



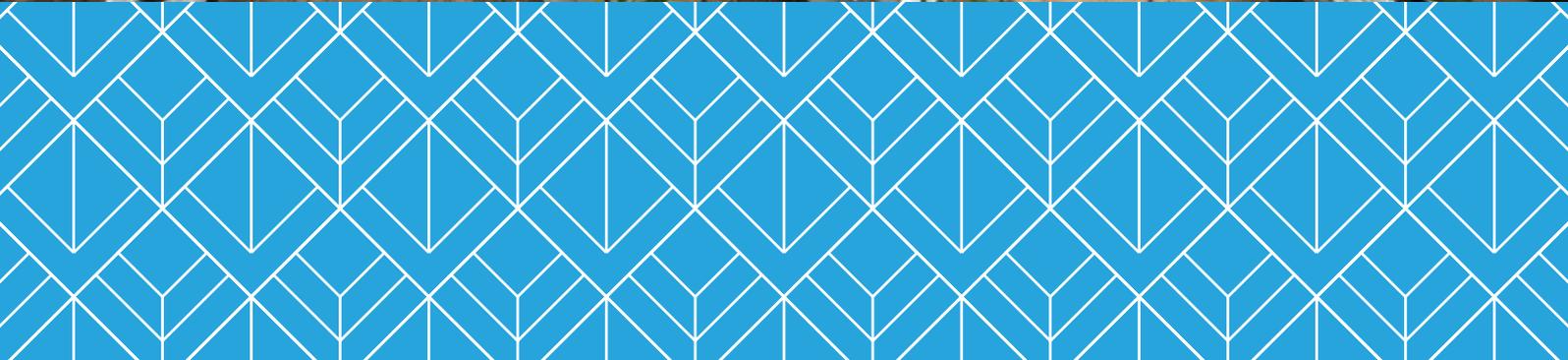
Investing in rural people

ENHANCING RURAL FINANCE DESIGN & IMPLEMENTATION

LESSONS FROM IFAD'S OPERATIONS IN EGYPT



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PREFACE

In the heart of Egypt's rural landscape lies a complex mosaic of agricultural livelihoods, where the challenges of accessing finance are often intertwined with the aspirations of smallholder farmers, rural women and agricultural small and medium-sized enterprises (SMEs). Amid this ever-changing landscape, IFAD has embraced a central role, weaving together initiatives focused on boosting agricultural productivity and nurturing sustainable rural development.

This report aims to examine the complexities surrounding inclusive rural finance in Egypt, inspired by IFAD's extensive engagement and experience in the region. We explore the diverse terrain of rural finance, highlighting challenges and opportunities, offering innovative solutions and humbly sharing lessons gleaned from IFAD's endeavours.

At its core, this examination underscores the critical importance of understanding the complex needs of rural communities, particularly in terms of financial services. From assessing the diverse needs of target beneficiaries to encouraging savings and supporting women entrepreneurs, IFAD's initiatives aim to address systemic gaps while fostering resilience and inclusivity.

Moreover, this exploration delves into the realm of financial sector innovations, highlighting approaches that stimulate the development of products and services tailored to meet market demand. Through collaboration and innovation, IFAD seeks to harness the transformative potential of rural finance, catalysing sustainable growth and fostering economic resilience within Egypt's agricultural sector.

As we embark on this journey through the complexities of inclusive rural finance, it is imperative to recognize the collaborative efforts of stakeholders, from governmental bodies to financial institutions and grassroots organizations. Together, we aspire to navigate challenges, seize opportunities and pave the way for a more inclusive and prosperous future for Egypt's rural communities.

This preface lays the groundwork for an insightful exploration of this issue, inviting readers to delve into the nuanced landscape of rural finance in Egypt and the humble role of IFAD in shaping sustainable rural development. Through knowledge exchange, constructive collaboration and dedication, we strive to catalyse positive change and foster inclusive growth, ensuring that the aspirations of Egypt's rural population are met with opportunities for prosperity and resilience.

