

Applying the Financial Services Lens in Practice to Understand Value Chain Finance

EDA's approach and emerging lessons

1 Introduction

EDA Rural Systems Pvt Ltd, Gurgaon, in this PLP, aims at improving the flow of financial services from banks and financial institutions to small and micro-enterprises including small farm producers. EDA has selected two sub-sectors, litchi (a fruit) and honey (beekeeping) for the PLP project. These sub-sectors were selected on the basis of criteria including involvement of a large number of small and micro-enterprises in these two sub-sectors, the market opportunities for these products, and EDA's core strength in the sub-sector development work. EDA has been working in the Muzaffarpur region, the area for this project, for a couple of years and has been engaged in developing the honey sub-sector. The Muzaffarpur region of Bihar is one of the most underdeveloped regions in the country with poor infrastructure, low income levels, frequent floods and draughts and low literacy rate. Therefore, in addition to the honey sub-sector in which EDA has been working, EDA chose to work in the litchi sub-sector as well in the PLP project.

EDA started with the sub-sector analysis using the financial lens in the litchi sub-sector. The information gathering is complete and the report is being documented on the basis of analysis of information gathered. EDA already undertook the sub-sector analysis of the honey sub-sector but without using the financial lens. Therefore, EDA is process of understanding the requirements of financial services by the value chain actors in the honey sub-sector as well – for this PLP project. In this brief document, EDA makes an attempt to share its methodology adopted in applying the financial services lens to understand value chain finance in the litchi sub-sector.

2 Methodology adopted in applying the financial services lens to understand value chain finance

EDA has undertaken a number of sub-sector analyses and BDS market assessments in economic sub-sectors such as honey, leather, sericulture, rice processing and agro-products in the past. However, almost all these analyses focused on understanding sub-sector actors, value chain players, their linkages, and problems that exist at each stage of the value chain and in the overall sub-sector. This typically resulted in identifying the opportunities that exist at each stage of the sub-sector for making an intervention and also the opportunities that the products and services of a sub-sector offer. There was less emphasis in these sub-sector analyses on understanding the financial service requirements in the value chain. As EDA started implementing activities in a sub-sector after the sub-sector analysis, we tried to understand the aspects related to financial service in this process and made appropriate modifications in the programme design often at a later stage. Therefore, to a great extent, EDA designed the programme mainly focusing the BDS and other aspects and incorporated aspects related to financial services as we made progress in implementing these activities. The subsequent texts discuss how we have attempted to understand the value chain finance in the litchi sub-sector from the start thereby making the research work more comprehensive and systematic leading to a comprehensive programme design.

2.1 Development of preliminary understanding for the litchi sub-sector

EDA's first step was to develop a sub sector map to better understand the litchi subsector. For this purpose, EDA interviewed a few small litchi growers to understand whom they undertake business transactions with. This informed us about other actors in the litchi sub-sector. Some of these actors are input suppliers who supply seedlings and fertilizer, traders of litchi fruits/wholesalers who buy litchi fruits from litchi growers, processors, representatives of litchi growers' cooperatives and other support agencies such as banks and government agencies aimed at helping the sub-sector growth. Some of them are located in the same geographical areas whereas some of them are spread apart in other locations. Then we interviewed a few of these sub-sector actors identified with the interviews with small litchi growers. This provided us a basis for drawing a draft map of the litchi sub-sector – showing different actors their business relationships.

2.2 Development of a preliminary checklist of questions

Having drawn the map, we developed a checklist of questions for each actor of the sub-sector. There were two sets of questions – one to understand in detail the basics of their enterprises, their business transactions, problems at various stages of their enterprises and the other set of questions were related to financial aspects. In a way, EDA integrated both the sets of questions in the same questionnaire to understand the sub-sector and value chain finance. Some of the questions related to understanding financial aspects are below

- For which purposes do you require finance and how much?
- How do you manage your financial requirements for different purposes including purchase of different inputs?
- From whom do you obtain finance/loans? What are the interest rates?
- When do you pay back the loans?
- Do input suppliers provide you the inputs for cash or on credit?

2.3 Testing the checklists of questions

EDA decided to test the effectiveness of checklist of questions with respective category of actors to learn whether we could obtain the information we want to gather. Since EDA had not integrated both the sets of questions in its earlier sub-sector analyses, we were not sure if this would work effectively.

