

A Summary

June, 2010

About Mercy Corps

Mercy Corps helps people in the world's toughest places turn the crises of natural disaster, poverty and conflict into opportunities for progress. Driven by local needs and market conditions, our programs provide communities with the tools and support they need to transform their own lives. Our worldwide team of 3,700 professionals is improving the lives of 14.5 million people in more than 40 countries.

For more information, visit

www.mercycorps.org



Central African Republic — Jenny Vaughan/Mercy Corps



Guatemala — David Evans/Mercy Corps

Developed by Andrea Mottram

Agricultural Development

Combining high-impact¹ value chain development with access to financial services

Context

Nearly half of the world's workforce relies on growing food for their livelihoods². That equals two billion people in the developing world — 400 million smallholder³ farmers and their families. Farmers grow crops and raise livestock to put meals on their own tables and to sell their products in the marketplace, earning the income they need to provide for their families.

Although their work could not be more important, smallholder farmers remain some of the poorest people in the world. Most live on less than \$2 a day and tough challenges limit their ability to successfully compete in the marketplace. Farmers must contend with poor infrastructure, unfavorable governance, limited access to business services, and a range of daunting laws, regulations and standards. These challenges mean that they have limited opportunities to raise themselves out of poverty.

Effective agricultural development gives smallholder farmers the boost they need to make their labor more profitable and increase standards of life for their families. It also has benefits that extend far beyond the farm, helping to address such global challenges as hunger, climate change and international security.

Recognizing this vital role across a spectrum of challenges — from household food security to large-scale economic development — Mercy Corps is currently investing more than \$145 million in agricultural development. The organization works with smallholder farmers, agricultural businesses and governments to reduce hunger, increase incomes and mitigate the environmental impact of crops and livestock.

“There is no other training in this area, this is the first time I have ever attended any cardamom training; we need much more training like this for other crops.”

— female farmer from loan group Bhalukhop, Nepal

¹High-impact investments are those that a) reach a large number of participants; b) sustainably create high economic returns; and c) fulfill locally specific social and environmental indicators

²World Bank Development Database

³Smallholder farmers are typically defined as those operating a farm of 2 ha or less

Useful definitions

Value chains are the full range of activities required to bring a product or service from its conception to final consumers and disposal.

Value chain development is the process by which businesses are linked to growing markets.

Financial services are the wide array of formal and informal services used by households and enterprises including savings, loans, insurance, remittances and leasing services.

Market systems are an arrangement of people, trading structure and rules that determines how a particular good or services is produced, accessed and exchanged.



Kyrgyzstan — Andrea Mottram/Mercy Corps

An analysis of a combined approach

Increasingly Mercy Corps has combined multiple program approaches in recognition of the need to ensure farmers' access to investment capital and other financial services, increase farmer productivity, and increase the competitiveness of the agricultural production markets. One such effort has been to combine *high-impact value-chain development and increased access to financial services*. After several years of program implementation Mercy Corps has undertaken a study to analyze whether this combined approach is in fact more effective than focusing on each element separately.

Information was collected from a variety of stakeholders (microfinance institution staff, smallholder farmers, traders, government representatives and Mercy Corps team members) and a variety of sources (case studies from Kyrgyzstan and Nepal, program results from Guatemala, Central African Republic and Indonesia, survey data from 12 countries, analysis of a multi-country program, and reviews by Mercy Corps technical experts).

The study demonstrates that developing value chains while improving access to financial services is effective because the approach helps smallholder farmers *1) more productively invest in improving their businesses; 2) acquire technical information so they can maximize investments and increase productivity; and 3) access more profitable and sustainable markets that let them earn higher incomes*.

In addition, with this technical support the farmers become less risky clients for the financial institutions, increasing the likelihood that these institutions will develop appropriate agricultural loan products and encourage farmers to borrow from them. By working together on many levels, the various stakeholders build knowledge, relationships and trust as a result of their participation.

Under a financial services-only model, both farmers and institutions take on more risk. Farmers may obtain a loan — but without the technical knowledge and market access to make best use of it, they are less likely to capitalize on opportunities to increase profits. Under a value-chain-only model, farmers remain trapped in borrowing cycles that often carry high interest rates, limit where they can sell their goods, force them to settle for low prices, and hinder their ability to expand their businesses.

Recommendations for project interventions

Three steps are essential to the success of a combined approach to agricultural development:

1. *Public, private and civil society stakeholders must be mobilized from the outset*. These relationships form a foundation that enables the more challenging activities to take hold, such as collective purchasing and marketing, greater learning and technical understanding, increased advocacy for smallholder farmers and improved access to markets.

