Smallholder Farmers Access to Agricultural Finance in Southern Africa

Southern Africa Trust 2013

Contents

1. Overview

Smallholder agriculture is the backbone to most countries in Southern Africa - this sector holds the potential for addressing the poverty trap among the rural population. Access to finance is a major limitation in commercialisation of the agriculture sector in most countries. Smallholder farmers in these countries have been excluded from participating in the mainstream economy, firstly as result of colonial regimes that discriminated against natives who are largely smallholder farmers. Discrimination was largely with respect to native's access to productive land, infrastructure and financial resources. Post-independence, Governments reversed such exclusion by supporting the marginalized farmers through inputs supply schemes, subsidies and controlled markets (parastatals).

During this period, the public sector, through various mechanisms, was responsible for financing smallholder agriculture. Most governments got rid of public support during the structural adjustment era. The liberalization of agricultural finances was supposed to reduce inefficiencies and waste of the public model, but it did not materialise.

Finance is out of reach for most of the smallholder farmers in the region. Africa's financial sector is still in its infancy, with only 23% of adults on the continent having a bank account. A growing number are using new alternatives to traditional banking, made possible by the rapid spread of mobile phones. The recent growth of mobile money in the form of branchless banking has allowed millions of people otherwise excluded from the formal financial system, to perform financial transactions relatively cheaply, securely and reliably, such as Kenyan based M PESA mobile banking and Eco-cash in Zimbabwe.

There is currently a move by major banks to capture the unbanked section of the rural population through provision of saving accounts, mobile banking platforms as well as un-secured loans. The gap left by banks is being filled by micro-finance institutions, as well as the informal sector, who offer accessible but expensive financial products. There is also a movement around local savings and credit groups that are establishing extensive coverage as well as innovative financial solutions. Mobile banking innovations by different players in the sector has increased supply and access to financial products by rural communities, especially smallholder farmers. Value chain financing innovations provide the best financial product for mainstreaming smallholder farmers, as it facilitates financial linkages between agribusiness and producers, shifting the need for guarantees or collateral as a pre-requisite of accessing finance.

2. Introduction

Financial systems in Africa generally lag behind those in other developing economies, even though many significant improvements were implemented within the past decades. An international comparison of private credit to GDP (a main indicator of financial depth) shows a gap with other developing economies.

The ratio of private credit to GDP averaged 24% of GDP in Sub-Saharan Africa in 2010 and 39% in North Africa, compared with 77% for all other developing economies, and 172% for high-income economies.

The non-bank segments of Africa's financial systems show an even lower degree of development than banking. Less than half of African countries have stock markets and only a few of these are liquid. Except for South Africa, African stock exchanges are small as measured by the ratio of market capitalization to GDP, only 38% on average, as compared to 44% in all other developing economies and 62% including high-income economies.
African stock markets are among the most illiquid in the world as measured by the ratio of traded to listed stocks. The depth of African financial systems has improved within the past two decades, but the gap with other developing economies remains.

Well-functioning financial systems serve a vital purpose, offering savings, credit, payment, and risk management products to people with a wide range of needs. Inclusive financial systems mean allowing broad access to financial services, without price or non-price barriers to their use - these are especially likely to benefit poor people and other disadvantaged groups.

Without inclusive financial systems, poor people must rely on their own limited savings to invest in their education or become entrepreneurs; and small enterprises must rely on their limited earnings to pursue promising growth opportunities. This can contribute to persistent income inequality and slower economic growth.

African countries experienced positive developments in access to financial services in recent decades. In many African countries with the deepening of the financial sector, more financial services, especially credit, is provided to individuals and enterprises. New technologies such as mobile money help broaden access to financial services, including savings and payment products. The financial systems of many African countries remain under-developed as compared to other developing economies, even though most of these countries have undergone extensive financial sector reforms in the last two decades.

Indicators of the use of financial products and services by adults and enterprises in the region show that many challenges remain toward building a more financially inclusive financial sector in Africa.

3. Objectives of this report

- Analyse the status of Agriculture finance sector in Southern Africa,
- Presentation of successful models on the use of Agriculture finance sector in driving smallholder development in Southern Africa,
- Discuss opportunities and failures of smallholder financing models in Southern Africa,
- Presentation of the role of agriculture finance in supporting smallholder farmers for increased agricultural production,
- Participants will propose policy recommendations for governments to increase financing for farmers.

4. State of the Financial Sector in Southern Africa

SADC is characterised by poverty - around 40% live in absolute poverty, and given that 70% of the population is rural, poverty is largely rural. In 2012, it was estimated that the population in the SADC region stood at 257.7 million, DRC having the largest population of 72 million. Thirty-nine percent of the population in the region is urban. The collective GDP for the region was set at US$471.1 billion. SADC has a generally low average GDP per capita compared to other regions globally; however, it is still the most developed in the whole of Africa.

In 2009, average GDP in the region stood at 0.5% and rebounded to 5.1% in 2010; and economic activity in return increased from 2.3% in 2009 to 5.5% in 2010. Access to finance is a major limitation with respect to growing the regional economies - this is generally an Africa- wide problem. Around 23% of adults in the Africa region have an account. Within Africa, there is a large variation in account ownership: 24% of adults in Sub-Saharan Africa report having an account at a formal financial institution, though this ranges from 51% in Southern Africa to 11% in Central Africa.
Data suggests that 40% of adults in the region report having saved or set aside money in the past 12 months, compared to a worldwide average of 36%. In Sub-Saharan Africa, 14% of adults (and 35% of savers) report having saved at a formal financial institution in the past year. Formal savings practices are particularly common in most countries in the region, notably through community-based savings methods such as rotating savings and credit associations (ROSCAs). Across the region, 19% of adults (and 48% of savers) report having saved using a savings club or person outside

the family. Southern Africa fares better than other regions (West, North and Central Africa) with respect to individuals who save with a formal institution.

