LIFT
LAND INVESTMENT FOR TRANSFORMATION PROGRAMME

CASE STUDY
SEPTEMBER 2019

Affecting change through an innovative financial product

1. Context

The UK Aid-funded Land Investment for Transformation (LIFT) programme works with the Government of Ethiopia (GoE) to deliver second level land certification (SLLC) to smallholder farmers and to create a national database to manage and update SLLC data and land-related transactions, the Rural Land Administration System (RLAS). The introduction of SLLC and RLAS is expected to improve both the administration and management of land in Ethiopia.

A better functioning land system creates multiple opportunities for improving the livelihoods of rural dwellers. LIFT works to leverage these opportunities, applying market systems thinking to three intervention areas: access to finance, land rental, and environment and conservation agriculture. Specific to access to finance, LIFT is using the SLLC to address a key barrier to lending regarding smallholder farmers, providing an opportunity for them to use their 'land use right' as collateral to access individual loans as opposed to group lending.

Ethiopian smallholder farmers – much like smallholder farmers worldwide – are underbanked. The majority of farmers have little to no access to formal financial services. Encouragingly, group lending schemes have been successfully rolled out by both state-backed and private microfinance institutions (MFIs). But there are a number of factors still holding back agricultural lending in Ethiopia: MFIs limit their exposure to credit risk by capping loan amounts at ETB 50,000 (around GBP 1,400), although until very recently they were capped at ETB 15,000 (around GBP 420), and granting maximum amounts only to long-term clients. Group lending shifts risk management from MFIs to borrowers and group members are therefore extremely conservative in who they accept, to minimise the risk of default. Many farmers, especially vulnerable groups such as single or widowed women, people with disabilities and elders get excluded from group lending due to the perception they are high risk. Finally, most farmers have no collateral to offer for loans, as they have few tangible assets and do not own their land.

All of these factors limit the possibilities for farmers to escape endemic poverty. Most struggle to access sufficient credit to invest in productive activities, which in turn means they are reduced to selling their assets to cover cyclical expenses, rendering them vulnerable to shocks such as crop failure, or the death of a family member or of oxen. MFIs are aware of these challenges and many have struggled for years to develop viable alternatives to group lending.

LIFT has worked with GoE stakeholders and partner MFIs to develop an agricultural loan product specifically tailored to farmers with SLLC, to allow them to access

Loan cycle meets growing financial needs of farmers

SLLC-linked loan introduced by LIFT: Farmers can use their land use right as a guarantee to apply for larger, individual loans with MFIs.

MFIs create awareness about the credit product and its benefits.

LIFT partner MFIs: ACSI, Aggar, HARBU MFI, OCSSCO, OMFI, PEACE and Wasasa.

MFIs offer an individual loan product for farmers

Using SLLC, farmers apply for loan at MFI

MFIs liaise with land administration office to ensure that SLLC is registered and only pledged once.

MFIs issue 1–5 year loans of up to ETB 100,000 (15-18% interest)

Higher loan amounts but at rates comparable to group lending. All include savings accounts, most include life insurance.

Farmers diversify and engage in more productive agricultural activities

The higher, individual loan enables investment in improved agricultural inputs and equipment, additional labour, livestock fattening and other agricultural activities.

Higher productivity leads to higher incomes, allowing farmers to repay their loans

Low default rates and high repeat loans allow for a sustainable loan portfolio.

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Figure 1. Second level land certification (SLLC) product cycle

larger loans on an individual basis. The land tenure regime in Ethiopia specifies that land is owned by the state. This means that land cannot be used as collateral for a loan, as it is not owned by the farmers. However, farmers do have the right to use the land. Through this land use right, LIFT and its partner MFIs introduced an innovation which specifies that the produce of the land and/or the land use right itself can be used as a guarantee to secure a loan. The current land proclamations, regulations and directives, except for the Amhara proclmation which allows for the land use right or SLLC to be used as a form of collateral, are currently in the drafting stages at the federal and regional levels. As such, the pilot was rolled out with the support from the land administration and use offices at both federal and regional levels.

