

# Profit and Impact

Lessons on operational  
efficiency in agri-SME lending

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# Acknowledgements

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Front cover image from Bianca Thielke.

# Foreword

Small Foundation aims to support initiatives that improve the business ecosystems that proliferate income opportunities for those in extreme poverty by expanding the access of micro, small and medium-sized enterprises (MSMEs) to knowledge, skilled human resources, finance, technology and markets. In the areas of access to finance, Small Foundation's goal is to increase the number of sustainable and scalable business models delivering rural MSME finance and, thus, to close the gap in supply and demand by significantly increasing the volume of capital flowing to rural MSMEs. In essence, Small Foundation is trying to develop the business case that there can be commercial sustainable and profitable business in agri-SME lending to provide an incentive (or 'pull' mechanism) for more local financial service providers (FSPs) to enter the market.

A key element to the sustainability of FSPs is their ability to manage the costs of delivering working capital to rural MSMEs and to maximise various income streams from such operations. Small Foundation seeks innovations in improving the operational viability of FSPs so that they are profitable on a commercial basis, specifically looking at ways to lower transaction costs to deliver small ticket working capital to dispersed and remote customers. While we recognise that transaction costs are only one element within the profitability equation, we believe the focus will allow us to drill down and find solutions to barriers more easily.

This report is a summary of research commissioned by Small Foundation to take a deeper look into business models that are engaged in agri-SME lending and understand how Small Foundation might best support innovation to drive greater efficiency and profitability in the sector.

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# Executive Summary

**Combining the identified best practices and strategies across the different lending stages would likely reduce the challenges that the lenders face, thus improving the prospects of profitability.**

**Improvements in agricultural productivity will be a crucial driver in providing nutrition for the world's growing population, particularly in Africa.** Against this backdrop, Small Foundation commissioned Genesis Analytics to conduct research into the operational processes and financial performance of seven agri-SME lenders, most of which are members of the Council on Smallholder Agricultural Finance (CSAF). The aim of this research was to identify operational best practices across the sample in order to better understand the most effective ways of serving agri-SMEs while keeping risk, costs and turnaround times within an acceptable range to improve efficiency, and ideally profitability.

The main limitation of this research is the small sample size. Out of the seven participants, only six submitted their agricultural portfolio data for operational performance analysis. As such the findings from this research do not represent the overall performance of the entire group of agri-SME lenders.



**The research attempted to measure operational efficiency of lenders in several different ways.**

**First**, the operational processes involved in making and servicing an agricultural loan were documented and benchmarked at each of the lenders. This included the main (level 1) and sub-processes (level 2). Level 1 processes are origination, servicing and recovery and can be further split into a total of six level 2 processes. Lenders turnaround times across each level 2 process were benchmarked, using the average, minimum and maximum turnaround time at each step. The results of this analysis were largely inconclusive, showing dramatic variation across the lenders, with big differences between the minimum and maximum turnaround times across each stage. Lenders performed strongly in certain stages, only to perform poorly in others indicating that no single lender had a highly efficient process from beginning to end.

**Second**, income and expenditure data for each lender was also gathered and allocated across the different stages of the lending cycle and by process. This provided some additional insight:

- Origination of new business emerged as the single largest cost driver for the lending group, while servicing was a proportionally much smaller cost. However, cost structures varied substantially across the group, suggesting that the lenders face cost minimisation challenges at different stages of their business and have not converged to a single cost structure that represents operationally efficient agricultural lending across the board.
- Notably, some lenders returned a positive gross income figure, indicating profitability before taking underwriting losses into account, with losses then turning income negative.
- As far as minimising write off costs is concerned, higher expenditure during the earlier stages of the loan lifecycle do not appear to dramatically reduce write off costs, i.e. committing more resources to the origination and servicing stages do not seem to guarantee lower underwriting losses.
- Of note, average loan size did not seem to impact profitability with some lenders with smaller loan sizes performing better than other lenders with seemingly higher average loan sizes.



**The analysis suggests that achieving operating efficiency within an agri-SME context requires managing three interlinking factors:** cost, turnaround time and risk. To assess the lenders' operational efficiency, Genesis in a final phase held in-depth interviews with them at both their field offices and headquarters, and used these insights, as well as their cost data to rank them based on the costs that they incur compared to their total loan book size. In particular, Genesis assessed how automation, process decentralisation and outsourcing can contribute to managing the three factors across the various stages of the loan lifecycle. Genesis identified the most critical challenges faced at each level 2 process, as well as analysing how these influence the lenders' operations.

The lenders displayed substantial variation in operational efficiency, which is reflected in the variation in their financial performance. Given the small sample size, it is difficult to link the above-mentioned identified strategies directly to profitability improvements. Indeed, all the lenders in the sample have motivations beyond profitability and seek to have environmental and social impact which can imply trade-offs in how efficient they can operate. However, some common challenges that added to lenders' costs, turnaround time and risk were identified alongside appropriate mitigating strategies. The table below summarises the main challenges in each process.

Level 2 process	Key Challenge	Key factor	Mitigation strategies
Customer identification and acquisition	Accessing reliable borrower information (due to poor record keeping)	Turnaround time Risk	<b>Decentralisation:</b> Creating a customer relationship database <b>Outsourcing:</b> Leveraging third parties for lead generation
Credit assessment and approval	High cost of due diligence and underwriting processes	Risk Cost	<b>Automation:</b> Use of software for generation of financial models and borrower risk ratings <b>Decentralisation:</b> Devolution of routine loan decisions to regional level
Disbursement	Manual pre-disbursement processes	Turnaround time	<b>Automation:</b> Development of standardised loan documents that can be automatically generated
Monitoring and reporting	High cost of site visits, lack of standardised monitoring approach	Risk Cost	<b>Automation:</b> Use of dedicated software that can process monitoring information and generate reports <b>Outsourcing:</b> Leveraging of third-party monitors and building client capacity
Repayments	Manual repayment processing	Turnaround time	<b>Automation:</b> Use of dedicated software that calculates how repayments are allocated across principal, interest and fees
Collections, restructuring and workouts	Costly and lengthy legal processes	Turnaround time Cost	<b>Outsourcing:</b> Engaging lawyers with debt collection experience, or establishing this capacity in-house



## Profit and Impact

### Lessons on operational efficiency in agri-SME lending

The analysis was unable to conclude which strategies above lead directly to improved profitability. However, combining the identified best practices and strategies across the different lending stages would likely reduce the challenges that the lenders face, thus improving the prospects of profitability. On the whole, the analysis shows that the current, largely inefficient processes employed by most lenders are passable – for now. This is because most lenders are managing a relatively small number of loans. As their businesses scale, however, more sophisticated practices will be required if their internal capacity is to grow along with their portfolios.

