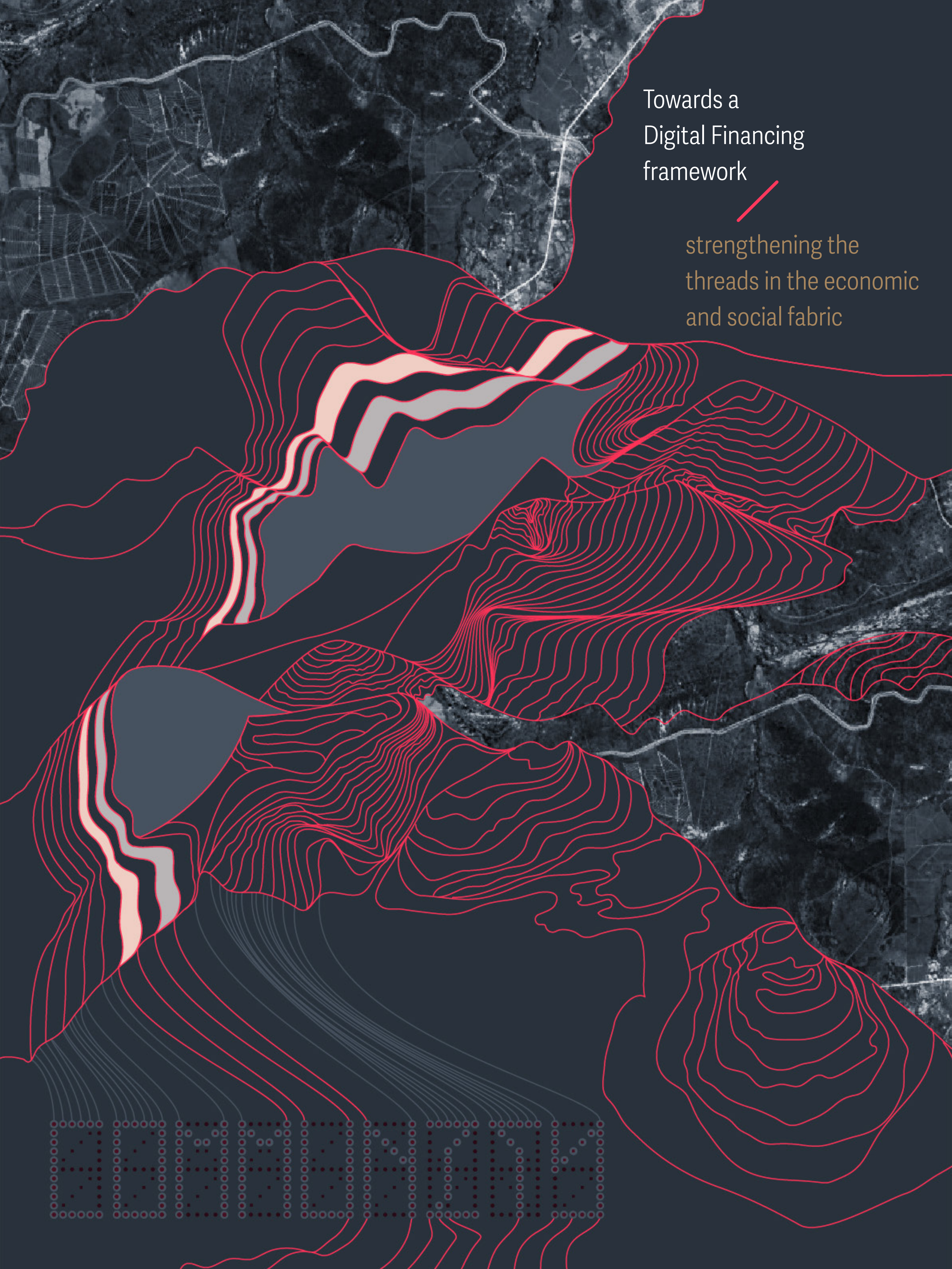
Towards a Digital Financing framework

strengthening the threads in the economic and social fabric



Summary Synthesis Report

2022

Digital finance in the context of informal economies and local community assets

Micro, small and medium enterprises (MSMEs) are correctly assumed to be the engines of growth in developing economies. Yet widespread informality holds such enterprises back, making it difficult for them to access financial services and finance, which is vital for cashflow and to invest in productive growth. Importantly, informality also affects how fast economies can grow, develop, and provide decent economic opportunities for their populations. This complexity is exacerbated for small countries, which are often hamstrung by their market size limiting their ability to attract investors and grow their economies.

The financial sector, as the leading decision maker on the allocation of financing, is a powerful enabler of/obstacle to inclusive economic growth. It faces an enduring challenge, though: coming to grips with the socioeconomic complexities of working in low-income markets. This research posits, however, that it is possible for the financial sector to use this challenge as a resource in extending the current boundaries in market formalisation. The research finds that the solutions are embedded in the myriad intersections of private and public sector financing, technology, and communities – and particularly in the areas of MSMEs' and smallholder farmers' success in meeting their own household/business financing needs.