“The EcoSad loan [specific loan product combined with technical knowledge] makes us spend the money on things we need for our apple business like seedlings, and we have knowledge from the trainers on where to buy seedlings from”

– Participating farmer from the EcoSad training and loan group, Kichy Jargylcbak, Kyrgyzstan



Kyrgyzstan — Jason Sangster for Mercy Corps

2. **Provide access to agricultural, business and financial services in a sustainable manner, through existing market players.** For example facilitate the provision of technical services through input suppliers, financial services through financial institutions or enable a financial institution to deliver financial and agricultural technical services through one product.

Microfinance institution (MFI) partners that provide financial services to smallholder farmers must already be sufficiently sound and sustainable to ride out any shocks from adding agriculture lending and must take on a commitment to make agriculture lending a key part of their activities.

When MFI partners open new branches to reach smallholder farmers, operating subsidies can be offered for a limited time but they should be structured to encourage MFIs to reach profitability and plan for long-term sustainability.

Where there are no MFIs, informal lending groups such as village savings and loan associations (VSLAs) can be supported — with the understanding that loans are limited to members’ capacity to save, and cannot provide for all credit needs of small-holder farmers. Informal borrowing can be a good stepping stone toward more formal borrowing, as long as MFI options are eventually available.

3. **Improve farmers’ access to markets** through such activities as marketing and facilitating pre-season contracts between smallholder farmers and buyers. Farmers should be helped to gain a clear understanding of market participants (buyers and sellers), support functions (infrastructure and financial services), rules and norms (formal and traditional) and the other players (private, public and civic) that collectively constitute the market system. Linkages should be facilitated between all these players and across the market system in order to benefit the entire value chain.

Recommendations for project design and manage-

Based on the study, the following program design and management recommendations are crucial to achieving sustainable, high-quality results:

1. From the outset, plan and fund value chain and wider market research **assessments** with local stakeholders. Such assessments ensure good understanding of the commodity and financial markets and help identify constraints and multiple leverage points. Ultimately, the profit potential of any investment in value chains or financial institutions must be quantified in order to design effective programs and compelling fundraising.
2. Within each program, **define high-impact** within the local context. In most cases, particularly in short timeframe projects, only those commodities that farmers already have some knowledge of, and only those that already contribute substantially to farmers’ household incomes should be identified as high-impact.

The full *Agricultural Development Learning Study: Understanding the effectiveness of combining high-impact value chain development with improved access to financial services* can be found on the Mercy Corps Digital Library, or copies can be requested from Anna Young, Director for Strategy and Learning (ayoung@mercycorps.org)



Central African Republic — Jenny Vaughan/Mercy Corps



Nepal — Andrea Mottram/Mercy Corps

www.mercycorps.org

United States

45 SW Ankeny Street
Portland, OR 97204
503.896.5000 tel
503.896.5011 fax
mercycorps.org

Europe

40 Sciennes
Edinburgh EH9 1NJ
Scotland, UK
44 131 662 5160 tel
44 131 662 6648 fax

3. **Team skills**, such as experience in the private and financial sectors, are critical to program success. To ensure program quality, hire team members with experience in these sectors and train them in the relevant tools and frameworks. A real-time monitoring web page that displays project information and results would also help to create a learning- and results-driven environment.
4. Nearly half of the agriculture projects were judged by program teams to have **insufficient timeframes**; this, combined with limitations in funding and team knowledge, affected the quality and impact of the projects. The following are the proposed optimum timeframes: one year for pilots with direct farmer intervention; two to three years for annual crops, livestock and commodities with some level of organizational development; five to six years for perennials and minimal levels of organizational development. When donor limitations only allow short-term projects, as is often the case, such projects must be designed to build on others and integrate into a clear country-wide strategy. The key to innovation and impact is flexible, multi-year programs; this needs to be advocated to donors.
5. Program **funding** varies, with some budgets exceeding \$2.5 million (USD). However, a majority (87%) of programs surveyed had an average budget of around \$700,000. Although traditional donors such as USAID and the EC still contribute the largest percentage of funding, 44% (in number) of the programs were funded by the private sector. Increasingly, private donors provide smaller — but often more flexible — funds than do traditional donors. This is especially true in countries that have fewer funding options, or greater competition for larger funds. Small funds can effectively be spent developing concepts and testing models; larger donors can then take successful pilots to scale.
6. **Measuring program impact** at a global level remains challenging despite significant recent improvements. Where appropriate, a set of agreed-upon agricultural sector indicators and variables should be incorporated into all projects. Explanatory variables are critical to understanding performance, so that Mercy Corps can make informed recommendations about future projects and detect global trends that may otherwise be missed.

Conclusion

The study concludes that Mercy Corps' approach to agricultural development should, where possible, continue to combine high-impact value chain development with increased access to financial services, rather than focusing on just one or the other. To be effective, programs should ensure that wider market-system constraints and opportunities are understood and addressed, not just for farmers but for other market players as well. If Mercy Corps takes this approach, working in partnership with the private sector, public sector and civil society, it can help smallholder farmers make significant progress in their quest for greater food security, higher incomes and a better standard of living.