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A. BACKGROUND

IFAD plays a significant role in Egypt by supporting initiatives aiming to enhance agricultural productivity and livelihoods in rural areas. IFAD's approach in Egypt encompasses two primary strategies: enhancing rural household livelihood options and improving policy frameworks for sustainable rural development. This involves promoting sustainable natural resource management and climate-smart agricultural practices, and engaging the private sector in agriculture.

IFAD's involvement in Egypt is extensive, encompassing IFAD's largest country programme in the Near East and North Africa region. Over the years, IFAD has invested substantially in 14 agricultural development projects and programmes, with investments totalling US\$1.1 billion, directly benefiting approximately 7 million people. These investments align with the Government of Egypt's economic reform and poverty reduction initiatives, particularly focusing on rural finance as a critical component.

Despite agriculture's significance in Egypt's rural economy, challenges persist, such as limited access to agricultural finance given the financial sector's risk aversion and lack of expertise in this area. Agricultural credit remains low, hindering farmers' ability to expand operations and invest in high-value crops. Recognizing these challenges, IFAD is working on enhancing rural finance through initiatives such as the Sustainable Agriculture Investments and Livelihoods (SAIL) project that aim to improve financing options for smallholder farmers, rural women and SMEs.

To address these issues comprehensively, IFAD has commissioned a policy brief focusing on rural finance and microloans. This brief aims to draw lessons from experiences and propose changes in project design and administration processes for better implementation coherence. The recommendations outlined in the brief emphasize the need for innovation and wider stakeholder consultation to enhance the effectiveness of rural and agricultural finance in Egypt. Ultimately, this initiative seeks to initiate strategic discussions between IFAD, the Government of Egypt and other stakeholders to shape future options for rural and agricultural finance in the country.



B. CHALLENGES & OPPORTUNITIES IN INCLUSIVE RURAL FINANCE: INSIGHTS FROM IFAD'S FINANCIAL LANDSCAPE

IFAD's review of rural finance in Egypt has identified several challenges impeding the expansion of inclusive rural finance. While some challenges fall within IFAD's current framework for design and implementation, others require broader discussions, consensus, collaboration and investments from various stakeholders to achieve significant impact. Several of these challenges have implications for good practices in inclusive finance and the strategic development of the financial sector, encompassing regulatory and policy considerations. The following list of areas for growth is illustrative and does not constitute a comprehensive review of how IFAD can address the challenges.

1. Improved assessment of financial services demand in project areas.

Understanding the broader set of financial services needs of target programme beneficiaries, including but not limited to credit needs, is a core tenet of IFAD's inclusive rural finance policy and good practice in rural finance. It is also a key takeaway from the SAIL project's experience. Assessing the services needs of the target beneficiary population, including specific groups such as women and youth, and their financial context, including household income and assets (e.g. for capacity to repay and provision of collateral), must be prioritized. Specific local economic and agronomic contexts, such as challenges in and around new lands and those related to climate change, must also be considered. Many individuals outside the formal financial system may need support in the transition to the formal sector, including technical assistance, financial literacy training and grant support for sustainable integration.

2. Savings promotion.

Initiatives must endeavour to help programme target groups to manage cash flow, smooth consumption and build capital (for investment or collateral), including through (i) formulating a robust policy for promoting savings among diverse target groups, (ii) advocating for project management to establish memorandums of understanding with financial institutions, (iii) establishing/working with community-based financial organizations/institutions and (iv) establishing financial and business literacy programmes.