Overall, Genesis found that even within the inherently risky context of agri-SME financing, efficient adoption of automation, decentralisation and outsourcing has the potential to drive profitability. Specifically, automation at the disbursement and repayments stages, along with effective use of outsourcing during customer identification and monitoring and decentralisation of credit approval appears to be the recipe favoured by the top-ranked lenders. There is scope for investigating how some of the best practices and solutions discussed earlier can best be implemented across a larger number of agricultural lenders. The research suggests that there is some reason for optimism – it is possible to improve lender efficiency, and thereby drive greater impact reach, but doing so will require a fundamental rethink across both lenders and donors on what it means to be efficient when serving agricultural value chains.



Alterfin



# Introduction

Improvements in agricultural productivity will play a critical role in the growth of several developing markets, particularly in Africa.

With the continent's share of the global population expected to grow in the coming decades, ensuring sufficient nutrition for this larger population will be of paramount importance, as will using Africa's arable land to grow agricultural exports to feed the world's burgeoning population. To that end, the question of how to improve the productivity of agriculture, particularly agricultural small and medium sized enterprises (SMEs), or agri-SMEs, is an important one, with far-reaching consequences.

However, doing so has proved challenging for both development partners and the financial institutions that extend the credit to these agri-SMEs. Agri-SMEs have difficulty with access to finance because they are too large for microfinance institutions (MFIs) and too small, risky, and remote for commercial banks. The agri-SME market segment is also difficult to make profitable because of high servicing costs associated with their dispersed and remote locations and have inherently higher risks associated with the uncertainties of crop production.



Root Capital



Small Foundation commissioned Genesis Analytics to conduct a research program with a cohort of agri-SME lenders<sup>1</sup> (most of which are members of the Council on Smallholder Agricultural Finance – CSAF) to identify whether there are any emerging best practices that can be implemented to improve the profitability of their operations, and thus their reach within the agricultural sector<sup>2</sup>. The interviews and research carried out provided a better understanding of the realities of financing agri-SMEs, with the sample of lenders providing insights across multiple geographies (mostly in Africa and to an extent, Latin America) as well as highlighting the different approaches that are commonly used to serve this group.

Drawing common conclusions is complicated by the range of different lending approaches adopted and the different target groups and value chains on which the lenders focus. Some lenders make use of a value chain business model, where loans are directly distributed to the borrowers (usually cooperatives or private businesses), but repaid via a triangulated agreement with the buyer of the borrower's output. Others focus on equipment-leasing in partnership with equipment suppliers while other lenders make use of a cash flow lending model, which involves providing credit directly to smallholder farmers, or financing other value chain actors that have linkages to smallholder farmers.

These different approaches lead to somewhat different operational processes amongst the lenders. Furthermore, the lenders have environmental and social impact goals which influence the decisions they make on what market segment to serve, which may imply higher operating costs and increased challenges for efficiency. While we recognise these differences, our focus in conducting the analysis was on operational efficiency, i.e. we did not seek to assess whether one approach is fundamentally better than another. Rather, our focus was centred on how lenders can ensure that their operations are as efficient as possible, irrespective of their strategic intent.

While the challenges surrounding the financing of agri-SMEs are all too real, the insights from our research suggest that there is hope – it is possible to implement systems and processes that aid in reducing credit risk, transaction costs and turnaround times in order to move lenders towards a point where their operations become financially sustainable.

<sup>1</sup> Lenders included: Alterfin, Equity for Tanzania, Mango Fund, Oikocredit, Root Capital, Shared Interest, SME Impact Fund

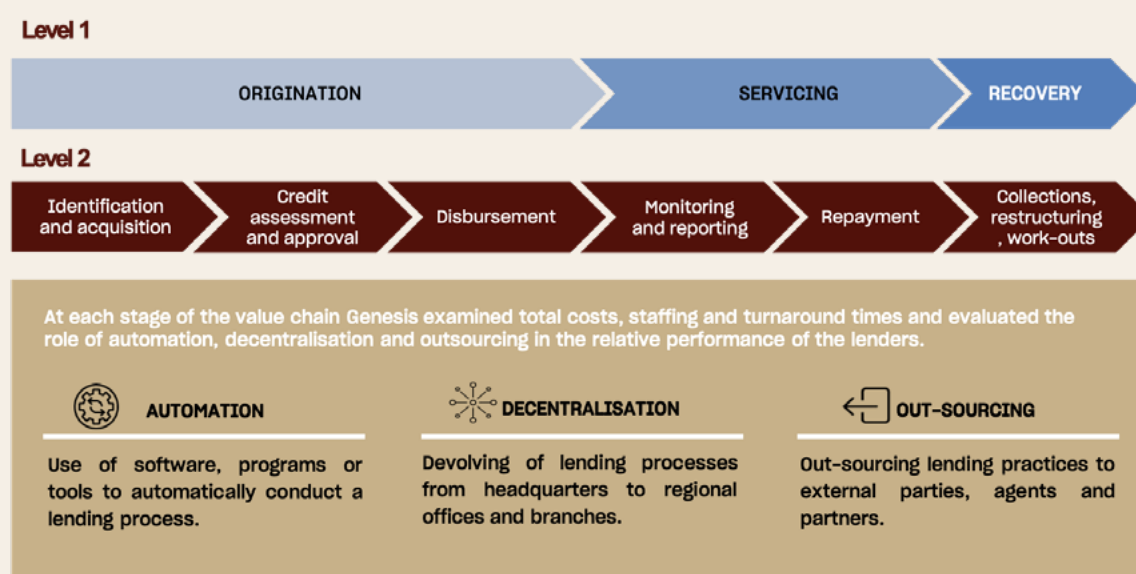
<sup>2</sup> A summary of the key findings from this report can be found here: <https://smallfoundation.ie/blog/>

