

**MICROFINANCE LEARNING PAPER SERIES**

# Developing Agriculture Loan Products for Poor Rural Communities

## *Metemamen Microfinance Institution: Ethiopia*

Rural communities in Ethiopia face significant challenges related to food security and economic stability. For most people residing in these communities, income-earning opportunities are limited to the sale of surplus produce or wage employment on large-scale farms. During times of drought these opportunities become even more scarce than normal, because the agricultural sector tends to suffer the most. Today, as many as 40% of all rural Ethiopian households fail to produce enough food or generate sufficient income to meet their basic nutritional needs. In addition, land constraints limit rural households' options for increasing cash-crop production and income-producing off-farm activities.

Ethiopia's public and private banking system is not designed to address the specific savings and credit needs of these food-insecure rural households. Even in urban areas, where more financial services exist, rigid banking criteria effectively place these services out of the reach of poor households. Rural households have even less access to banks and correspondingly fewer options, which leaves them vulnerable to traditional moneylenders who charge interest rates as high as 100% on a two-to-three-month loan.

### **PROFILE OF METEMAMEN AND ITS LOAN PRODUCTS**

Metemamen Microfinance Institution, a CRS partner, has been serving the Ethiopian credit market for over five years, using the village banking (VB) methodology. A formal, registered MFI, Metemamen, like many other young MFIs, initially took a "one product fits all" approach to lending.

But within the first year of operation Metemamen faced a significant challenge, with an increasing number of clients "dropping out" in almost all operational areas. In an effort to discover the causes for its high client drop-out rate and identify solutions, Metemamen conducted market research using the MicroSave toolkit.<sup>1</sup> Based on the results of that research, the loan size, terms, and frequency of repayment for Metemamen's VB product were modified to better satisfy client demand.

The modified loan product was launched at the beginning of 2004. The revisions made to this loan product however, were not sufficient to address all of the changing needs of Metemamen's clients. A follow-up market study, conducted in mid-2006, showed a need for further product diversification. In response, five new loan products were designed and introduced in 2006. One of these, the Eshet loan, was specifically geared toward agricultural production in rural communities.

The Eshet product was designed to serve as a catalyst for Metemamen's entry into rural areas. Pilot projects were conducted in two of its twelve operational areas, Meki and Alem Tena. These sites were selected because of their location in the Rift Valley, where CRS

<sup>1</sup> For more information, visit the MicroSave website at <http://www.microsave.org/>



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Ethiopia was implementing a white pea (navy) bean agroenterprise project. Metemamen saw this as an excellent opportunity to partner with CRS on a specific product, intending to use the experience gained to inform further expansion to other rural areas.

The primary objectives of introducing the Eshet product were to:

1. Provide loans to 440 resource-poor farmers in Meki and Alem Tena in 2007. Using the experience gained in that effort, Metemamen would then expand its rural market penetration into new areas.
2. Link with CRS Ethiopia's agroenterprise development intervention through the provision of loans to farmers involved in white pea bean production. Farmers raising white pea beans account for at least 20% of the total number of clients receiving Eshet loans.
3. Generate 82,000 birr (USD \$9,160, approximately) in interest income, which would significantly contribute to Metemamen's operational and financial self-sufficiency.

### **LINKING CRS ETHIOPIA'S WHITE PEA BEAN WITH MICROFINANCE SERVICES**

Before offering the Eshet loans, Metemamen's field staff, together with CRS staff, identified suitable farmers in farmer groups already involved in CRS' white pea bean production initiative. Only those farmers with good credit history from their previous involvement with CRS were selected to participate.

In May 2007, 308 farmers were organized into 15 village banks that would be able to access agricultural loans from Metemamen. The farmers first received an orientation by Metemamen's staff to explain the program objectives, loan and savings policy, village bank group management, and drafting of by-laws. After they completed this training, loans were disbursed in June 2007, timed to coincide with the arrival of the rainy season in Ethiopia (early June to mid-September).