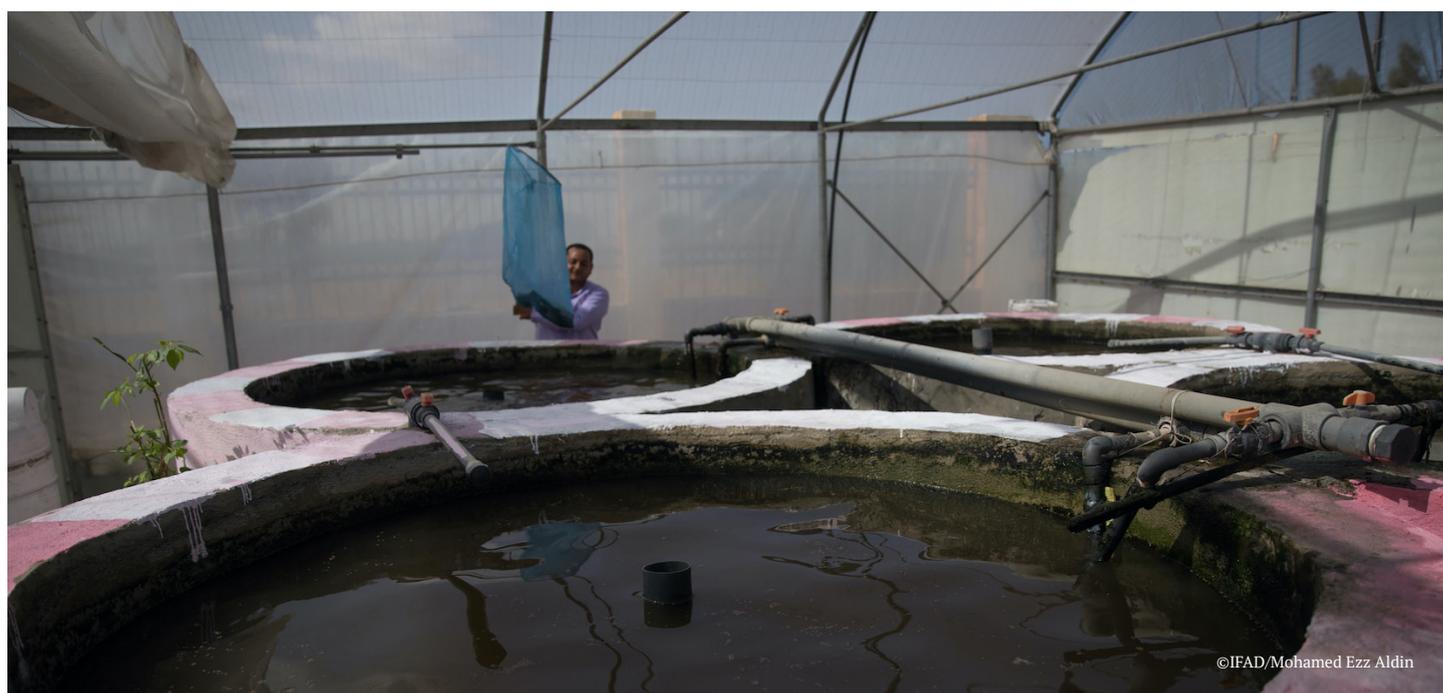
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3. Financing of women's needs.

In Egypt, only 19.3 million out of 32.3 million eligible women are included in the formal financial system. Women rely heavily on high-cost microfinance institutions (women constitute 70 per cent of microfinance institution clientele) and about 500,000 women use informal, community-based financial organizations¹. Beyond the household, there are notable gaps in agriculture and microenterprise credit for women and there is a gap of US\$283 million for female-owned SMEs. SAIL's experience of supporting financial services for women is mixed. Outreach to women through the Agricultural Development Programme (ADP) is just 10 per cent, with challenges such as meeting partner banks' requirements (e.g. collateral and income) being cited as a reason. Micro-, small and medium-sized enterprise development agencies, through microfinance institution partners, could enhance outreach. Establishing dedicated efforts and institutions to provide finance to poor women, such as that provided through the Agricultural Bank of Sudan Microfinance Initiative (ABSUMI), could likewise enhance outreach. Financial and business literacy training could be critical for inclusion, both generally and for women specifically.