Negotiating a better social contract between communities, business and government. Development is in need of broader thinking around the social complexities of economic growth. The civic space and how households and small enterprises organise themselves in their local communities to generate their livelihoods and achieve their goals is a crucial pillar of small business success, more so than for any other income group. The necessary breakthrough in the ability of MSMEs (which includes smallholder farmers) to contribute to growth is only likely to be achieved through formal financing's close engagement with local realities to identify opportunities with communities on the ground.

The impetus behind MAP's development of the digital financing framework is to strengthen *de facto* communities of practice among financing partners, boosting current individual efforts – each with its existing objectives, budgets and programmes of action – to achieve success at greater scale. In Lesotho and Eswatini (the twin focus of the study), a number of partners, public and private, are already actively engaged in initiatives with a mandate to unlock financing and growth for MSMEs and smallholder farmers. The study and resulting draft framework use the examples of and lessons from the practical realities of communities as a galvanising construct for how financing partners can engage for increased momentum on the ground towards inclusive growth. While the challenges are complex, with many layers and overlaps, the answers will not be found in individual initiatives in parallel and isolation but in focusing on areas of *common cause* – in the process amplifying existing successes from the ground up (communities) and the top down (financing and development funding) but not starting from scratch.

With the development of the digital financing framework, MAP now has *two* distinctly different MSME technical frameworks. Stacking the two, however, allows a new perspective that helps those active in financing to mesh their efforts for improved coverage, amplifying provision of much-needed financing to this vital but-hard-to-reach segment:

1. **The MAP SME methodology: tightly targeting a very small pool.** The distinguishing feature of the MAP SME methodology is its focus on providing extremely targeted formal financing to a very small pool of high-impact/high-potential SMEs. Typically, transitioning only 1% (SMEs) of the entire pool of informal MSMEs in any given least developed country (LDC) to the formal sector through focused and ongoing support could have substantial and far-reaching impact on both the formal employment market and added value to GDP.

2. **The MAP digital financing framework: opening up MSME growth pathways at scale.** With the assumption that a digital solution can be scaled to a broader base than traditional financing solutions can, the digital financing framework does not limit the focus to high-potential SMEs. The framework allows targeting of both high-potential SMEs and MSMSEs in general, thereby also supporting natural growth for the smaller pool of MSMEs that may become high-potential SMEs in future.

Current business models and commercial planning repeatedly run the risk of failing to reach these micro-segments. The MAP digital financing framework is being developed to open up the market for MSME financing in socioeconomically vulnerable communities by zeroing in on real opportunities to invest in improved provision while identifying the practical business-development activities needed to prepare these markets to be commercially feasible. In this case, *digital* financial services (DFS), given its potential and already-proven ability to get down to community level at pace and, potentially, scale – when implemented with communities within their local context – is positioned as an enabling mechanism.

The affordances of digital financing. MAP's ongoing research into DFS has indicated high levels of compatibility/complementarity between digital financing and existing mobile money usage, thus suggesting a potential finance delivery mechanism to low-income target market segments. As a delivery channel for financial services, DFS offers several benefits on top of those of traditional formal financial services: DFS can do a better job of facilitating finance flows to make access to opportunities more equal, of funnelling capital down to the community level, and of fuelling local economic activity, in the process radically modifying the size and shape of the financial sector for the better.

Access to finance is a two-way street. The MAP research highlights that increasing formal financing in developing countries and LDCs is a two-lane highway – with both lanes mostly blocked. MSMEs face a range of obstacles to formal financing and largely fail to see their needs reflected in existing offerings. And financiers – whether private sector, public sector or development funders – struggle to see into the realities and opportunities in a real economy teeming with informal activity. This opacity partly explains the general failure to serve the needs of the bulk of the population in developing countries and LDCs. At the same time, the fact that formal, private sector financing has mostly struggled to penetrate socioeconomically vulnerable communities serves as a testament to those communities' resilience.

Micro-targeting communities. The digital finance assessments (2022) that underpin the MAP digital financing framework employed a complex new socioeconomic lens, targeted into pockets of highly localised economic activity in a limited number of communities in Lesotho and Eswatini. The research built on the existing work done by development partners, with the intention of increasing the body of knowledge on local livelihoods generation and economic activity that could spearhead economic growth at community level. In addition to identifying consumer pain points and the nascent nature of financial services provision in the low-income informal marketplace, the research highlighted opportunities for bridging the gap between MSMEs, on the one hand, and financial institutions, investors, development financing and government, on the other. The digital finance assessments and related research were instrumental in MAP's development of the draft digital financing framework, which starts to define and codify a collaborative financing framework at the domestic level for more inclusive local financial markets.

