SUPPORT TO HAITI'S MICROFINANCE, SMALL AND MEDIUM ENTERPRISES SECTOR (HAITI MSME)

ACCESS TO FINANCE FOR HAITI'S AGRICULTURAL VALUE CHAINS: PROGRAMMING OPTIONS

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REPCOPCOMO. (mango – represents three former associations that have consolidated)

Introduction

The Haiti Medium, Small and Microenterprise project (MSME) is a USAID funded program currently being implemented by DAI. The MSME program Objective 4 intends to *promote economic growth that benefits poor households by supporting the access of MSMEs to new market opportunities.* Under Objective 4, Haiti MSME will improve linkages among financial institutions, productive sectors and key enabling environment stakeholders to increase the supply of financial services to high growth MSMEs. Key productive sectors include agricultural value chains. Haiti MSME has commissioned this report to leverage prior investments by USAID and other donors in order to provide guidance to the Program's rural finance activities, particularly in regard to working capital for agricultural value chains.

Haiti MSME builds upon the prior experiences of the USAID Hillside Agricultural Program (HAP) and the microfinance support program FINNET. Through these programs, USAID has invested significant resources in technical assistance and capacity building for community based organizations in agricultural value chains (specifically coffee, cacao, mango, yams, taro, pumpkin and hot pepper) and for microfinance institutions. However, sustainable access to adequate working capital remains a major challenge for all actors in export crop value chains.

The lack of finance for rural and agricultural MSMEs in Haiti is well documented. As stated in the recent IDB report on rural finance[1]:

The majority of Haiti's active population and the current productive potential resides in rural areas. A rapid observation of access to finance in these areas exposes two important conclusions: the mechanisms and financial institutions for productive rural enterprises are noticeably weak and arouse little interest outside of NGO and donor programs. Also, basic financing is provided by traditional mechanisms put in place and organized by rural populations themselves, but these mechanisms exhibit weak capacity that does not assure sufficient financing in the best of conditions.

There are a number of unique risks of rural and agricultural markets that constrain both the supply and demand for finance in these areas. These challenges include:

- dispersed populations and poor transportation and communication infrastructure resulting in high transaction costs for both borrowers and lenders
- high risks faced by potential borrowers and lenders due to the nature of agricultural incomes – seasonal, non-diversified, and low incomes
- high risks faced by potential borrowers and lenders due to external shocks (climate, pests) and global price volatility
- co-variant risks and homogenous borrower pools
- exaggerated perceived risks resulting from poorly designed prior programming (directed credit, subsidized interest rates, poor loan recovery practices)

[1] Rapport de Mission, Finances Rurales, Emmanuel Pic, Juillet 2005

- limited tools to manage risk
- difficulty accessing reliable information about borrowers
- limited management and governance capacity of farmer associations
- lack of adequate collateral
- inhospitable policy, legal and regulatory frameworks

Haiti MSME faces the challenge of leveraging prior USAID investments in agricultural value chains and in the financial sector in order to address the challenges listed above and increase access to finance for these productive sectors. Although no single intervention or solution can address all the potential obstacles to growth and productivity for Haitian agricultural MSMEs, key to success will be the Program's ability to:

- utilize existing knowledge of value chains to identify opportunities, constraints, and potential solutions
- coordinate with other programs working to strengthen value chain productivity and competitiveness[2]
- assist the financial sector to assess and reduce risk – including microfinance institutions, commercial banks, and other financial service providers
- build alliances within the financial sector and between the financial sector and value chain actors

Lessons Learned from HAP Agricultural Finance Activities

This brief overview summarizes the opportunities, constraints and lessons learned from the HAP and FINNET programs, as well as from the recent series of value chain assessments produced by the IDB.[3] Although the challenges ahead are significant, Haiti MSME is fortunate to have a strong foundation of experience and information on which to design and build programming.

The analysis is oriented primarily towards meeting the needs of community based organizations (CBOs) and farmers, which have been identified through prior USAID programming as key points of intervention. Lack of working capital is a critical constraint impeding the CBOs and traders ability to market significant volumes to exporters. However, as noted above, the key to meeting the needs of the target population is an understanding of the entire value chain and the opportunities and constraints for both value chain actors and relevant financial institutions.