Increased savings was attributed to robust mining activities, due to increased capital flows into the region. More recent developments on the global stage, specifically the Euro crisis, have undermined growth prospects in the region. In 2011, GDP was recorded at 4.7%, a 0.8% drop from the previous year, with Lesotho, Namibia, and Swaziland recording the lowest growth. Only Mozambique achieved the 7% growth target set by SADC. Growth for the region is forecast at 5.1% in 2012.

Table 1: Selected statistics on SADC financial sector

	Global Index		**Enterprise Surveys**		**IMF Financial Access**	
	Formality	**Adults with credit regulated institutions**	**Ranked Enterprise**	**Enterprises with a LOC**	**Points of Service**	
	% with accounts	% with loan	% SME with account	% SME with loan	Branches per 100 000	No. of ATMs per 100 000
Angola	39	8	86	9	1.2	12.66
Botswana	30	6	99	48	9.15	30.6
Lesotho	18	3	89	33	3.48	7.28
Malawi	17	9	96	39		
Mozambique	40	6	75	10	3.37	5.7
Zambia	21	5	94	13		
Zimbabwe	40	6				
South Africa	54	9	98	29	10.1	59.58
Swaziland	20	12	98	21	5.7	21.43

In this table, three measures are used to show financial penetration for households and businesses in Southern Africa:

- Global index (access by households to bank accounts and credit),
- Enterprise surveys (access by small business to bank accounts and credit) and
- IMF financial access with respect to access to banking infrastructure (spread of bank branches and ATMs).

Despite the fact that a high number of persons who do not have an account at a formal financial institution may lose out on the security and reliability that such a relationship provides, they often employ fairly sophisticated methods to manage their day-to-day finances and plan for the future. A growing number are using new alternatives to traditional banking, made possible by the rapid spread of mobile phones.

The recent growth of mobile money has allowed millions of people otherwise excluded from the formal financial system, to perform financial transactions relatively cheaply, securely and reliably.

5. Supply and demand of Agricultural Finance in Southern Africa

Botswana

- 67% of adults were financially included, with 41% formally banked, 18% using formal other products, 8% using informal products.
- The most common loans for rural respondents are from motshelo/savings clubs (56.5%) and from friends/family (53.3%).

- Relatively few have transmission accounts, especially in low income rural communities, partly because of the high cost of transactions.
- Only 16% of adults have current accounts with commercial banks and almost the same percentage (14%) have a life assurance policy.
- Nearly 25% have some form of funeral insurance, but no information was found about how many policy holders are in rural areas.
- Agricultural insurance was launched in Botswana in 2010, but information is not yet available about the extent and nature of uptake.
- The most common type of insurance is a funeral policy, held by 26% of adults, followed by long-term investment products, medical aid and short-term insurance (e.g. motor).
- About 48% of the population live in settlements not immediately served by banks, but the majority of the unserved (37%) live in rural areas, with no rural settlements having bank branches.
- Approximately 29% of adults use mobile phone banking (81% of the population had mobile phones), though such services were limited to account balance queries and airtime purchases only.
- The demand for formal sector financial services in Botswana is dominated by households and businesses in urban areas. Although many rural households use financial services supplied by formal institutions, the demand in rural areas is still overwhelmingly met by informal institutions. The most common form of loans from formal sources for rural people are medium-term loans for the purchase of non-farming assets, such as cars or household appliances, and short-term loans for the payment of school fees.
- While farmers of all sizes and in all lines of production need short-term finance, it is almost exclusively large-scale commercial, mainly livestock, farmers who borrow from formal financial institutions. As all but a few small farms are on land without freehold rights, the demand by small-scale farmers for long-term loans, for land purchase and fixed improvements, can be assumed to be relatively small.

Malawi

- 19% of Malawian adults were banked, 7% had other formal access, 19% had informal access and 55% were financially excluded.
- In rural areas, 14% were banked, 7% had other formal access, 21% had informal access and 58% were excluded.
- In 2012, 59% of MSMEs were financially excluded, with the same issues of access and cost as with individuals.
- 24.3% of MSMEs are borrowers, of which 11.4% borrow from formal sources (mostly MFIs).
- 22.1% of rural adults borrowed money in 2011, while 74.5% of rural adults save.
- Only 3% of Malawians have insurance.
- Most of the rural population is excluded from formal financial services - it is estimated that the demand for rural financial services in 2008 is as much as five times the level of supply. While surveys by government, as well as the FinScope Survey indicate that much of this unmet demand relates to the need for savings and insurance (especially medical insurance) facilities, other information reveals a high level of apparent self-exclusion from available credit facilities by rural people, either on account of age, health or gender or because credit was felt to be too expensive. Recent nominal interest rates charged on formal sector loans to small and micro-enterprises (SMEs) have been close to, or even in excess of 50% per annum, leading to the dominance of informal sector lenders in this segment of the market. It is certainly also true that of the 70% of full-time farmers who are women, many are still effectively unable to seek loans because of domestic traditions which reserve transactions involving credit solely for men.

Mozambique

- 78% of the Mozambican adult population were financially excluded and did not use either formal or informal financial products.

- Most Mozambican adults who were financially served used informal products.
- 2% of adults used a commercial bank product and 5% non-bank financial products, mainly insurance.
- About 20% of the adult population were saving, but only 6% of adults used formal saving products and around 8% of adults borrowed money or took goods on credit during 2008.
- Reasons for borrowing are mainly short term, i.e. for emergencies such as medical attention and living expenses.
- Almost half of the adult population (47%) would consult family or friends for financial advice rather than a financial institution. Only one in four would approach a bank.

