

## **CLP Access to Finance (A2F): Case Study**

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## Acronyms

A2F	Access to Finance
ATM	Automatic Teller Machine
BSL	Business Savings and Loan Scheme
CBC	Char Business Centre
CID	Char Input Dealer
CLP	Char Livelihoods Programme
CSR	Corporate Social Responsibility
FSP	Non-Bank or Bank Financial Products and Services Provider
HH	Household
IMO	Implementing Organisation
LSP	Livestock Service Provider
M4C	Making Markets Work for the Chars
M4P	Making Markets Work for the Poor
MFI	Micro Finance Institution
VSL	Village Savings and Loan Group

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## 1. Executive Summary

How a new Seasonal Loan Product for Char Farmers is spearheading systemic change in the Bangladesh Finance Market System is discussed in this case study. Despite significant and breakthrough work in pioneering access to finance for the poor in Bangladesh, such services remain scarce in hard to reach chars. This market failure is primarily related to the nature of exchange due to high transaction costs. Lack of information and poor intermediation functions means excessive search and information costs are incurred. Chars farmers have little or no bargaining power and except extortionate rates from moneylenders and, with limited enforcement options for lenders and borrowers and poor access to courts, there is no trust in the system.

CLP used a M4P approach to identify areas preventing farmers from accessing appropriate finance. The evidence indicated that available products and services were unable to meet all the needs of chars farmers. A lack of market information (for farmers as well as financial market players) and limited assistance for farmers who get loans constrained market growth. Finally, the remoteness and unorganised char farming community was a risk few institutions were willing to take. These areas were immediate priorities and CLP targeted interventions to address the constraints.



Farmers were supported by CLP to improve their productivity and to farm scientifically using modern technologies, livestock practises and getting access to ready feed, medicines and a network of para-vets and other services. Collective action groups were formed with the Char Business Centre being the hub for market information, loan negotiation and aggregating products. This overcame the remoteness and provided financiers with the means to meet and do business with farmers.

A critical intervention was to work with United Finance to develop new loan products that were appropriate for the payment and receipts cycles of livestock businesses, to pilot a seasonal loan product and help them to build a business model to scale up the initiative. An investment of Tk. 2,102,560 (£18,772) was made in United Finance which unlocked Tk. 642,300,000 (£5,736,875) in seasonal loans to 8,000+ char borrowers.

The major building blocks for systemic change are in place but it is too early to report any changes. From the pilot done in 2013 borrowers were able to post 24% higher profits on average against non-borrowers. This illustrates the potential for the seasonal loan to fast track the growth of char livestock businesses.

Lessons CLP learnt in doing this was to focus on supporting United Finance to change their business model, to ensure that farmers have the necessary technical skill to farm scientifically, and to be realistic about the time and effort it takes to bring about systemic change, in this case, three years.



## 2. Background

### 2.1. The Chars Livelihoods Programme



The overall objective of the CLP was to “Improve the livelihoods, incomes and food security of at least one million extremely poor and vulnerable women, children and men living on remote isolated riverine char islands of north-western Bangladesh.”

The chars are pockets of extreme poverty for a variety of reasons. Physical vulnerability due to erosion and flooding is a major factor, which leads to low investment by government and little assistance from non-

government actors. Steady employment is rare, with much income for poor people coming from low-paid and irregular daily agricultural labour. All of this generally means that the extreme poor living on the chars have worse health, food security, nutrition and literacy than comparable people living on the mainland.

The CLP was therefore set up to address extreme poverty. It uses a combination of activities to address the various economic, physical and social vulnerabilities that the extreme poor face: asset transfers (plus cash grants called stipends); infrastructure such as flood protection (plinths), water and sanitation; social development capacity-building and production.

In addition, CLP implemented a series of activities using the ‘Making Markets Work for the Poor (M4P)’ approach. The M4P approach is based on the understanding that markets are important for poor women and men, and that economic growth is one of the main contributors to poverty reduction. Competitive and inclusive economies require systems for the exchange of goods, services and commodities, i.e. markets that operate effectively for everyone but especially for the poor as consumers, producers or employees.

In the context of the M4P approach, a market system is seen as a multi-function and multi-player arrangement comprising the core function of exchange, several supporting functions and rules and regulations for the system which are performed and shaped by a variety of market players. Market systems change is a change in the way that supporting functions and rules perform such that they ultimately improve the poor’s terms of participation within the market system.

CLP’s M4P activities focused on the milk and meat sectors, given that 98% of CLP participants chose cattle as their income-generating asset. A series of interventions were implemented to bring about systemic changes in the behaviours of farmers and market players. CLP’s interventions focused on access to finance, knowledge and skills and market linkages.

CLP identified access to finance as a project output early on in the life of CLP (2011, 2012). Despite significant and breakthrough work in pioneering access to finance for the poor in Bangladesh, such services remain scarce in hard to reach chars. This market failure is primarily related to the nature of exchange due to high transaction costs. Lack of information and poor intermediation functions means excessive search and information costs are incurred. Chars farmers have little or no bargaining power and accept extortionate rates from moneylenders and, with limited enforcement options for lenders and borrowers and poor access to courts, there is no trust in the system.

CLP set itself a project target of facilitating “1,200 loans for business purposes” through its meat and milk projects. Despite meeting this target, CLP was aware that there were still huge unmet Access to Finance (A2F) needs that required systemic changes to the financial market system.