As shown in the chart below, existing sources of working capital to finance seasonal buying campaigns are inadequate:

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[2] Particularly the IDB DEFI program and the European Union PRIMA program which will provide support a total of 20 value chains.

[3] The IDB reports include value chain assessments of 40 value chains, an assessment of the rural finance sector, and an assessment of the macroeconomic sector as it impacts rural finance. The value chains assessed and the method of analysis are included as Annex Two.

Source of Capital	**Constraint**
Equity	Extremely limited. Traders' savings (equity) are vastly below required levels. One CBO reported having $425 available against a total working capital need of $2,500. Commercial bank lending to exporters is very limited.
Donor funds	Grants or loans from donor funded projects are sporadic and non-sustainable. Only accessible by CBOs (not by private firms or individuals). Donor programming drives amounts, terms, and conditions. Subsidized interest rates negatively impact the development of a dynamic credit market.
Advance payments	Advances from exporters (buyers) are both inadequate and difficult to access at critical times in the season – particularly at the start of the buying period and during peak harvest. Advances from exporters also limit sellers' negotiating power (because they are committed to selling to that exporter) and can be a method for exporters to hold down prices.
Supplier credit	Farmers commonly supply credit in the form of product advances against the promise of future payment by CBOs or traders. Such arrangements are undesirable for poor farmers with a desperate need for cash.

Relatively large loan amounts are required for seasonal agricultural market needs (estimated at $5,000 to $30,000). At this time, most micro-finance NGOs are excluded from this market, since their liquidity and credit methodologies cannot accommodate these loan sizes. Most commercial banks perceive lending to the agriculture sector as too risky, lack the branch networks necessary to reach into rural areas, and do not have the skills or interest to manage lending either to groups such as CBOs, or to individual traders who lack collateral. Therefore, building alliances that take advantage of each actor's core competencies may be necessary to successfully increase sustainable access to finance.

An important prior intervention is the HAP loan guarantee program.[4] The loan guarantee attempted to catalyze increased working capital lending to one group of value chain participants, marketing CBOs, by one financial institution, Fonkoze. The assumption was that increasing access to working capital would increase competitiveness, increase volumes, and increase farmer incomes. The pilot succeeded in disbursing $1.2 million in loans. However, since 90% of those loans were to the coffee sector, there is still a lot to be learned about how to scale up lending to the cacao, mango, or other value chains.

[4] See the USAID-Haiti report *The HAP Loan Guarantee Initiative: Lending to Agricultural Marketing Associations, An Evaluation of Performance and Lessons Learned*, March 2007. The Executive Summary of this report is included as Annex One.

HAP Guaranteed Lending by Sector

Client	Number of Borrowers	Total Lending Oct 2001-March 2006	Percentage of Total Lending
Cacao Marketing CBOs	6	$89,865	7.9%
Cacao Exporter	1	$40,000	3.5%
Mango Marketing CBOs	4	$34,459	3.0%
Coffee Federation FACN	1	$236,000	20.8%
Coffee Marketing CBOs	41	$775,128	68.3%

Since the termination of the loan guarantee program in March 2006, Fonkoze has continued lending to these three sectors but the number of borrowers and the amount of lending has decreased.

Lending to Target Groups After End of Guarantee Program

Client	Number of Borrowers	Post-Guarantee Lending to the Sector	Prior Average Annual Loan to Sector[5]
Coffee Federation FACN	1	$50,000	$59,000
Coffee CBOs	7	$155,000	$238,799
Cacao CBOs	1	$1,750	$33,108
Mango CBOs	2	$10,000	$19,595
Totals		**$216,750**	**$350,502**

Haiti MSME seeks options for increasing access to finance in these and other value chains, and has an emphasis on working with financial institutions. MSME will attempt to increase financial flows throughout the value chain, using resources from across the financial sector. Following are recommendations for moving forward in working with financial institutions and value chain actors, as well as a set of lessons learned from prior experience working in the agricultural finance sector in Haiti.

Recommendations for Agricultural Finance Programming

While lessons learned should be used to encourage Fonkoze to continue its lending to agricultural cooperatives, they should also be utilized for the next generation of agricultural finance activities. It is important to note that the following recommendations are based on the units of analysis considered under this report – namely CBOs in the coffee, cacao, and mango value chains. Additional analysis may be required to make recommendations at other levels within these value chains or for value chains not reviewed under this report.