Key disabling factors include:

- few banks offering specialized financial services for agriculture; most microfinance institutions only offer credit, not savings services, seriously limiting outreach
- government lending predominates with poor management capacity and poor repayment rates
- informal credit cooperatives and savings and credit associations are widespread, but management, outreach and lending capacity weak
- contract enforcement for formal sector loans weak
- credit bureau services not available to micro-financiers
- lack of appropriate information about availability, terms and conditions of credit and deposit services
- high transaction costs incurred by potential depositors
- elevated risks faced by farmers
- lack of financial literacy and technical skills among potential borrowers.
- Most formal financial services are limited to urban areas. About 80% of the population is effectively excluded from access either because they reside in rural areas or because they are too poor. Of those that do have access, 12.7% use formal sector services and 9.6% informal. With less than 9% of adults in Mozambique in formal sector jobs and 42% receiving incomes of less than US$200 per annum, the costs of both formal and informal financial services are simply unaffordable to most.
- Small farmers in Mozambique, especially those who market a significant part of their output, need short- and medium-term credit, just as their counterparts in most other African countries. But, in common with so many others, effective demand is limited by high transaction costs, risk aversion and lack of information and education. Furthermore, there appears to be a substantial, though unmeasured, demand for savings and transmission services. All are available in urban areas, but not in rural areas where most of the population lives.

South Africa

- The formally served rate of 63% remained stable from 2010, after increasing by 4% from 2009.
- Those served informally in 2011 stood at only 5%, having decreased by 4% since 2010.
- 27% were financially excluded, up by 4% from 2010.
- Affordability, the lack of jobs and irregular income are the key barriers for entry into formal financial services for lower-income citizens.
- The number of Msanzi accounts (low-income transactional bank accounts marketed by all major banks) continues to grow, with 15% of South African adults (±5 million) having such an account.
- Coverage of rural population is relatively low in 2010; rural population stood at 11.5 million with 2.4 million rural small business owners. Only 4.6% of rural individuals and 36.8% rural small business owners said that they used formal savings facilities.

- In respect of credit, 3.7% of the rural population and 3.2% of rural small businesses indicated that they had access to formal credit.
- Only 2.5% of rural small business owners borrow from the bank with 0.7% using other formal means of attaining credit. However, 3.3% of rural small business owners borrow from friends and family.
- In terms of insurance, 12.5% of rural small business owners indicated that they have formal insurance, with just 9.5% of rural individuals reporting that they make use of insurance.
- Medical aid, physical asset insurance and life cover were the main purposes for which insurance cover was obtained.
- Only 17.4% of the rural population and 36.4% of rural small business owners indicated that they have formal transactional accounts.
- Access to financial services in rural areas is more difficult than in urban areas, both for individuals and for small enterprises, including farms.

Zambia

- The overall level of financial inclusion increased from 33.7% of adults in 2005 to 37.3% in 2009.
- The level of financial inclusion was 42% in urban areas and 34.4% in rural areas.
- Nevertheless, 65.6% of the adult population of Zambia continued to be financially excluded in rural areas.
- The level of exclusion was still greater in small enterprises, where 85% of rural-based MSMEs were financially excluded in 2010 and only 5% of MSMEs were banked.
- About 62% of the country's adults live in rural areas and more than half of rural adults earn the greatest part, if not all, of their income from agriculture.
- About 18% of rural adults in Zambia use formal services of some kind, of whom less than half have bank accounts, while about 24% use informal services.
- The percentages are similar for farmers, a little lower for formal services and a little higher for informal, confirming the relative importance of the role of savings and credit groups for small farmers, as in most other countries in the region.
- Nearly two thirds of rural adults (66%) still do not make use of any kind of financial service, including 62% of farmers.
- Of the services used, 14% of rural adults have savings accounts, 10% take advantage of transactional facilities and only 3% have some kind of insurance cover.
- For farmers, all the comparative percentages are substantially lower: 3% for savings, 7% for transactions, 1% for insurance and only 9% for credit, suggesting that most rural people who borrow do so for consumption smoothing, not for agricultural production.

Zimbabwe

- 40% of Zimbabwe's adult population were financially excluded and did not use either formal or informal financial products.
- Most Zimbabwean adults who were financially served used either formal (38%) or informal (41%) products.
- Around 69% of the population has household savings - of these, 27% did so at home, 12% were members of savings clubs and 11% use a commercial bank.
- There is little recent statistical information on the demand for rural financial services in Zimbabwe, perceptive analysis of available material by the country specialist was able to generate considerable insight. One of the few areas in which recent statistical data is available, is the demand for credit by Model A1 (largely subsistence resettlement smallholders) and A2 (commercialising resettlement small and medium-scale farmers) rural households respectively.
- In a 2010 field study, 45% of the former and 65% of the latter who were interviewed (including as many as 70-80% of medium-scale A2 farmers) said that they would take out agricultural loans, if financial institutions began to offer them. Credit offered at present is almost entirely by

government – and is only for short-term purposes. As in the instance of Zambia, there are reasons to expect that the uptake of medium-term credit for the purchase of machinery, livestock and some kinds of fixed improvement, such as fencing, would be considerable if available, while for long-term loans it would not be good given the predominance of traditional/communal land rights and the political instability in the market for freehold land.

6. Factors affecting demand and supply of Finance

In 2011, there were 161 separate banking institutions operating in the region, with 234 subsidiaries, in total there were 234 bank licenses issued in SADC. Around 15 out of 161 banks have subsidiaries operating in more than one jurisdiction, while only eight banks have a presence in more than five SADC countries. Select Africa, a regional housing micro lender, has its head office in South Africa but practices in Malawi, Kenya, Lesotho and Swaziland, and is building up operations in Tanzania and Mozambique.

The table below shows the distribution of the banking institutions in Southern Africa.