## 2.2. A Market Systems view of the Chars Financial Market

CLP undertook numerous investigations to understand the chars financial market. This analysis helped CLP understand that there were limits to potential future growth if the A2F circumstances were not systemically addressed. Business growth would be organic and limited to reinvestment of profits. This was at odds with the vision expressed by most households to rapidly grow their livestock-based businesses.



In 2012, CLP searched for a viable and sustainable inclusive commercial financing model for char livestock producer groups. The assignment included a survey and analysis of the access to finance situation, review of major suppliers and estimating the financing demand-supply gap in the chars of northern Bangladesh<sup>1</sup>. In 2013 a survey was conducted to assess the effectiveness of a bull fattening loan product piloted by United Finance<sup>2</sup> adding to CLP's growing knowledge base.

Further insight was provided by the research into the effectiveness of the Village Savings and Loans (VSL) products and services pioneered by CLP for all CPHHs<sup>3</sup>. The VSL success was copied for other CLP constituencies in the chars, namely businesses (Business Savings and Loans (BSL) groups) and adolescents (Adolescents' Savings and Loans (ASL) groups) from which CLP learnt more of the market system.

CLP's understanding of how the market system functions as well as the main blockages are outlined in Figure 1. A series of direct and indirect interventions were targeted at the blockages as this is the only realistic way systemic change can occur.

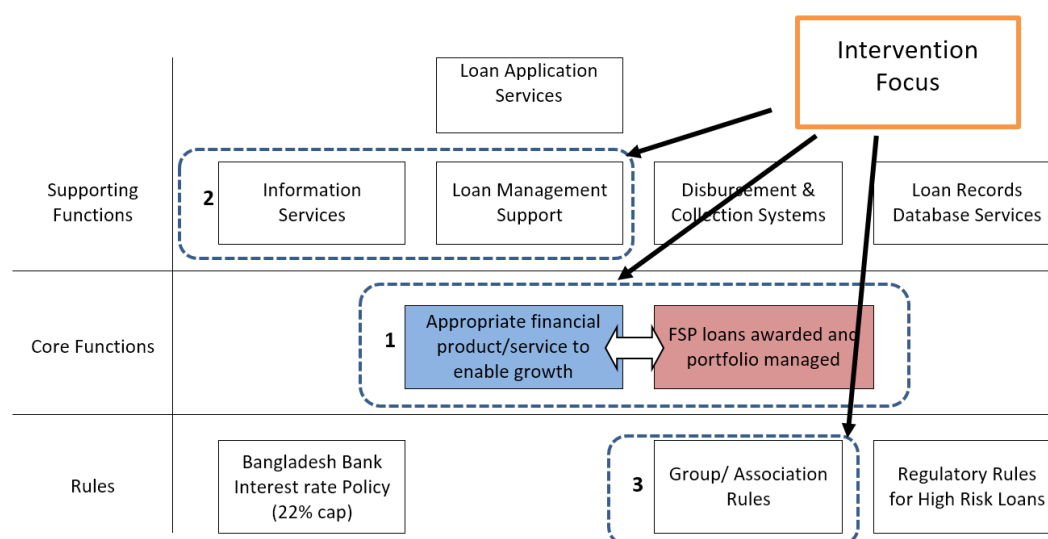
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<sup>1</sup>United Leasing Company (2013)

<sup>2</sup>iDE (2013)

<sup>3</sup>CLP/Maxwell Stamp (2013)

**Figure 1: A2F Market System**



The demand and supply of appropriate finance products and services (1 above) comprises the core of the market system. The evidence indicated that available products and services were unable to meet all the needs of chars farmers. Furthermore, a lack of market information (for farmers as well as financial market players) and limited assistance for farmers who get loans (2 above) constrained market growth. Finally, the remoteness and unorganised char farming community (3 above) was a risk few institutions were willing to mitigate. These areas were immediate priorities.

### Appropriate financial products and services

Char farmers working with CLP produce milk and meat. The production cycle involves spending monies on acquiring the animal and managing it optimally for 9 months (milk) or 4 months (bull rearing) before realising income from milk sales or selling the bull. MFI products operate on weekly payment cycles. VSL and BSL Loans are only occasionally available and share-outs are distributed annually (these loans embed new behaviours of saving and loan management and prepares members to engage with outside lenders with more confidence and knowledge). Moneylenders' loan costs and terms cannot be carried by the business – it is too expensive and reduces profits.

In finance schemes that char farmers could access the individual household is the unit of assessment. The business per se is not the focus – it is never investigated to determine if the loan is appropriate or necessary. From a CLP perspective our view was that it is necessary to shift this focus to the business and advise market players to take cognisance of the cash flows of the business.

### Market Information & Loan Management

Chars farmers have limited knowledge of loan products or services available to them in general and financial intermediaries know nothing of char loan demand. The result is that chars are bypassed by formal actors and no financial innovation takes place. Where farmers access formal loans it is through MFIs where the loan product is inappropriate for the business.

Another area of risk is the management of the loan once a farmer gets it. Ensuring that the loan is used for the purposes intended (for instance paying for feed and medicines and no other urgent household consumption) and that the terms of trade with suppliers remains favourable (input product prices on the chars can change drastically as retailers / input dealers exploit their monopoly positions) is a challenge in a dynamic environment. But, farmers have to master this if they are to determine their own destiny. In addition to technical skills and the

benefits of belonging to a collective action group they need essential business management skills and a level of financial literacy commensurate with this.