Initially, the individual SLLC-linked loan product was piloted in Amhara region by the Amhara Credit and Saving Institution (ACSI) and in Oromia region by Wasasa MFI. The approach was tested with a limited group of beneficiaries, carefully reviewed and refined in close cooperation with the management of ACSI and Wasasa. LIFT assisted the land bureau, ACSI and Wasasa in signing a memorandum of understanding (MoU) to pilot the product, in order to ensure governmental buy-in and ensure land offices would pledge the specific parcel for the loan, so that no other transaction could be initiated on it while it was being used as a loan guarantee. After a final review, LIFT supported ACSI and Wasasa in scaling up the product across Amhara and Oromia regions.

The SLLC product (Figure 1) is currently being rolled out in three regions: Amhara, Oromia and the Southern Nations, Nationalities, and People's Region (SNNPR) through seven MFI partners, namely ACSI, Oromia Credit and Savings Share Company (OCSSCO), Wasasa, Aggar, Omo Microfinance Institution (OMFI), Harbu, and Poverty Eradication and Community Empowerment (PEACE) MFI. As of August 2019, over 13,100 SLLC-linked loans totalling ETB 395 million (GBP 10.7 million) have been disbursed, with very positive feedback from clients and MFIs. On the demand side, strong signs of impact have been documented: farmers are experiencing gains in their

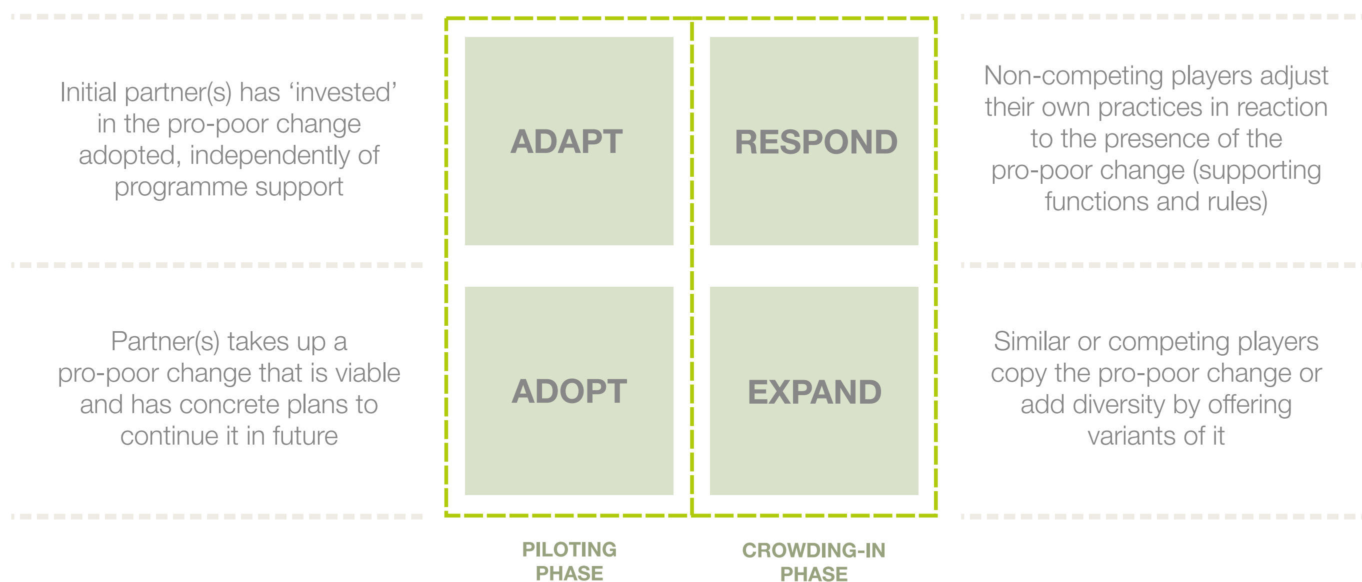

Figure 2. Adopt-Adapt-Expand-Response framework

Source: The Springfield Centre, Adopt-Adapt-Expand-Respond: a framework for managing and measuring systemic change processes, 2014

socio-economic status, with strong family participation in decision-making around loans. In addition, farmers are beginning to diversify their investment from crop production to other on- and off-farm activities.

In this case study, anecdotal experiences of different partner MFIs on how the piloting of this innovative product has led to changes and accrued benefits to the institutions and industry as a whole are detailed. As a backdrop to these changes, an overview of how LIFT has enabled these institutional and behavioural changes, through provision of technical assistance on different topics such as product development, cost–benefit analysis, savings mobilisation and default management, is presented.