Table 2: Financial Institutions in Southern Africa

Bank	Botswana	Namibia	South Africa	Tanzania	Malawi	Zambia	Zimbabwe
Absa/Barclays	X	X	X	X		X	X
African Banking Corp	X			X			
Citibank				X		X	
Finabank	X						
First Rand/FNB	X	X	X			X	
KCB				X			
Nedcor			X				X
Stanbic	X	X	X	X		X	X
Standard Chartered		X	X	X		X	X

Botswana

Botswana has a well-established formal financial sector; however, the rural financial landscape is still dominated by informal suppliers, mostly located in small towns and larger villages. After the enactment of new policies in 1990, nine commercial banks have established in Botswana. Licensing does not require nationwide presence or rural branches, but branches are located only in major and a few smaller urban centres.

Botswana is classified as a middle-income country; few international donors and local NGOs have made grants for rural projects; those which provide grants do not focus on rural finance. The absence of services in rural areas is being reversed by introduction of mobile phone banking services. FinScope's most recent survey showed that 29% of Botswana's population used mobile phone banking services in 2009, although it is not known what proportion of users were in rural areas.

Botswana has few formal sector MFIs, however some of these have a strong rural presence, such as the Women's Finance House. Registered and informal sector savings cooperatives are widespread in rural Botswana, but they provide limited credit facilities. The country also has numerous micro-lenders, or cash loan shops, which were once unregulated, but are now regulated by the Non-Banking Financial Institutions Act.

Banking cooperative and credit associations also provide significant support to Botswana's rural population, especially with respect to financing agriculture initiatives.

Malawi

The country has eleven licensed commercial banks currently operating in Malawi, that provide a standard range of services including savings, credit and transmission facilities and foreign exchange and insurance services. In terms of physical accessibility, Malawi is ahead of many other countries in the region.

Although most bank branches are located in larger or smaller urban areas, in relation to the geography and population distribution, branches are reasonably well spread across the various districts and mobile banks and agencies supplement brick-and-mortar branches.

The challenge remains on high transactions costs, as banking fees for small accounts are still very high. This is expected to change as cell phone banking products are gaining momentum across Malawi. Public sector financial institutions and formal and informal MFIs also have a have strong presence in Malawi's financial sector, given the widespread poverty and under-development in the country.

Malawi Rural Finance Company (MFRC) has an extensive network, including six branches and twenty sub-branches that have targeted mainly, but not only, small farmers. Institutions operating in similar fields include Malawi Rural Development Fund (MARDEF), Small Enterprise Development Organisation of Malawi (SEDOM) and PRIDE Malawi. MARDEF was set to provide loans to rural groups, whereas SEDOM's target market is supported by both government and donors. PRIDE provides standard working capital loans mainly to female borrowers engaged in urban activities.

The donor community is also active in provision of financial services, the two main support institutions are IFAD and CARE International. The presence of micro-finance institutions in Malawi's financial sector is also significant. Malawi Union of Savings and Credit Cooperatives (MUSCCO) is a 59-member apex body with a central finance facility to which its members have access. In addition to training and capacity building, it conducts monthly field visits and audits and requires members to submit monthly performance reports.

Malawi Microfinance Network (MAMN) is a formally incorporated professional association with 20 member institutions. It offers donor-funded training courses to develop and promote microfinance activities and ensures that good governance and practices. The informal players are significant players in Malawi's financial sector, they are popularly known as Katapilas. They provide short-term loans at short notice without necessarily requiring security, but at relatively high interest rates. Loans are typically payable within a few weeks or months and are generally repaid in a single instalment. Borrowers are usually known to money lenders, who use familiarity as a substitute for collateral. Lending is based on ability to repay; interest charged on loans is high compared to formal sources.

Mozambique

Mozambique's sixteen commercial banks, in common with most of their counterparts in the region, are only peripherally involved in agricultural lending and, to the extent that they are involved, provide services only to large-scale commercial farming enterprises engaged in producing sugar cane, tea, cotton and cashew nuts.

The Land Bank, a public-private partnership, also offers commercial loans to all players in food and fibre value chains. Beyond this, it works with partners to assist associations of small farmers to develop their enterprises in order to position them to borrow and repay loans.

About 120 MFIs have operating licences but are thought to have no more than about 10% of the market at present. The Bank of Mozambique provides incentives, such as lower reserve requirements for institutions with rural branches that engage actively in developing and marketing financial products and services geared to the needs of the rural population.

Government's Program of Support for Rural Finance (PAFR), has three components: institutional, policy and legislative support, an innovation and outreach facility, and support for community-based financial institutions such as accumulated savings and credit associations (ASCAs) and VSLAs. It also offers technical and financial support to financial institutions starting up in rural areas, partly through subsidising the cost of building new facilities.

While donor support is generally strong in Mozambique, not many multilateral and bilateral donor institutions are active in the rural economy. However, those that do are playing a leading role in developing rural financial systems, providing loan capital and educating enterprises and households on financial matters. Few of Mozambique's MFIs operate in rural areas, but informal institutions, such as ASCAs play an important role, even though the total value of their savings and lending is small.

Some recent innovations are the first weather-based index insurance products on offer for agricultural production, even though these will only be taken up initially by large scale commercial enterprises.

Much more important for rural people at large, is the commencement of mobile phone- based money transmission services, which will surely be followed, before long, by additional financial services, as has happened in neighbouring countries. Government has also recently launched a rural savings mobilisation campaign and the Central Bank has published a strategy to bring more banks to rural areas.

South Africa

The country has the most advanced financial sectors in the region, even thought to be more advanced than developed nations. The bank sector is dominated by five banks: ABSA (recently acquired by Barclays), Standard Bank, First National Bank, Nedbank and the newcomer Capitec.