# Benchmarking agri-SME lender performance

To benchmark the performance of the sample of lenders, we broke down the agri-lending cycle into stages, from the origination of loans, to loan servicing and recovery management. Each of these stages is further broken down into several sub processes (level 2 processes). As shown in Figure 1 below, the origination stage includes the identification and acquisition of new clients, credit assessment and approval, as well as loan disbursement. Loan servicing includes monitoring and reporting as well as receiving and reconciling

loan repayments. Finally, recovery management involves collecting loans that have fallen into default or restructuring them. In benchmarking the lenders, we formed a thorough understanding of the sub-processes that make up these stages across each lender. We also identified and assessed the role that automation, decentralisation and out-sourcing played in each of these sub-processes and how these contribute to overall operational efficiency. Definitions for these three terms are also provided in Figure 1 below.

**Figure 1: Agricultural SME lending operational efficiency framework**



- At each stage of the lending process Genesis identified common pain points for the lenders and assessed these in terms of contributions to risk, cost and longer turnaround time.
- Genesis distinguished top ranking lenders and bottom ranking lenders by looking at their costs per stage relative to total loans originated, and identifying the strategies used to minimise these costs.

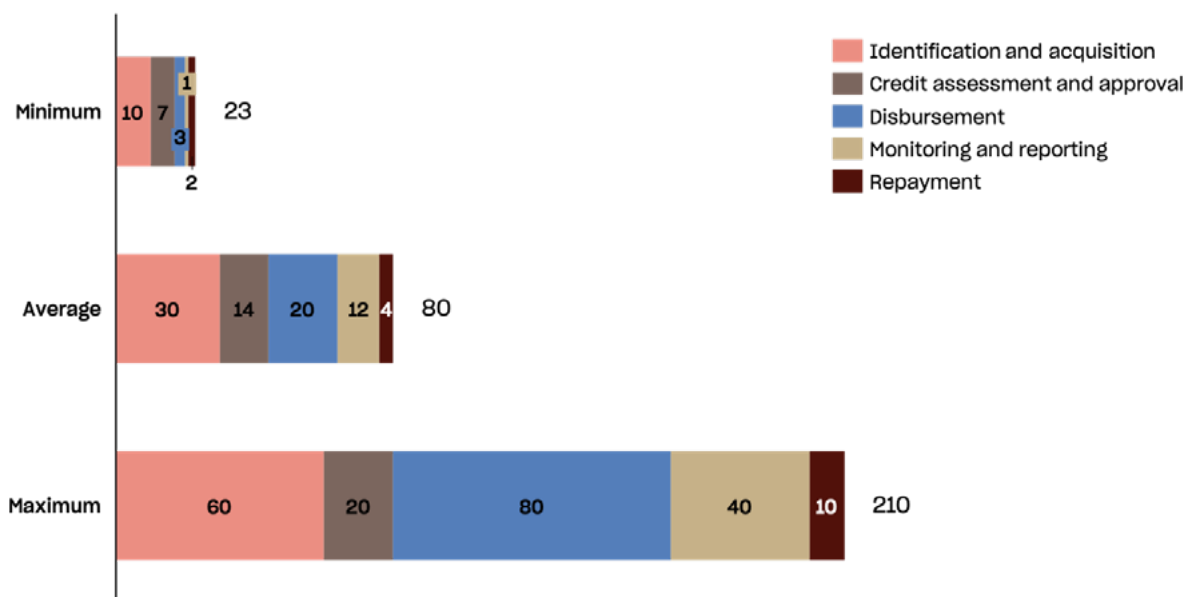
Source: Genesis Analytics



We began by benchmarking the participating lenders by comparing their turnaround times across the six level 2 processes that were mentioned above. The results from this analysis were largely inconclusive – lender performance varied substantially across the stages, with all lenders performing strongly in certain

stages, only to perform poorly in others. In addition, the turnaround times per stage varied dramatically across lenders, with enormous differences in the minimum and maximum turnaround times sometimes being witnessed in each stage as illustrated in Figure 2 below.

**Figure 2: Range of turnaround times across stages of seven agri-SME lenders**



Source: Genesis Team Analysis

The second assessment benchmarked the lenders across the three level 1 processes – origination, servicing and recovery, making use of financial data provided by the lenders drawn from the financial benchmarking studies conducted by Dalberg Advisors in a previous research project for USAID<sup>3</sup>. We proceeded to rank the lenders by analysing the costs incurred at each level 1 stage as a proportion of total value of loans originated across the 2017 and 2018 calendar years. The analysis showed strong economies of scale in lending operations across the portfolio – ie larger lenders had proportionally much lower costs, yet there was quite a range in profitability across lenders with some lenders with smaller portfolios demonstrating positive net incomes. In addition, average loan size did not seem to impact profitability with some lenders with smaller loan sizes performing better

than other lenders with seemingly higher average loan sizes. However, this is not conclusive given the small sample size in the research.

