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RESEARCH NOTE

USING MARKET RESEARCH TO INFORM PRODUCT DEVELOPMENT: THE CASE OF SMALL FARMER FINANCIAL PRODUCTS IN SOUTH AFRICA

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Abstract

Most lending products used by micro-finance institutions do not necessarily meet the requirements of borrowers they are meant to serve, leading to high default and dropout rates. Considering constraints that face small farmers, e.g. their inability to access formal credit, the high transaction costs of serving the sector and the seasonal nature of agriculture, it is important to design products that could be safe for the institution and still satisfy the client. Such products ought to accommodate their inability to present collateral and the diverse nature of their incomes. The Wye/Land Bank project aims to co-operate with three financial institutions in South Africa that lend to small-scale farmers, using market research to inform product development.

1. INTRODUCTION

Small-scale farmers need access to capital to finance operations and make necessary purchases. If a small-scale farmer does not have sufficient equity capital, she has to borrow money and go into debt. For a small-scale farmer to acquire a loan from a traditional lending institution, such as a bank, she must have good a credit record or substantial collateral. Since most small-scale farmers in South Africa have limited resources and no credit history either, they have problems accessing formal finance.

The specific features that seem to determine small-scale farmers' access to credit have to do with the dispersed location of farm households, the seasonality of agricultural production and farm incomes, the risky nature of on-farm investments, low profitability of investments and insecure loan collateral. Of these issues, collateral is often quoted as the main reason for not

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granting loans to small-scale farmers. In addition, large numbers of relatively small transactions culminating in higher than normal transaction costs of the small-farm sector also contributes to limited lending.

Despite unfavourable notions about small-scale farmers, they represent a pool of potentially successful farmers who are caught up in a difficult situation. Many are able and willing to repay loans, capable of producing output levels equal to those of commercial farmers, and contributing to economic welfare in their communities, yet they remain unable to access the formal banking system for loan funds.

Market research offers an opportunity to change this state of affairs by increasing understanding of the real needs of small-scale farmers. The aim of market research is to improve the quality and depth of knowledge about the potential impact of new products and services on clients by better understanding client product and service needs (Lee, 2000). This issue is addressed by asking how products, services and methodologies could be better designed to meet client demand. In this sense, market research differs from impact studies. In the case of the latter, clients of an institution are compared to non-clients, the unit of analysis being changes in individual variables such as income, sales, assets levels. In the case of market research, however, client demand for products and services is assessed, and the unit of analysis is client demand related to assets, liabilities, competition and market opportunities (Lee, 2000).

Lack of access to finance by small-scale farmers is partly due to the inappropriate design of traditional financial service products. Commercial financial institutions have traditionally attempted to serve this market with their existing instruments, ignoring the real needs of this potential group of clients, and not taking the initiative to engage these clients in an attempt to establish their real needs. The need to develop new products emanates from the need to respond to the demand and preferences of customers. Small-scale farmers, and the rural poor generally, are not a homogenous group with homogeneous needs. They need products that present solutions to their unique problems (Wright *et al*, 2000).

2. THE WYE/LAND BANK PROJECT

The failure of seasonal credit provision has been identified as a constraint on growth in smallholder agriculture in much of Africa. Subsistence producers are unable to access finance from commercial and interlocking lenders, while informal and micro finance arrangements are not suited to financing seasonal

crop inputs (Dorward, *et al*, 1998). The Land Bank of South Africa, with a mandate to serve previously disadvantaged farmers, has had to address this failure in seasonal credit, but has not been able to find an acceptable solution. Regional banks such as Ithala Development Finance Corporation in KwaZulu-Natal province and Uvimba Finance Corporation in the Eastern Cape have also struggled with these issues. Close liaison between the Land Bank, Wye College (University of London) and the University of Pretoria has, therefore been established, and their collaboration has been ensured in a project whose aim has been to conduct market research into the real needs of these farmers.

The project assimilates international experience addressing seasonal credit problems and, using a livelihoods approach, examines financial flows to and from households' farm and non-farm activities. This is used as a base to investigate the potential scope for innovative seasonal lending and related micro finance activities in case study areas in South Africa. Policy recommendations were meant to identify conditions under which different approaches to improving access to seasonal finance may be appropriate.