The top two have sophisticated products to support a small group (estimated at 30 000) of large commercial farming units. The financial needs of the rural economy, dominated by many smallholder farmers (estimated at 2.4 million), is catered for largely by government and the informal financial systems popularly known Asmashonisa. The country has strong public finance institutions and instruments, which include Land Bank, Industrial Development Cooperation, Small Enterprise Development Agency (SEDA), Development Bank of South Africa (DBSA), South African Microfinance Apex Fund Post Bank, Khula Enterprise Finance.

Land Bank provide financial services to all farmers, especially the historically disadvantaged; it has a network of 27 branches and 45 satellites and suites of products geared specifically to the needs of the large-scale commercial agribusinesses which account for more than 95% of its loan book, but the portfolio for small and emerging farmers is growing.

Development Bank of South Africa specialises in financing of public sector infrastructure in the region, some of which is in rural areas and benefits agriculture more or less directly, e.g. water and energy reticulation, roads.

Post Bank has an extensive network through post offices nationwide, providing savings and transmission facilities. It is working towards getting a full licence and corporatizing.

South African Microfinance Apex Fund (SAMAF) is a microfinance institution targeting low-income rural areas through the provision of loan capital to industry members. It also facilitates management and systems development, as well as other forms of capacity building and training.

Micro-Agricultural Finance Initiative of South Africa (MAFISA) is an apex system that provides loan portfolio indemnity to accredited financial intermediaries to encourage the extension of credit to emerging farmers who have demonstrated the capacity, or are considered to have the potential, to service and repay loans, but who lack sufficient collateral. Launched in 2006, its implementation has been disappointingly slow, its beneficiaries few and its sustainability questionable.

Khula Enterprise Finance, a state-owned national wholesaler of finance for enterprise development, received approval from government to provide retail financial services to micro and small enterprises.

Industrial Development Corporation also finances agriculturally related activities, though the focus is still with large scale operations in the export market and post-harvest production activities in the agricultural value chain.

Rural Housing Loan Fund (RHLF) provides wholesale funding to accredited intermediaries for the purchase or construction of houses in rural areas.

Small Enterprise Foundation (SEF), a non-profit microcredit institution operating in several of South Africa's poorest provinces, targets groups of women, particularly in rural areas, using a Grameen-type model which requires the groups to have accumulated savings prior to receiving a loan, lending on average R2 000 to groups consisting of about five individuals. At the end of 2010, the total value of loans advanced since inception in 1992 was R1.1 billion to more than 730 000 clients, with a debt write-off rate of less than 1% in most years and a current client portfolio of over 60 000 clients, it is firmly self-sustaining.

Women's Development Businesses (WDB) is a private sector and donor-funded trust. The trust follows the same methodology as SEF with a client base of 40 000.

Marang Financial Services is similar to WDB, with client base of 20 000.

Zambia

The main suppliers of financial services to agriculture and the rural economy at large, by value, are Zambia's five large and thirteen smaller commercial banks. Before liberalisation of the sector in 1992, commercial banks were obliged to operate an extensive network of branches not only in urban but also rural areas. After reforms, the number of rural branches dropped drastically but have recovered since then.

Commercial banks largely provide financial services to medium and large-scale commercial enterprises and for crop marketing (mainly funding the Food Reserve Agency for maize marketing). There is one large commercial bank, Zanaco, which specializes in providing a range of financial services to smallholder farmers through the Lima scheme, operating with the Zambia National Farmers Union.

The role of commercial banks in the agricultural and rural sector is increasing as more banks are opening branches in rural areas and technological innovations, particularly mobile phones, are making it easier for them to extend their services in rural areas. Other initiatives include partnerships: e.g. Zanaco recently partnered with Zambia Postal Services (Zampost) to utilise the postal services infrastructure to extend its rural presence.

Non-bank formal sector participation in rural financial service provision has been mainly in the form of supply chain finance. Generally, the supplier is a large lead firm that can purchase inputs in bulk. 'Outgrower' schemes that make use of such finance have developed in the cotton, tobacco and seed production industries. While the cotton schemes involve only smallholder farmers, the tobacco schemes work both with smallholders and with commercial farmers.

For seed suppliers, the outgrower schemes are primarily with commercial farmers. Supply chain finance is a dominant source of production finance in all three instances. The rapid spread of mobile phones has provided a new channel for expanding rural financial services. Among the institutions that have taken an early lead are Zanaco, CelPay, Mobile Transactions Zambia and Airtel. Competition in the provision of mobile banking is growing rapidly, as is demonstrated by the impending entry of a fifth major mobile phone service provider, MTN.

The informal financial sector is vibrant in Zambia, the money lenders are popularly known as kalobas. The data from FinScope's 2009 study found that 16% of rural adults used informal financial products. The informal sector includes rotating savings and credit associations (ROSCAs) known as chilimbas, and accumulated savings and credit associations (ASCAs). Most money lenders offer short-term unsecured loans at high interest rates, typically 100% per month. Loans are used to finance a wide range of needs including school fees, medical fees, funeral expenses, small business assets, food, entertainment and even the servicing of MFI weekly repayments.

ROSCAs are popular among women in both urban and rural areas. ROSCA members make a periodic collection that is pooled and given to individual members in rotation. ASCAs are similar to ROSCAs but are more flexible and responsive to group members' demands. Groups typically consist of 15 to 30 members who make weekly contributions. After about one month, members can apply for a loan, with savers benefiting from interest paid by borrowers (typically 10% per month).

Zimbabwe

The financial sector in Zimbabwe has gone through a series of phases driven by developments in the political economy and their impact on macro and microeconomic policy. The two major interrelated historical developments that shape the current environment of agriculture and agricultural/rural financial services in Zimbabwe are the government's land acquisition policy that took effect in 2000 and hyper-inflation in 2007-8.