2. Methodology

In order to capture these changes, a qualitative approach was taken. Key informant interviews (KIIs) were held with head office managers at ACSI, Wasasa and Aggar, covering the different ownership structures of MFIs currently in operation (i.e. government, NGO and private respectively). In addition, KIIs were held with the branch officer and loan officer of one branch of each of these institutions. Three branches in three different regions (i.e. Amhara, Oromia and SNNPR) were interviewed. The data from these interviews was cross-checked with findings from previous assessments.

These interviews were analysed using the Adopt-Adapt-Expand-Response framework (Figure 2): after successful piloting and *adoption* of the product, the focus of this case study is on the *adaptation* by MFIs of this product and the early signs of *expansion* and *response* by other market actors.

3. Changes at institutional level

The initial pilot started in early 2016 with ACSI in Amhara and Wasasa in Oromia. Following the successful rollout of the SLLC-linked loan by the additional five partner MFIs, the first signs of adaptation are apparent.

Firstly, as a result of their experience with this new individual loan product in rural areas, MFIs are looking at **product innovation** through a different lens: whereas previously many saw only urban areas as suitable for individual loan products, some are now discussing or piloting other individual loan products in innovative ways. One MFI is looking at linking an individual loan product with perennial crops, such as avocado, offering farmers a viable option into further income diversification. MFIs cite the importance of portfolio diversification as a motivation for this product innovation. These innovations illustrate how MFIs' perception of rural clientele is transforming towards a potential market for individual-based loans.

Secondly, **loan sizes have significantly increased** after the introduction of the SLLC-linked loan product. For example, for customers who have successfully repaid their first SLLC-linked loan, ACSI has recently increased the size of the loan available from ETB 50,000 to 100,000. While the loan limit is not as high for other MFIs, many have seen an increase in the loan size limit for SLLC-linked loans. However, loan amount adaptation did not stop there: several MFIs indicated that they have also increased the loan size for group loans. For example, at ACSI, the group loan size limit increased more than threefold from ETB 14,000 to 30,000 and recently to ETB 50,000 over the span of a few years. While inflation certainly plays a role in this, the increases are substantial and a clear spill-over effect from SLLC-linked loans.

In addition, a paradigm shift is occurring in the **range of clients** that are being covered by the SLLC loans: MFIs are starting to treat rural finance clients as individuals with heterogeneous characteristics and needs rather than a homogeneous segment. MFIs are more careful in considering the loan amount (covering a wider range of loan limits – more on this in the next section) as well as the types of products, thereby differentiating between clients and their different needs. This diversification is not only helping the MFIs to expand their portfolio strategically, but also further widening the range of clients being served, contributing to their social and financial mission of an inclusive client portfolio.

This paradigm shift is accompanied by **changes in institutional practices** for serving rural demand for individual-based loans. Many MFIs have included the product manual for the SLLC-linked loan in their operations manuals, strengthening the institutionalisation of the product within MFIs. Through training on various topics, MFIs have also started to identify their gaps and work towards improving practices. For example, the cost–benefit analysis (CBA) training provided by LIFT, head office managers further improved their understanding of the rural segment's net profitability: following the training, MFIs found that the SLLC-linked loan was profit-making, motivating them to expand their SLLC-linked loan portfolio. Most MFIs participating in the CBA exercise confirmed it was their first time carrying out such an analysis, and it also helped them gain a better understanding of the financial viability of other products. In addition, the training made participants realise that their MFIs need to set up stronger monitoring systems to track detailed transaction costs, which in turn will enhance the MFIs' capabilities to analyse the profitability of products.

On cost–benefit analysis training

"This training was an eye-opener as it enabled us to correctly categorise our products and highlighted the need for better transaction cost gathering."

MFI Head Office Manager

Lastly, managers at both head offices and branch offices, as well as woreda officials and farmers, indicate their general satisfaction with how the product is **enabling individual farmers to improve their socio-economic standing**. Branches consistently report having high demand for this loan. Many clients are happy about being solely responsible for the loan and not carrying any risks for others as is the case with the group loan. Many MFI managers indicate how this demand and general satisfaction with the SLLC-linked loan is helping to improve the reputation of the MFI at woreda level.

