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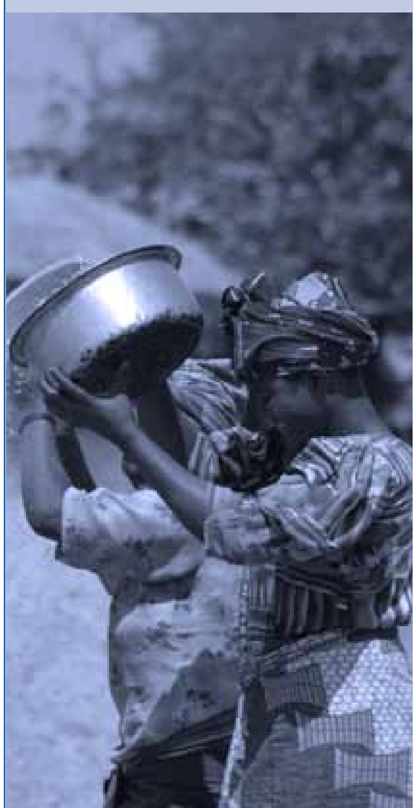
# Microfinance

## OCCASIONAL PAPER

# How Savings-Led Microfinance Has Improved Chickpea Marketing in the Lake Zone of Tanzania



Organizing farmers into groups allows them to bring together their production to create sufficient volume of product for interested buyers. Though effective, implementing this approach has several challenges. One challenge is creating disciplined groups that are able to maintain their cohesiveness when members are faced with immediate household needs following harvest, and need to sell their crop to generate income. Another challenge is determining how to provide access to loans that facilitate the operations of the farmer groups in buying from their members and selling to traders. This paper looks at how savings-led microfinance has helped smallholder producers in Tanzania successfully address these challenges. The following were some of the findings captured during a field study which took place in June 2009.

## *The chickpea promotion project*

In the Lake Zone of Tanzania, chickpea is one of the most important cash crops for small farmers. Farmers sell their crop to middlemen and traders for export to South Asia. Between 2000 and 2008, Catholic Relief Services (CRS) partnered with the Mwanza Rural Housing Project (MRHP) and local farmers to increase chickpea production in the region and improve export marketing. While CRS' financial support for the project ended in 2008, farmers were still engaged in production and marketing activities at the time of the study in 2009.

The ultimate goal of the project was to use a market-oriented approach to increase the incomes of smallholder farmers and their families. The project sought to integrate production, farmer organization, enterprise development, and marketing. The first step was introducing four improved varieties of chickpea. One was an improved *desi* variety of chickpea. The other three varieties were *kabuli* type, which had not previously been grown by farmers. While *desi* chickpea is commonly grown by farmers to be processed into flour for consumption, *kabuli* chickpeas varieties are sold to be consumed as a whole grain and thus can attract a premium price as compared to the varieties used for flour.

One of the challenges faced by farmers during the period 2000-2006 was their lack of success in selling collectively. While they had come together in producer marketing groups to sell their produce collectively, many of the groups lacked the cohesion needed to successfully engage in these marketing activities. As a result, most farmers ended up side selling their chickpeas (on their own) to meet their urgent cash needs at the harvest period.

In 2006, a new model of farmer organization was introduced to the farmers in the MRHP project. This model was based on the Savings and Internal Lending Communities methodology, known as SILC. The evidence of success in nearby CRS projects inspired the application of the SILC model to the chickpea project. Chickpea project staff quickly saw the benefits that the SILC model could bring, particularly in the areas of financial management, group governance, and group cohesion. These skills were seen as critical to create and manage effective farmer groups.

## Need for financing

Before the introduction of SILC, the urgent need for cash at harvest time forced many farmers to quickly sell their produce to the nearest buyer at a low price. This meant that producer marketing groups rarely had sufficient volumes of product for collective sale because they had no means of accessing cash advances. The formal finance sector in Tanzania offered no immediate solution to this problem since banks had yet to develop affordable financial products for smallholder farmers and were unwilling to lend to farmers with little or no collateral.

