findings are summarised below:



Most farmers earn their primary income from agriculture while a few raise livestock or engage in commercial activities, too. The primary crop across all farmers was potatoes with some farmers engaging in horticultural production.



Many of the farmers interviewed had borrowed from the two institutions before the start of this project. Farmers selected these institutions for their good service, reasonable costs and quick processing times. The majority were referred by friends, relatives or neighbours. Only a few farmers learned of the agricultural loans available through project-supported promotional activities.



The experienced farmers observed that the banks' services had improved since the project began. The loan processing time had lessened noticeably.<sup>8</sup>



Many new and existing farmers perceived the loan process time to be faster compared to other regional FIs/banks. In Musanze, both UB and UFC process agricultural loans less than one week while at the other branches, loan processing takes between two and three weeks.



Despite this, farmers report that it takes considerable time to travel to the banks and to wait in queue for their turn, they recommend the banks to open other branches or send agents to some remote areas to serve clients effectively.



Generally, farmers were satisfied with the loans provided in terms of the amount, the cost and the potential uses of the loan. Farmers perceived the cost of the loans to be low.



There was a range of opinions about the collateral requirements with male farmers finding them reasonable while women found the requirement to be high relative to the loan amount and they perceived this as a barrier to borrowing.

<sup>6</sup> Data is for June 30, 2016.

<sup>7</sup> Fifty-four farmers from UB and UFC were interviewed through focus group discussions, with equal shares of men and women participating. The sample was also split between younger (Youth under 30 years of age) and older farmers.

<sup>8</sup> For example, the length of time that a farmer needed to be a client of the bank before they could borrow was shortened at UFC. The processing time for subsequent loan applications was expedited for farmers who had repaid their previous loan on time.



## Use and impact of agricultural loans



*"The loan has enabled me to produce much than before: before I produced only one ton of potato, but today I can produce 1.5 tons per season."*

43-year-old male farmer.



*"We used to produce potato, but there was no much profit. When we joined Unguka Bank we started garlic production which earns more profit and we can pay the loan on time and improve our economic livelihood."*

46-year-old female farmer.

The main objective of the ACU project was to improve the liquidity, productivity and output levels of agricultural value chains by supporting farmers to invest in inputs, hired labour, mechanisation, and value addition facilities. Actual usage and impact are illustrated below :

### Use

- To continue, extend or diversify agricultural production
- To purchase inputs such as seeds and fertilizer, to buy or rent land, and to hire labour
- To purchase post-harvest equipment
- To diversify production by getting into higher-value crops (particularly for women)
- Among younger farmers, a few used loans to start agricultural production

### Impact

- Most farmers reported positive effects from the use of the loans including increased production, ability to access more remunerative markets and improved production quality
- Farmer clients of UFC in the northern province reported mixed results due to problems with the potato crop.
- The increased income enabled them to improve well-being and to meet the basic needs of their families (including healthcare, school fees, food and mobile phones)
- Younger farmers, in particular, reported they are now highly considered in their respective communities and their voices are heard

Farmers revealed that they appreciated the new agricultural loans conditions, appraisal processes and time efficiency of loan provision which have improved considerably. Most clients report that they intend to stay with their FI and continue to use the same loan services. Some report that they have referred their friends and neighbours to their FI. A small share of farmers reported that they will stay only if their bank extends the loan payment period as the term is too short for the crop's season.

At UFC's Gahunga branch, clients were less likely to stay with the FI. This branch has specific issues including the high default risk due to risks associated with climate change. Female clients are more willing than male clients to borrow again from this branch but they are uncertain about their farming prospects given climate change.

At UB, most clients intend to borrow from the FI again. However, male clients seem more enthusiastic about the bank than female clients. They report appreciating UB's quick service and helpful staff. More experienced female clients are unhappy and feel demotivated that UB changed the requirement for solidarity group membership from 5 to 10 people.

## Factors that supported project success and sustainability

The ACU project has demonstrated that FIs in Rwanda can sustainably offer agricultural finance to smallholder farmers. The mix of financial and technical support as well as the activities included in the ACU package - market research, evidence-based product development, capacity building and financial support for start-up costs - has been shown to allow FIs to overcome the barriers to successfully provide agricultural finance. Additionally, AFR has shown that getting buy-in at the highest level of the institution is essential for FIs to effectively pursue agricultural finance. The project has demonstrated that farmers will take up agricultural loans, in increasing numbers, if the loans are tailored to farmers' needs.

### Factors supporting project success and sustainability



The willingness of FIs to make co-investments and to devote time and energy to the project. Growing competition in the financial services sector motivated them to offer effective agricultural finance would afford them a competitive advantage in rural areas.



The introduction of new agricultural credit policies and procedures which emphasized flexibility and more supportive loan conditions, such as appropriate loan terms and grace periods, improved the FI's service. New policies supported more responsive loan services, for example, faster application processing and loan disbursements to meet the time-sensitive needs of agriculture. One institution started to accept crop contracts instead of traditional collateral. Buy-in at the board and senior management levels were considered critical to the implementation of these new policies.



Budget support for staff salaries and motorcycle purchases at the FIs. Although the provision of operational support for FIs can be controversial, the investment provided was considered critical to unlocking the potential of the FIs to successfully expand into a new business area. The initial operational support has shown to be a catalysing investment for launching sustainable agricultural finance – an area that is new and risky for FIs.

### Factors working against project success and sustainability



High non-performing loan rates due to market and weather risks, as well as portfolios heavily concentrated in particular commodities, can constrain profitability.



Limited resources for further investment in technical assistance or assets constrain the FIs from significantly expanding operations on their own.



The high cost of capital and the relatively high costs of serving farmers are also limiting factors.



## Lessons Learned

- The ACU project has demonstrated that agricultural finance can be profitable if the financial service providers have the knowledge and skills to work with farmers. This requires a broader set of skills than those needed to serve other clients.
- FIs report that providing agricultural finance requires continuous innovation. Not only do loans need to be tailored to particular crops, but the loans for particular crops often need to be tailored to the specific region. With climate change, they anticipate that loans will continuously need to be refined.
- More importantly, FIs have learned that if they go into agricultural finance, they need to be prepared to meet the demand which means being prepared to manage liquidity requirements. In rural branches, banks have a high level of deposits at harvest time and face a high demand for loans just before planting time. This creates challenging liquidity management issues which have caused at least one institution to borrow loan capital at a relatively high cost, to manage their cash availability. AFR could explore and support liquidity management solutions related to agricultural lending.
- All project partners have recognized the need for better mechanisms for managing agricultural lending risks, particularly those due to climate change. Agriculture insurance is one solution that is being considered.
- Another solution which can help farmers manage risk is for the financial institutions to be more flexible with farmers in the case of a bad season, allowing them to refinance and then repay all their loans when the harvest improves.

## Recommendations

for taking a market systems development approach to supporting agricultural finance

Recently, AFR adopted the market systems development approach to financial services but it came too late to integrate into this project. In the future, strategies for supporting market systems change should be integrated in projects at the beginning. To support market development, AFR could:







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