

## Rural Banking in Africa: The Rabobank Approach

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**M**any people in the vast rural areas of Africa lack access to financial services, and most commercial banks are not interested in moving into these areas due to their low income levels, lack of scale economies, and poor infrastructure. Also, few banks actually understand the most common economic activity in rural areas: agriculture.

Consequently, the absence of financial institutions in rural Africa has often enticed governments to step in, particularly with state-dominated banks focused on agriculture. Many of these initiatives have failed, however, because they were too bureaucratic, too policy oriented, too concentrated on risk to only one segment of the population, or too weak in customer focus. In addition, clients considered these government-sponsored institutions to be instruments that provided grants; hence, the banks suffered from poor loan-recovery rates.

While microfinance institutions have made some inroads into rural Africa with the financial backing of international nongovernmental organizations and other sponsors, their sustainability is questionable. They tend to lack banking licenses and therefore have a very limited product range, and they cannot afford modern technology-based distribution systems.

### Key gaps in rural banking in Africa

One of the most prominent gaps in developing banking services for rural Africa is poor infrastructure—for example, bad roads, erratic electricity provision, and lack of communications systems—which impedes effective outreach to customers.

The legal environment in these rural areas is also suspect. Insecure property rights—especially land titles in rural areas—limit any bank's collateral options; combined with poor contract-enforcement opportunities, this takes away a bank's incentive to provide credit, especially for long-term loans. Proper land registration and enforceable mortgage systems are important issues for rural development.

The inefficiency of markets is also a barrier to developing rural financial services. Agricultural value chains are often poorly organized, lacking in transparent pricing, and fragmented in primary production—all of which results in high transaction costs. In many cases, the banking environment is distorted by stakeholders—including donors, governments, and development banks—who do not always regard agriculture as an economic activity, but rather as a social problem. These stakeholders provide subsidized funding to farmers or cooperatives, which means private banks often lack a level playing field. Poor financial literacy rates, especially among small farmers, and a limited understanding of banking requirements also pose a problem.

### Rabo Development

In an effort to serve the financial needs of emerging markets and developing countries, Rabo Development (RD) was created with a mission similar to that of its parent organization, Rabobank, which was created by farmers in the Netherlands more than one hundred

years ago. In order to achieve its mission of providing access to financial services to those in rural areas of developing countries, RD participates in financial institutions and provides management services and technical assistance. It has made investments in Tanzania, Zambia, Mozambique, Rwanda, Paraguay, Brazil, and China. RD also works with cooperative "enterprises" and financial institutions that want to increase their own access to financial services. While RD focuses on investments, Rabo International Advisory Services (RIAS) provides technical assistance. RIAS has a 20-year history in consultancy services mainly to financial institutions and cooperatives in emerging markets.

Rabo Development has made investments in some existing financial institutions with the objective to transform these organizations into leading banks with a rural orientation. Financial participation is limited to minority stakes (variation between 10 and 45 percent); the majority of shares are locally owned, thereby retaining the status of a local bank. This allows customers to better identify themselves with the institution and appeals to national pride.

Financial investment demands a shared vision of the future development of an institution, so stakeholders should agree on a mission and business plan, which are likely to entail servicing new customer segments, including rural clients (mainly farmers), and developing a broader product base. In order to assist implementation, Rabo Development not only provides capital but also management services, technical assistance, and representation on the board of directors. At present, Rabo Development has four investments in banks in Africa, which have a total of more than 3 million customers collectively.

There is no standard recipe for exactly how capacity should be built because it very much depends on each individual institution's stage of development and the country concerned. In any case, however, special attention should be given to getting the product distribution strategy of the institution right. To distinguish customer segments and develop their value propositions, it is pivotal to organize an efficient outreach, using both physical channels (such as branches) and virtual channels (such as ATMs, mobile banking, and Internet banking).

### Lessons learned

These lessons have been learned by Rabo Development's work in developing countries and emerging markets.

- Banks with a rural orientation still need a strong urban presence, as most banking assets are concentrated in urban areas. New distribution concepts, such as mobile banking and products, are also normally piloted in urban areas.
- Banks need to service all client segments with the appropriate mix of products (including microloans) in order to effectively use the branch network and establish a well-balanced portfolio, thereby reducing the concentration of risks.
- Financial institutions that want to practice rural finance need to be committed to this segment and need specialized knowledge-based departments, including agriculture and small

and medium enterprises (SMEs), in order to be effective to these target groups. Political pressure has forced institutions in some countries to provide rural financial services, but, with no commitment, results are poor.