2.4 Changes made in the checklists of questions on the basis of the testing exercise

The testing exercise had been very helpful in enabling us to understand the sequencing of questions suitably considering the understanding level of respondents. This exercise also helped us as to how to ask questions related to financial aspects – initially we were using some jargon but gradually felt that we should use their own terms that they understand. In addition, this exercise also helped us understand which question to skip while interviewing a respondent. For example, if a litchi grower has not obtained a bank loan there is no use asking questions related to interest rate on the bank loan and the quality of financial services provided by the bank. But, this also enabled us to think that even though the grower has not obtained a loan he may be obtaining funds or short term credit from other informal sources

such as friends relatives and sub-sector actors. On the basis of this we incorporated these additional questions in the set of financial questions.

2.5 Revision of checklist of questions

We reworked and revised the checklists of questions related to each actor of the sub-sector on the basis of learning emerging from the testing exercise. For example, in the revised checklist of questions related to the litchi grower, we added a few more questions such as

- From where you obtain funds if required when a bank denies you a loan?
- What are the terms and conditions if you obtain funds from an informal source? Do they charge any interest and how much, if so?
- Do you obtain funds from these informal sources easily and on time and the amount that you require?
- If you obtain financial services from buyers of litchi fruits, do they charge an interest? Do you enter into any agreement with and the buyers of litchi fruit. Are these agreements formal or informal/verbal? What if you don't sell your fruit to that particular buyer?

2.6 Execution of the detailed checklist of respective actors

Finally, we executed the revised checklist of questions with a larger sample size. It is important to mention that even at this stage, we added a few more questions related to financial aspects. Those questions mainly related to the litchi growers include the following

- If you approach a bank and it denies you a loan, does it provide you a reason for denying the loan?
- Are you satisfied with these reasons for denying a loan? Do you approach regional office of the bank if the bank branch in your village denies you a loan? If not, why not?
- Do you require other financial services such as insurance of orchard or litchi crop? Are you aware of such service providers?

The execution of this the checklist of questions with sub-sector actors is being carried out by a Management Executive with about 4 years of work experience related to enterprise promotion in sub-sectors including experience in facilitating links of small and micro-enterprises with banks and financial institutions and having understanding on sub-sector analysis process. The guidance and supervision to this research is being provided by the Team Leader, Enterprise Promotion and BDS.

3 Some emerging lessons

- Be open to revise checklist of questions as your understanding develops particularly in relation to value chain finance.
- It is useful to explain the sub-sector actors about the purpose of information gathering – this should done at the start of the interview as the interaction process may increase their expectation from the project and sometime it is difficult to meet their expectations. On one or two occasions, litchi growers asked if EDA will provide loans to the sub-sector.

- Make a judgment about which questions should be skipped while interviewing a respondent – if there is enough information already collected on the basis of an enterprise and their business relationships, it may not be very helpful in obtaining same information from all the respondents. This saves both time of researches and interviewees and keeps the subsequent interviews focused on exploring new information.
- It was found that the respondents, in particular small litchi growers, often do not keep systematic financial records and they ended up calculating afresh all the expenses incurred during the running of the enterprise.
- It was also observed that some of the litchi growers were hesitant in disclosing the financial information related to their businesses. However, after convincing them about the rationale of the study, most of them disclosed the financial information.
- It was found that marketing agents/pre-harvest contractors were more articulate in their responses and they maintained systematic financial records of their sales. However, they were also are hesitant in sharing the financial information. EDA managed to persuade these respondents by convincing them that the information will only be used to have better understanding of the litchi trade and the information provided will be kept confidential.
- It is essential that during the interview the respondents should be alone, otherwise some other villagers unnecessarily interfere and the respondents were unable to divulge the financial information.
- **Integration of both the sets of questions, sub-sector related questions and the financial questions in the same checklist of questions seem to work effectively and EDA has been able to gather required information. However, there could be other effective ways also that the PLP partners may be testing in their project. It will be good to learn those approaches.**

4 How is EDA using information gathered on financial services?

EDA has used the information related to the financial services in some of the following ways the following ways

- For designing appropriate loan products for different activities including new plantation of litchi orchards, canopy management, rejuvenation and orchard management. And discussions with banks and encouraging them to embed appropriate features in the loan products to meet the financial requirements of litchi growers and beekeepers.
- For providing information to banks about the demand potential of financial services from litchi growers and beekeepers.
- For up-scaling effective existing mechanisms and value chain relationships through which financial services are already being provided to litchi growers.

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