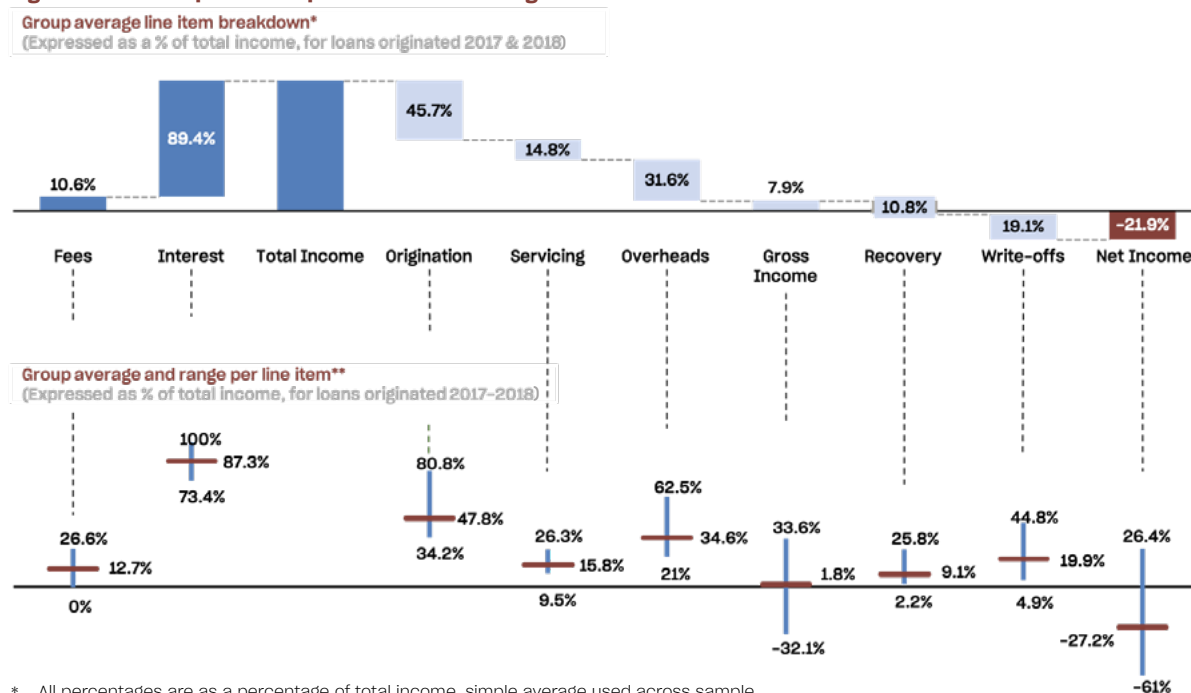
The third assessment considered how the costs were spread across the lending cycle. Figure 3 below shows the average and the substantial variation in the share of costs incurred at each stage of the lending process, as a share of total income.



Blanca Thielke

<sup>3</sup> CSAF Financial Benchmarking Final Learning Report, July 2018, <https://www.agrilinks.org/file/csaf-financial-benchmarking-final-learning-report>

**Figure 3: Overall operational performance of six agri-SME lenders**



\* All percentages are as a percentage of total income, simple average used across sample

\*\* Mean and range, as a percentage of total income, across sample. Green bar represents group average, top and bottom values represent maximum and minimum

Source: Dalberg Advisors

This final analysis brings several interesting insights to light. **Firstly**, originating new business is the single biggest contributor to expenses across the lending group, while servicing existing loans is proportionally a much smaller expense. This has implications for the lenders' ultimate financial sustainability, since the origination phase involves substantial resources being committed to bringing in new business, which may or may not ultimately result in a new loan being created to recoup the expenses incurred.

**The second** observation centres around the distribution of the different cost structures of the lenders, which is highlighted by the lower half of Figure 3 above.

There is a large variation in the relative contribution to total costs of each expense item across the lenders. This suggests that the lenders face challenges in cost minimisation across different operational aspects of their businesses, i.e. they have not converged to a single cost structure that represents agri-SME lending as a whole. This further suggests that at an individual lender level, there are a variety of efficiencies and/or inefficiencies that contribute to lower/higher costs at each stage.

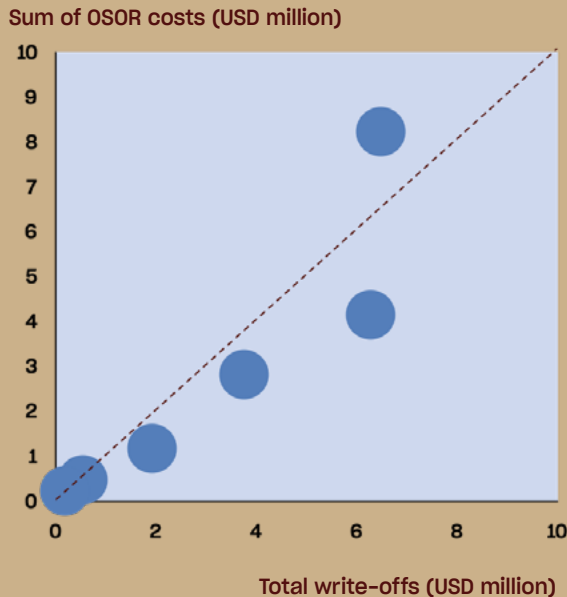
**Thirdly**, overall, the lenders' portfolios are profitable before underwriting losses, as evidenced by the positive gross income figure, i.e. income from loans sufficiently offsets the costs incurred to originate and service these loans, as well as covering overheads. However, additional resources incurred to recover and write-off non-performing loans push the lending group as a whole into a significant loss position. Mitigation of the risks that contribute to recovery and write-off costs is therefore of crucial importance to ensure financial sustainability. We analysed whether there is any correlation between the costs that the lenders incur and their ability to avoid write-offs. Though cost minimisation is a priority for profitability, the distinction between origination, servicing, overheads and recovery (OSOR) and write-off costs is that the former contribute in some sense to income being earned, whereas write-offs represent a deadweight loss. The results are shown in Figure 4 below.





**Figure 4: Total write offs versus total OSOR\* costs (both in USD million)**

\*OSOR: origination, servicing, overheads and recovery



It is more desirable for lenders to lie on or above the line (i.e. relatively high OSOR costs compared to write-offs) than below it (high write-off costs relative to OSOR costs). Two lenders perform best on this measure, keeping write-off costs at a similar value to other lenders, despite having higher OSOR costs (which are incurred as a result of larger loan portfolios). Two lenders fall just under the line, indicating that they have incurred relatively high write-off costs relative to their OSOR expenditure. Or put another way their high operating costs are not resulting in a lower level of write offs. Overall, performance on this measure appears to be mixed when considered across the sample as a whole.

# Best practices and common challenges across the lending group

The results of our analysis of the overall lending sample in the previous section suggests the key to operating efficiently and sustainably within the agri-SME lending context lies in minimising three core factors.