[5] Calculation = sum of the average annual loan amount disbursed to each borrower in the sector

It is important to note the recommendations and considerations made below do not take into account Haiti/MSME's budget limitations. Haiti MSME may be able to consider some of the recommendations as one-off technical assistance activities or that fit within the capacity of their long term technical stuff. Other activities may require an integrated approach and longer term sequencing, or rely on significant input of other USAID or donor programs.

Empowered farmers with increased access to credit can raise their incomes[6]

In general, CBOs pay higher prices than traders, since they return profits to their members. Therefore, successful lending to CBOs **may** have a stronger poverty reduction impact than lending to traders. When the cacao and mango CBOs had better access to credit through the HAP loan program, the share of increased world prices captured by the small farmers also increased. In the cacao value chain small farmers increased their share of the world market price from 31 percent to 49 percent over the period. In the mango value chain, before the CBOs had access to credit the *fournisseurs* were free to set their own prices. However, the CBOs increased access to finance created a new level of market competition, and forced the *fournisseurs* to react by raising their own prices.

Reporting and verification of stocks and sales is key to successful lending

Agricultural marketing operations are simple:

1. marketing agents (traders, CBOs) use working capital to buy product
2. marketing agent consolidates, stores, and sometimes processes (sorting, grading, washing) the product
3. marketing agent sells product to the next buyer (another marketing agent, or a processor/exporter).

A financial institution that offers a line of credit to a marketing agent must be able to verify the purchase of stocks and the sale of stocks. Draw downs on the line of credit should be commensurate with the volume of product purchased, to prevent funds being used for other purposes. The loan officer must be able to verify volumes already purchased with initial draw downs, distinguish marketable quality product from low quality or spoiled product, and make a reasonable estimation of an acceptable amount for the following draw down. The financial institution should also be able to verify delivery to the next buyer. Assigning sales receipts (see below) can eliminate this step and reduce risk.

Assigning receipts is a powerful mechanism to increase lending

Lending for agricultural marketing is well suited to risk reduction provided by the assignment of borrowers' sales receipts to the lending financial institution. Financial institutions can build alliances with marketing agents (traders or CBOs) and buyers (processors or exporters). The financial institution can provide access to working capital for the marketing agents. The marketing agents can assign the rights to their sales receipts to the financial institution. Upon delivery of the product, the buyer can deposit

[6] A full discussion of these impacts is in the USAID-Haiti report *The HAP Loan Guarantee Initiative: Lending to Agricultural Marketing Associations, An Evaluation of Performance and Lessons Learned*, March 2007

payments to the financial institution, which will subtract its capital and interest payments and return the remainder to the borrower. To discourage cross-selling, the financial institution should monitor the traders' activities, know when stocks have been accumulated, and notify the buyer of expected deliveries. This type of alliance allows each player to focus on their core competency (trading, lending, exporting). This structure also lowers transaction costs for both the borrower and the financial institution.

Secured transactions are powerful mechanisms for increasing lending

Secured transaction structures are more appropriate for increasing access to finance for producers. A secured transaction is any lending in which the borrower assigns ownership of the product to the lender. Warehouse receipts are an example of secured transactions. The producer delivers his product to the warehouse, receives a receipt verifying the quantity and quality, and then delivers this receipt to the lender. The lender then has title to that property (the product) until the loan is paid back.

The concept is that the holder of the receipt should have an easier time borrowing against it than borrowing directly against the produced inventory. This could create a broader accessibility to credit than now exists in the market. However, for it to work well, there needs to be a bonded warehouse system for controlling stocks, coupled with a quality appreciation to judge the stock's true market value. This mechanism is particularly appropriate for a product such as coffee, which requires a long storage period before export, and therefore creates cash flow challenges for exporters and producers.

Participant in Secured Transaction	Benefits of Secured Transactions
Producer Producer Association	1. Access to cash for immediate needs 2. Ability to delay sales until prices are higher 3. Ability to consolidate larger quantities before selling 4. Ability to sign contracts to deliver larger quantities 5. Quality control 6. Reduced spoilage
Financial Institution	1. Reduction of risk 2. No client screening or monitoring necessary 3. Automatic loan payment upon sale of product 4. Third part determination of product value 5. Quality control and insurance of collateral
Warehouse Manager	1. Creates demand for new service 2. Can be a catalyst for similar structures in a variety of value chains

Loan guarantee programs
The HAP loan guarantee program experience shows that guarantees can catalyze new lending to agricultural sectors by interested financial institutions. Lessons learned should contribute to continued successful guarantee program design in the future.[7] MSME should provide inputs to any donor considering loan guarantees in the agricultural sector, and leverage existing USAID DCA initiatives as a potential tool for value chain lending.