Following the fast track land reform from 2000 to the end of 2008, government, the Reserve Bank of Zimbabwe, through the almost-fiscal role that it played as a subsidiser and director of public rural finance resources until 2009, farmer contracting agencies and NGOs became the main suppliers of finance to rural smallholders and large-scale farmers. The commercial banks, previously major players, have been able to provide little credit to either of these groups because of the lack of secure land-based collateral.

Even the 99-year leases given to new land occupants by government have provided no substitute, being non-transferable. A further consequence has been a sharp reduction in the already small number of commercial bank branches in rural areas. Unique among the commercial banks is the Commercial Bank of Zimbabwe: as a small institution, it has focused on micro-lending to SMEs, but is now moving into micro-insurance, micro-leasing and low-income housing finance. It is unknown what proportion of these activities is conducted in rural areas.

The Agricultural Development Bank of Zimbabwe (Agribank), a public institution that was also previously an important financial service provider, has struggled to source external capital for much the same reason, more so because of its mandate to lend for what most potential investors have seen as high risk farming activities. The result has been an acute lack of liquidity, not limited to agriculture and rural finance, which government has been trying to find sustainable ways of countering since 2000, not helped by the reluctance of many of the major multilateral and bilateral donor agencies to become involved in a turbulent situation.

One component of a solution has been the reshaping of the public sector Post Office Savings Bank, into the People's Own Savings Bank (POSB). It has the most extensive network of branches in the financial/communications sector – 185 at present – distributed throughout urban and rural areas. And, from being only a licensed deposit-taking institution, it has now entered the small loans market, using borrowers' savings and salary streams (which are required to pass through a POSB account) as collateral.

A further new role that it is playing is that of wholesaler of funds to MFIs. While this is materially improving low-income rural clients' access to credit, a limitation from an agricultural point of view is that POSB's six-month repayment period is too short to make its loans suitable for financing many agricultural activities, most critically the annual grain crops which form the foundation of most households' diets. In addition, along with some commercial banks, POSB is now acting as an agent for some of the big international money transmission companies.

Another public institution that has played a role in providing loan capital for rural enterprises is the Small Enterprises Development Corporation (SEDCO). However, given its dependence on the tightly constrained national budget for capital and its high debt write-off rate, it is not clear how sustainable its role will be.

7. Disabling Factors

There are several factors that affect supply and demand of finance in Southern Africa, they can be classified into enabling and disabling factors.

Enabling factors
The key potential enabling factors are:

- the extensive ownership of and access to mobile phones
- rapidly improving communications infrastructure
- the liberalised macro- and micro-economic policy environment
- the Botswana Building Society's access to the post office network.
- Expanding rural/agricultural financial services in the country will require:
- further measures to reduce government/parastatal involvement in financial service provision
- the development of agency banking and mobile money services for sparsely populated rural areas
- the development and extension of rural risk reduction financial products, particularly for livestock
- the strengthening of meso-level institutions to improve financial service providers' input into policy
- policy-level reforms to promote SME lending.

Malawi
The enabling factors are:
- substantial enabling legislation
- high rural population density
- relatively good communication infrastructure
- high latent need for financial services
- good opportunities for contract farming
- good opportunities to work with informal financial service providers

- considerable evidence of financial innovation
- pressure on banks to move into less competitive rural markets.
- Expanding rural/agricultural financial services will require:
- absorption of recent legislation and adaptation by both the regulator and regulated
- development of agency banking and mobile money services
- development and extension of rural risk reduction products
- financial education
- supporting mechanisms for farm inputs, including relevant savings mechanisms, contract farming schemes and agri-input credits.

Mozambique

The enabling factors include:

- mobile phone-based financial services spreading rapidly
- informal savings and credit groups widespread
- contract farming becoming popular, facilitating formal sector lending
- financial sector infrastructure includes developed national payments system and electronic network
- credit bureaux available to serve formal financial institutions.

South Africa

South Africa's financial sector is the largest, most advanced in the region, with mobile money transfer, short-term insurance products, lower cost transactional products, more ATMs and services delivered through retail service centres, taxi ranks etc. It has significantly improved financial access in rural areas in recent years and some meso-level systems are well developed (associations, training, credit bureaus, information etc.).

Expanding rural/agricultural financial services will require a combination of interventions that include:

- expanding branchless financial services to rural areas, e.g. through mobile money or agent banking
- finding alternative collateral mechanisms, e.g. use of movable assets as collateral
- supporting financial education initiatives in rural areas.

Zambia

The key enablers in Zambia include:

- the economic recovery that has developed since dollarization in 2009
- the policy priority given by government to the rural economy, entailing subsidized loans (at the cost of stifling the regeneration of private/NGO formal and informal lending).

Expanding rural/agricultural financial services will require a combination of interventions that include:

- expanding branchless financial services to rural areas (e.g. through mobile money or agent banking)
- finding alternative collateral mechanisms (e.g. the use of movable assets as collateral)
- supporting financial education programmes in rural areas
- addressing key national issues affecting the financial sector, the economy and law enforcement, thereby creating a conducive environment for investment
- exploring various insurance and guarantee services to reduce risk.

Zimbabwe

The culture of saving is reported to be strong in Zimbabwe, difficult economic times notwithstanding. The demand for savings facilities is driven by non-agricultural 'seasons', e.g. the need in January to pay school fees and buy school uniforms. Because conventional money transmission services have, until recently, only been available in urban areas, rural demand has been met through the informal 'courier' services provided by bus and taxi drivers.

As in many other countries in ESA, mobile phone transmission services are now beginning to come on-stream. There is no data yet on the extent of uptake, but, if patterns elsewhere in the region are a guide, the demand for these convenient, relatively secure, low-cost services is likely to be substantial and largely eclipse the demand for alternative transmission facilities.