**The first factor is cost.** Ensuring that the various stages of the loan life cycle are executed as cost-effectively as possible is crucial in driving overall performance. While cost minimisation is a priority across the entire operation, it is especially important during the origination phase, when money is tied up in generating new business, but only recouped when loan repayments are received.

**The second factor is turnaround time.** There are a number of sub-processes that must take place during each of the level 1 processes mentioned earlier, and without proper operational processes, certain aspects of the process may be delayed, thus creating inefficiency by eating up staff time.

**The third factor that affects performance is risk.** Ensuring that risk is effectively mitigated along each step of the loan lifecycle is therefore crucial in avoiding costly recovery and write-off processes that erode profitability. Most importantly however we observe that some of the institutions have much higher costs for the same level of risk (as measured by write offs), suggesting that some of these costs could be reduced without increasing overall loan losses.

**The three factors** above are all interlinked. Effective cost minimisation requires that efforts are made to ensure that processes are carried out as quickly as possible, while ensuring that risk is minimised. Similarly, keeping risk to an acceptable level can aid in ensuring that the loan does not incur additional recovery and write-off costs, while also reducing the time spent on attending to these non-performing loans. The key puzzle to be solved in promoting sustainable and profitable lending to agri-SMEs can therefore be summarised as follows: the lenders' internal processes must ensure that new loans are originated as cost effectively and quickly as possible, while retaining an acceptable level of risk.

In order to assess how the above key puzzle may be solved, we conducted in-depth interviews with the lenders, both at their headquarters and their field offices. This allowed us to gain deeper insights to the sub-processes that make up the loan lifecycle, specifically the challenges that the lenders face at each stage, as well as the strategies adopted in order to mitigate these. We evaluated the use of automation, decentralisation and outsourcing across the lenders' operations.

## Origination

During the origination phase, the lenders focus on identifying prospective borrowers and building a complete and accurate picture of their operations in order to gauge the feasibility of extending a loan. Typically, this includes a pre-screening process during which potential clients are compared to certain pre-set criteria, e.g. annual revenue requirements or number of years in operation. Following this, the lenders generally perform a due diligence visit in order to form a more complete picture of the borrower, including gaining a thorough understanding of the applicant's financial situation and how this is likely to change. A formal loan proposal is then drafted and submitted to the investment committee, who approve the loan and authorise the drafting of a formal loan agreement and disbursement of the loan.

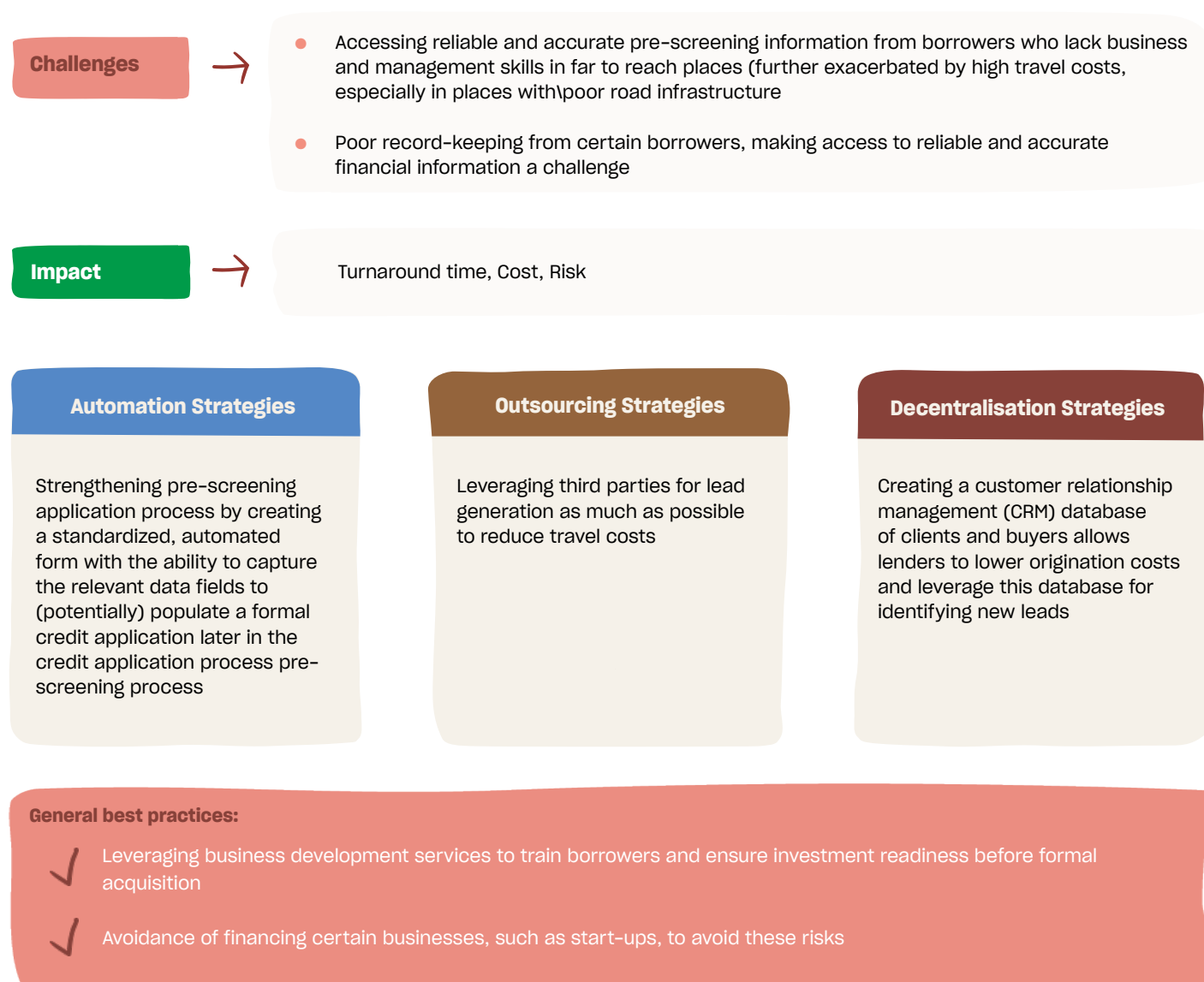
Automation was assumed to contribute positively towards operational efficiency by reducing staff time, and therefore cost. Decentralisation and outsourcing could be either positive or negative influences, but if used properly, both have the potential to reduce costs and improve turnaround time. To that end, we sought to highlight the lenders' use of automation where applicable, as well as the positive contributions of decentralisation and outsourcing.