#### *Changes Noted at the Midterm Point:*

Most of the farmers who received Eshet loans had no prior experience with formal credit and savings programs, except for the white pea bean seed credit received from CRS Ethiopia. The Eshet pilot project gave these farmers the opportunity to organize themselves into groups to manage their own affairs and to access loans from a formal MFI. Borrowing from traditional moneylenders at prohibitive interest rates had previously been their only alternative, given the shortage of grain for domestic consumption during the rainy season in these areas. As a result of the Eshet loans:

1. Farmers were able to avoid expensive loans from moneylenders since Metemamen's terms were less expensive and more flexible. This attracted farmers to the pilot.
2. The previous seed credit from CRS Ethiopia required farmers to repay principal but not interest. With the Eshet loan, farmers were required to pay both principal and interest. Despite their past experiences with interest-free credit, farmers in the program areas showed a keen interest in taking loans on a commercial basis. The change in farmers' attitude toward borrowing has had a positive impact on program sustainability and furthered the ultimate objective of serving rural markets.
3. The loans were tied to compulsory savings, properly deposited by farmers in the institution. These savings partially guarantee the loans, but more importantly they help to promote a savings culture among farmers. This is expected to lead to the creation of a community-managed credit and savings program.
4. The four-week training has helped raise farmers' awareness and has opened opportunities for them to manage their own village banks. Leading a group meeting,

taking minutes, and registering their transactions are some of the activities that they now have the ability to manage. These activities reinforce CRS Ethiopia's Agriculture and Natural Resource Management efforts to organize farmers into groups that can successfully access inputs, information, credit, and markets.

5. Word-of-mouth promotion has helped Metemamen to reach more farmers in the rural communities.

From the outset, the project brought together key stakeholders in the design and implementation stages. Metemamen, CRS Ethiopia, the local Catholic Church development agency, and *kebeles* worked together on how and when to channel the resources and put in place the mechanisms for follow up during implementation.<sup>2</sup>

The role played by *kebeles* cannot be overemphasized. They were particularly helpful in providing background information (credit worthiness, *kebele* membership, addresses, etc.) for each potential borrower during the client-selection process, and they expressed strong commitment to assisting Metemamen in loan repayment collection, if needed.

### ROLE OF PARTNERS

The key partners involved in implementing this project were CRS Ethiopia, Meki and Alem Tena Catholic churches, and the respective *kebele* administration offices. This was possible because CRS Ethiopia has been the major donor to Metemamen, providing technical and financial support from the beginning. CRS' long experience managing development projects, particularly agroenterprise development initiatives, was an essential factor in linking these partners together for this project.

The Meki and Alem Tena Catholic churches, through implementation of various development activities, have also achieved a long-standing and respected relationship with the community. Their knowledge of the project areas was quite important in client recruitment and in obtaining background information about the prospective clients.

KEY PARTNERS	ROLES
<b>CRS Ethiopia</b>	<ul style="list-style-type: none"> <li>• Provided technical support.</li> <li>• Assisted in the selection of clients, especially from among the white pea bean program beneficiaries.</li> <li>• Monitored project implementation.</li> </ul>
<b>Kebele</b>	<ul style="list-style-type: none"> <li>• Provided information on each client (creditworthiness, addresses, etc.).</li> <li>• Assisted in creating moral pressure to ensure on-time loan repayments.</li> </ul>
<b>Meki and Alem Tena Catholic churches</b>	<ul style="list-style-type: none"> <li>• Assisted in the recruitment of clients, especially from the among white pea bean program beneficiaries</li> <li>• Facilitated client seed purchases.</li> <li>• Provided technical support in group leadership, production and marketing.</li> <li>• Organized the groups.</li> <li>• Linked the groups with market actors.</li> </ul>

<sup>2</sup> *Kebeles* are government institutions responsible for all administrative matters in their locality.

## USE OF EVALUATION MECHANISMS TO IMPROVE PROJECT IMPLEMENTATION

As the Eshet product was rolled out, Metemamen discovered that a number of key modifications were needed to ensure its success. For example, Metemamen initially intended to extend loans to farmers only for the purchase of improved seeds; however, it was quickly recognized that farmers also needed funds to purchase fertilizer and other agricultural inputs to ensure adequate yield from the improved seed. Metemamen therefore decided to increase the loan fund to cover these additional loan purposes.

Another area where more flexibility was needed was the time at which loans were made available. While the goal had been to provide loans to coincide with the rainy season, some farmers wanted to borrow funds after the rainy season to finance planting other crops. Using small-scale irrigation techniques, the farmers were able to continue production throughout the year while engaging in other economic activities, such as grain trading. In response, two loan periods were introduced. The first, from mid-June to mid-September, coincides with the rainy season. The second, from mid-December to the end of June, is timed to finance dry-season, irrigation-dependent farming.