A feature of demand which is particularly prominent in Zimbabwe, but which is also known to exist in most other countries in the region, is the need by small, informal cross-border traders (some of who are farmers) for foreign exchange services. Informal cross-border trade in agricultural products, mainly maize, rice and beans, amounts to tens of thousands of tons or hundreds of thousands of US dollars in most months and the number of traders registered (excluding the many who are not) also runs into the tens of thousands. At present, this involves the carrying and keeping of substantial amounts of foreign exchange, with all the attendant security risks, which better access to banking facilities could do much to reduce.

In response, some Zimbabwean banks are understood to be experimenting with foreign exchange cards for such traders, but it remains to be seen whether the uptake will be substantial, given the exposure to taxation and to unexpected and unwelcome intervention by the country's monetary authorities, as well as to the deduction of transactions charges, that it will entail.

Disabling factors
The key disabling factors identified were:
- farmers and rural MSMEs are widely dispersed
- there is high information (poor communication) and transaction costs (poor quality roads/high transport costs)
- the provision of basic public services in rural areas is weak and social safety net programmes are poorly designed
- farming risks are high, resulting in adoption of diversified income strategies
- MSMEs find it difficult to provide collateral for loans
- farming, especially rain-fed arable farming, is a marginal, risky and low return activity
- smallholder agriculture is characterised by low productivity
- in livestock, the traditional focus is on number, rather than quality, of animals and off-take rates are relatively low, resulting in an over-mature, poor quality herd
- financial literacy is poor, with the fear of asset seizure from borrowing widespread.

Malawi
Key disabling factors are:
- economic instability
- agricultural volatility
- weak rural infrastructure
- difficulties with identity verification
- property rights that do not encourage investment
- limited regulatory experience of the new legislation
- high levels of rural poverty
- fear of debt
- low financial literacy

- weak institutional capacity
- high levels of government involvement as a financial service provider
- inappropriate financial product design.

Mozambique

Expanding rural/agricultural financial services will require a combination of interventions that include:

- a change in the structure of incentives for formal financial institutions, as a result of technological (particularly branchless banking) and product (particularly those designed for young customers) innovations or/and the arrival of new institutions into the industry that may change the structure of current market competition
- the development of pilot schemes linking urban and rural financial institutions (including informal financial groups), so they can facilitate the understanding of the financial needs of farmers
- a holistic approach to improving value chain finance, focused on raising incomes in rural areas
- investment in education and the development of financial literacy programmes
- offering more payments via branchless banking systems
- the upgrading of meso-level financial infrastructure, such as credit bureaux
- the improvement of rural physical infrastructure, mainly in respect of transport, irrigation and communication.

South Africa

Important disablers include:

- lack of good roads, electricity and internet connections in rural areas
- fiscal policy and taxes on bank charges exacerbate the high cost of accessing financial services
- National Credit Act (NCA) improves access to credit only for salaried employees, thus not helping unemployed informal sector employees, many living in rural areas
- NCA also obliges banks to tighten risk assessment procedures, further reducing access to finance for many rural households/SMEs
- communal land tenure system means land cannot be used as collateral for loans
- weak public sector financial service provider
- most formal financial institutions have poor understanding of circumstances, needs and potential of small farmers as clients
- general lack of appropriate, affordable products that meet needs of low-income, rural residents, despite success of the Mzansi account and some mobile money applications, such as WIZZIT
- formal financial institutions mostly located in urban or peri-urban areas
- widespread fear of losing assets due to failure to repay loans means many people do not even attempt to access credit- linked to low levels of financial literacy
- National Credit Registry reports more than half of population has impaired credit record
- high cost of infrastructure and staff, lack of capacity of management and staff in financial institutions.

Zambia

Major disabling factors include:

- widely dispersed rural population
- income of rural household is erratic and lumpy, especially for farmers
- most small farmers face bottlenecks that hinder productivity, including isolation from markets and other basic services caused by poor public infrastructure (roads, electricity, mobile phone coverage, etc.), low yields, vulnerability to crop failures from drought and disease, poor

livestock reproduction rates and limited access to information on improved agricultural practices
- limited understanding of financial services
- costs of setting up and operating financial institution branches in rural areas are prohibitive. The reasons include regulatory requirements, high cost of personnel resulting from limited capacity of financial services sector, high-risk perceptions regarding agriculture caused by lack of understanding of market and poor ability to develop and deliver appropriate financial products, as well as institutional capacity constraints, especially among non-bank financial institutions (MFIs and SACCOs).

Significant enablers include:
- the appearance of new agricultural market facilitators, such as Musika, Conservation Farming Unit (CFU), and iDE Zambia
- the introduction of new types of regulated financial institutions (e.g. microfinance institutions licensed to offer savings and loans)
- the introduction of contract farming and outgrower schemes that allow farmers access to production loans and input credit
- the emergence of mobile phone-based money transactional facilities.

Zimbabwe

In Zimbabwe, given the uncertainty of land tenure, even long-established commercial farmers are often unable to access standard financial services. Most formal and informal micro-lenders were wiped out either by the financial asset destruction caused by hyperinflation leading up to dollarization in 2009 or have found it impossible to compete with subsidised lending for agricultural inputs by government. The recent decline in the latter can be expected to regenerate demand for formal and informal microfinance institution (MFI) credit.

8. Policy and Financing in Southern Africa

On the supply side, barriers to entry are raised by, among others, applying risk assessment criteria that are often difficult to meet, such as high minimum income levels and strict security requirements. Often, too, product design is not geared to the needs and circumstances of smallholder farmers in the region.

Most formal banks in the region have high minimum balance, high interest rates as well as exorbitant bank charges which dis-incentivize rural communities to access products offered by the banks. On the bankers' side, these customers present high transaction cost as the cost of servicing small-turnover, low-value client groups or individual is very high. The transaction costs are a product of poor public infrastructure (road and electricity), market failure (monopoly - few players) as well as lack of telecommunication infrastructure (low fixed lines and mobile penetration in most countries in the region).
Despite these challenges, there are several dynamics in the region that are positive with regards to the inclusion of marginalized communities in the financial markets.