### **Group/Association Rules**

The economies of scale are stacked against the chars. Without collective action groups it is difficult to intervene but establishing these groups presents its own challenges. CLP's market projects established producer groups (meat and milk) and overarching Char Business Centres (CBC) creating the means to mitigate risks resulting from scale, bargaining power, technical skills and representation (voice). In doing so there may be a tendency to overreach and move from facilitating to inserting them into individual loans (as guarantor) or undermine farmers' vision and limit growth aspirations (advising against loans for instance). CLP wanted to avoid a scenario where we evolved a market system that focused on the CBC as opposed to the individual farmer.

### **Other Supporting functions and Rules**

In addition there are other supporting functions and rules that need attention before complete systemic change is a reality. However due to the interrelatedness and links within the market system, a focus on the CLP interventions resulted in progress in alleviating all the constraints. Supporting functions that need to change include:

- Loan application support: Farmers have been trained<sup>4</sup> to do basic business plans but do not keep or use records in a consistent manner. Their ability to complete a basic application form is limited due to low levels of literacy.
- Disbursement and Collection Systems: MFI, Moneylenders and VSL/BSL are cash based systems. Chars are geographically difficult to access and do business with thereby increasing the costs and risks of operations (theft/robbery). The lack of a focal point means that the cost of doing business is significantly higher than on the mainland. E-banking (bKash) was introduced through other CLP projects and the technology needs to be harnessed for disbursement/ collection.
- Credit Information: There is no known accessible database on credit histories that can be used to reduce individual loan decision risks. But there is an opportunity to use this intervention to build credit records. Sharing this will require an industry level response (credit bureau) to avoid multiple loans as more crowding in takes place and to make it easier for good payers to benefit from repeat loans and better loan conditions.
- With regard to 'rules' the financial market system would benefit if the Bangladesh Bank Interest Rate Policy (22% cap) is addressed. All formally registered non-financial and financial intermediaries are required to comply with this rule. This limits the ability to price the product at its actual risk profile. These are sensitive policy level decisions which are unlikely to be influenced from the bottom up.

In CLP's view the ultimate contribution of this market system change is to enable farmers to make sound financial investment decisions and use appropriate financial products and services to profitably grow their agriculture businesses. To realise this CLP identified two important elements to be addressed by the markets projects.

- Ensure that chars farmers have the knowledge and skills to make good loans decisions and apply loan financing to grow their businesses; and
- Support market players to innovate and develop appropriate financial products and services.

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<sup>4</sup>As part of the CLP markets projects, milk and meat farmers are organised into producer groups and benefit from direct training in livestock management.



Using the analysis as a starting point we needed to identify how we should bring about market systems change so that supporting functions and rules perform to improve the poor's terms of participation within the market system.

### **3. Interventions**



The CLP markets projects interventions were guided by a Strategic Framework with a poverty reduction objective of increasing household income of meat and milk farmers. Access to finance was a cross-cutting intervention recognised as a missing / inadequate supporting function which needed a specific response. Accordingly, a series of specific interventions were implemented.

#### **3.1. Enhancing Technical and Business Knowledge and Skills of Char Farmers**

CLP used a group based approach in both the livelihoods and markets projects to encourage farmers to adopt new technologies and engage in new practices to improve productivity of their livestock farming. New technologies and new practices brought significant increases in milk and meat production which in turn increased the char farmers' income.

New technologies included introducing grass chopper machines, silage making, production of milk products in the chars, training and demonstration of improved practices.

Financial literacy was bolstered through the VSL and BSL schemes operating in the chars with the BSLs run by CBCs. VSLs provided poor char households with a safe place to save, earn interest and occasionally take out small loans. During the last six years, CLP established nearly 7,000 VSL groups. Between January and June 2015, VSL groups gave loans totalling Tk. 159,578,517 (£1,387,639) illustrating the high demand for such services on the chars. 34 CBCs operated BSL groups.

### 3.2. Strengthening Char Business Centres<sup>5</sup>

Chars are cut off and isolated and the need for business information and coordination of businesses on the chars is paramount. The CBCs were designed to overcome this. The CBC has elements of a business association, cooperative and NGO embedded in its management and operations. 70 CBCs were established to act as informal market places and market information centres and serve the char-community business groups and value chain actors to overcome market challenges. CBCs add value to the char livestock market system by executing the following key functions and services as depicted in Figure 2.

**Figure 2: CBC Roles**



<sup>5</sup>CBCs are collective action organisations whose members are farmers and other businesses operating in the char. It is a central and apex body for local business groups, input providers and buyers to facilitate a better and more productive and profitable business environment for all types of char value chain actors in the milk, meat and fodder sectors.

Much was expected of CBCs and – given that the membership was drawn from local char businesses where the levels of literacy and numeracy is not high, where social capital is low (evident from the lack of any collective groups before CLP intervened) and geographic areas where there is little or no infrastructure – the drive towards sustainable CBCs became an underpinning strategy for CLP. They proved remarkably effective as gateways for the private and public sector as well as aggregators of char products. The more



successful CBCs are constantly searching to grow the value they offer members. CLP's strategy focused on two areas simultaneously, namely proper governance and management of the CBC, and helping the CBC to create value for its members by, inter alia, building the capacity of CBC leaders to generate business opportunities with private sector market actors. Access to finance was and continues to be a highly valued service in CBCs.