The Value Chain Approach to Agricultural Finance
The most important current innovation for increasing access to agricultural finance is the value chain approach to assessing agricultural markets and developing appropriate financial products and services. It is critical that financial institutions develop the capacity to use this approach:

- to analyze value chain operations, from production to final sale
- to identify support services (transport, storage, etc.) in the value chain
- to identify the demand for finance from value chain actors or support service providers
- to analyze the existing and potential providers of financial services
- to identify critical constraints to growth and profitability for the value chain as a whole, and for individual value chain actors
- to create financial solutions where appropriate

The value chain approach addresses many of the causes of failure in agricultural credit programming of the past. It ensures that increased access to credit is market driven and responsive to client needs. It also ensures that finance is used only where appropriate, and in a manner which supports growth with equity in the value chain. It encourages dialogue and the development of alliances among financial institutions and between financial institutions and value chain actors. These alliances bring together the strengths of value chain actors (market information, interdependent relationships) and the strengths of financial institutions (risk assessment, credit methodologies, diverse products and services) to create integrated solutions to financial constraints.

Working capital credit is a critical piece of the puzzle
Working capital lines of credit play a key role in marketing agents' seasonal financial management strategy. Marketing agents use varying combinations of loans, delayed payments to farmers, and advance payments from buyers to maximize their buying power and profitability throughout the marketing campaign.

The most important role for financial institution lending may be to provide working capital at two key periods of the season: in the beginning for the season while waiting for the advances from the exporters and when farmers are most desperate for cash; and during the peak period in the season when volumes are greatest, demand for working capital is highest, buyer advance amounts are not sufficient, and competition from speculators is most intense. During these periods, timely and flexible access to capital from a financial institution can be critical.

[7] ibid

Strategies for reaching poor smallholder farmers

As the MSME project considers ways to increase agricultural sector lending, and other donors consider providing technical assistance or guarantees, it is important to analyze how increased finance can be most effective to catalyze growth in the sector, and to ensure increased benefits to farmers. Alliances among financial institutions, and with value chain actors, can yield creative solutions that result in benefits to farmers as well as the growth of the entire value chain.

Although many financial institutions and donor projects identify poor smallholder farmers as their target clientele, the most effective mechanism for delivering finance to these clients may not be direct lending. Lending to other value chain actors such as input suppliers, traders or CBOs, can create opportunities for on-lending to small farmers.

Another suggestion is to offer buyers (processors, exporters) a line of credit for paying marketing agents upon delivery. Payments to marketing agents could be made by the financial institution upon presentation of a delivery receipt from the exporter. This provides the exporter with an additional source of liquidity and more flexibility in cash flow management. It also ensures that marketing agents will be paid in a timely fashion, and may also solve their cash transportation problems (payments can be made at any branch). Finally, the exporter can offer collateral (factory, equipment) which marketing agents lack. It is also possible that the exporter could assign his sales receipts to the financial institution for payment of the line of credit.

Considerations for Implementation of Agricultural Finance Programming

Consideration with Financial Institutions

Financial institutions have an important role in increasing access to finance for agricultural value chains. However, there is significant resistance by Haitian financial institutions to working with either agricultural value chains or CBOs (regardless of sector). Financial institutions face high real and perceived risks in working with these target populations (see above) and have limited capacity to assess these risks or tools to mitigate them. Education, alliance building, and instruments such as loan guarantees or asset backed transactions will be necessary to address the real and perceived risks of working with these clients.

It is critical to identify the proper role for a particular institution, based upon their capacities and resources. An examination of potential alliances among financial institutions, or between financial institutions and value chain actors, can lead to innovative solutions which reduce risk, lower cost, and increase financial flows. Once the relevant institutions and alliances are identified, the Program should ensure that the institution offers the necessary strategic commitment and follows a high quality product development process.