In its initial stages the project sought to bring together international experience in addressing the problem by assessing examples of successful systems, and identifying models, lessons and principles for success. This phase of the project resulted in a paper by Dorward *et al* (2001) on the potential for seasonal finance for staple crop production for livelihoods creation. The paper addressed aspects related to rural poverty from a livelihood perspective, the role of agriculture in rural livelihoods in Sub Saharan Africa and seasonal crop finance in smallholder agriculture. The South African issues discussed in detail include rural livelihoods, the impact of HIV/Aids on rural livelihoods and an overview of financial services in South Africa. Secondary household survey data from KwaZulu-Natal and Eastern Cape were analysed using cluster analysis in a bid to inform hypothesis formulation.

3. METHODOLOGY

Based on the background work on the Wye/Land Bank project, it became clear that one way in which the failure of seasonal credit programmes could be mitigated was to design products that could serve farmers in their specific setting. To this end, client based market research was planned, to be conducted in three components. The first component was cluster analysis of secondary data, the second a structured household survey questionnaire, and the third focus group discussions.

Cluster analysis will be used to group households in more homogeneous groups, based on the most relevant variable. The aim is to create intra-group homogeneity, and inter-group heterogeneity. Variables linked to the wealth of a household, level of education, income generating activities, etc, will be used to cluster households.

The household survey questionnaire is intended to capture household demographic information, asset profiles, income and expenditure flows and sources throughout the year, access to factors of production, cropping enterprises engaged and the saving patterns of households. The questionnaire is also meant to document customer's use of current products of Ithala, Land Bank and Uvimba. The field-level research entails extensive interviews with poor people to better understand their financial behaviour and risk profile. In the process it is hoped that this will help the institutions to better listen to clients and design appropriate financial products based on better market information. These research activities are complementary and will be used to plan curriculum development and dissemination efforts.

Focus group discussions will then be used to better capture the perceptions and views of the respondents. This technique is a relatively new addition to the market research tools conventionally used in the development finance arena. It is to be used to collect qualitative data in a manner that provides mostly descriptive information. Usually 6-8 participants, facilitated by a moderator, discuss a particular issue. The task of the moderator is to probe but not prompt, and to help the group to explore the issues at hand in more depth. The discussion is recorded. The 'Focus' in Focus Group Discussion describes the importance of focusing on a few key (generally related) issues (Wright, *et al* 2000).

There are different tools that can be utilised in a focus group discussion. The project will use:

- Seasonality Analysis of household income, expenditure, savings and credit to obtain information on seasonal flows of income and expenditure, and the demand for credit and savings services;

- A Life-cycle Profile to determine which of the events require lump sums of cash; to examine the implications of these for household income/expenditure; to establish current coping mechanisms; and then finally to discuss how access to financial services can help the household respond to these;

- Simple Ranking can be used to a explore a wide variety of issues when an understanding of the relative importance/desirability etc. is needed (e.g. for understanding the relative importance of different elements of products – interest rate, opening balance, grace period etc. or the reasons for people to discontinue the services of a financial institution);

- Relative Preference Ranking is used to see how clients and potential clients perceive the financial service providers and components of the financial services they provide;

- Pair-wise Ranking to examine in detail how clients and potential clients compare and contrast critical components of financial services, and why those elements are important to them.

It is believed that a combination of these tools of a more qualitative nature with the more quantitative structured questionnaire work will extract enough information required to inform product development.

4. PROJECT OUTPUTS

The main project outputs are:

a) Improved understanding of demand and constraints on demand for financial services to support the farm and non- farm livelihood activities of poor rural people;

b) Development of a better understanding of the key issues, opportunities, systems and problems in promoting access to seasonal finance for subsistence crop production;

c) Improved international networking between stakeholders concerned with seasonal financial services;

d) Development of viable institutional innovations to support access to seasonal crop inputs;

e) Identification of the necessary conditions for effective functioning of different institutional systems.

CONCLUSION

The purpose of this research note has been to introduce a current research project in South Africa on small farmer finance. This project aims to address the design flaws inherent in earlier attempts to serve these farmers by following an approach that recognises the importance of a better understanding of client needs as an input into product design. As such, this research is one of the first attempts in South Africa to use a deeper understanding of the real needs of small farmers to inform product design.

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