SILC was introduced in an attempt to find a solution to the smallholder farmers' demand for finance, while at the same time addressing the challenge of cohesiveness within farmers groups. Through SILC, farmers were able to access loans from the group's internal savings to meet immediate food consumption and other cash needs at harvest. Funds through SILC could also be used to purchase agricultural inputs at the beginning of each growing season.

Within the chickpea project, the SILC methodology was quickly incorporated into the creation of a second organizational level after the first year. The SILC groups realized that they could work more effectively together under the umbrella of a SILC Group Association (SIGA). The purpose of the SIGA was to bring together SILC groups for the purpose of achieving the volumes of chickpea necessary to market collectively at higher prices.[1]

## The SILC Group Association

Each SILC group had between 25 and 30 members. SIGAs were made up of 3 or more SILC groups. By mid-2009, 28 SIGAs had been formed from 190 SILC groups with a total membership of 5,020 farmers.

SIGA and SILC structures had similarities and were connected (Figure 1). Members met together to save and borrow. The funds were managed under a governance structure that included a chairperson, a treasurer, and a secretary who were elected by the SILC groups.

1 CRS and MRHP adapted the SIGA model from a pilot that CARE undertook with its partners in Magu district.

**Figure 1: SILC-SIGA Structure showing relationship between SIGA and SILC**

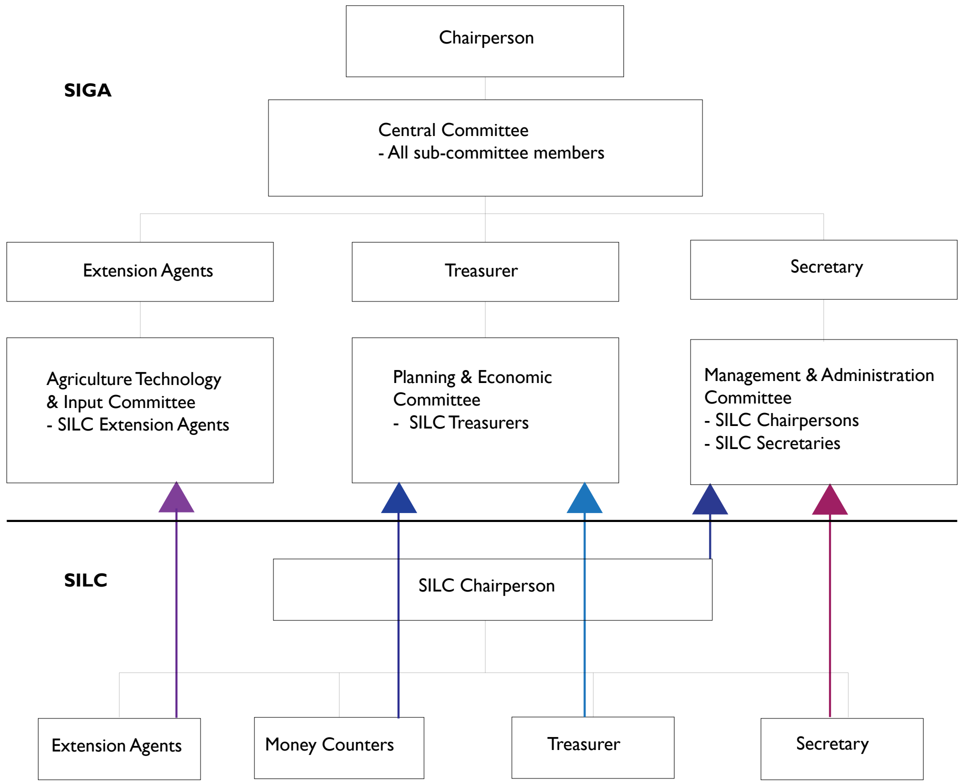



**Figure Developed by Edward Charles**

The SIGA structure included an extension agent, who was assigned to the group by the partner, and one or two community resource persons (CRP) who were responsible for the oversight of the financial activities. The extension agent's role was to facilitate input purchases, link SILC members to government extension services, provide limited agricultural technical support, and ensure the quality of produce that was marketed. The CRPs assisted primarily in developing and supporting SILC groups. They were selected from within the community. In many cases they were well-performing SILC members — perhaps a secretary or treasurer — that had shown exemplary skills in SILC management. The CRP offered his/her services to the community on a voluntary basis, although some CRPs were receiving payment from the SILC groups and the SIGA to which they provide support services.

