IFPRI Podcast Series
Episode 7: The Road to Financial Inclusion in Kenya

Sivan: Hi and welcome to "Research Talks", a podcast series that explores how research is making an impact on people and policies (with a focus on the 'how'), brought to you by the International Food Policy Research Institute, IFPRI. I am your host, Sivan Yosef. In this episode, we'll be exploring a financial inclusion product that IFPRI has been developing together with private sector partners. It's called risk contingent credit (RCC). RCC addresses the problem of banks being reluctant to give loans out to farmers because farming is—inherently-- a risky business.

Liang: In the end, if you want a sustainable, so called scalable, you know, we have to rely on private sector to kind of scale it up to kind of help, because the loss from drought is just too large for any government or any foundation to deal with. So this is why we want to get the private sector involved.

Sivan: Our story takes place in Kenya. Many farmers there are subsistence farmers, with little access to credit or other means to improve their situation. That's how IFPRI researchers became interested in the subject.

Liang: My name is Liang You. I'm a Senior Research Fellow at the International Food Policy Research Institute. I'm a dinosaur at IFPRI. I have been working for IFPRI for 20 years. This is my first job. Maybe it will be my last job.

Sivan: In 2016, Liang and a colleague, Apurba Shee, were discussing work that Apurba had done in graduate school. The work centered on finding a way to make bank credit or loans available to small farmers.

Sivan: Why can't farmers get loans from banks in places like Kenya?

Liang: Normally you don't have collateral and then farming, more important, farming itself in particular rain fed agriculture is a risky business. We are talking rain-fed, semi-arid area. This is very semi-arid. The weather is very, very chaotic. Because of risky farming, you know, normally banks don't want to lend to the farmers. That is because they are afraid to give you loans, you know, if I lend you and then you lost your harvest; you cannot return. Right? Even I cannot force you to return because you cannot even feed yourself.

Sivan: Liang and his colleagues designed a way to convince banks to loan money to these risky farmers and to convince the smallholder farmers to take on loans. Their idea? Bring in an insurance partner to absorb the risk for both sides.

The idea is this: a farmer applies for, let's say, a $100 loan. The bank treats it as a $110 loan—that extra $10 goes to an insurance company. If the harvest goes well, the farmer pays back that $110 loan plus interest at the market rate. But, if the harvest doesn't go well—like if there's a drought that destroys all of the farmer's crops—the insurance company first checks the rainfall numbers from the local weather station to confirm the lack of rain, and then it covers the loss and pays back the loan for the farmer. The bank is happy, and the farmer is happy.

Liang and his team designed a pilot study to see whether this Risk Contingent Credit would work in Kenya. Their first step was to get stakeholders on board.

Liang: You have to get the Kenya Government, this is like a financial regulatory authority. You have to have them approve it. You know, it's like you're selling insurance or sell mutual fund to anyone. So that is a process. The Kenyan government actually encouraged Equity Bank. You know, of course they are going to have a big tradition working with farmers. Equity Bank, by the way, is the largest bank in Kenya, and the whole of East Africa. And we have this, insurance company. The insurance company, they said, "Oh your premium paid it to me is fair." Otherwise, you know, I got a huge loss I cannot afford. We actually have a Swiss Re-insurance company to kind of re-insure our insurance for free because to us, they are kind of a pro bono workforce.

Sivan: Had those companies ever worked with a nonprofit or an NGO on a project?

Liang: Swiss Re does, but not the other insurance company or the Equity bank.

Sivan: The team picked Machakos County in Kenya as the place to run their baseline study.

Liang: That's, I would say is not the poorest region in Kenya, but as Machakos County is actually so far away from Nairobi, so it's not that good. And then the drought and then, you know, sometimes flood, you know, kind of is a big problem there. And people already are realizing that farming is very hard, you know. The major crop over there is maize, and sorghum, and millet. Actually, you know, the land is very harsh.

Sivan: They recruited 1,200 farming households for a randomized controlled trial, meaning that the farmers were randomly selected to receive an RCC loan or a traditional loan. A third group, the control group, was given no loan. Their baseline study found that 50% of the farmers had no access to any credit.

And then it was time for the pilot intervention. But before the farmers could start with the RCC loans, they had to get training.

Liang: We design this product, get approved and then you know, we go to financial trainers. This is very important. It's like anybody who wants you to buy life insurance, you have to be transparent. We train actually the whole day for the farmers. We tested their knowledge about this product, their knowledge about risk management, their knowledge about where the loans come from, what kind of benefit and cost.

Sivan: Had the farmers that underwent the training, had any of them ever had financial literacy training before?

Liang: Well, this is a good question actually. I would say very little, maybe around 10%. I would say majority of farmers never had a bank account at all.

Sivan: Wow.

Liang: This is our idea, right? We are trying to target the poor.

Sivan: Did you have confidence that the pilot would work before you implemented it?

Liang: No, of course we never tried before. To be honest with you, I don't know. And you, you have been, with IFPRI long enough, and I think most of our research or project comfort zone would have been working with NGOs, government, another research organization, right. I don't think there's so many IFPRI projects working with private sector, you know, a bank. It is very different, total mentality. So they are looking at the bottom line. Right. You cannot blame them for that. They look at how much profit we get? This is their mentality. In the end, if you want a sustainable, so called scalable, you know, we have to rely on private sector to kind of scale it up to kind of help, because the loss from drought is just too large for any government or any foundation to deal with. So this is why we want to get private sector involved.