These developments include:
- Monetary and fiscal/exchange rate management – given the improvements in region monetary policies in individual countries (e.g. Zambia, Botswana, Malawi and Mozambique), the macroeconomic environment has become more adaptive for design and distribution of cheap financial products to rural population than before.
- Financial regulatory systems– the region was not exposed to the global financial crisis to the same extent as other regions. This is mainly due to two main reasons, either a result of low integration levels to the global financial systems (e.g. Malawi, Zimbabwe and Lesotho) or as a

result of financial prudency (e.g. South Africa). The financial regulatory systems have improved significantly with respect to availability of data (collection and publishing), thus reducing the embedded risk of financing risk sectors such as agriculture.

- Road infrastructure– the region has poor road network except for South Africa and to a certain extent Botswana and Namibia. There is huge investment in road networks in the region with Mozambique, Zambia and Angola spending more on improving their road infrastructure. Investment into road is likely to reduce the cost of doing business in the region especially among smallholder farmers who are located in remote inaccessible parts. Mobile phone-based banking platforms are redressing the challenges brought by poor road infrastructure in most countries in the region.

The advent of mobile phone banking has bridged the infrastructure divide, penetration of mobile banking services in Malawi, Zambia and Zimbabwe provides testimonies in this regard.

Political environment– the region has experienced a long period of political stability, even Zimbabwe after dollarization has become political stable. Such stability provides a conducive environment for the development of the financial sector, which in turn increases investments into productive sectors such as agriculture. On the other hand, the liberalization of financial markets has not delivered the expected results, especially with respect to getting rid of banking monopolies. The lack of competition in the banking sector crowds out innovation, especially around development of financial tools targeting smallholder farmers. The case of MPESA East Africa has shown the effect of opening the sector to more players. Such new players have developed smart financial solutions for serving marginalized smallholder farmers. These solutions include mobile banking, value chain financing and micro-insurance tailor made for the smallholder target market.

9. Summary and conclusion

The discussions presented show the trends (commonalities and differences) of the financial sectors in the region, with respect to their access by smallholder farmers. The region has a strong formal financial sector compared to its counterparts on the continent. The significance on alternative finance channel such as development banks, micro-finance institutions has been established. The structure of the banking industry in these countries is oligopolistic characterized by with fewer suppliers and many consumers. Most of the populations in the region are excluded from the formal banking sector, with the majority relying on informal channels which tend to be unregulated and very expensive.

Most countries have attempted to liberalise the banking sector; however, many have failed to reverse the structure and dynamics of this sector. This has been to the detriment of efforts by these governments to drive the inclusion of the rural poor (especially smallholder farmers) into the financial sector.

There is a mixed position in the region on financing smallholder farmers; some countries such as Tanzania, Malawi, Zambia and Mozambique have desiccated financial products targeting smallholder farmers. South Africa, Namibia, Botswana and in the past Zimbabwe have their financial system geared towards supporting established commercial farmers. In these countries, smallholder financing is the prerogative of Government and the donor community. There are exciting and smart financial products that have been developed in the countries that are making strides towards financing smallholder farmers.

Mobile banking has increased, to the benefit of individuals who were previously excluded by the formal banking sector, Malawi, Zambia and Zimbabwe have strong presence of mobile banking service providers. South Africa, despite having the most advance banking system as well as the highest mobile phone penetration, has been the least developed in terms of mobile banking services targeting smallholder farmers.

Overall, the region's financial sector is vibrant through more could be done with respect to developing new products for serving smallholder farmers who have unique set of needs and challenges. The region is experiencing significant economic growth with Angola and Zambia being in the big league with global counterparts such as China and Brazil. Growth factors such as economic stability, market liberalization, increased literacy and increased investment in public infrastructure are providing a good basis for the development of a financial sector that can provide solutions for smallholder farmers.

10. Recommendations

Several recommendations can be drawn from this analysis:

- Demand-related
- Improve understanding of the demand for financial services in low-income rural communities, to influence policy design and implementation.
- Remove gender-based demand barriers to which many women are subject.
- Cut red tape around access to finance by allowing for innovations in the financial sector e.g. mobile phone-based banking platforms, or other branchless banking.
- There is need to work with farmer organisations to assist the formation of smallholder commodity producer groups, to boost market size and reduce unit transaction costs and risks (also supply-related).
- There is need for Governments in the region to prioritise investment into infrastructure, especially in respect of roads, power (and water) reticulation and communications (also supply-related).
- Supply-related
- Curb the monopoly in the financial institutions, opening space for rural or village banks.
- Facilitate a comprehensive value-chain financing approach that provides financial solutions, instead of narrow focus on smallholder farmers.
- Support the development of specialist agricultural units within banks.
- Enlarge the area of land available for freehold tenure by smallholder commercialising farmers.
- Develop alternatives to land-based collateral, including non-collateral based group (and individual) lending techniques, such as warehouse receipt systems and equipment leasing.
- Develop mechanisms to promote competition among rural formal sector financial service.
- Facilitate collaboration by multilateral donor agencies to advance the outreach, appropriateness and sustainability of formal and informal rural financial services.
- Regional level recommendations
- Establish regional initiatives on improving the efficacy of financial institutions, especially in relation to fostering development.
- Establish a regional monetary union to facilitate the integration of financial institutions in the region, e.g. extending the SACU Monetary Union.
- Improve collaboration among organisations promoting supply and access of agricultural/rural finance services in the region, such as the Southern Africa chapter of the African Rural and Agricultural Credit Association (AFRACA), Centre for Inclusive Banking, IFAD, African Development Bank.

11. References

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