The Foreign Policy Centre

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ROUNDTABLE DISCUSSION SUMMARY NOTE

This roundtable discussion took place on Wednesday 26th March 2014.

ENTERPRISING AFRICA: WHAT ROLE CAN FINANCIAL INCLUSION PLAY IN DRIVING EMPLOYMENT-LED GROWTH?

'Creating new businesses and new jobs: Exploring how financial inclusion stimulates agricultural and industrial development' was the second in a series of three roundtable discussions supported by Barclays. The event aimed to take a more sectorial focus to explore the potential impact of financial inclusion in driving the expansion of jobs in agriculture and manufacturing across the continent.

Discussions principally focused on how financial institutions might offer greater flexibility to small enterprise, helping them to better identify, manage and address risks to grow their businesses and ultimately expand employment.

SUMMARY OF ISSUES EXPLORED

1. Creating competitive lending environments to support employment creation.
2. Improving access to capital for enterprise requires the development of better tools to assess risk.
3. Improving the commercial viability of small scale farming across Africa.
4. Training agricultural entrepreneurs to manage complexity.

CREATING COMPETITIVE LENDING ENVIRONMENTS TO SUPPORT EMPLOYMENT CREATION

In order to fully explore the jobs objective, stakeholders need to understand what types of financial access create jobs and then develop the institutional infrastructure to ensure employment generating businesses have adequate access to affordable credit, appropriate savings instruments and other financial services and products. The development of competition in lending markets (across Africa) has led to the emergence of new African (and other) financial institutions increasingly focused on domestic markets and small firms/enterprises. The once perverse incentives for lenders to provide credit to national governments at high rates – which would be taken up due to poor fiscal management – have been removed and no longer crowds-out lending to the private sector.

In addition, increasing competition in credit markets has help to drives down costs even further due to the growing provision of electronic payment platforms. This electronic payment infrastructure reduces the cost of doing business by decreasing the risks associated with managing cash transactions – which are often hugely expensive for small entrepreneurs, particularly in agriculture. Universal postal services can also work to facilitate the distribution of financial services and products (and thus reduce costs) - particularly in rural areas where mobile network coverage is limited - through integrating supply chains in the areas of finance, logistics and communications. Given the advent of these new payment platforms, there are concerns related to developing better financial literacy, particularly for rural dwellers, to help build trust.

In Kenya, for example, the brand recognition provided by products such as M-Pesa for mobile payment services and M-Bima for accessing insurance products via a mobile phone platform, has gone some way to overcoming the trust dilemma. In the case of Nigeria, a public private partnership between MasterCard and the Nigerian Central Bank has been launched to promote financial inclusion through dual purpose national ID payment cards. While this scheme has only recently been launched (so it would be premature to assess its impact), there are concerns that it might lead to overregulation through a lack of flexibility and competition, as the current system is over-reliant on point of sale (POS) devices.

IMPROVING ACCESS TO CAPITAL FOR ENTERPRISE REQUIRES THE DEVELOPMENT OF BETTER TOOLS TO ASSESS RISK

For many agricultural enterprises, limited access to capital constrains their ability to expand employment. Securing access to affordable finance is hampered by a lack of adequate institutions which provide relevant information to build trust, transparency and adequately price and mitigate risk.

Survey data compiled by Afrobarometer registered disproportionately low levels of trust by citizens across Africa compared to other developing countries. This arguably constrains the development of financial institutions. Low levels of public trust might be attributed to the transatlantic slave trade and colonialisation. These brutal systems of exploitation and acquisition damaged community and regional social fabrics. Yet, in a country like Bangladesh, public confidence is also low and yet the development of financial institutions has made good progress.

Bridging the trust gap by developing new ways to reduce risk, would enable financial service providers and entrepreneurs to adequately identify, assess and mitigate risks through the development of appropriate indicators. These could then produce functioning and appropriate credit reporting systems. For providers, this ensures capital is being channelled to the most commercially viable enterprises and for the entrepreneur, reliable credit reporting data generates cheaper credit costs and more flexibility regarding forms of collateral (which is often scarce and might include: cattle loans, warehouse finance and credit card borrowing - used with designated suppliers) in lieu of credit history. In addition, establishing registries for mobile collateral (beyond mortgages and fixed collateral) to help plug the credit information gap may prove to be useful.