Each SIGA had three sub-committees: a planning and economic committee, an input and agriculture committee, and a management and administration committee. These sub-committees convened to make decisions on the use of funds, collective marketing and input purchases, and to approve loan requests that come from within the SIGA's scope of operations.

At the time of this study, all leadership positions within the SIGA structure were unpaid with the exception of the secretary who at times received compensation for record keeping during the period of collective marketing and sale. Most SIGAs were not formally registered. Although several were taking steps to do so as they anticipated that it would help protect them legally during the buying and selling process.

## The SIGA's Collective Marketing Function

The SIGAs undertook the following marketing activities:

- Estimating production for sale before the harvest.
- Identifying a trader for crop purchasers.
- Signing delivery contracts.
- Cleaning the crops delivered by the farmers, organizing storage in the warehouse, and preparing crops for delivery to the buyer.
- Ensuring that the quality of the crops delivered met the buyers standards.
- Managing purchase advances from the trader and distributing them to SILC groups.

The SIGA and SILC members met to agree upon an asking price for their crops. The asking price was then used to negotiate the actual price with traders. Although many groups had mobile phones, they did not use them to collect information on prevailing market prices before setting their asking price. Unfortunately, no information was collected as to why this did not occur. Perhaps they did not know this was an option. This lack of knowledge of current prices led to some frustration and mistrust between the farmer groups and traders, particularly as the prices traders offered to pay often fluctuated on a daily basis.

CRS and MRHP were instrumental in developing relationships with the traders on behalf of the farmer groups. As the farmer groups gain experience, they will need to take on the responsibility of maintaining relationships and undertaking negotiations with the traders.

## SIGA's Financial Management Functions

The second function of the SIGAs was financial management. With a demand for cash by farmers at various periods during the production and marketing cycle and an inability to access appropriate financing from financial institutions, SIGAs acted as informal financial intermediaries for certain agriculture activities.

SIGA members contributed to four funds: an operating fund, an input fund, an insurance fund, and an education fund. SIGA members (comprised of SILC group members) benefitted from the use of these funds, from the higher prices obtained through collective sale, and from the commission generated from the SIGA's agreements with traders. The SIGA also bought chickpea from non-members who benefitted from the SIGA's ability to secure a higher price through collective sale but did not benefit from any of the other SIGA services.

### *Operating fund*

At the beginning of each marketing season, SIGA committees came together to estimate the costs to be incurred for collective marketing. All SILC group members were obliged to contribute equally to meeting those operating costs at a rate that was determined by the SIGA committees. SILC group contributions to the operational fund differed from one SIGA to another, ranging between 30,000-45,000 Tsh (US$23-35) per SILC group.

The operating costs included local government taxes per kg sold, the purchase of packaging materials, allowances for the secretary, compensation for those that cleaned and sorted the chickpea, purchase of stationery, meal allowances, and storage space rental.

## *Education, insurance, and input funds*

In addition to the annual operating fee, SILC groups were required to contribute monthly to the insurance fund, the input fund, and the education fund. The availability of these funds enabled households to take out loans to meet their immediate needs without having to sell their crop in the field or quickly to middlemen after the harvest. Farmers could now afford to wait and sell their production through their SIGA and thus receive the additional benefit of a higher price.

SILC members could apply for loans from the input and education funds through their SILC group (to the SIGAs) as needed. These loans incurred a 10% flat interest rate per month to the SILC member, of which 5% went to the SIGA and 5% went to the SILC group. The term for loans from the input fund varied according to the specific crop production cycle. Loans from the education fund had a one month term to pay for children's school fees.