1. For example, village savings and loan associations, savings and credit groups and village sanadiq networks. See Central Bank of Egypt, "Women's financial inclusion indicator's as of December 2021" (2022), <https://www.cbe.org.eg/-/media/project/cbe/page-content/rich-text/financial-inclusion/women's-financial-inclusion-indicator's-as-of-december-2021.pdf>

ABSUMI is a successful collaboration between the Agricultural Bank of Sudan, the Central Bank of Sudan and IFAD aiming to provide microfinance services to women in rural areas who struggle to access traditional finance. Established in 2010, ABSUMI employs a group lending model with joint liability to minimize default risks, building on the proven village sanadiq approach while incorporating strategic innovations. Through outreach efforts, credit officers engage local leaders and village committees to form savings and credit groups, offering Sharia-compliant financial services and training in business skills and financial management. ABSUMI's loans support diverse activities such as those involving agriculture, livestock and microenterprises, resulting in nearly US\$7.4 million disbursed across 70,000 loans by 2018, with an impressive repayment rate of almost 100 per cent. An agreement with IFAD in 2013 aimed to expand ABSUMI's reach to an additional 150,000 poor households, indicating the initiative's ongoing success and scalability in addressing financial inclusion in Sudan's rural communities.



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4. Improved assessment of financial services supply.

For the sustainability and effective delivery of the programmes, it is crucial to have a comprehensive understanding of the willingness and capacity of financial institutions to meet the demand for inclusive rural finance. This knowledge is essential for determining the technical, product and market outreach requirements of financial stability plans, ensuring their interest, capacity and ability to reach target beneficiaries.

5. Targeted, disciplined and valued technical assistance for financial institutions.

To enhance partner financial institutions' capacity to offer inclusive rural finance products and services, targeted technical assistance is often necessary. Given the limited resources for such assistance, it should be delivered with market discipline to effectively meet the needs of financial institutions and, ultimately, improve access for target beneficiaries.

6. Well-designed grants.

Grants that work to induct very poor beneficiaries into financial services require the support of community institutions, especially those managing matching grant programmes. Effective delivery of grants may require technical assistance tailored to the needs of these institutions.

7. Blended finance.

Combining grants and loans may be required to lower the costs of financial services, particularly the provision of credit to target beneficiaries. The box below exemplifies a successful IFAD blended finance project in India.



The Post-Tsunami Sustainable Livelihoods Programme (PTSLP), supported by IFAD and implemented by the Government of India in Tamil Nadu's coastal districts, exemplifies successful enterprise promotion and innovative financing strategies. The project, with a focus on empowering women entrepreneurs, engaged retired bank officials to provide business plan development training, enhancing participants' understanding of essential business linkages. Through collaboration with NABFINS, a microfinance institution, PTSLP introduced a blended finance facility mechanism, providing patient capital alongside regular loans. This innovative approach facilitated access to finance for first-time entrepreneurs, with NABFINS lending 70 per cent of the total credit requirement from its resources and 25 per cent as patient capital from IFAD at a reduced interest rate. The structured repayment system, prioritizing higher-interest loans, ensured sustainability and enabled financing for 7,404 entrepreneurs, achieving a remarkable repayment rate of 97 per cent with a low non-performing asset ratio of 3 per cent. In summary, PTSLP's success lies in its holistic approach to enterprise development and innovative financing mechanisms, empowering women entrepreneurs and promoting sustainable livelihoods in coastal communities. By leveraging partnerships and creatively addressing financing challenges, the project effectively supported entrepreneurship, thus contributing to economic resilience and social uplift in the region.

8. Continuous attention to policy, regulations, strategies and the sector.

This involves adopting a diversity-centric approach, tailoring policies to cater to the distinct needs of various target groups, including smallholders, rural women and SMEs. This customization ensures inclusivity in the provision of financial services. Furthermore, it is crucial to develop an accessible regulatory framework that promotes affordability and accessibility, encouraging financial institutions to extend their services to underserved populations. In addition, incorporating risk mitigation measures is essential to creating an environment conducive to financial inclusion and addressing the challenges associated with serving diverse customer bases. Lastly, supportive and well-defined strategic sector development and regulation provides the stability necessary for long-term investments and commitments to market development.

