Creating Opportunity for Smallholders through Microfinance

ABHAY PAREEK

Asia Pacific Financial Inclusion Summit

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About **MicroSave**- in a Nutshell

- We are a Development Consulting with over 2 decades of experience of working in Asia-Pacific and in Africa
- Focus Domains: Digital financial services, inclusive finance, MSME finance and private sector development
- Our clients: include a variety of institutions like NGOs, MFIs, Banks, Corporates
- What is common to our client profile: Working either directly or indirectly with the low-income and marginalised sections of the economy
- Nature of Consulting: From **Innovation to Implementation**

### **MicroSave in Numbers**

- 17 projects to design and implement DFS across Africa and Asia
- **150+** plus banks, MFIs and MNOs which have improved operational efficiency on the basis of our advice
- **100** plus financial products developed across the globe
- **40+** countries across Africa and Asia in which we have in-depth financial market intelligence
- **300** papers, focus and briefing notes, and other print and online published
The Palay Value Chain Analysis

Key Findings
Value chains and the power dynamics

There is a complex social and economic relationship between the agent/aggregator and the farmer which brings in scope for power dynamics and exploitation.

Controls flow of produce in the market, stores it for peak season or some way influences price for lean and peak season.
Value chain map of Palay/Rice

Activities & Channels ➔

Channel 1
- Local trader

Channel 2
- Trader in other provinces ➔ Traders in Bulacan
- Large Miller ➔ Local Trader/Agent

Channel 3
- Local Trader ➔ Large Miller ➔ Local Trader/Agent

Channel 4
- Large Miller ➔ Co-operative

Channel 5
- NFA

Retailing
Wholesaling
Trading
Warehousing
Milling
Transportation
Production

Input Supplier
Farm Machinery Supplier
Extension Services
Credit and Insurance
Simplified value chain map of Palay/Rice

Activities & Channels

- Retailing
- Wholesaling
- Trading
- Warehousing
- Milling
- Transportation
- Production

Trader in other provinces

Traders in province

Large Miller

Local Trader/Agent

Farmer

Input Supplier

Farm Machinery Supplier

Extension Services

Credit and Insurance
Price variation and margin within the rice value chain

Farm gate price
Value Added
Margin in %

<table>
<thead>
<tr>
<th>Stakeholders</th>
<th>Price (Peso/Kilo)</th>
<th>Margin in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farmer</td>
<td>15</td>
<td>17%</td>
</tr>
<tr>
<td>Traders</td>
<td>3</td>
<td>10-15%</td>
</tr>
<tr>
<td>Rice Millers</td>
<td>14</td>
<td>9%</td>
</tr>
<tr>
<td>Wholesaler/Retailer</td>
<td>32</td>
<td>3%</td>
</tr>
</tbody>
</table>

35 peso/kg is the selling price

Hints: Financing of drying units, aggregation at the producer level, facilities for warehousing and finance against the WRs
Seasonality in price of dried palay

Farmgate Price of Dry Palay (Php / Kg)

Dry Season

Wet Season 1

Wet Season 2

Source: Bureau of Agricultural Statistics (BAS)
Sources of finance for farmers

**The Input supplier**

- Providing input credit at a rate of 5% per month
- Local suppliers - in-kind charges
- Inputs supplier charges 50 Peso extra over the retail price

**Microfinance Institutions**

- Provide agriculture loan
- At times the loan amount is insufficient to cover consumption and agri expenses

**Traders/Private Financers**

- Provide loans at a rate of 5-6% per month.
- Farmers have to sell produce at the earliest to repay loan(s),
• It has emerged as a powerful tool in creating an impact on the livelihood of farmers
• The “value” gets created in three ways—space, form and time, shown as the three axes
An Example

- **Fresh Palay farmgate**
  - X Php/Kg

- **Fresh Palay mill**
  - X+1 Php/Kg

- **Dry Palay mill**
  - X+1.8 Php/Kg
  - Milling: +1.44
  - Drying of FP: +0.8
  - Storage: +0.25 to +1.50

- **Rice+ By product**
  - X+3.24 Php/Kg
  - Trading of FP: +1
  - Storage of Rice: +0.544*

- **Dry Palay mill, lean season**
  - X+ (2.05 to 3.3) Php/Kg

* Based on past trend of price fluctuations in cost of rice in a span of 3 months@ Php 1 per Kg and Rice obtained from 1 Kg FP= 544 gms
## MFIs do extend finance to value chain actors

<table>
<thead>
<tr>
<th>Value chain actors</th>
<th>External financing</th>
<th>Internal financing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Co-operatives</td>
</tr>
<tr>
<td><strong>Small holders/Marginal farmers</strong></td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Traders</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Processor/Rice miller</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td><strong>Wholesaler and retailer</strong></td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td><strong>Input suppliers</strong></td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: MicroSave research
Credit required for production / to avoid distress sales

**Phase**

**Price trend**

**Credit supply**

**Income realised**

**Outcome**

**What can be done**

- MFIs, Traders, Input suppliers
- Inadequate loans
- Informal credit @3-5%

- Adequate loan
- Low income realisation
- Sell the produce immediately

- Palay – 14-16 peso/Kg
- Palay – 18-20 peso/Kg
- 3 months, Palay

- Traders and Cooperatives

✓ Loan to improve the produce
✓ Receivable finance

Innovative financial products can help marginal farmers realise benefits of time arbitrage

Source: MicroSave research
Emerging Themes for VCF
Model 1: Receivable Finance

**Benefits**

- Quick and easy cash
- Higher realisation from same volume of produce
- MFI gets collateral

**Challenges**

- Aggregation requires significant institutional effort
- Wilful default by farmers
- Quality of warehousing facility
- Government regulation
- Success of RF will be contingent on macro-economic factors
Model 2: Institutional finance (1/2)

Institutional buyer

Securing Contract

Selling produce

Building institution

Co-operative/Association

Farmer Farmer Farmer

TA Support Microfinance Financial services
Model 2: Institutional financing (2/2)

**Benefits**
- Finance based on contract secured by the farmer or the co-operative
- Impact of price fluctuation can be minimized
- Increased collective bargaining power of farmer(s)
- Reduced dependency on traders
- Technical inputs for farmers

**Challenges**
- Model requires a gestation period
- Requires investments of time in building relationships with the community
- Quality parameters
How will VCF affect the MF sector as it moves forward and goes beyond MF?
Affects on VCF on MF sector

- Direct impact on majority of microfinance clients who are engaged in agriculture
- VCF represents a “ecosystem approach” over a “decentralised approach”
- Requires a shift to client-centric products design for small and marginal farmers and for the value chains

Pressure on MFIs:
- Reduce cost and develop innovative delivery channels

Risks for MFIs:
- Shift from core business of financing to households to an eco-system approach
- Lack of expertise and experience in comprehensive value chain finance