IMPROVING THE COMMERCIAL VIABILITY OF SMALL SCALE FARMING ACROSS AFRICA

The agricultural sector across Africa is characterised by small scale farming, some of which is commercial but most of which can be described *as 'too small to be big and yet, too big to be small!'*. This results in such enterprises being served neither by microfinance institutions nor by banks and constrains their ability to access credit to grow. This unwillingness to lend is driven by a number of factors. Production risks, which resource-rich commercial farms are more capable of mitigating against (e.g. through index-linked insurance) compared to smaller-holder farm enterprises. There are price risks associated with whether revenues raised from sales can be adequately re-invested as well as covering the costs of production. In addition, there are risks associated with procuring good quality seeds and fertilisers. Furthermore, there is the lack of technical know-how and extension services (dissemination of useful and practical information related to agriculture) to help increase productivity and alleviate adverse environmental impacts such as deforestation which is often adopted to expand farmland. Furthermore, there are issues associated with collateral, particularly where land tenure and access to land (either buying or leasing) can be problematic. In order to support the profitability of the sector, what role might financial institutions and national and regional governments play in helping small scale farming enterprises build and develop business networks to mitigate those risks which prevent employment expansion across the sector? How can the advantages and limitations of small scale farmers working collaboratively through producer cooperatives be better understood? This might: promote intragroup/peer-to-peer lending, build extension services, support the development of more viable and sizable economic sales and procurement units through pooling, build value chains - which might commit to buying agricultural off-takes as well as provide access to technical assistance (through MNCs). This could all go some way to help increase levels of profitability, reduce risk and ultimately build resilience to expand employment for small scale farmers. Yet, while the collectivisation of small farms into coops could prove very effective at managing risks, the success rate of the cooperative farming model in Africa is mixed. Where coops have succeeded, the roots of the movement has been indigenous and built from the bottom up – as opposed to being imported from outside (e.g. through colonial powers or religious movements).

TRAINING AGRICULTURAL ENTREPRENEURS TO MANAGE COMPLEXITY

In supporting agricultural enterprises to expand employment, financial products and services needs to be local and affordable in order to meet both working/operational capital requirements as well as investment (for business infrastructure and equipment) needs. Ideally, such finance should provide the flexibility needed to promote investment in training entrepreneurs to manage complexity and risks associated with a number of factors:

1. Firstly, risks associated with financial cost, as profit margins are often lower unless large volumes are traded.
2. Secondly, access to capital needs to be provided at an appropriate time which is neither too early nor too late in the season. In addition, adequate timing is crucial to determine the best time to buy agricultural inputs and sell agricultural outputs.
3. Thirdly, accessing or identifying appropriate collateral and guarantees for businesses which often have very few fixed assets.

The often volatile nature of work in the agricultural sector (due to pricing, climate, quality of harvest, mitigating the impact of pests/diseases, etc.) is particularly acute for small enterprises. Support from financial institutions which helps these businesses understand issues such as the nature of the global commodity markets (as there are very few developed commodity exchanges in Africa excluding South Africa and Nigeria) and supports them to identify their target markets and main competitors etc. plays an important part in managing potential risks to smallholder farming (and ultimately increasing employment). Furthermore, financial institutions and donor agencies, diaspora communities, the business community etc. might explore building this risk management capacity through supply chains, trade facilitation and loan guarantees financed by match funding or commitments to buy products.

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On the supply side, a useful example might include using weather or crop-based index-linked data to provide insurance coverage more competitively. However, without appropriate financial literacy and education, innovative products such as index-linked insurance can appear intangible and somewhat suspicious to end users. Thus, without developing financial capabilities, little benefit might be associated with insuring against a weather event that may not happen. On the demand side, SAB Miller's experience in Colombia found that micro-retailers in their value chain, preferred to employ the use of informal money lenders who often charged exorbitant rates. Credit lines from banks were viewed with deep apprehension, as conventionally they had shown little interest in supporting access to finance for this sector or help to develop their businesses. SAB Miller was able to act as an intermediary between the two sides. Thus, the micro retailers' MNC supply chain association provided what might be regarded as a 'credit reference indicator' giving banks the confidence to offer more affordable financial products and services to approximately 10,000 small retailers.

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