Sivan: So it's 2017. The farmers in the intervention group have finished financial literacy training. They have received loans, in the form of vouchers for things like fertilizer and seeds. Liang and his team are monitoring the project. And the year is turning out to be a very…strange one for Machakos County.

Liang: in 2017, it was a very peculiar year. Normally, you know, if you look at any index insurance, they just look at a total rainfall for the growing season right? I just make it up, this growing season 100 millimeters and even above 100 millimeters, I will pay you 50% of the loan as a payment. But in 2017 it is a very peculiar year. In that particular year, there's a lot rain, even flooding at the beginning of the season, but no rain at the end of the season. So you can imagine the farmers lost their crops, but the insurance, the insurance did not that trigger because a lot of rain total.

Sivan: In other words, the way the project was designed, insurance payout was only triggered if the *total* rainfall was too high or low. The 2017 growing season had torrential rains in the beginning and a drought at the end, but its total rainfall, on paper, was in the normal range.

Liang: We feel very sorry for farmers actually. We put the project money to pay the farmers, you know, because remember, this is by law, the insurance company has no obligation to pay; because everything is, this is a contract, right? So in the end, we actually paid the RCC loans to the farmer.

Sivan: But this setback had some unexpected benefits. For one, the farmers whose loans were repaid by the project were so happy that they promoted the product to their neighbors. So the project got a huge marketing boost.

Liang: I wouldn't say drought is good, you know, but from a promotion point of view, you can imagine, RCC is very popular now. The second time you go there, people will, "Oh, this is so good, you know, you give me $100." They are going to say "no, I don't need to pay anything back." So from a promotional view this drought is good for us.

Sivan: It also prompted the researchers to fix the rainfall trigger.

Liang: The farmers had to tell us the rainfall is more erratic than ever. They used to be, for example, the rainfall, they said most of the rainfall should come around very regularly around October. Nowadays, you know, nobody can predict even the rainfall onset. And then the rainfall also come very erratic in the sense that when there is a lot of rainfall concentrated in a few weeks, and then there's just no rainfall at all. We redesign the trigger. Instead of one trigger, total rainfall, we have every 21 days, a different trigger.

Sivan: At the end of the growing season in 2017, the pilot wrapped up. And the results were encouraging. The uptake rates of the farmers offered the RCC loans, or their agreement to take on the loans, was 40%, compared to 30% for those in the traditional loan group.

The project is ongoing. Liang's team is on round three of the interventions. But the project has already taught researchers some important lessons.

Liang: The farmers are actually very smart, very smart entrepreneurs. They know the risk. They know what they're doing. They know what they are growing, what was the last year's harvest, they know how much to get in a good year and what you get in a bad year. I think it's just they don't have a means to deal with the risk. That is what I feel like.

We need to learn from the local people. I would not have imagined, for example, giving the farmer voucher rather than the cash. But the local branch, they know better. They said, you know, you don't want to give these people cash. They may, you know, just pay their school fees. So what we did actually, they mostly get vouchers. The bank select some local suppliers of fertilizers, seed, that is the kind of trusted suppliers. They are on the front to actually handle the loans, handle the payment, so they know better.

Sivan: Risk Contingent Credit faces a long road as it moves from being an experimental public-private research model to becoming a commercial, profitable product in the banking and insurance world.

Liang: I would say, you know, this risk contingent credit is still a new product. I would say it is successful in the sense of we have a very close relationship with the bank, with the insurance company. To be commercially viable, right? This is our goal. We're still a long way to go. For example, you know, we find training is very important right now. You know, actually, we subsidize the training. How do you incentivize for the banks to kind of take up this product? Also we want to reduce the cost for the banks. Cost is important. So, right now we actually subsidize the bank, its labor to manage the loans. So one way to go forward is take on the new technologies. We are not taking mobile money yet. This is one idea we are trying to modify. Why don't we get all those areas on mobile? That will dramatically decrease the cost of managing these loans.

This new product is not just for one particular drought. This is the advantage of the product. It can be used to deal with a lot of drought; any drought. Actually this is where the beauty of this product is scalable. It's not just Kenya.

Our goal is to make the product sustainable, and so-called market-based. So it can be scaled up, after IFPRI, after the research of the project, right? So the bank can think this is a commercially viable product. I think we are not here yet. To be able to go commercially viable so it can be benefiting to us. Not just a few thousand people benefiting, but if you have a dozen or even millions of people, the banks have to say this a commercial viable product, so they can be willing to take as a regular portfolio, lending to farmers.

Sivan: It sounds so fulfilling.

Liang: Yeah, yeah, exactly. I mean this is real. I can see the people. They are so happy to see. These people never had a bank account. Suddenly you're talking about the loans and local interest, and your insurance payout. Right. And then, you know, as I said, one of the, the lady, She actually called me. She actually benefited from it. She can send her kids to school. You know, that is very wonderful for me.

Sivan: A big thank you to Liang You for his time. To learn more about Risk Contingent Credit, you can google that phrase plus the word IFPRI, and it will lead you to a bunch of papers, blogs, presentations, and really interesting videos. And don’t forget to subscribe to our podcasts so you don’t miss a single episode of Research Talks from IFPRI. Till Next Time!