Across the customer identification and acquisition phase, we found that the most common challenge faced by the lenders relates to accessing accurate and reliable pre-screening information from borrowers, as highlighted in Table 1 below. This is because prospective borrowers tend to lack the capacity to provide in-depth, audited financial figures, or do not keep accurate records spanning any substantial period of time. Some of the larger lenders in the sample made effective use of their own business development services to assist borrowers in building this capacity before allowing them to make a formal application. While this approach is likely to pay dividends for both the lenders in question and the borrowers who undergo such a capacity-building process, most lenders were not able to offer this service (and it comes with its own costs which should ideally be added to the overall cost structure of the business to achieve comparability).

**Table 1: Customer identification and acquisition challenges, strategies and best practices**

## CUSTOMER IDENTIFICATION AND ACQUISITION



Once the pre-screening process is complete, lenders generally struggle with the high cost of performing due diligence visits, as shown in Table 2 below. This is particularly true when the borrower is located in an area with poor infrastructure. Internally, a common challenge relates to the preparation of the loan proposal, which is often too lengthy and contains superfluous information while omitting other more relevant aspects of the application.

Some lenders have responded to this challenge by establishing a credit analyst desk between the investment officer and the credit committee in order to ensure that the final loan proposal contains all relevant requirements. This is a useful checkpoint to ensure quality control, but a more effective solution would likely involve greater capacity building for investment officers in order to ensure a deeper understanding of the agricultural sector (rather than simply a general understanding of the risks involved in lending).



**Table 2: Credit assessment and approval challenges, strategies and best practices**

## CREDIT ASSESSMENT AND APPROVAL

### Challenges



High costs of due diligence exercises, particularly the manual collection and assessment of credit information, validation and valuation of security ownership, as well as the lack of high quality financial information

### Impact



Turnaround time, Cost

### Automation Strategies

- Automation of underwriting process through software, such as for generation of financial models and borrower risk rating
- Automating back office underwriting process by investing in an on-line loan processing workflow platform that stores all relevant information in the cloud and is accessible to all departments involved in the credit application process

### Outsourcing Strategies

Leveraging third parties for lead generation as much as possible to reduce travel costs

### Decentralisation Strategies

Devolution of routine loan decisions to regional level in order to save time

### General best practices:

- ✓ Establishment of a credit analyst desk that sits between the investment officer and credit committee and serves as a checkpoint, thus reducing time for credit committee proposal review
- ✓ Develop greater capacity building initiatives for investment officers to ensure a deeper understanding of specific agricultural value chains these risks

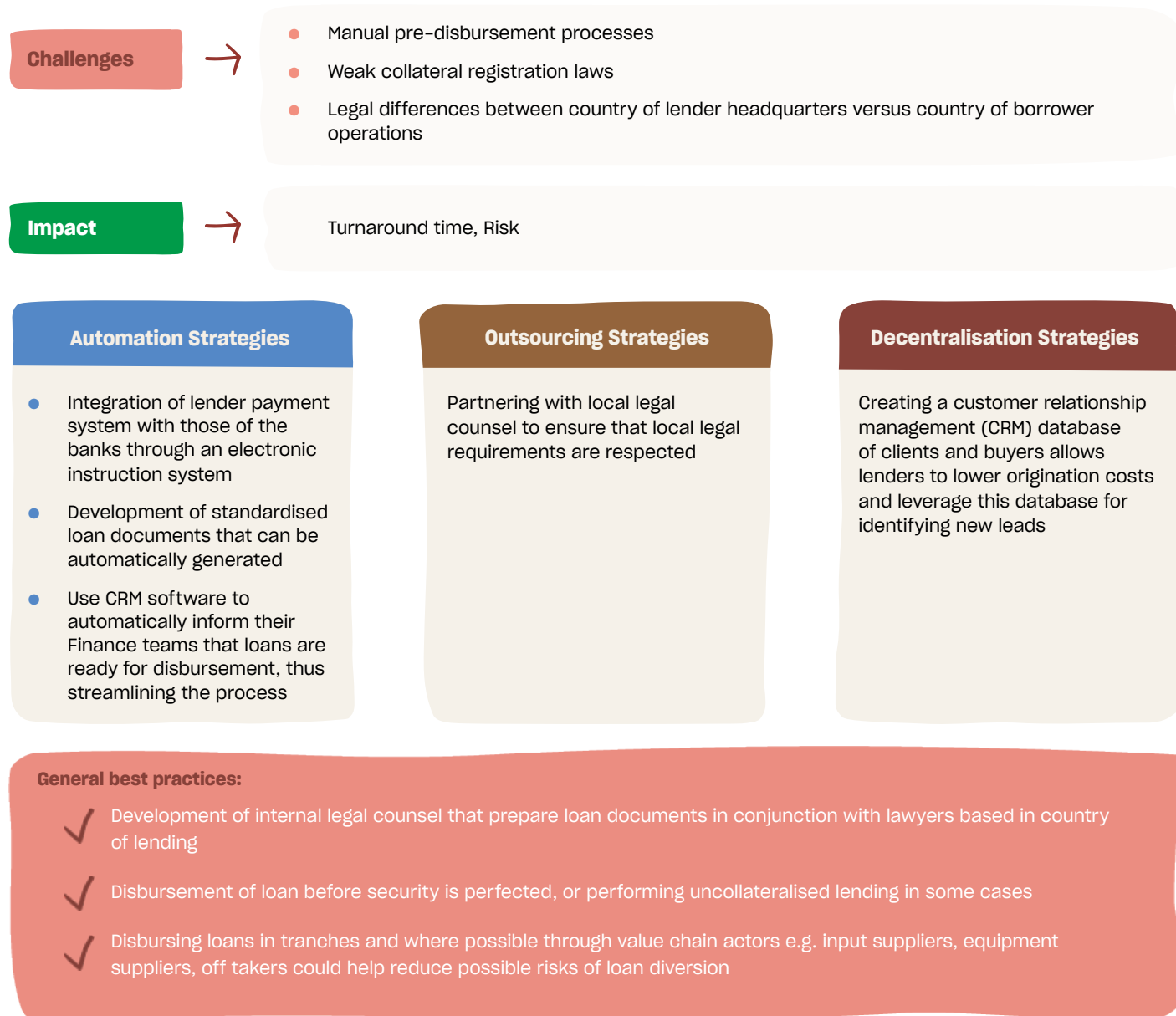
Following loan approval, the process moves to the final stage of the origination phase, disbursement. This stage currently involves substantial manual preparation loan documents from the lenders, which causes a delay in transferring the loan to the borrower. In addition, there are often legal differences between the country where the lender is headquartered and the country where the borrower is located.