Challenge	Recommendation
Financial Institution Assessment and Development of Alliances	The Haitian financial sector has many institutional actors – MFIs, banks, NBFIs. There is also a high degree of information, organization, and engagement among financial institutions, donors, and technical assistance providers. This network should enable MSME to identify the financial institutions which are relevant to a specific value chain, or a specific region. The strengths and weaknesses of each relevant institution should be assessed, with the goal of generating ideas for alliances that take advantage of the institution's strengths. Some institutions may have significant rural branch infrastructure, some may have excess liquidity, some may have prior experience working with producer cooperatives (even in non-agricultural sectors), some may have a loan guarantee mechanism. Creative strategic planning can result in alliances that deliver sustainable access to finance for productive agricultural sectors.
Alliances with Value Chain Actors	Alliances should also be explored with value chain actors, including international buyers. Secured transactions (see lessons learned section below), the assignment of sales receipts, and other creative financial structures can take advantage of the core competencies of each player in order to scale up access to finance. Value chain actors that are committed to the growth of the value chain and the increase of their own profits will seek sustainable solutions that make business sense and can provide a "reality check" to donor programming.
Strategic Commitment	Long term strategic commitment from the financial institution's board, management and staff is necessary. Involving stakeholders throughout the institution will create a constituency that can maintain momentum and continue to innovate when challenges arise. Lending to productive rural sectors must be a part of the institution's strategic plan. To gain buy in and measure success of new initiatives, a clearly defined business plan with profit targets should be developed for each new product or service. Since the ag portfolio may comprise only a small portion of the institution's business, it's strategic importance must be understood at all levels.
Liquidity	Borrower's access to adequate working capital at the right time is crucial. Managing the peaks and valleys of seasonal demand for credit is challenging. Institutions must develop the cash flow management capacity to anticipate and meet client demand. They must be able to project liquidity needs and ensure access to thoe necessary resources. Sustained growth for the value chain, and sustained profitability for the financial institution, can only be attained with sustained access to credit.
Agricultural Technical Support	Institutions should attempt to train existing credit staff in understanding agricultural value chains and assessing the creditworthiness of value chain enterprises. Alternatively, institutions can hire employees who understand agricultural value chains, and train them in credit activities. This brings together the core strengths of both parties – financial institutions have capacity in training credit officers, and the employee contributes the understanding of the value chain. If this is not an option, then a cadre of trainers must be identified or developed that can provide training in value chains and assessment of farmer production. However, dependence on outside agricultural experts should be avoided as, in the long run, it is costly and does not build and maintain institutional capacity.

Institutional Expertise	Similar to strategic commitment, institutional expertise must be developed broadly and deeply across the institution. While there may be agricultural value chain specialists, there should be an adequate number of staff and an on-going staff development program to promote the development of real institutional expertise. In all cases, the branch staff servicing the customers must be directly involved in all aspects of the lending and monitoring activities.
Sector Risk Assessment	The history of the sector should be understood, particularly price volatility and production volatility, in order to predict future risk. Prior lending initiatives must be examined and understood (see evaluation of HAP loan guarantee). Product development processes and pilot programs are extremely important.
Product Design: Flexible Credit Facilities	– A line of credit is better suited to agricultural marketing than a term loan with regular payments. The marketing of agricultural products allows CBOs and traders to turn capital quickly – a loan can be used to purchase a large volume of product and deliver it for sale within one week. Working capital needs vary throughout the season, based on volumes and access to other sources of capital such as advance payments from buyers. Throughout the buying season borrowers can effectively use the line of credit for liquidity when it is needed, but not accumulate unnecessary finance charges. – Lines of credit do not require regular interest payments. Given that the marketing campaign does not proceed at steady volumes throughout the loan period, borrowers do not accumulate sufficient profits to make regular monthly interest payments. Interest payments reduce the total available amount of working capital available, since borrowers are using working capital to pay the interest payment.
Product Design: Interest Rate	Standard interest rates may not be appropriate for agricultural lending. The underwriting and monitoring of the loans is different from that of the traditional solidarity group or individual microenterprise loan. Strong relationships with borrowers, loan officers who understand the market, and adherence to regular reporting of stocks and sales related to the draw downs on the lines of credit may allow for a lower interest rate. The documentation and oversight of asset backed transactions such as warehouse receipts eliminates the need for extensive direct contact with the borrower. Technical assistance with activity-based costing can help financial institutions determine the appropriate interest rate.
Multiple Products and Services	Clients will require a variety of financial services, not limited to credit. Rural households and agricultural producers need savings, cash management, money transfers, and other services. These may be provided by a single institution, or through partnerships among institutions. Meeting client needs with a variety of well-designed products and services will increase client loyalty and the financial institution's profitability.