The insurance fund was available to a SILC group in the event that a member passed away. It was used to repay any outstanding loan balance of the SILC member to either the SILC group or the SIGA.

With the exception of the input fund, there were concerns regarding the management of the education and insurance funds at the SIGA level which had little, if anything, to do with agriculture activities. These issues will be discussed later.

## *Traders' advances for procurement*

Procurement financing at the SIGA level was another important component of the financial arrangements for marketing. Buyers advanced funds to the SIGAs to pay for chickpea delivered by members, non-members, and middlemen. These regular cash advances were useful for SIGAs as they did not have the capital to pay for the purchase of chickpea.

The processes involved in handling cash advances and product inventory were recorded on special forms. The forms were used to control the use of advances and the physical inventory of grain coming in and out of the collection centers. The advances were collected by SIGA leaders — usually the treasurer — from the traders. Cash advances were accounted for by comparing the cash advance balance with the actual value of the products collected by the trader's agents from the SIGA collection centers each day.

## *Trade commission paid to the SIGA*

The commission paid by buyers for each kg of chickpea supplied was another important income stream for SIGAs. In 2007, the first year of SIGA operations, the Afrisian Ginning Ltd. paid a commission of Tsh 12/kg. In 2008, the SIGAs changed their buyer from Afrisian to the Export Trading Company and received a higher commission, ranging from Tsh 12 to 20/kg depending on the quantity of chickpeas supplied and mix of Desi and Kabuli varieties.

Many SIGAs had chosen to set twenty-five percent of the commission aside to capitalize the input fund. This allowed them to provide short-term loans to farmers once they had delivered their production to the SIGA, but for which the SIGA had not yet received payment. When the full commission was paid to the SIGA, the remaining 75% was forwarded to the SILC groups on a pro rated basis (volume sold). The SILC groups in turn distributed it to their members based on the volume each provided.

## Outcomes from the collective marketing efforts of the SIGAs

In 2007, the first year of collective sales, the SIGAs sold their chickpea to Afrisian Ginning Ltd. In total 9,150 farmers (1,048 SIGA SILC members and 8,102 non-SIGA members) sold 1,352 metric tons (MT) of chickpea through SIGAs. In order to have a greater return the SIGA's encouraged non SILC members to market collectively with them. It was thought if they saw the advantage of this then they would be interested in joining SILC groups later. This, however, did not occur.

In the second year they changed from Afrisian to the Export Trading Company; however, this change was not positive. The Export Trading Company used a different system from Afrisian to advance cash to the SIGAs. First, the advances were not available on a regular basis. Second, most of the advances to SIGAs were channeled through the Export Trading Company's agents located in the various production areas. Since the Export Trading Company's agents also collected products from middlemen, who are in direct competition with the SIGAs, this arrangement did not favor the SIGAs and actually reduced the volumes that were marketed through them.

This problem was exacerbated by the global economic crisis, which caused a wide fluctuation in commodity prices during 2008. At one point, the Export Trading Company ceased making advances to the SIGAs. In the end this significantly reduced the number of farmers willing to sell through the SIGAs. As such, only 2,380 farmers (946 SIGA members and 1,434 non-SIGA members) sold a total of 482 MT through the SIGAs.

Despite the reduced collective marketing activity, farmers did continue the saving and lending activities in their SILC groups. While CRS' financial support for the project had ended, many of the SIGAs reconvened in 2009 and collective marketing has been expanded to include green gram.

## Challenges with the SIGA model

The performance of the SIGAs has been somewhat shaky, partly due to external factors as discussed above and partly due to some of the structural issues related to the model. Some of the structural challenges include:

### The Limited Marketing Skills of SIGA Committees

Given that the SIGA committees were composed of the leaders of the SILC groups, which were primarily for microfinance and social services, few of their leaders had any relevant experience in marketing. This led to a greater emphasis on the microfinance activities rather than on the marketing functions within the SIGAs. Weaknesses included limited skills in market assessments, quality assurance, and negotiation with traders.