Consequently, incorporating unique local legal legislation into the loan agreement sometimes presents a challenge. To combat this challenge, some lenders have successfully created partnerships between their own internal legal counsel and lawyers located in the country, in order to streamline the preparation of the loan agreement, as shown in Table 3 below.



**Table 3: Disbursement challenges, strategies and best practices**

## DISBURSEMENT



## Servicing

Servicing the existing loan portfolio involves processing and reconciling incoming payments, as well as monitoring borrower behaviour in order to ensure that they continue to meet their obligations. The monitoring stage of this phase generally includes physical field visits by investment officers, as well as reports that are submitted by the borrowers themselves. The high cost of these on-site visits was commonly reported as a challenge by the sample of lenders, along with poor record-keeping from the borrowers, which makes it difficult to form a clear picture of recent events.

Some lenders have been able to make effective use of outsourcing, with third-party monitors responsible for monitoring borrower behaviour. Even so, there are substantial operational challenges that affect the efficiency of this stage, which are highlighted in Table 4 below. We found that, in spite of the high costs incurred to perform monitoring visits, not all lenders carry out their monitoring activities as efficiently as they could. Some lenders lack a standardized monitoring template, which means that the same information is not being collected across the board.

In addition, while the collected information may give an indication of a given loan's current condition, not all lenders use the collected information as a formal input into future decisions. In other words, the collected information is not always used to its full potential.

Some lenders, however, do have software solutions that allow for monitoring information to be used as an input in updating a borrower's risk profile. Similar to in the origination phase, some lenders benefitted from leveraging their internal advisory units to build borrower capacity, thus allowing them to place a greater reliance on information submitted by the client, and reducing the need for frequent physical visits.

**Table 4: Monitoring and reporting challenges, strategies and best practices**

## MONITORING AND REPORTING

### Challenges



- High cost of site visits (especially in areas with poor internet connectivity since this makes electronic submission of information more difficult) and accessing credible monitoring information, which makes it difficult to verify that information is accurate
- Lack of a standardised monitoring template means that consistent information is not always collected across the board

### Impact



Cost, Risk

### Automation Strategies

- Investing in dedicated software solutions that can process monitoring information, generate and disseminate monitoring reports
- Use of software solutions to update the borrower risk rating based on inputted monitoring information
- For asset financing cases, investing in remote tracking solutions for assets and their utilisation can also contribute to monitoring efficiencies by reducing costs associated with monitoring visits

### Outsourcing Strategies

Leveraging third party monitors and building capacity of clients to provide monitoring information using internet based channels, where possible, can significantly lower costs of monitoring visits for lenders

### General best practices:

- ✓ Combining monitoring visits with other client visits for lead generation and due diligence visits
- ✓ Leveraging of advisory capacity to train borrowers in order to make submitted information more reliable
- ✓ Standardising the monitoring protocol and ensuring there is consistency in how monitoring information is collected and when monitoring visits are scheduled contributes to quicker monitoring processes. Monitoring templates should be succinct focusing on key issues that are being tracked and should be in an easy to fill format which can be quickly populated. This allows for a more streamlined portfolio assessment process which draws on standardised information



In handling repayments, the key issue identified across most of the lenders centred around the amount of manual work involved. For a number of lenders, payments are identified manually, with bank statements being manually checked every day. Following this, these payments are often manually allocated to the borrower's profile, leading to manual calculation of the amounts to be allocated to fees, interest and the principal. While this approach is passable for some small lenders, it is unsustainable as the business scales. This is especially true when considering that while the client relationship exists at a local level, lenders generally process their repayments at headquarters. As such, any inefficiency that exists at this stage has the potential to create a time-consuming back-and-forth between headquarters and local offices.

Consequently, this is an area where automation has great potential to drive efficiency – and those lenders that have embraced it have been rewarded by a substantially smoother repayment/reconciliation process. There is some correlation between the use of automation during the repayment process and the relative cost of the servicing stage compared to a given lender's total loan value. However, we feel that the key benefit of greater automation during the repayment stage lies in its ability to allow the lenders to easily process a larger number of loans. This is an important consideration for smaller lenders looking to scale their operations. Table 5 below sets out the most common challenges faced during the repayments stage and the best practices commonly used to adapt to these.

**Table 5: Repayments challenges, strategies and best practices**

## REPAYMENTS

### Challenges



- Payment identification and reconciliation, including manual bank statement checks and allocation of payments across fees, interest and principal
- Poor client referencing
- Payments made in foreign exchange are sometimes delayed by Central Banks that delay the process due to a lack of enough foreign exchange to facilitate payments

### Impact



Turnaround time, Cost, Risk

## Automation Strategies

- Investing in dedicated software that automates submitting of notifications to clients when payments become due and reconciles payments when made
- Investing in software that automatically calculates how received payments should be allocated to principal, interest and fees
- Use of software that automatically calculates how received payments should be allocated to principal fees
- Use of software that automatically updates borrower statements after payment reconciliation

### General best practices:

- ✓ Use of a buyer-driven repayment model in order to reduce the time delays in reconciling small borrower payments
- ✓ Creating separate loan payment accounts to avoid mixing of funds which results in lengthy payment allocation processes
- ✓ Using a payment reference system linked to contracts for ease of payment identification reduces lengthy and costly payment identification processes
- ✓ Where possible, and for smaller payments in particular, leveraging mobile money payment solutions can improve efficiencies in the repayment process as these are better referenced and can be made quickly from a mobile device

# Recovery

The recovery process is largely an exercise in mitigating the damage done by a loan falling into default. This often involves following prescriptive legal processes, such as sending demand letters, before ultimately taking legal action in order to recover funds. Given that the recovery process is rather prescriptive from a legal viewpoint and is time-consuming by definition, the challenges in this process can be

attributed more to the process' inherent difficulties, rather than glaring inefficiencies of the part of the lenders.