The role of the CBC in the United Finance scheme is laid out as follows in the agreement between United Finance and CBCs:

- Select and recommend genuine farmers for financing;
- Monitor proper and timely utilisation of disbursed funds;
- Be involved in the process of disbursement and collection;
- Regularly meet with farmers to disseminate new methods and ideas, adoption of technologies, training on credit procedures and similar capacity building activities;
- Maintain proper records of activities and books of account; and
- Be fair, transparent and reliable in their activities and transactions and protect the interest of all relevant parties.

Clearly this places them at the centre of the credit generation, delivery and recovery process. Are they up to the task?

CBCs have been central to the CLP markets work and all have benefitted from an intensive intervention package. A comprehensive assessment of CBCs was done in 2014<sup>6</sup> in order to determine how best CLP could support them to become sustainable and enhance their impact in the chars. The assessment process analysed five major aspects of sustainability of CBCs including institutional, economic, technological, ecological and social dimensions. Based on the assessment CLP altered its intervention strategy in line with the level and type of support recommended by the Team. Using the same toolkit, the Operations Division commissioned an update on this study to understand how, over the course of 12 months, the bespoke intervention strategy helped CBCs on their path to sustainability. CBCs have improved their grading dramatically. In the first assessment 9 CBCs were in category A, 43 in B, and 18 in C. After 12 months of bespoke interventions, 56 CBCs are in category A, 14 in B and none in C. Some shifts were gradual such as B to A; and some dramatic such as C to A. No CBC assessed in 2015 slipped down a grade.

CLP focused on turning the recommendations of the 2014 Assessment Report into interventions that focused on the specific needs of each grade of CBC. These activities have strengthened CBCs business performance and helped them achieve sustainability as their focus on continuous income, improved organisation management, increased fund and its

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<sup>6</sup>Nepali, N (2015)

management have deepened linkages and relationship with stakeholders and added value to char meat and milk market systems.

CBCs have high levels of customer satisfaction with 94% being positive. The picture emerges of an organisation that has gained a foothold in the chars and extended its reach beyond the narrow group of initial members. The focus is still on the contribution to the production of meat and milk. While the future holds many challenges for CBCs especially as CLP no longer supports the network, the final assessment shows that CBCs achieved a certain level of capacity to sustain themselves in future.

### 3.3. Partnering to Build a Viable Business Model

In September 2012, iDE was contracted to deliver the meat and fodder market projects which included an access to finance component. The milk market project started in March 2013 and was done in-house by CLP with a similar access to finance element. iDE was able to interest United Finance<sup>7</sup>, a non-bank financial intermediary operating under the financial services regulations of the Bangladesh Central Bank, to consider working in the northern chars having successfully partnered on access to finance in the southern chars.

Both iDE and CLP continued to facilitate loans and investments from MFIs and, to improve the impact, CLP decided to develop a common platform under CLP management in early 2015 freeing iDE to focus on other areas of the market development projects. M4C, a specialist M4P project which focuses on agriculture development (other than livestock) in the chars, and CLP strengthened their mutual markets based work which included operating a joint service centre and persuading United Finance to scale up the pilot project. Together M4C/CLP challenged United Finance to consider how its business operations could be reshaped around a business model that included a range of embedded business services. In 2015 United Finance presented a proposal to scale up the seasonal loan product.

M4C/CLP jointly investigated the proposal to determine the scale and scope of further investment in United Finance. The joint strategy was based on an understanding of their incentives ('will') and capacity ('skill'). In terms of this it was noted that United Finance has 'High Will' but needs further strengthening of their organisation to profitably deliver these new products. With no support it is unlikely that the scale needed to change the market system will be achieved. In terms of M4P, where a prospective partner displays strong incentives (will), but lacks the capacity to pursue a change (skills) the support should strengthen their capacity to operate outside their current 'comfort zone'.



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<sup>7</sup>United Finance, formally known as United Leasing Company, was established on April 27, 1989. An associate of the Group, ULC was set up as a joint venture with participation from Asian Development Bank (ADB), Commonwealth Development Corporation (CDC) and Lawrie Group Plc, Duncan's parent Company in the U.K. UFL is a non-bank financial intermediary operating under the financial services regulations of the Bangladesh Central Bank and is an organisation in good standing.



### 3.3.1. New Product Development (2012-2013)

In 2012 United Finance was contracted to conduct a survey, analyse access to finance in the chars and develop viable and sustainable options for new loan products. The research identified moneylenders as the main providers but at exorbitant rates. Borrowers using this channel usually fell into a vicious debt trap. CLP started to introduce more scientific ways of rearing cattle but the lack of appropriate finance constrained the take up of new practises in many cases. MFIs who wanted to fill the gap did not have the product(s) for cattle rearing as there is no scope for daily income. United Finance then proposed five new products that it believed could be successfully introduced in the chars.