Considerations with Value Chains

The bankability of value chain actors is determined by a large number of factors, many of which are rooted in agricultural production, marketing and quality control techniques, or in the management and governance of CBOs. Haiti MSME will seek out partnerships with other programs or institutions which can provide technical assistance to value chain actors seeking to upgrade or expand their production. However, from the perspective of increasing access to finance, there are important tools and lessons that MSME will contribute to addressing constraints such as lack of credit history and collateral, poor financial management, and lack of transparency.

Challenge	Recommendation
Identifying demand	• Analysis to identify critical constraints–and limiting interventions to key points where finance is the critical constraint • Analysis of value added in the value chain to quantify lending opportunities • Analysis to identify key role for financial institution vs. value chain lender (e.g. borrowers may seek FI loans at the beginning of the season and at the peak harvest period when value chain lenders are unable to advance payments)
Producer federations vs. solidarity groups[8]	MFIs are accustomed to working with solidarity groups, and they may assume that a producer federation can be managed in a similar fashion. However, the size and structure of producer federations, their management capacity, and their governance is very different. The traditional solidarity group model of "all loans must be paid or no new loans will be given" may put the financial institution out of the market. Accountability at smaller unit levels can ensure that good lending continues, while non-performing borrowers are eliminated.
Transparency and financial management	• As with most MSMEs, financial records are non-existent and household and business income are combined, making it difficult to assess creditworthiness. Fortunately, the "lumpy" nature of agricultural production can make it easier to reconstruct prior and predict future cash flows (farmers easily remember volumes and prices from previous years). Accounting training for MSMEs and agricultural business training for loan officers are important to ensure realistic risk assessment and design appropriate products. • An initial cash flow analysis should determine whether or not a borrower's underlying activity generates enough margin to warrant increased leverage with the obligatory interest payments. This is important for risk assessment, and for ensuring the borrower is clear about the costs and benefits of borrowing.
Broad based technical assistance	Financial solutions cannot address every critical constraint. Upgrading value chains through improved farmer productivity, quality improvement and control, buying and processing capacity, and financial management and reporting capacity requires broad based technical assistance.

[8] Producer federations bring together multiple associations under one board of directors and management structure. This is becoming increasingly popular due to economies of scale and increased production that is possible for a larger organization of producers..

Conclusion

Increasing sustainable access to credit for agricultural value chains requires engagement with multiple actors, including actors in the value chain, financial institutions, providers of support services to the value chain, other donors and technical assistance projects. Although no single intervention or solution can address all the potential obstacles to growth and productivity for Haitian agricultural MSMEs, key to success will be the Program's ability to:

- utilize existing knowledge of value chains to identify opportunities, constraints, and potential solutions
- coordinate with other programs working to strengthen value chain productivity and competitiveness
- assist the financial sector to assess and reduce risk – including microfinance institutions, commercial banks, and other financial service providers
- build alliances within the financial sector and between the financial sector and value chain actors

At this time, most micro-finance NGOs are excluded from this market, since their liquidity and credit methodologies cannot accommodate the required loan sizes – nor do they have the risk appetite. Most commercial banks perceive lending to the agriculture sector as too risky, lack the branch networks necessary to reach into rural areas, and do not have the skills or interest to manage lending either to groups such as CBOs, or to individual traders who lack collateral. Many value chain actors do not have the resources, capacity or relationships to engage in value chain lending. Therefore, building alliances that take advantage of each actor's core competencies may be necessary to successfully increase sustainable access to finance. These alliances must respond to client demand, and the terms and conditions of the financial innovation must be grounded in a complete understanding of the operations of the value chain and the specific needs of the target clients.

Other financial instruments such as secured transactions, asset based transactions, and loan guarantee programs will also be important to increase financial flows that support the growth and profitability of agricultural value chains. These products reduce risk and lower costs for financial institutions and value chain actors. Lessons learned with similar products in Haiti, and worldwide, can inform the product development process to ensure success.