Generally, the best approach seems to include the establishment of in-house legal counsel, or out-sourcing the process to lawyers who specialise in debt collection, as mentioned in Table 6 below.

**Table 6: Recovery challenges, strategies and best practices**

## COLLECTIONS, RECOVERY AND WRITE-OFFS

### Challenges



- Costly and lengthy legal processes are a common feature of the recovery process
- Weak collateral laws make it more difficult to effectively enforce lender claims

### Impact



Turnaround time, Cost, Risk

### Automation Strategies

Acquiring a dedicated loan management system to track the recovery management process and generate notifications and letters of demand as they become due

### Outsourcing Strategies

Engaging lawyers with debt collection experience directly rather than contacting debt collectors

### General best practices:



Establishment of an internal special collections unit to handle the recovery process





# Conclusion

The lenders in our sample have a common strategic intent – to drive impact across the agricultural value chain by extending access to finance to those not typically served by larger financial institutions. There was, however, substantial variation to be found in the group's operational efficiency, leading to large variations across the lenders' overall financial performance. Given the small sample size in the research and the wide variation in business models, we are unable to conclude which strategies to improve operational efficiency lead directly to improved profitability. However, we see the potential of employing a combination of the various best practice strategies across the lending stages to improve the overall financial performance of individual lenders.

For example, the most efficient lenders generally make effective use of automation when it comes to handling the administrative tasks around loan disbursement and the processing of repayments, as well as the updating of borrower risk ratings based on collected monitoring information. In addition to effective use of automation, there is a lot to be said for decentralising certain processes as far as possible, especially as far as the approval of routine loans are concerned. Finally, outsourcing tasks that require capacity that is not readily available in-house was also found to be an effective to reduce costs – particularly when it comes to the monitoring of borrower performance (which is often a costly exercise if performed by internal staff members), as well as the legal aspects of loan disbursement or the recovery process.

While some of the lenders that we engaged have achieved a degree of automation and have a clearly thought out strategy with respect outsourcing and decentralisation and have seen the associated benefits, in many of the lenders there remains a large amount of inefficient, paper-based or manual work at key stages of the loan lifecycle. We believe that these inefficiencies exist separately from the lenders strategic intent, i.e. the best practices identified during the study are applicable irrespective of a given lender's decision on where to drive impact. In fact, our analysis suggests that they may be of crucial importance if the lenders are to grow the footprint of their impact. The current, largely inefficient processes are passable due to the fact that most of the lenders that we considered are managing a comparatively low number of loans. As their businesses scale, however, more sophisticated practices will be required to ensure that their own capacity stays in stride with their growing portfolios. Indeed, some of the medium-sized lenders in our sample are facing up to this exact bottleneck, where they need to embrace new ways of operating, or find themselves limited by a ceiling.

In short, the noble goal of expanding the impact that agri-SME lenders have on the value chain cannot be separated from the goal of ensuring that these businesses are as operationally efficient as possible. From a donor perspective, there is scope for investigating how some of the best practices and solutions discussed earlier can best be implemented across a larger number of agricultural lenders. Our research suggests that there is some reason for optimism – it is possible to improve lender efficiency, and thereby drive greater impact reach, but doing so will require a fundamental rethink across both lenders and donors on what it means to be efficient when serving agricultural value chains.

## About Small Foundation

Small Foundation is a philanthropic foundation based in Ireland with a vision of Africa free from extreme poverty by 2030. Our mission is to catalyse income-generating opportunities for extremely poor people in rural sub-Saharan Africa. We aim to support initiatives that improve the business ecosystems that proliferate income opportunities for those in extreme poverty by expanding the access of micro, small and medium-sized enterprises (MSMEs) to knowledge, skilled human resources, finance, technology and markets.

[www.smallfoundation.ie](http://www.smallfoundation.ie)

## About Genesis Analytics

Genesis Analytics, established in 1998 and headquartered in Johannesburg, South Africa, is Africa's largest economics-based consultancy, with over 100 professional consultants. Genesis' purpose is to unlock value, especially in Africa, by providing expert recommendations to our clients, backed by rigorous analysis and logic. Genesis has successfully executed assignments across Africa, the Middle East and Europe, relying on the expertise of our teams in South Africa, Nairobi (Kenya), Abidjan (Côte d'Ivoire), Lagos (Nigeria), London (United Kingdom) and Toronto (Canada). Our work extends across a number of areas, including financial services, competition and regulation, behavioural economics and development, amongst others.

<https://www.genesis-analytics.com/>

## About Council on Smallholder Agricultural Finance

The Council on Smallholder Agricultural Finance (CSAF) is the leading global network promoting a responsible finance market for inclusive small- and medium-enterprises (SMEs) in the agriculture sector. Our 13 members are pioneering financial institutions that come together to share learning and develop standards and best practices for a finance market that generates long-term economic, social, and environmental impact by meeting the financing needs of inclusive agricultural SMEs globally. CSAF releases an annual state of the sector report that shares data and learning from members' collective lending (\$700M per year to SMEs aggregating 2M+ smallholder farmers across 65 countries). CSAF members and affiliates include: AgDevCo, Alterfin Global Partnerships, Impact Finance, Incofin Investment Management, MCE Social Capital, Oikocredit, Rabobank's Rabo Rural Fund, responsAbility Investments AG, Root Capital, Shared Interest Society, SME Impact Fund, and Triodos Investment Management.

<https://csaf.org/>

## Participating Lenders







## **Profit and Impact**

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**By Adriaan Slabbert and  
Richard Ketley**

Genesis Analytics