**Table 1: Summary of Products<sup>8</sup>**

	<b>Cattle Fattening</b>	<b>Cattle Purchase + Fattening</b>	<b>Milk Production</b>	<b>Green Fodder</b>	<b>Char Input Dealer</b>
<b>Loan Purpose</b>	Cash Facility to buy improved and balanced feed and medicines	Cash facility to buy cattle as well as feed and medicines	Cash Facility to buy improved and balanced feed and medicines	Inputs (seed) and cost of production for 1 acre	Cost of buying and holding ready feed
<b>Estimated Amount</b>	Tk.11,401 upwards depending on number of cattle	Tk.20,000 per cattle purchase + cost of feed / medicines	Tk.31,330 per milk cow	Tk.72,760 per acre	Tk.80,002 per 2,353kg of ready feed
<b>Income &amp; Expenses</b>					
<b>Income</b>	17,980.00	35,480.00	56,040.00	93,000.00	87,024.00
<b>Expenses</b>	11,401.00	26,401.00	31,330.00	72,760.00	80,002.00
<b>Net Profit</b>	6,579.00	9,079.00	24,710.00	20,240.00	7,022.00
<b>Net Profit %</b>	36.59	25.59	44.09	21.76	8.07
<b>Annualised</b>	19,737.00	27,237.00	29,899.10	20,240.00	84,264.00
<b>(How calculated)</b>	3 cycles of bull fattening per year	3 cycles of bull fattening per year	300 day cycle (1.21 cycles per year)	This is the per season cost and only 1 season per year	This is based on the CID selling 2,353kg per month
<b>Decision</b>	Yes	Yes	No	No	Yes

<sup>8</sup> United Leasing Company (2013)

In terms of net profit percentage and annualised returns the milk product stands out. However, on closer inspection United Finance may have overestimated the milk production (estimating between 5-6 litres per day) as current hybrid production is not more than 1.6 to 2.3 litres per cow. The cattle fattening products have an interesting dynamic – basically you only have one opportunity to earn a higher net profit (37% - when you have your own cattle) after which the business has to either self-fund the purchase of new cattle or United Finance has to loan the funds.

The estimations for cattle were accurate as the final profit per cow per month was Tk.2,564 which, when annualised, is Tk.30,768 versus the projected Tk.27,237. The Char Input Dealer (CID) is a retail business with smaller margins but high turnover and to-date CIDs and CBCs have shifted Taka 2,234 million (£20,088) of ready feed.

To take advantage of current conditions in the chars where farmers have bulls for fattening, United Finance opted to start with the cattle fattening loans and eventually include other products. Fodder financing and milk may take longer to become mainstream.

### 3.3.2. Piloting a new Seasonal Loan Product (2013)

A pilot project was done in the Bogra chars during 2014/ 2015 in which United Finance, supported by M4C and CLP, successfully disbursed and (importantly) recovered crop and beef fattening loans from 89 farmers. The main features of the product were a loan amount to cover the partial cost of feed and medicines, an interest rate of 22%, a six-month repayment period and hand-holding by CLP markets projects staff and contractors.

**Table 2: Pilot Loans for Cattle Rearing (Ready Feed)**

Upazila	Clients	Average Loan (Taka)	Total (Taka)
Sariakandi	16	3,328	53,248
Shaghata	19	3,316	63,004
Bera	16	3,500	56,000
Gongachora	38	3,618	13,7484
<b>Total</b>	<b>89</b>	<b>3,440.5</b>	<b>30,9736</b>

Despite doing the research, having in-depth knowledge of the char CBCs and iDE and CLP on-site markets project staff to support the pilot, United Finance started cautiously. The loans only covered a portion of the ready feed required (Tk.3,400 as opposed to Tk 11,000) and was geographically restricted to areas where oversight was highest – close to Bogra.

Other challenges to overcome included technical issues with bKash (wrong PIN), standardising weighting procedures (CLP and United Finance used different methods which confused clients) and the expectations for repeat loans which United Finance held back pending senior management approval.

### 3.3.3. A Repeatable and Scalable Business Model (2015)

The end result of the collaboration was that United Finance settled on a business model that they were confident to scale up.

#### A) Commercial considerations

United Finance provided a detailed 4-year financial analysis of the proposed scaled up operations. Over that period a cumulative loss of Tk.6,024,414 (£53,789) is recorded before the scheme becomes cash flow positive in the fourth year. The main reason

delaying breakeven is the inability to price the loan at its full commercial risk profile due to central bank regulations. Policy changes that will allow United Finance to reduce its borrowing costs (relative to MFIs and Banks their cost of capital is higher) and/or improve its margin (by charging higher interest) are likely to take years to realise.



*Representatives from CLP, DFID, UFL and M4C gather to sign partnership agreement on February 22*

**Table 3: Summary of Projected Portfolio**

	FY16	FY17	FY18	FY19
<b>Yearly No of Borrowers (CLP)</b>	490 (250)	1,660 (980)	4,240 (2,460)	8,200 (4,700)
<b>Average Loan Size</b>	21,855	30,175	41,177	49,305
<b>Yearly Borrowing</b>	13,550,000	50,090,000	174,590,000	404,300,000
<b>Yearly Operational Profit/(Loss)</b>	(2,170,344)	(2,059,203)	(1,794,867)	252,218

Through negotiation M4C/CLP and United Finance arrived at a conclusion on offsetting part of the projected loss without compromising the product (seasonal loan) or the scale proposed.

**Table 4: M4C/CLP Investment**

	FY16	FY17	FY18	Total
<b>Yearly Operational Profit/(Loss)</b>	(2,170,344)	(2,059,203)	(1,794,867)	<b>(6,024,414)</b>
<b>M4C+CLP's Contribution</b>	1,102,560	590,000	410,000	<b>2,102,560</b>
<b>Loss Carried by UFL</b>	(1,067,784)	(1,469,203)	(1,384,867)	<b>(3,921,854)</b>

In Table 4 (above), it is noted that the proposed M4C/CLP investment of Tk. 2,102,560 (£18,772) is destined to unlocked Tk. 642,300,000 (£5,736,875) in seasonal loans to 8,000+ char borrowers. United Finance is prepared to shoulder a Tk. 3,921,854 (£35,016) loss however without the CLP/M4C support they would continue to develop this loan product but in a slow and organic manner.