Finally, Metemamen had to reduce the minimum village-bank membership size, to 12 from 20, to correspond to the realities of farming communities. The long distances between villages limited the pool of farmers who knew and trusted each other sufficiently well to be able to form a viable village bank.

**The experience has also opened up opportunities for further linkages with CRS Ethiopia's agroenterprise project and created demand for agriculture loans in a number of communities.**

### RESULTS OF THE PILOT

During the pilot phase Metemamen observed a number of successes that have helped the institution to better understand how it can extend its Eshet loan product to additional rural communities. The experience has also opened up opportunities for further linkages with CRS Ethiopia and created demand for agriculture loans in a number of communities.

Metemamen exceeded its goal of 440 farmers for the pilot project; a total of 446 farmers received Eshet loans. Of these, 119 were involved in CRS' white pea bean program, representing 27% of the total Eshet borrowers. 26,200 birr (USD \$2,920) in interest income has already been generated, which is 32% of the 82,000-birr (USD \$9,160) target. The lag in interest income is due to the staggered dates on which the farmers took the loans. The initial business plan had assumed all loans would mature at the same time. Consequently, at the time that this report was completed, only 39% (120) of the farmers had reached their loan repayment dates and thus paid their total loan principal together with interest. The majority of the farmers (326) still had outstanding loans. In fact, some groups have only just finished their payment at the end of June 2008. These are the farmers who took loans toward the end of December 2007. To date, 100% of the loan principal due has been recovered.

While Metemamen's total portfolio at risk over 30 days past due (PAR > 30 days) was 6.9% on December 31, 2007, the PAR > 30 days for the pilot product was negligible. This achievement can be partially attributed to the success of CRS' agroenterprise development program, which introduced the idea of credit before the CRS MF Lifelines-funded project.

A total of 120 farmers have received a second loan, after repayment of their first loan. Although still low, the percentage of women clients increased from 29% registered at the beginning of the project to 57% at the end of December 2007.

**The Eshet pilot... highlights the demand for diversified loan products among farmers that take into account differences in income, gender, type of activities (on-farm versus off-farm), and distance from major urban centers.**

### Reasons for Success

Eight key factors contributed to the success of the pilot project:

1. Loan repayments were based on projected cash flows. Consequently, farmers repaid the total loan principal at the end of the loan term, which coincided with the harvest period, while interest was equally apportioned over the loan period and was paid on a monthly basis.
2. The interest rates charged on loans were competitive with other MFIs in the market. Excluding the interest rate, no other fees were charged on the Eshet loan product. The farmers found this to be less expensive than offers made by other financial-service providers.
3. As a result of linkages between CRS Ethiopia's agriculture programs and Metemamen, farmer yields and farmer incomes have increased. CRS lent support in organizing farmer groups, providing seeds and motor pumps, and training farmers in production and marketing. Metemamen provided them access to credit to purchase fertilizer and pesticides.
4. Good weather conditions helped farmers plant and harvest their crops on time.
5. Rural clients were found to be more honest and had stronger solidarity relationships among themselves than urban clients, because unlike urban clients they relocate infrequently and so can develop relationships over time.
6. Close monitoring of activities, from client selection to final repayment, by Metemamen staff encouraged on-time repayment.
7. Hiring loan officers from the project area who knew the community's culture and spoke the local language, helped to quickly establish a strong level of trust between the institution and the farmers.
8. The role played by the partnering organizations (CRS Ethiopia, the respective *kebeles* and the Catholic Church agencies) ensured that recruitment, group formation, and follow-up were conducted without difficulties.

The Eshet pilot program's success has strengthened Metemamen's operations and its ability to expand into rural areas. It further highlights the demand for diversified loan products among farmers that take into account differences in income, gender, type of activities (on-farm versus off-farm), and distance from major urban centers.

### Constraints and Challenges

At the same time, a number of constraints were identified. These were:

1. Distance from major centers is a limiting factor for expanding operations deep into the rural areas, because of the lack of a viable road network.
2. The male-dominated culture exerts more restrictive control over resources for women in rural areas than in urban areas. Important decisions related to farm production and non-farm activities, including access to credit services, remain the exclusive domain of men, with little input allowed from women.
3. While there is ample demand for Eshet loans, Metemamen used overly restrictive selection criteria to ration the number of loans because of a shortage of funds.