4. Changes at branch level

Beyond broader institutional changes, a trend towards branches improving their processes and procedures was also observed, which in turn is leading to sounder loan portfolios.

From talking to different branches in different regions, it became clear that the SLLC-linked loan has led to

On improved loan follow-up processes

"Previously, when farmers asked for a loan, we simply gave them a loan. Now, we meet every week with loan officers and discuss outstanding and new loans. We became more cautious in assessing the character [of the customer]."

MFI Loan Officer in Sodo Woreda, SNNPR

a more structured credit appraisal process. When appraising the loan, loan officers are performing more rigorous checks, including visits to the farmer's land, critically assessing both the business plan and the overall ability of the farmer to repay the loan. For some branches, this rigour has been internalised by the overall branch team. A clear spill-over effect is occurring as this more rigorous loan appraisal process is now also being carried out for group loans in certain branches. For example, one branch manager in Tole Woreda in Oromia used the cost of production[1] calculation for SLLC-linked loans as an inspiration to develop a similar cost of production calculation to be used for group loans, where each group member is required to detail how his/her part of the group loan will be spent. LIFT played an important role in enabling MFIs to improve these loan appraisal processes, for example through business plan appraisal training, which helped MFIs to better assess the business plans submitted as part of the loan application process.

In addition, once a loan has been disbursed, branch officers have changed their **approach to loan management**. There is an enhanced awareness of the importance of checking up on loan utilisation, which in turn helps the MFI branches to have an early warning system for underperforming loans. Loan repayment is being watched closely and farmers are being more carefully checked regarding their utilisation of the funds. In addition, some branches indicated that they approach default management differently: whereas initially they tended to move more quickly towards the court in case of default, they are learning that it is important to understand the reasons behind default – which in turn helps them to find better solutions towards full repayment. A key next step in this process is to promote the institutionalisation of these branch-level changes at the head office.

On loan default management

"If you understand their problem, they become a good customer for you."

MFI Head Office Manager

Related to this, managers and loan officers indicate that one of the main advantages of introducing SLLC-linked loans has been the significantly **lower default rates**. Compared to group loans (as well as other products), very few clients have defaulted on their SLLC-linked loan. This is further augmented by a quick assessment of the portfolio at risk (PAR) for the SLLC-linked loan performed during July 2019. The result shows that the PAR >90 days for all LIFT partners is less than 1% for the SLLC-linked credit portfolio. This rate is very low compared to the PAR for the group loans and many other products. For example, the industry average PAR for MFIs, inclusive of all their products, is above 5%. This performance improves their liquidity, as well as the profitability of branches, and the interviewed branch managers indicated that they are very keen to further expand the SLLC-linked loan as a result.

The various training courses provided by LIFT have enabled these important changes. Besides the above-mentioned cost–benefit analysis training, staff of different MFIs also participated in savings mobilisation training. This training has enabled branch managers and loan officers to strengthen savings mobilisation, which in turn will improve their liquidity position. In addition, training on default management is helping to institutionalise the above-mentioned changes in attitude towards defaulting rural clients.

5. Changes in client base

Beyond changes at the institutional level and practices at branch level, an important change is in the client segments that MFIs are reaching. While many customers are existing customers of the MFI, some are newcomers.

[1] This cost of production calculation involves an estimation of the cost of production for specific crop types on a farmer's plot of land, giving an estimate for the maximum loan size that an MFI could disburse to that farm.

Many of these new clients are better off, and were previously hesitant to participate in group loan products. Their hesitation can be attributed to their unwillingness to be bound by group liability and the limited loan sizes of group loans. In the view of many branch managers, the inclusion of these new clients has helped to improve the financial sustainability of the branch, both through improved repayment rates and higher savings. Therefore, clients who were left behind as the MFIs did not have a product that fitted their financial needs (in terms of loan size, guarantee/collateral option and duration) are being served through this product.

The SLLC-linked loan offers credit amounts to access to finance beneficiaries that are on average 2.6 times higher than other available credit instruments, such as group loans, could offer; and this percentage is even higher for non-beneficiaries, with 3.6 times higher amounts compared to other available credit instruments (EEU Impact Survey, 2019). This shows that the SLLC-linked loan unlocks credit amounts that are higher than other available formal and informal credit instruments and is contributing to overcoming the underfinancing that is pertinent in rural areas.