Introducing innovations in the financial services sector requires a strategic approach, particularly when partnering with private sector donors to stimulate the development of products and services based on market demand. IFAD programmes bring advantages such as targeted financing, heightened visibility, collaboration opportunities and dedicated programme management. A crucial lesson learned by IFAD is that innovative financial services require substantial investments in technical assistance, market studies, piloting and capacity building, all aspects governments may be hesitant to finance with borrowed funds. Nevertheless, innovation holds substantial potential for scaling up service outreach and delivering returns on both private and public investments. By collaborating with other donors, even modest government investments in innovation can leverage significant private sector finance and provide crucial support for the introduction of new products and services. IFAD's assessment of its inclusive rural finance initiatives in Egypt identified various innovations for advancing inclusive rural finance. The following list of innovations provides an illustrative compilation of these findings.

1. Challenge funds. Challenge funds can support innovative financial services. These funds provide time-limited risk capital/grants for developing and introducing new financial approaches, products and processes on a competitive basis. This allows financial service suppliers to respond to the demand that they have identified in the target market. Financial service suppliers match a portion of the grant with their own financing. Technical assistance to help the financial service supplier with product development, piloting and commercialization of services often accompanies the funds.

2. Credit guarantee funds. These funds are dedicated to guarantee loans for smallholder farmers and could encourage financial institutions to lend to community-based financial organizations. A credit guarantee fund seeks to share or absorb risks, making lending a more accessible substitute for traditional collateral. Credit guarantee funds offer higher coverage for new lands, thus addressing credit disparities among regions and serving as a policy instrument. A portfolio credit guarantee fund would support financial institutions lending at scale, covering short-term and medium- to long-term loans for both working and investment capital loans.

3. Value chain financing. Value chain financing addresses the historical reluctance of financial institutions to lend to smallholders and agricultural SMEs due to perceived risks and transaction costs. By fostering business relationships within the same value chain, value chain financing can provide financial products and services. This approach comprehensively evaluates the entire value chain, moving beyond simple credit risk assessments. It considers links between activities, value chain actors, financing relationships, and flows of information and resources, thus leading to customized financial products. Typically, value chain financing involves collaboration with aggregators, facilitating affordable pre-season financing for financially excluded farmers. While some micro-, small and medium-sized enterprise development agency partners are piloting value chain financing, broader implementation has yet to be seen.





4. Multipurpose wholesale mechanisms. Traditionally, mechanisms such as lines of credit and revolving funds offer debt-only funding to financial institutions. A more adaptable strategy to cater to the diverse needs of a broader range of financial institutions involves a wholesale fund providing funding on a subordinated basis to blend the cost of and lower risk to higher-priced private capital. This can extend to multiple players in the financial sector, including guarantee funds and equity funds, or play a role in collaborative financing arrangements with private sector investors. These approaches allow wholesale funds to provide cost-reducing financial institutions risk coverage, leverage financial institution liquidity and finance specialized investment tools (e.g. guarantee funds, lease companies), optimizing their effectiveness and impact, while amplifying government and donor investments.

5. Crop insurance. Crop insurance is underutilized in Egypt, with only 7.8 per cent of households covered, and agricultural insurance uptake is minimal. This form of insurance is vital for smallholder farmers and SMEs, offering protection against potential devastating losses by transferring risks to a third party. Covering production, weather and commodity prices for crops, livestock and fisheries, agricultural insurance acts as a safety net, providing indemnification for losses caused by unpredictable events. It also serves as collateral for loans, enhancing the financial security of investments. However, the low adoption level is attributed to farmers' distrust of this insurance, emphasizing the need for thorough testing, affordability and a reliable payout system.

Through a partnership with UAP Insurance and supported by the Global Index Insurance Facility, the Syngenta Foundation for Sustainable Agriculture introduced the Kilimo Salama weather insurance product, revolutionizing farming practices in Kenya and Uganda. With a low – 5 per cent – premium and facilitated registration at input shops via barcode scanning, farmers are protected against adverse weather conditions without the need for farm visits. The success of this initiative led to the establishment of the Agriculture and Climate Risk Enterprise (ACRE)², which has expanded its reach to over 200,000 farmers across Kenya, Rwanda and the United Republic of Tanzania. This innovative scheme, utilizing mobile technology and automated weather stations, exemplifies a successful model of the provision of affordable and accessible insurance solutions to smallholder farmers, contributing to their resilience and sustainable agricultural practices in the face of climate change.

