Palladium
MAKE IT POSSIBLE

UKaid
from the British people

Improving Market Systems for Agriculture in Rwanda

IMSAR LEARNING SERIES

IMPROVING ACCESS TO FINANCE THROUGH PRODUCT INNOVATION AND THE VALUE CHAIN FINANCE APPROACH

Learning and insights from Equity Bank Rwanda

THE CONSTRAINTS

Lending to agriculture is considered as risky and costly. Banks shy away from the high transaction costs and risks related to agriculture such as crop failure, diseases, market price fluctuations and high fragmentation of smallholder farmers and agribusinesses. Such costs and risks lead to high interest rates, which can reach up to 24%, as well as significant collateral requirements, which are often difficult to meet by farmers and agribusinesses. Information which can help mitigate such risks is in short supply.

Furthermore, commercial banks consider agriculture mainly as encompassing crop and livestock production and often overlooks many of the key market actors as off takers and processors and those providing auxiliary services.

The lack of relevant, well-designed, and accessible agricultural finance products for farmers and agribusinesses ultimately leads to agriculture being largely underfinanced. Indeed, while agriculture contributes 28% to the national GDP, employs 66% of the workforce, and generates more than half of the country's export revenues, it amounts to less than 6% of total commercial lending.

In order to develop new lending approaches for the agriculture sector, IMSAR partnered with Equity Bank Rwanda (EBR), a lead commercial bank in Rwanda. EBR started its operations in Rwanda in 2011 and was financing agriculture using a conventional lending approach. At the start of the intervention (2018) the agriculture loan portfolio represented only 4.2% of the bank's RWF 144 billion (£107,629,520) Loan portfolio.

THE SOLUTION

An assessment of the rice, maize, Irish potato, tea, coffee, dairy, poultry and horticulture value chains showed that the key needs across these value chain actors were around access to working capital, capital for acquisition of assets and trade finance. With IMSAR support, EBR therefore developed four categories of products to address those needs:

- **Commercial Agriculture working capital loans** (Zamuka Muhinzi), short term and seasonal (up to 36 months period) for both farmers and agribusinesses to meet their working capital needs using a combination of conventional collateral and asset-based securities.
- **Commercial Agriculture Investment loans** (Igire Muhinzi) targeting farmers/cooperatives and agribusinesses long term investment for Fixed Assets and Movable Assets. The loan term goes to maximum of 60 months for movable assets and 120 months for immovable assets; assets financed are considered as collateral.
- **Agriculture Funded Trade Finance Facilities** that includes invoice discounting, contract financing and purchase order financing for agribusinesses short term financing needs of up to 6 months and 70% of the face value of the financed instrument;
- **Non-funded Trade Finance products** for SMEs, including bid bond securities, performance bonds and advanced payment guarantees.

In addition, IMSAR assisted EBR to adopt the value chain financing approach vs the sole use of traditional lending. In the context of weak value chains, where several functions are performing below capacity, chances are higher that a single borrower cannot meet a bank's requirements to access a loan; the risk of default is equally higher, as the performance of the borrower may be affected by the underperformance of other actors in the value chain. Under these circumstances, the value chain finance approach serves both as proactive strategy to originate a loan portfolio and one to mitigate risks, while increasing the ability of a financial institution to understand the environment potential borrowers operate in and provide tailored solutions that meet their specific needs.

In contrast to conventional lending that targets and assesses individual borrowers' repayment capacity and value of security/collateral, the agriculture value chain financing approach is characterised by a comprehensive risk assessment and understanding of the entire chain, to which an "anchor" actor is often identified and leveraged. The approach brings together individual producers, input suppliers, aggregators and processors, harnessing their collective capacity and relationships to greatly diversify and transfer credit risks.

The commercial agriculture working capital, investment loans (Zamuka Muhinzi and Igire Muhinzi) and traded finance facility target both individual borrowers as well as, using the value chain finance approach, multiple value chain actors under a **Value Chain Facility:**

- The value chain facility targets multiple (at least three) value chain actors in a given agriculture sector for the purpose of developing a financing partnership beneficial to all the parties. The actors will include the Anchor actor and 3 – 4, or more, other chain actors with profitable commercial relationships with one another.
- The Anchor Actor will be the lead partner and must have been in a commercial relationship with the other chain actors for the past two seasons. To mitigate attendant credit and market risks, the bank will aim to partner with the Anchor Actor to mobilise the upstream chain actors. The Anchor actor aggregates financing needs among the other value chain actors and is the lead guarantor of the financing facility. However, the other enjoined chain actors must co-guarantee the loan facility.