- Sufficient scale and market share is essential for banks with a rural orientation.
- Client linkage to corporate governance—for example, rural and urban client shareholders or client panels—can positively influence performance and safeguard the rural mission of an institution.
- Clear client segmentation linked to products and distribution channels is essential to effectively delivering products in the rural environment.
- Direct product distribution channels—including mobile-phone banking, ATMs, and electronic point-of-sale devices—are becoming increasingly important for rural finance delivery. A modern and up-to-date IT system is crucial to these services.
- Rural banks in Africa need to focus on both sides of the balance sheet (that is, offer an appropriate mix of savings and lending products). Due to a lack of well-operating markets, they need to be largely self-financing.
- Policy instruments based on risk or cost sharing can be effective but need to be based on clear client segmentation. In cases of sufficient payment capacity, they can be used to overcome the lack of enforceable collateral or to make the credit itself more enforceable. Clients with insufficient payment capacity can only be assisted through income-support mechanisms, meaning grants not loans.

## The Rabobank approach to financing agriculture

Among the most important lessons Rabo Development has learned about building sustainable agrifinance in Africa is that segmentation of farmers is essential. In general, a small group of commercial farmers is responsible for a large part of a country's agriculture production and exports, and often these farmers are the only ones with access to financial services. A large group of subsistence farmers who lack sufficient repayment capacity for bank loans resides at the bottom of the pyramid. The group between the subsistence farmers and the commercial farmers consists of both farmers of small cash-crops (for example, coffee, cotton, or cocoa) with a low annual marketable surplus and so-called "emergent" farmers. The latter group has the potential to grow into commercial farmers but lacks both the financing and farm-management expertise.

Financing small cash-crop farmers is only feasible through a supply-chain approach. These smallholders should be financed indirectly via contract farming with better-rated "off-takers" (or processors). Under such schemes, the farmer commits to supply 100 percent of a particular crop to the off-taker, and the off-taker commits to buy 100 percent of the farmer's product but pays that

money directly to the bank, thereby allowing a direct repayment. Under these structures, the repayment risk to the individual farmers is converted into performance risk to both the farmer and the off-taker. In many cases, cooperatives can play a facilitating role by being the counterpart of the off-taker and the borrower of the loan. A cross-liability system whereby the members guarantee one another's loans could provide extra comfort to the bank. Also, systems involving warehouse receipts can provide additional financing to this target group; they have been used effectively by the banks that Rabo Development has invested in.

Emergent farmers justify an individual approach since they have the potential to develop into commercial or professional farmers with corresponding growth of financial services. Strict criteria need to be established regarding minimum size, sufficient entrepreneurial spirit, basic understanding of business planning, and farm-management skills. With a combination of financial services and technical support, these farmers stand a fair chance of success.

Emergent farmers can be financed under the existing retail structure of a particular bank, but the local branches involved would need to hire and train agrifinance specialists who understand farming and have the ability to appreciate the particular risks associated with it (including, among others, climatic, disease, and price risks). It is essential to form alliances with other stakeholders in the value chain who also have an interest in developing and investing in the farming sector (for example, farmers' organizations, commodity exchanges, agri-input providers, and off-takers).

The main obstacles to financing agriculture are unpredictable or erratic government behavior and interference in the agricultural sector. This is especially the case in cash crops like coffee, which are often important sources of hard currency, and in grains, of which African countries are often net importers. In several coffee-exporting countries, the coffee export is not free but rather regulated through auctions with only a limited number of private exporters licensed. In grains, prices are often regulated by the government to safeguard food security. This comes often at the expense of local farmers who are struggling to break even, and it is aggravated by relatively high transaction costs and the weak market position of African farmers.

## Conclusion

The Rabobank approach is strongly focused on the value chain, as ultimately the farmer—who runs the price risk, to a large extent—will only be able to get a fair price when the whole chain operates effectively. The success of agricultural development depends on the creation of a large group of professional local farmers producing high volumes of marketable output at a consistent quality. This will have a positive effect on reducing the transaction costs throughout the whole value chain. It is also imperative that all those involved share a common vision on development and contribute in effective, constructive, and committed ways. ■

See more information at [www.rabobank.com](http://www.rabobank.com).

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