# THE STATUS OF AGRICULTURAL AND RURAL FINANCIAL SERVICES IN SOUTHERN AFRICA, 2011

## EXECUTIVE SUMMARY

Access to financial services is an important contributor to enterprise productivity the world over. In Sub-Saharan Africa, where most people still live in rural areas and agriculture is the mainstay of the rural economy, access to financial services of all kinds is still poor. Yet relatively little is known about the demand for, the supply of and effective access to rural and agricultural finance and about the policies, institutions and many other factors that determine them.

As part of its purpose to make financial markets work for the poor in Africa, FinMark Trust commissioned the Centre for Inclusive Banking in Africa to undertake a study to examine and document the current state of rural and agricultural financial services in Southern Africa, as the first phase of a 3-year programme to increase access to and the uptake of such services. Research was undertaken in six Southern African Development Community (SADC) countries – Botswana, Malawi, Mozambique, South Africa, Zambia and Zimbabwe.

The findings of the first phase have contextualized the second phase, in which the best current practices and innovations from across the African and international spectrum are identified to address areas of policy challenge in the region. The objectives of the final phase will be to use the findings of the first and second phases to work with policy-makers and practitioners to develop appropriate policy frameworks and strategic approaches to address these challenges and to assist on-the-ground implementation.

This summary relates the findings of the six country studies, the central purpose of which was to document the key financial characteristics, in particular, the current demand for, supply of, access to and uptake of financial services in each country, to identify the respective sets of enabling and disabling factors and, from these, to deduce appropriate recommendations for policy and practice.

Common challenges across the six countries identified for attention by the best practices and innovations study are summarized in the following table:

| Thematic area | Common issues |
|---|---|
| Role of government and development policy | • Unstable macroeconomic performance<br>• Some financial policies cause market distortions (e.g. mandatory interest rate ceilings)<br>• Some governments are directly involved in financial services (e.g. through ownership/management of DFIs, implementation of SME and guarantee funds)<br>• Agricultural policies that do not facilitate (crowd-out) private sector participation (e.g. some subsidies, export bans, price fixing) |
| Supply-side constraints | • Limited incentives for financial institutions to offer/increase agricultural/rural finance |

| | |
|---|---|
| | • Finance often available for commercial agriculture but less so for small-scale farming<br>• Suitable products also not available for emerging farmers (those moving from small-scale to more commercial agriculture)<br>• Weak value chain finance: lack of linkages, poor level of trust among players<br>• Lack of capacity (MIS and human) in financial institutions (especially among non-banks and informal providers) |
| Demand-side barriers to financial access | • Low population density: highly dispersed (limited aggregation among many smallholders)<br>• High level of poverty in rural areas<br>• Lack of access to markets by many smallholders<br>• Exposure to risks: highly erratic income flow and vulnerable to loss of livelihood (e.g. crop and livestock failure); health (e.g. HIV/Aids)<br>• Land issues: difficulty of using land for collateral<br>• Lack of financial capacity/literacy |

The main findings of the respective country studies are as follows:

**Botswana**

Key financial characteristics include (FinScope, 2009):

- 67% of adults were financially included, with 41% formally banked, 18% using formal other products, 8% using informal products (smaller than in most other African countries) and 33% financially excluded. In 2004, the level of the banked population was similar.
- The most common loans for rural respondents are from *motshelo*/savings clubs (56.5%) and from friends/family (53.3%).
- 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).
- 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.
- 29% of adults use mobile phone banking, though such services were limited to account balance queries and airtime purchases only. According to CGAP, 81% of the population had mobile phones in 2010.

Key disabling factors identified were: farmers and rural MSMEs are widely dispersed; there are 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; and financial literacy is poor, with the fear of asset seizure from borrowing widespread.

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; and 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; and policy-level reforms to promote SME lending.

**Malawi**

Key financial characteristics include (FinScope 2008, 2012):

- In 2008, 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 are 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.

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; and inappropriate financial product design.

Key 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; and 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**

Key financial characteristics include (FinScope, 2008):

- 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. 12% of Mozambican adults used a commercial bank product and 5% non-bank financial products, mainly insurance.
- 20% of the adult population were saving, but only 6% of adults used formal saving products.
- 8% of adult Mozambicans 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 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; and lack of financial literacy and technical skills among potential borrowers.

Key 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; and credit bureaux available to serve formal financial institutions.

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**

Key financial characteristics include (FinScope, 2011):

- 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 (approximately 5 million) having such an account.

Important disablers include: lack of good roads, electricity and internet connections in rural areas; fiscal policy and taxes on bank charges exacerbate 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 delivery capacity, coordination; 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; and high cost of infrastructure and staff, lack of capacity of management and staff in financial institutions.

Important enabling factors include: South Africa's financial sector is largest, most advanced in region; mobile money transfer, short-term insurance products, lower cost transactional products, more ATMs and services delivered through retail service centres, taxi ranks etc., have 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; and supporting financial education initiatives in rural areas.

**Zambia**

The key financial characteristics identified in FinScope (2009, 2010) were that the overall level of financial inclusion increased by 3.6%, 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, the majority of adults in Zambia continued to be financially excluded – in rural areas, 65.6% of the adult population. 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.

Major disabling factors include: widely dispersed rural population; income of rural households 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, cell 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 prohibitive - 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; and the emergence of mobile phone based money transactional facilities.

Expanding rural/agricultural financial services will require a combination of interventions that include: strengthening the non-bank sector; introducing other tiers of financial institutions that are better placed to service more remote locations; promoting an integrated financial system (e.g. through linkages/partnerships between current suppliers); strengthening institutions that provide agro-technical support to farmers (e.g. to facilitate clustering/aggregation of small-scale producers, support crop diversification, and facilitate access to markets); and supporting financial education.

**Zimbabwe**

Key financial characteristics include (FinScope, 2011):

- 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.
- 31% of Zimbabweans did not save: of the 69% who did, 27% did so at home, 12% were members of savings clubs and 11% had/used savings products/services from a commercial bank.
- 31% of Zimbabweans had/used some kind of financial product covering risk.
- 40% of Zimbabweans sent or received money: 17% from within Zimbabwe and 14% from outside.

Key disablers at the macro-level include: the lack of liquidity in the economy, as a result of the country's recent economic history, constraining financial institutions from making loans and inducing high interest rates, with agriculture particularly marginalized, as a high risk sector; the collapse of about half of country's formal and informal micro-lenders collapsed due to the loss of financial assets due to the hyperinflation (2007–2009) or due to inability to compete with government subsidies on agricultural inputs; the mandatory interest rate ceilings on loanable funds at levels below market-clearing rates, leading to banks' preference to lend to a few large, low risk borrowers; land reform policies which have halted most foreign investment; the rejection of 99-year leases as collateral by most lenders; poor physical infrastructure resulting in poor access to financial services and high transactions costs. At the meso-level, the critical constraint is financial institutions' collective lack of IT and skills. At the micro-level, medium/long term finance is almost unobtainable for famers, given the high risks of the sector and the shortage of liquidity, while financial institutions' rural branch networks have contracted substantially, owing to high costs and depressed turnover. Low levels of financial literacy also constrain the demand for financial services.

Important enablers 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 (for example, through mobile money or agent banking); finding alternative collateral mechanisms (for example, 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.