### Weak Fund Management

Setting aside funds for production and marketing activities was useful for a SIGA. However, the necessity of managing the education and insurance funds at the SIGA level was questionable. Since the education fund was being used primarily for school fees for children of SILC members, and not to improve knowledge on agriculture technologies, funds would have been better managed at the SILC level.

The management of multiple funds at the SIGA level also posed a challenge for bookkeepers, who did not have sufficient skills for data capture or in the use of an appropriate management information system to capture and analyze the data.

There is also the possibility that payment demands on the insurance fund would exceed the resources available, which has not yet occurred. Experience with actuarial calculations show that it is a matter of when and not whether this will occur. Discussions with a local insurance company to ensure that these funds could be used to pay for premiums to better cover the risk would mitigate the outcome from this happening.

### Complex SIGA Governance

The SIGA structure was much more complex than the SILC structures. One of the key considerations for sustainability and replication was how to ensure that the management structure was both robust and manageable. Since the primary purpose of the SIGA was to facilitate collective marketing, the structure and role of the SIGA sub-committees should reflect this purpose. At this time, it appears that those activities that have little to do with collective marketing and production should be removed from the SIGA, until they have fully managed the basic activities.

### Lack of Transparency

One of the benefits of the SILC model is that a group is fully accountable to its members with respect to what finances exist and how they are being used. This was not the case in the SIGA model. It was not clear if SILC group members actually knew how much money was being managed at the SIGA level and how it was being used. One of the reasons for this was the management of multiple funds, which could lead to potential abuses, given there were too few control systems at the SIGA level.

## Building on the SIGA Experience—Making the Model Work

Despite these challenges, the SIGA model holds a lot of promise. SIGAs are an excellent entry point for linking smallholder farmers to traders so that they can maximize the net

income (profits) from their production that would not have been otherwise possible. There are two important points to help strengthen the SIGA model. These include:

1. *Understanding what holds the SIGA together*. One of the challenges highlighted under the initial producer marketing group model was the lack of cohesion among the farmers at the time of sale. Under the SIGA model, greater cohesion of groups had been achieved despite the challenges experienced in 2008. If money management is the 'glue' that holds SILC groups together, then it might be expected that the same will be true for the SIGAs. In this sense, SIGAs should maintain and strengthen their financial functions but avoid competing with SILC. This means that the funds managed at the SIGA level should focus primarily on those core functions that are imperative for collective marketing.

2. *Understanding the core benefits of the SIGAs for participating farmers*. SILC members can find tremendous value in participating in a SIGA for collective marketing. Some traders, such as the Afrisian Company, saw value in working with the SIGAs, especially if there was potential for scaling up to include more farmers. At the time of the study, the volume of chickpeas that Afrisian purchased from the SIGAs represented only about 1% of Afrisian's portfolio. This confirmed that SILC groups were unlikely to be viable units for collective marketing to large traders such as Afrisian and thus would need to come together in SIGAs.

Given these two issues, there are a number of pieces to the model that would need to be modified and strengthened in order for it to work more efficiently. These include:

1. Simplifying the current structure to focus on the core purpose of the SIGA model. Since the primary purpose of the SIGA is to mobilize farmers for more effective collective marketing, then the structure, activities, and fund use should concentrate only on these core activities.

2. Reinforcing the skills necessary for recording and maintaining the balances of the funds deemed essential at the SIGA level. While the techniques used at the SILC level are transferable, the demands at the SIGA level are greater and thus require better skills.

3. Ensuring sufficient assistance is given to SIGAs to develop their negotiation skills as well as their skills in assessing and maintaining the quality of produce being sold to traders. For the traders, these were two key deficiencies that could negatively impact their long-term relationship with the SIGAs.

4. Working with SIGAs over a number of cycles to determine at what point SIGAs are able to manage both their marketing and financial management activities on their own.

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