2. IFC Advisory Services, Kilimo Salama: Index-based agriculture insurance; A product design case study (2021), <https://acreafrica.com/wp-content/uploads/2020/04/Kilimo-Salama-Product-Design-Case-Study.pdf>

D. KEY LESSONS FROM IFAD'S OPERATIONS IN EGYPT

IFAD's review of the inclusive rural finance sector activities in Egypt identified several notable lessons learned regarding the design and implementation of its sovereign operations in the country and region.

1. Effective design and implementation of inclusive rural programmes. This involves adopting a targeted demand-/market-driven design, ensuring that the unique needs of smallholder farmers, rural women and agricultural SMEs are met. Collaborative partnerships with diverse and qualified financial institutions are critical for meeting demand on a sustainable basis, providing support to assess and fill unmet but profitable demand. Engaging and challenging regulators and stakeholders to identify and work together on formulating programme approaches that follow good practices in all programme activities is fundamental. Similarly, to enhance sustainable financial inclusion, it is crucial to involve financial sector and non-financial sector business and social development community-based organizations. In addition, integrating innovative financial products and services, such as grants, credit guarantees and value chain financing, is essential to address gaps and promote inclusive rural finance.

2. Improved collaboration among sector stakeholders. IFAD's support for rural finance in Egypt can be enhanced by improving design elements for better cohesion, providing technical assistance to financial institutions, conducting credit need assessments in new lands before project implementation, collaborating with multiple partner financial institutions, offering well-designed grants for the graduation of target households, addressing savings services and strengthening the Community Development Associations (CDAs) in delivering need-based financial services. This is particularly true in the pursuit of financial services/sector innovations able to decrease transaction costs and radically improve the scale of outreach and customized financial services.

3. Improvements needed in the overall management of credit lines. There are five valuable lessons in the management of credit lines that can be gleaned from the implementation of recent IFAD projects. The design of future projects needs to take into account the valuable lessons learned and some of the good practices emerging elsewhere.

- **Enhance credit line management.** Leverage insights from IFAD projects in Egypt and across IFAD's global portfolio to improve credit line management in future projects.
- **Expand financial institution collaboration.** Collaborate with a broader range of financial institutions while diversifying on-lending channels for greater outreach (in agreement with the Ministry of Investment and International Cooperation).
- **Establish a central coordination committee.** Form a high-level coordination committee with the implementing ministry, IFAD programme director(s), IFAD and implementing financial institutions to focus on programme implementation, timely decision-making, and improved financial and technical assistance.
- **Involve the implementing ministry in subsidiary loan agreements.** Engage the ministry as a party in subsidiary loan agreements to ensure a comprehensive understanding of the financing scope and partner financial institutions.
- **Develop a comprehensive credit manual.** Require partner financial institutions to prepare and regularly update a detailed credit manual approved by IFAD before commencing work.
- **Integrate the credit line with annual work plans.** Integrate the credit line into the annual work plan budget. Ensure coherence through periodic reviews, field monitoring and integration into the management information system. Conduct sample-based utilization checks to monitor beneficiaries of the rural finance component.

E. CONCLUSION



IFAD's involvement in promoting inclusive rural finance in Egypt highlights both progress and challenges. Despite significant strides in enhancing agricultural productivity, issues such as limited access to finance persist. IFAD's strategic opportunities encompass improving demand assessments, promoting savings and addressing the financial needs of women. Innovations such as challenge funds and value chain financing also hold promise as solutions. Key lessons underscore the importance of demand-driven design, collaboration and improved credit line management. IFAD's commitment demonstrates its dedication to sustainable rural development, emphasizing innovation, stakeholder engagement and strategic coordination to ensure lasting impact in Egypt's agricultural sector. Ongoing collaboration aims to catalyse positive change and foster inclusive growth in rural communities.



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