Annex One: Executive Summary - The HAP Loan Guarantee Initiative: An Evaluation of Performance and Lessons Learned

The Loan Guarantee Program: The Haiti Hillside Agricultural Program (HAP) is a USAID funded program implemented by DAI from January 2001-March 2007. The HAP program had two main objectives: 1) increase small farmer incomes; 2) contribute to sustainable natural resources management with an emphasis on preventing soil erosion. HAP worked with farmers and farmer associations, providing agricultural technical assistance, management capacity building, market linkages, and access to finance. HAP identified lack of working capital as a major constraint impeding the CBOs ability to market significant volumes to exporters, and therefore developed a loan guarantee program for lending to agricultural marketing CBOs in the cacao, mango, and coffee sectors. Fonkoze, a microcredit NGO, was HAP's partner in the guarantee program.

The loan guarantee operated from September 2001 – March 2006. It provided $200,000 to be disbursed in tranches commensurate to the amount of the outstanding portfolio. During this period, Fonkoze disbursed $1.2 million in working capital to 51 CBOs, one exporter, and the coffee federation FACN. The guarantee mechanism covered at 100% of first loans, and 75% of subsequent loans, for the cacao and mango CBOs and for the coffee federation FACN. It covered 50% of all loans to the CBO members of FACN. FACN also provided a 100% loan guarantee for its members, so the HAP guarantee would only be applied if FACN did not honor its guarantee.[9]

The original loan guarantee agreement included a provision that all funds remaining in the collateral account at the end of the guarantee program period would become the property of Fonkoze, for use as loan capital. Both HAP and Fonkoze made strategic decisions and engaged in long term planning that incorporated this future availability of capital. A later USAID review of the grant agreement required an amendment stipulating that all funds not disbursed through guarantee claims would be returned to HAP. This had a significant impact on Fonkoze's capacity to continue sustainable lending at the levels established during the loan period.

Performance Evaluation: The performance of the loan guarantee program is considered from two perspectives: the program's success in meeting its objectives; and the financial performance of the guaranteed portfolio.

The loan guarantee program succeeded in meeting its three main objectives, as described below:

1. *Increase access to credit for agricultural marketing CBOs*
   Credit to the cacao, mango and coffee sectors was increased over the guarantee period by $1.2 million, benefiting 51 CBOs. However, the vast majority of

[9] Additional details are described in the report, including diminishing coverage percentage for loans over $15,000.

lending (85%) targeted the coffee sector, with only 12% to the cacao sector and 3% to the mango sector. The limited effective demand in the cacao and mango sectors presents a challenge to increasing credit.

2. *Develop a sustainable market driven supply of credit to the CBOs*
   Fonkoze continues to extend credit to all sectors, though at lower levels than during the loan guarantee period. Challenges to continued lending include: liquidity, competing strategic commitments, limited effective demand, loss of HAP as a technical partner, and limited institutional expertise.

3. *Increase competitiveness and volumes of CBO marketing activities, resulting in increased small farmer incomes*
   In all sectors, increased access to working capital enabled the CBOs to increase volumes and to capture an increased percentage of farmer production (vis a vis other traders). These increases were sustainable despite variations in borrowing levels. Since in all cases CBOs pay higher prices than other traders, the increased market share by the CBOs translates directly to increased farmer income. In the cacao sector, evidence shows that during the borrowing period small farmers also increased their share of the world market price from 31% to 49%. In the mango sector, evidence shows that when CBOs were able to compete for larger market share, trader prices increased disproportionately to world market price increases and to CBO price increases.

The financial performance of the loan guarantee itself is straightforward. Eight principal claims against the guarantee were made, for a total of $88,056. Based on percentage coverage, this resulted in payments of $59,506 from the guarantee fund. Principal payments by the guarantee fund were 5% of total lending disbursed. Therefore, each dollar paid out in guarantee payments leveraged over twenty dollars in lending. Given the general dismal state of agricultural finance in Haiti and the upheaval in the political-economic climate during the duration of the program, these figures are indeed impressive.