In December 2015, CLP/M4C and United Finance entered into a 3-year triparty agreement and completed the transaction with United Finance. The investment was subject to stringent DFID rules and guidelines for subsidising commercial businesses<sup>9</sup>. At the core of the motivation was CLP's assessment and experience that pointed out:

- access to appropriate finance is a significant barrier to the continued evolution, growth and expansion of businesses that CLP has supported and helped to grow as part of its market-based project;
- char-based entrepreneurs have the skills, drive and energy to continue to expand and grow their businesses;
- these entrepreneurs are able to manage and service credit successfully;
- United Finance is committed to continuing to roll out its appropriate agricultural financing projects; however
- this 'organic' growth would be significantly slower without this investment which would mean many more chars-based entrepreneurs would continue to face financial obstacles to the successful expansion of their businesses for many years.

All parties were satisfied that in this 'thin market' the investment would not be distortionary nor provide United Finance with an unfair market advantage. Efforts to ensure crowd-in were simultaneously underway and, at the time of the investment, two bigger MFIs (GUK and NDP) were starting their own seasonal loan product experiments with M4C.

## **B) M4P aspirations**

The commercial considerations seemed in order but working with United Finance was about systemic changes in the financial market system in the chars. During the diagnostic and vision exercises, CLP identified changes needed in the way support functions and rules perform. Two important elements to be addressed by the markets projects were (a) to ensure that chars farmers have the knowledge and skills to make good loans decisions and apply loan financing to grow their businesses and (b) to support market players to innovate and develop appropriate financial products and services. It was necessary to match this vision to the United Finance proposal to decide if this partnership was worth considering.

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<sup>9</sup> DFID (2012), DFID policy framework for the provision of grants or concessional finance to for-profit firms



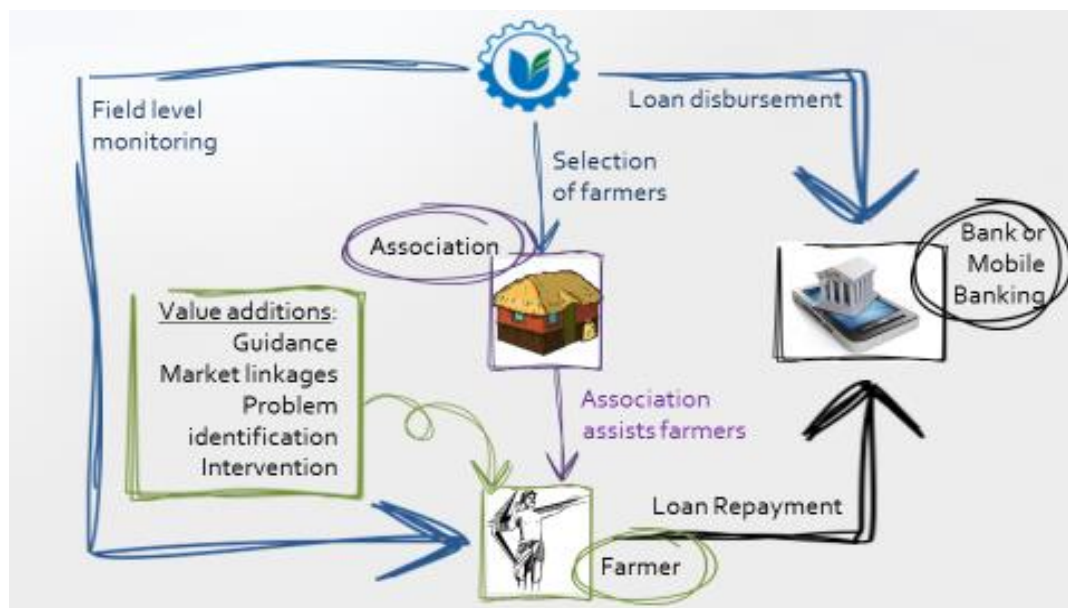
**Table 5: United Finance and Market Systems Change**

Where we need change	Support function or rule affected	United Finance Contribution
<b>Farmers making better investment decisions</b>	<p>Information on financial products / service.</p> <p>Supporting loan applications for farmers with limited financial literacy.</p> <p>Working with or through farmers groups (CBCs) for better quality loans.</p>	<p>United Finance will work through CBCs who will provide detailed information to farmers (members) about the bull rearing loan.</p> <p>Loan applications will be collated by the CBC who will also serve as a referee for the farmer.</p>
<b>Appropriate financial products and services available</b>	<p>Products and services that meet farmer needs but comply with regulations.</p> <p>Disbursement and collection procedures and systems that do not disadvantage farmers because they are Char based.</p> <p>Incorporating financial records into subsequent loan decisions and sharing these records with other institutions (credit bureau).</p>	<p>United Finance will be targeting the bull rearing loan product at Char farmers. This has been tested with 100% repayment rates.</p> <p>The product is a structured loan with a fixed interest rate meeting all regulatory requirements.</p> <p>By meeting all their obligations farmers are building a loan record and all farmers will have access to repeat loans.</p> <p>Cash based disbursement and collection remains the norm for the near future but moves are underway to use the bKash system.</p>
<b>Improved business management skills to allow growth through loan financing</b>	<p>Leveraging the associations or groups that farmers belong to.</p> <p>Improved knowledge and skills of farmers to manage businesses profitably.</p>	<p>United Finance places a premium on the role of the CBC – this it sees as the main risk mitigation strategy. CBC need to ensure that farmers meet their obligations.</p> <p>The structure of the loan promotes / requires farmers to use quality inputs, keep detailed records and become (some training is offered) financially literate.</p>

A monitoring and results management system (MRM) will analyse how systemic change is taking place, as this is the main purpose of the investment. The market system will be tracked by M4C to pick up behaviours of other non-partner financial institutions primarily to note the extent of crowding in and if United Finance reaches a point where the collaboration could become distortionary. The MRM system will be managed by M4C who will produce output / outcome reports to describe and inform Donors of the ongoing status including the performance of the loans which this investment catalyses. The system will remain active for the entire duration of the investment (3 years).