However, this does not mean that MFIs are just helping richer farmers through these SLLC-linked loans. Women and other vulnerable groups are also included as long as they have productive capacity. For example, MFIs such as ACSI have over 50% women clients with a commitment of making it 70%. As supported by the findings of various previously conducted assessments, all the women who were assessed indicated that this loan has not created any additional pressure or burden but rather has allowed them to be more engaged in the economic activities of the household. Moreover, in an effort towards making the product more inclusive, MFIs are addressing some barriers that limit vulnerable groups from accessing the loan. For example, in one of the branches assessed during a previous study, a branch manager explained how they had a blind woman who was the head of her household as a client. She was getting support from her son in crop production, so the branch was willing to work with her. Such efforts indicate that the MFIs are taking the initiative in addressing a wide variety of client segments as long as the business plan and the client's productive capacity meet their credit worthiness criteria.

In line with the discussion above, the data below from one branch shows that, through a more rigorous loan appraisal process, some farmers are offered smaller loans initially – however, over time they can 'graduate' and access larger loans, implying the loan caters to different segments of the rural population.

The boxplot (Figure 3) shows the evolution of loans from round 1 to round 3.

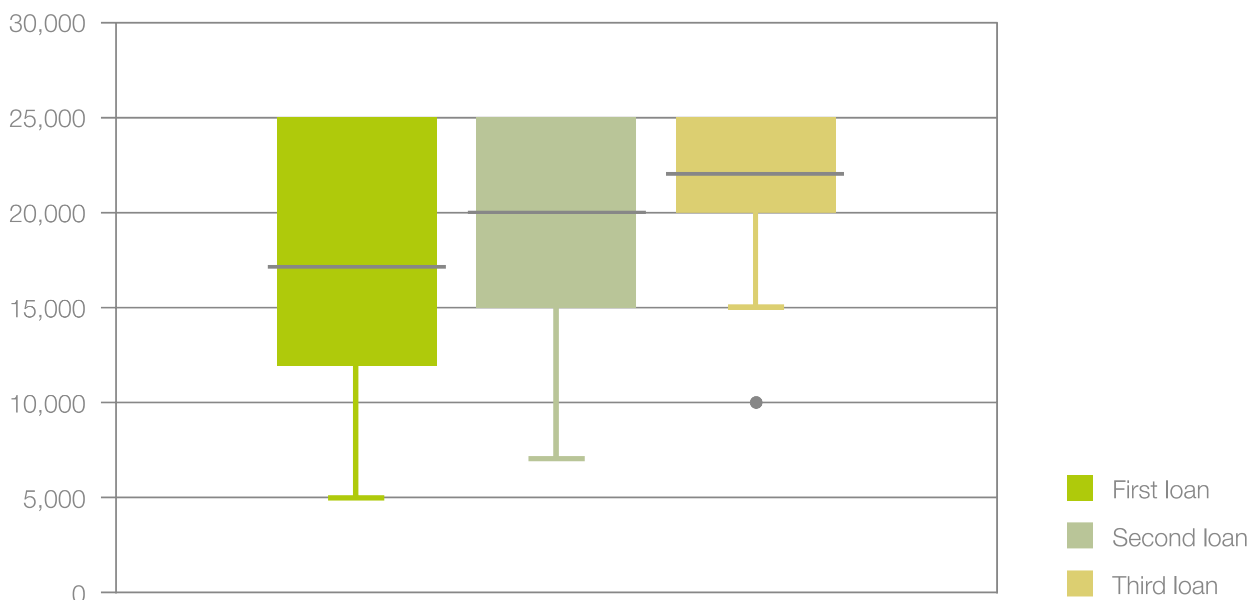

Figure 3. Deep dive: starting with smaller loans and increasing over time

The data above is from a branch in Sodo Woreda in SNNPR. The thick line represents the mean loan amount.