A more detailed examination of the performance of the HAP guaranteed portfolio, however, shows that an additional $296,035 (25%) in defaulted principal payments was covered through other mechanisms. The coffee federation FACN and the HAP program provided these additional payments for association loans that would have otherwise defaulted. Therefore, the real default rate on the portfolio which should be considered for future risk assessments was 32%.

The HAP loan guarantee initiative provides both positive lessons learned and challenges for continued lending to agricultural marketing CBOs in Haiti, and for any loan guarantees intended to catalyze rural and agricultural lending. Primary issues concerned:

- Loan product design
  - Importance of flexible access to credit during marketing season peaks and troughs
  - Interest rates must be affordable for the borrowers, and interest payments should be scheduled according to cash flows

    - Relationship banking can contribute to long term partnerships
    - Valuable to have receipts assigned to lender
- Loan monitoring systems
    - Important to have loan officers close to the borrowers
    - Important that the financial institution is responsible for performance monitoring
- Strategic commitment and long term planning
    - Clear understanding of resource requirements for sustainable success, and strategic long term commitment by the financial institution, are crucial
- Branch engagement in the program
    - Disperse rural borrowers need the attention of branch staff for monitoring and future borrowing. Difficult to carry this out from headquarters.
- Role of working capital credit
    - Access to borrowed working capital plays a key role at specific times during the marketing season. CBOs pursue an overall financial strategy which uses multiple sources of funds. It is critical that product design meets the specific timing and amounts needed by borrowers.
- Importance of broad based technical assistance
    - Upgrading in value chains requires technical assistance as well as access to capital. Many of the program successes in increasing volumes, increasing quality, and increasing competitiveness and profits were the result of a combination of technical assistance and access to capital.

Fonkoze lending to the coffee sector provided specific challenges in relationship to FACN. These challenges included the moral hazard of relying on FACN for monitoring of members' performance, and the lack of accountability or evaluation at the individual association level.

The HAP loan guarantee initiative provides an excellent model of collaboration with a financial institution to develop a sustainable supply of credit to the agriculture sector. The primary objectives were met, with increased access to finance and improved performance of CBOs. Lending continues after the end of the guarantee program, though at lower volumes. While the percentage default on the entire portfolio was high, the primary difficulties were in the coffee sector. Lessons learned suggest modifications to loan product design and management that could further increase the long-term availability of working capital.

Annex Two: Identification of Potential Market Opportunities in Rural Value Chains in Haiti

Republic of Haiti
Ministry of Agriculture, Natural Resources and Rural Development
By
Interamerican Development Bank
French Fund for Technical Cooperation

These reports present a "horizontal analysis" of cross cutting factors that impact the entire rural economy, and a "vertical analysis" of 40 value chains in rural and agricultural economies of the country.

The horizontal analysis addresses :

- The macroeconomic environment an dits impact on national agricultural production
- Rural finance
- Rural workforce
- Land title
- Sanitary and phyto-sanitary standards

The value chains selected for study included :
Cereals: rice, maize, sorghum
Legumes: beans, peanuts, peas (pois congo)
Bananas
Yams
Sugar cane
Fruits
Cut flowers
Ornamental plants
Coffee
Cacao
Essential oils
Caprins
Bovins
Pork
Poultry
Rabbits
Bees
Rural artisanal production

Each value chain was described including the actors and the marketing channels, the volumes, prices and added values, the constraints and opportunities, and recommendations for supporting the growth and development of the sector.

These reports provided an input to the choice of 12 value chains which will be strengthened through the program:

LE PROGRAMME DE DÉVELOPPEMENT ECONOMIQUE DES FILIÈRES RURALES « DEFI » - Montant ~ 18 MUSD – Durée 5 ans – Exécution : MARNDR

There are important synergies between the program DEFI and Haiti MSME:

1) The DEFI value chain assessments are an important input to the MSME program – providing an excellent base of information regarding the operations of 40 value chains.
2) Haiti MSME will deepen the understanding of the financial constraints that present obstacles to the expansion of the value chain, and design programming to address those constraints.
3) DEFI does not have a rural finance component, and will focus on the constraints to productivity and competitiveness. Collaboration between the two programs can alleviate both production and finance constraints, providing greater opportunities for growth.

There are also opportunities for collaboration with the "Programme de renforcement intégré du milieu des affaires – PRIMA"(financed by the European Union) which will work to strengthen 8 value chains.