Working Within the Value Chain to Get Financial Services to Micro & Small Enterprises

By Bob Fries



Accessing credit is a challenge for most rural entrepreneurs in developing countries. While there has been considerable growth in microfinance institutions and private commercial banks serving micro and small enterprises (MSEs) in urban areas over the last fifteen to twenty years, too often rural areas lack sufficient financial services. The growth of rural enterprises and the industries or subsectors in which they operate is often limited by the scarcity of institutions offering a range of financial services including overdraft protection, working capital, investment and lease financing, savings and others.

Looking Beyond Just Financial Institutions

One answer to the challenge of rural finance lies in our ability to complement a financial market orientation, which focuses on institutional sustainability, with a value chain approach, which addresses service delivery within a particular industry or sector. In this case, a value chain approach focuses on rural enterprises, the value chains they participate in, the opportunities and constraints they face and the most critical financial services they demand. This approach is relevant because it begins with what is already happening in the field—the actors, relationships, rules of play, range of services and bottlenecks to growth. It increases the likelihood that interventions and innovations will help to close the gaps in rural finance by recognizing market realities and incorporating them into the delivery of expanded financial services.

Tapping Embedded Services

Trader credit, contract farming and warehouse receipts are three mechanisms for expanding rural credit that have grown out of value chain relationships. Trader credit refers to short-term or seasonal loans between buyers and sellers of inputs or products, typically provided in commodity-based value chains such as rice or other basic grains. In contract farming, loans are tied to purchase agreements: farmers agree to sell to a given buyer, who in turn often commits to providing additional services such as technical assistance. This increased level of commitment is more appropriate for buyers and sellers of high-value, specialty products. Warehouse receipts, issued to depositors of nonperishable commodities by safe and secure warehouses, allow financial institutions to use the deposited inventory for collateral and farmers to sell their products for higher prices in the off-season.

Through mechanisms such as these, buyers and sellers "embed" financial services with other services, such as technical assistance, marketing and secure storage. This bundling of embedded services allows traders to sell more inputs, producers to enter into purchase agreements with buyers, and buyers to increase the volume and reliability of their supply. Yields can increase through expanded access to quality inputs and through reduced spoilage during storage. The services embedded in these mechanisms can also reduce transaction costs by facilitating bulk purchases and sales and reinforcing the use of standards that allow buyers to confidently purchase products sight unseen.

Linking Financial Institutions and Value Chain Actors

The embedded services of value chain actors are one mechanism for expanding financial services in rural areas. These services represent a significant percentage of loans to small-scale producers, and the ways in which their terms and conditions mirror and enhance business transactions offer lessons for financial institutions committed to expanding their share of the rural market. These services, however, are not sufficient for meeting demands for expanded rural financial services. Formal financial institutions, with their ability to attract and intermediate capital, are also critical players. They can provide loans for investments and make working capital loans to larger-scale rural enterprises that can in turn extend working capital loans to smaller enterprises. Formal financial institutions can use value chain analysis to expand their definition of creditworthy borrowers by building on the performance of actors within promising chains, in addition to offering savings and funds transfer services.

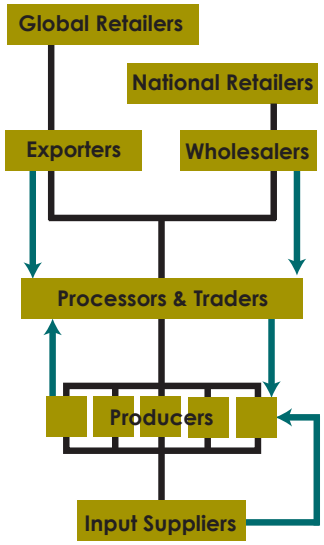
As we look to increase access to rural financial services, practices and innovations in the delivery of these services by value chain players offer significant promise. The value chain approach allows us to respond to rural entrepreneurs' demand for financial services, and to identify and address bottlenecks to economic opportunities with the outcome of increasing the incomes of small producers and other rural entrepreneurs.

Bob Fries is senior technical advisor for financial services in the Technical Services Division.

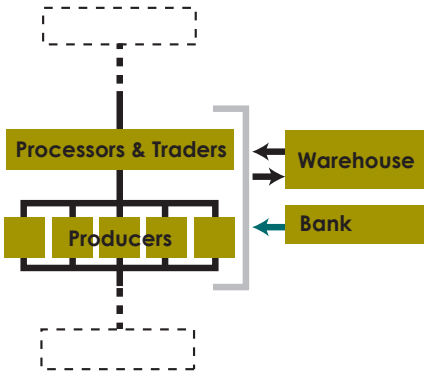
Services Embedded in the Value Chain

Trader credit, contract farming and warehouse receipts are three mechanisms for expanding rural credit that have grown out of value chain relationships. The diagrams below illustrate each mechanism. Black lines indicate product flows and dark green lines indicate loan flows.

Trader Credit

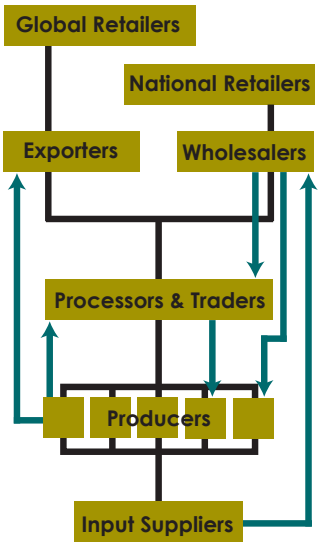


Warehouse Receipts



Because warehouse receipts impact the middle to lower portion of the value chain, the other portions have been omitted from the diagram.

Contract Farming



Warehouse Receipts in Bulgaria

Reaching New Sources of Financing

Grain warehouse receipts programs provide both storage and a source of reliable financing for grain producers. No longer forced to sell at the end of harvest season, farmers can sell when prices are higher and borrow against those sales to make further investments in their enterprises. In Bulgaria, for instance, ACDI/VOCA worked to introduce and implement a warehouse receipts system. After a successful education and public policy campaign, ACDI/VOCA developed a demonstration project to encourage private grain storage facilities to begin similar programs. After witnessing the successes of the project, several grain elevators applied for licenses to participate. At the close of the program, there were 42 licensed public grain warehouses with a total storage capacity of over 470,000 metric tons, and approximately $20 million in credit had been issued against grain warehouse receipts.



This article (Working Within the Value Chain to Get Financial Services to Micro & Small Enterprises) highlights many of the conclusions from a longer paper entitled, "Value Chains and Their Significance for Addressing the Rural Finance Challenge," by Bob Fries and Banu Akin of ACDI/VOCA.

For the full article, visit http://www.microlinks.org/ev_en.php?ID=7098_201&ID2=DO_TOPIC.