These constraints disproportionately affected the poorest farmers living furthest from Metemamen's branch and sub-branch offices, and further restricted opportunities for women to access loans. Women's participation, however, gradually improved throughout the pilot period, after discussions with their husbands and the targeting of a portion of the loan funds exclusively to activities where women's involvement was high.



With regard to the funding constraint, Metemamen has approached other donors about similar agroenterprise programs in other geographic areas, seeking to raise additional capital for Eshet loans. Metemamen will continue to strengthen its collaboration with local organizations, since the strong collaboration between Metemamen, *kebeles*, and CRS greatly contributed to the pilot project's success.

### *Lessons Learned*

While Metemamen's experience in rural lending is still limited, the pilot program has shown that farming communities are not homogenous. There is a need for continuous participatory market research and product and methodology adjustments to address the needs of different farmer groups. Other lessons learned:

1. Organizations involved in rural lending need to strengthen their collaboration with local institutions, such as peasant associations and edirs (local government institutions), involving them from inception to program completion.
2. Lending to rural areas requires real commitment on the part of the lending organization. This is because rural lending is more expensive and risky than urban lending, due to higher costs for travel and increased risks of natural calamities, such as drought and floods.
3. It is advisable to start with rural villages located close to the branch and sub-branch offices, to minimize costs until the organization acquires sufficient experience to manage the additional costs of serving more remote communities.
4. The institution needs to hire loan officers who are well acquainted with the local culture and speak the local language, as this plays a pivotal role in the development of the mutual trust needed for successful rural lending.
5. There are advantages to linking with agroenterprise groups that are organized and supported by a partner organization, such as CRS. Given that both parties have limited resources, the MFI can focus exclusively on the loan product and the partner on market-led production and product marketing activities. These linkages will help to build the group members' confidence in market-led production activities.

### **FARMING PROVIDES HOPE FOR A BRIGHTER FUTURE**

Milko Bati, a 37-year-old widow and a mother of seven children, lives in rural Alem Tena, central Ethiopia. As the head of the household, she used to struggle to feed her children with her meager crop yields and limited income.

In 2007, a team from CRS Ethiopia and two of its local partners, Metemamen Microfinance Institution and Alem Tena Catholic Church, visited the agroenterprise group of which Milko was a member, in an effort to scale up white pea bean production among small farmers in the area. The team shared with the group Metemamen's Eshet loan product, which provides small loans to meet the credit needs of poor farmers. The news was a blessing to Milko and her family. "Accessing the loan made me an asset owner," Milko explained.

Milko benefited from CRS Ethiopia's program to increase production and improve the local marketing of white pea beans. She received a 600 birr (\$67) loan from Metemamen and used it to purchase fertilizer for the white pea bean seed provided by CRS Ethiopia through the Alem Tena Catholic Church. Leveraging the use of fertilizer and production advice from CRS, Milko harvested a significant amount of white pea bean, which earned her an income of 5,000 birr (\$556).

The links between CRS Ethiopia's integrated agroenterprise project and microfinance services helped Milko increase her income. She was able to repay

her loan, cover the costs of hired labor and use some for household consumption needs. With the extra income from her white pea bean activities she has been able to purchase an ox.

“If it was not for the fertilizer purchased using the Eshet loan, I could not have produced 14 quintals of white pea bean and earned such an income,” Milko stated. “I never had that kind of money and assets before. Now I have an ox that will enable me to continue producing white pea bean and I can access Metemamen’s loan for purchasing inputs (fertilizer and improved seed). The future is bright.”

Milko expects to continue to borrow from Metemamen to increase her assets and improve her livelihood. She is just one of the many rural women who need access to loans to support their families. Thanks to this program, Milko for the first time has been able to receive a loan from a formal credit institution and has used the funds to considerably improve the quality of life for her family.

*The Learning Paper Series is produced by MF Lifeline Grant recipients from various CRS country programs and partners. The purpose of these papers is to document key lessons learned via the grant projects and to disseminate that learning to other CRS programs, partners and interested practitioners.*

*CRS serves the poor in more than 100 countries on five continents and ranks among the world’s major players in microfinance. Its investments in microfinance have helped to eliminate sources of economic injustice around the world.*

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