### C) How it Works<sup>10</sup>

**Figure 3: United Finance Business Model**



Farmers are vetted by the CBC (Association) and United Finance staff who then approve a seasonal loan at 22% for a maximum period of 6 months. United Finance is a non-bank institution and uses the Bangladesh banking system to disburse and recover loans.

The loans are disbursed in instalments to acquire food and medicines to fatten bulls. The bulls are sold in month 4 or 5 and the full capital and interest returned to United Finance. An example of the product is outlined in Table 6 below.

**Table 6: Livestock Seasonal Loan Product**

	Month1	2	3	4	5	6	Total
<b>Disbursement</b>	5,000	5,000	5,000	-	-	-	15,000
<b>Total Outstanding</b>	5,000	10,000	15,000	15,000	15,000	15,000	
<b>Yearly Interest Rate</b>	22%	22%	22%	22%	22%	22%	
<b>Interest</b>	90	181	271	271	271	271	1,356
<b>Effective Interest Rate (6 months)</b>				<b>9%</b>			
<b>Effective Yearly Interest Rate</b>				<b>18%</b>			

United Finance is primarily responsible for field-level monitoring and their system promotes the use of quality inputs and better cultivation techniques. Farmers keep records of fodder and medicines given to cattle and are encouraged to use these to improve overall management of the business. Instalment disbursement of the loan provides United Finance and the farmer

<sup>10</sup> United Finance (2016)

with a mechanism to limit the loan exposure. Any deviation resulting from poor performance or factors outside farmers' control (loss of cattle) would stop further disbursements thus reducing the loan value.

While many of the Value Additions are embedded in services within the structured product, there are areas where external support can reduce risk even further.

Technical problems can be overcome by the using the CBC network of Livestock Service Providers (LSPs), Artificial Insemination (AI) workers, CIDs and other production focused specialist effectively. Furthermore, United Finance's access to other big commercial operators in the input (feed and medicines) and output (milk and meat) markets places it within a network of market actors who are also interested in the success of char businesses. Opportunities for co-creating new businesses or supporting further innovations are possible. Another source of support will be M4C who will provide strategic guidance and support to United Finance for the next 3 years.

#### **D) An alignment of interests**

CLP believes that United Finance will remain committed to expanding the portfolio as planned and continue to partner with M4C and char based groups. This confidence is based on the alignment of various interests as noted below.

- With regard to the increase in volume of appropriate loans for growing char livestock businesses, United Finance aims for market share growth in niche markets while CLP/M4C wants systemic change so that appropriate finance is generally available to all qualifying farmers.
- With regard to the increase in the size of individual loans, United Finance seeks improved profitability in the longer term through gradually increasing the loan size (bigger loans have less administration costs) while CLP/M4C sees graduates gaining important knowledge and skills as they learn to manage bigger loans and become small commercial farmers.
- United Finance wants to be recognised as a socially responsible company and comply with the Bank of Bangladesh (Central Bank) regulations on financial inclusion and corporate social responsibility. CLP/M4C demonstrated to United Finance and others that there is a path that is both profitable and contributes to reducing poverty.

The M4P approach encourages support to partners who are prepared to make changes to their commercial business practices so that poor women and men can profit from new products and services as producers/entrepreneurs or consumers. United Finance benefited from CLP support for new product development and a successful pilot project. Further incentives have been provided through the CLP/M4C direct investment to scale up operations. This will allow CLP/M4C's impacts (through the successful capacity-building, linkage and institutional

#### **Box 1: United Finance Seasonal Loan Offer**

Loan Purpose: Crop cultivation, cattle feed purchase and cattle with feed purchase

Loan amount: Depends on cost of cultivation or cattle rearing

Minimum is Tk.4,000 - Maximum is Tk.150,000 - Average is Tk.45,000

Loan period: Depends on the crop/cattle rearing cycle

Transaction through either BEFTN or Mobile Banking

Interest: Calculated on daily loan outstanding, currently charged at 19.75% p.a.

Security: Hypothecation of crop/cattle, group guarantee and undated cheque (if borrower has bank account)

support provided by its markets work) to both continue to grow and to fix in place the benefits already accrued. It is both a continuation of the processes put in place by CLP and allows markets participants to continue their growth trajectories in a manner that would not be possible without the support. It is also pointing the way for other financial service providers who have adopted a wait and see attitude.

## **4. Impacts**

### **4.1. Pilot Results Confirm Underlying Assumptions**

The pilot project conducted in 2012 was evaluated in 2013 in order to assess the impact of the seasonal loan product. The repayment rates (100%) provided a measure of confidence that borrowers are familiar with and have the necessary discipline to meet their obligations. But, was there any effect on the businesses themselves in terms of turnover and profit?