Several observations stand out:

1. The average loan size (indicated by the thick black line) increases from ETB 17,200 when a customer applies for a loan for the first time to ETB 20,160 and ETB 22,080 when they apply for their second and third loans respectively.
2. The full range of loan sizes is being offered during the first round: farmers are accessing loans of a minimum size of ETB 5,000 up to the maximum of ETB 25,000 depending on their capacity – showing the inclusive and diversifying approach used with SLLC-linked loans.
3. Over time, not only is average loan size is increasing, but most customers are accessing bigger loans: in the first round, 75% of the loans are being offered in the ETB 12,000–25,000 range, while the third round has 75% of the loans in the ETB 20,000–25,000 range.

While more rigorous evidence is required, this trend towards larger SLLC-linked loans demonstrates the potential for greater financial inclusion: farmers who initially might only be able to borrow small loans of ETB 5,000 can over time access loans of three or more times that amount, indicating that they could indeed be engaging in more capital intensive and productive investments. Thus, the SLLC-linked loan offering, across the MFIs, ranges from ETB 5,000 to 100,000 covering a wide variety of customers.

6. Signs of expansion and response

After adoption and adaptation of the SLLC-linked loan by MFIs, the first signs of expansion are visible. The overall growth of the number and total portfolio size of SLLC-linked loans clearly points towards the further expansion of the SLLC loan portfolio. Part of this growth is driven by MFIs expanding the number of branches offering the product, reaching ever more farmers in different parts of the country. In addition, some branches are expanding their SLLC-linked loan portfolio: the interviewed branch in Sodo assigned half of its agricultural portfolio to SLLC-linked loans, after introducing the product only two years ago.

The first signs that other MFIs, financial actors and similar development programmes are interested in experimenting with the product are visible. Some MFIs that are currently not partnering with LIFT have indicated, during the General Assembly of the Association of Ethiopian Microfinance Institutions that they are interested in piloting the SLLC-linked product. For example, Metemamen MFI has adopted the product manual and even signed an MoU with the Oromia regional land office in preparation for disbursing the loan product. Additional financial service providers that have not been supported by LIFT are 'crowding in': in Dangila Woreda of Amhara region, four rural saving and credit cooperatives have started disbursing individual loans to their members, for a total of ETB 1.3 million. These individual loans are collateralised against savings and cooperative shares of the members. Land use right as evidenced through SLLC serves as collateral for any remaining balance. This loan product has been successfully launched, using a similar formal blocking process with land administration offices to the SLLC-linked loan.

In addition, the product outreach is not limited to LIFT woredas, but SLLC-linked credit is being offered in areas where the land certification is performed by REILA (Responsible and Innovative Land Administration Project), another land programme funded by the Finnish Government, or directly by the Government of Ethiopia. For example, ACSI and Aggar MFI are offering SLLC-linked loans in more than five non-LIFT woredas in Amhara and one woreda in SNNP region, respectively. Though at a nascent stage, there is an indication that the expansion also reaches non-LIFT regions as REILA plans

to roll out the SLLC-linked loans in Benishangul-Gumuz region where it is doing the land certification and a land proclamation similar to Amhara has been adopted. These expansions demonstrate the product's versatility and potential for adoption by a variety of financial institutions and programmes.

Beyond this expansion, the first responses in the legal environment are occurring. Amhara Regional State has published a new proclamation which allows the landholder to commit his/her land use right and the harvest (crop) obtained from it as collateral separately or together to access individual loans from formal financial institutions. The other regional states, Oromia, SNNPR and Tigray, have drafted similar proclamations, in which land use right can be used as collateral. In addition, while not being a region in which LIFT operates, Benishangul-Gumuz has also published a proclamation with similar provisions to those described above. On top of these regional proclamations, a federal land proclamation has also been drafted with a clause that states that land use rights can be used as a collateral to access credit by the landholder(s) – and is being presented to the Council of Ministers. Another big milestone for the SLLC-linked loan, from the regulatory perspective, is the approval of the Federal Movable Property Security Right Proclamation of the National Bank of Ethiopia, which entitles rural land use right holders to utilise their land use rights for collateral to microfinance institutions. This law expects each region to come up with their respective laws that provide details on how such a right can be exercised. The Proclamation is currently approved by parliament and awaiting signature from the President to become law.

The practice changes at branch level to the institutional changes at MFI head offices and changes in regional regulation, coupled with signs of financial actors and lawmakers embracing this new product, point towards the expectation that the SLLC-linked loan will continue to improve the socio-economic status of farmers and revolutionise rural finance in Ethiopia in the future.

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