THE RESULTS

- **The training and coaching provided to EBR staff was effective, improving the bank's capacity to serve the needs of agriculture.** EBR has hired the 4 market research assistants subsided by IMSAR since February 2021 as agriculture loan officers. Even prior to the launch of the new products, the training and coaching provided to the officers allowed them to better serve the needs of the agriculture sector. Over RWF2,107,545,700 (or £1,621,189) were loaned to 58 clients (11 female-led for £621,052) in the pilot branches of Musanze, Rusizi, Rwamagana and Huye. This included 19 farmers and two cooperatives with over 6,500 members;

- **Despite the significant challenges brought about by the pandemic, the size of the Agri lending portfolio increased by 17%**, reaching RWF 3,411,500,000 (£ 2,549,848). Equity Bank Rwanda however is committed to increase their agrilending portfolio further and aim to have 30% of their total lending portfolio targeting agriculture by 2026.

- **The new products reached farmers and agribusinesses effectively:**

  - **over 18,000 smallholder farmers, largely through 6 cooperatives.** These loans amount to RWF 486,874,100 (£ 347,280) and mainly targeted the rice (40%), maize (31%) and coffee (23%) sectors;

  - **16 agribusinesses**; the loans amount to RWF 3,411,500,000 (£ 2,433,634), across the coffee (72%), horticulture (13%), rice (9%), tea (4%) and maize (3%) sectors.

- **The performance of the new loan products is high, evidence of sustainability and that lending to agriculture is profitable.** As of February 2022, the agri portfolio computed only 1.57% of non-performing loans (NPL) that have reached 90 days of arrears – well below the 5% National Bank of Rwanda requirement.

- **Agribusinesses which accessed the loans expanded their operations and increased sales.** Access to working capital loans allowed agribusinesses to either source and process more produce or serve more customers by expanding their operations. As a result, sales have increased e.g. a coffee exporter used the working capital loan to increase the volume of coffee sourced from three cooperatives, to be processed and exported to India. Reportedly, sales have increased from RWF 400,000,000 (£298,970) to RWF1,000,000 (£ 747,427). A processor (banana), who accessed a combination of working capital and investment loans has increased its processing capacity and is now looking at export opportunities. More than half of agribusinesses have already received additional loans upon repayment, of a higher value.

- **Most cooperatives are using the working capital to purchase inputs to be distributed on credit to members, increasing farmers' productivity.** Timely and adequate access to inputs (in the case of maize and rice, seeds, fertilisers, and crop protection) have led to increased yields and therefore incomes; for instance, rice yield increased by 128%.

KEY LEARNING

- **Financial institutions tend to seek and prefer aid support in the form of guarantee funds vs technical assistance.** Product types, loan amounts, disbursement and repayment policies offered by finance financial instutions are misaligned with the needs of agri-clients. Finance providers have been reluctant and slow to invest in developing capabilties, systems, procedures and service offerings to better respond to the financing needs of agri-clients, largely due to the fact that other sectors of the economy provide easier and more profitable opportunities. While guarantee funds are an effective modality to de risk investment and incentivise financial institutions to lend to agriculture, this modality alone is often insufficient, and technical assistance is necessary to develop and establish financial products that meet the needs of agribusinesses and farmers at scale.

- **The shift required to move to value chain financing is significant; it requires resources, time and expertise.** Although the pandemic has inevitably delayed implementation, this intervention took almost 28 months from design to launch, and the support of a team of four specialists. These processes cannot be rushed, especially during the first steps, when financial institutions need to first understand the approach. The sole development of new financial products, and related systems, targeting agriculture is resource intensive, and requires building a strong understanding and knowledge of the sector and actors.

- **This type of intervention requires buy-in from top management from the onset, and engagement necessary along the process.** While EBR top management was extremely committed from the start to the development of an agricultural strategy and portfolio, it is important that the top management remain closely involved in the process in order to provide feedback and strategic direction timely, whilst ensuring that the lower management is actively engaged in the research and analysis, as well as in the capacity building activities. Ensuring that adequate staffing is in place at the start and sufficiently retained is key to maximise the benefit of the training and coaching provided by the specialists and therefore the intended outcomes.

- **The working capital loan is, so far, the most popular product from coops and agribusinesses alike.** Working capital loans are currently ~70% of total agriculture loans disbursed by EBR. This is not surprising – agribusinesses and farmers need access to capital at the beginning of the season to be able to invest in sufficient inputs to generate revenue. Nevertheless, as access to working capital increases, increasing investment in the sector and improving turnover, agribusinesses will be in a position to expand their operation and modernise. Therefore, the ability to access investment loans to purchase assets is critical.

- **Trade finance loans show good promise.** While working capital is the loan type in highest demand, EBR is also lending to SMEs who are backed by a reputable anchor actor, using invoice discounting loans. These are largely cereal aggregators selling to large processors.

- **EBR is already expanding their offer.** A micro loan product has been developed for Dairy farmers who need working capital to produce and supply to large milk processors. This micro loan product derives from the main "Zamuka muhinzi" product, where milk farmers with a 6-month track record with the cooperative are able to get up to RWF 1 million (£750) unsecured short-term loan. Similarly, EBR has hired an expert from Kenya to support the promotion and adoption of the trade finance products.

funded by: UKaid from the British people

implemented by: Palladium MAKE IT POSSIBLE

in partnership with: swisscontact

www.thepalladiumgroup.com

follow us on in