A survey of 160 businesses (80 who received loans and support and 80 who did not) and interviews and focus group discussions with key informants and other stakeholders was done.

Borrowers had to use the loans for feed and medicines and had access to ongoing support while non-borrowers were informed of the need to use proper feed and medicines and also had access to ongoing support. In other words the skill of the group and their ability to access support was similar.

Borrowers' returns (using a standardised weighting system) were Tk.10,283 within 110 days (equating to a profit of Tk.2,843 per cow per year). Non-borrowers returned Tk.8,804 within 126 days (equating to a profit of Tk.2,125 profit per cow per year). After payment of the interest cost of Tk.196 (cost of borrowing Tk. 3,440 for 110 days) borrowers achieved 24% extra profit.

Non-borrowers noted that if they had access to the same finance they would have followed proper diet recommendations and advice from LSPs and CIDs. It was only the lack of funds that prevented this.

### **4.2. Systemic Change**

It is too early to find hard evidence to indicate systemic change has taken place with regard to financial markets in the chars. But, finance is oil in the system and there is indisputable evidence that trading between chars and mainland businesses has increased dramatically in input and output markets. CLP is also sure that trade in the chars between businesses located there as well as with the CBC has increased. LSPs and CIDs report growing incomes and growing markets in the chars. Where there are CBCs and support services, livestock producers are adopting new technologies and changing their practices.



### Box 2: United Finance Seasonal Loan Performance

Employment Generation: 2.75 million Seasonal labourers (Tk. 825 million)

Entrepreneurship Development: 125 Agricultural input businesses

Break out from Traditional Financing: 76% full break out, 24% partial break out

Inclusion in Formal Banking System: 1,250 Mobile Banking, 8,740 Bank Accounts

Financial Literacy: 8,530 farmers on responsible borrowing

675 signature learning

Non-Discriminatory: 1,195 woman farmers (15%), 1,284 landless farmers (18%), 4 ethnic communities (Chakma, Tanchangya, Tripura, Marma)

Financial market players are still wary of working in the chars. However, through the United Finance intervention and a deliberate attempt to engage with all financial market players on a level playing field, CLP/M4C has noted the beginning of crowding-in.

GUK and NDP both long-standing contractors to the CLP have relooked at the micro-finance products and started experimenting with a seasonal loan product. Here the exact same advice and guidance provided to United Finance has been made available. While it is too late for further CLP support, M4C may consider investing on a similar basis as the United Finance deal.

Awareness that the char as a good place to do business has been one of the major wins for CLP. Backed by strong evidence from CLP's Innovation, Monitoring, Learning and Communications Division (IMLC) and market players who were early-adopters it is now generally accepted that the chars offer profit opportunities for the right market players, including financial market players.

In United Finance there is now a live example of actual seasonal loans taking place in the chars. This probably is the best illustration of the beginning of systemic change. United Finance has summed up their performance to date in Box 2.

The current statistics of their overall portfolio includes the work done during the pilot and the subsequent slow build up since 2012. The disclosures are made in their Annual reports and to regulatory authorities and are therefore considered authentic.

## 5. Future Outlook and Lessons Learnt

At the heart of the confidence that systemic change can occur in the financial market systems in the chars is the growing business base. The limited options for sustainable livelihoods in the chars have spurred char households to seek entrepreneurial solutions. There are no jobs other than labouring and relocating from the area simply means finding another entrepreneurial solution in another poor area. For those households currently in the chars this is their best chance to move out of poverty and no further motivation is needed!

The main lessons in pursuing systemic change in this system are:

- Recognising and responding to the need to support poor farmers with knowledge and skills to farm productively. This may need direct intervention through training contractors as well as encouraging partners to embed this in their own products and services.



Financial market players are not technical providers and, regardless of how the partnership is structured, will be reluctant to engage if the technical ability of farmers cannot meet modern scientific ways of doing business.

- Be realistic about the vision for change in financial market systems. Access to finance is a perennial problem for all programmes, and doubly so for those focussing on poor producers. The chars are considered high risk due to their remoteness and vulnerability to natural disasters such as erosion. Many micro-finance institutions and larger credit providers were therefore reluctant to increase their exposure. Over the course of three years, CLP and its partners successfully engaged with United Finance to develop and pilot-test a series of appropriate credit products, tailored to suit the business cycle of milk and meat producers. It needs patience and commitment.
- Market players must have a strong commercial incentive as demonstrated by a willingness to change their business model. If this is not possible and a 'business as usual' approach is adopted with some accommodation for poor farmers then it is unlikely that the partnership will contribute to systemic change. Skilled facilitation by CLP and M4C ensured that United Finance understood and acted on this. This case study presented the economic argument for market failure being linked to the nature of financial transactions and the prohibitive transaction costs for all stakeholders. It is fitting to reconsider this in the light of the work undertaken over the last 3 years to address the access to appropriate finance challenge.

[Click here for the full Lessons Learned Brief on M4P / Market Systems.](#)

The excessive search cost for both farmers and financial institutions should be a thing of the past as market information is more readily available. Bargaining costs, for which the interest rate is a proxy, are now within the regulatory remit enjoyed by other borrowers in Bangladesh – and there is additional regulatory oversight as United Finance has to comply with banking regulations. Finally, high enforcement costs have been overcome through building social capital through CBCs and producer groups. By becoming part of group guarantee schemes the risk to financial providers can be mitigated.

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