Selecting the focus target markets: cross-border traders and smallholder farmers

Starting with the broad, nationally representative financial inclusion livelihoods data, MAP funnelled down through industry analysis that forecast growth sectors, and in-country intelligence on the ground, to focus in on two main target market segments: urban-based informal cross-border traders and rurally based smallholder farmers. The traders comprised two main groupings: one importing second-hand clothing and other goods (e.g. cigarettes, cleaning products) for resale, and the other importing fruit and vegetables. The smallholder farmers were engaged in significant levels of agricultural activity in specific geographic areas. The target market segments were chosen because they represent a key component of livelihoods generation and typify the overall economy for informal MSMEs.

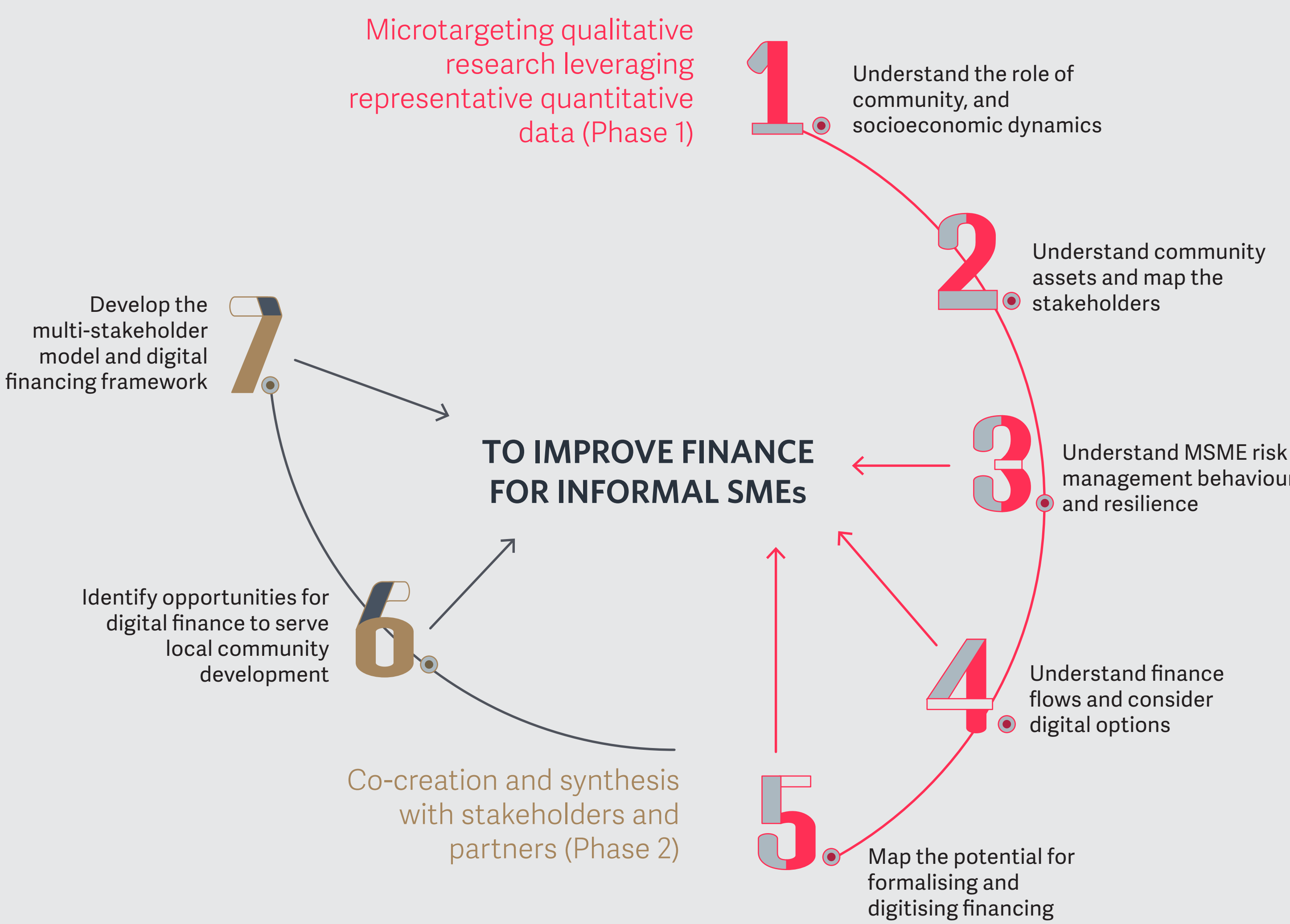
Participants comprised **32 traders** and **32 farmers** (total for both countries), of which 50% were female participants, in the age range of 22 to 76 years. In addition, 22 supply-side stakeholders were interviewed: formal cooperatives, trade associations, input suppliers, off-takers, banks, mobile network operators and government agencies.

Taking advantage of the network effect in the DFS space for financing. The MAP research has highlighted existing real-economy activities at community level that could form the basis for stronger engagement by a range of players. The resulting digital financing framework will make it possible for financing partners to identify activities that share objectives and a common agenda, to partner and participate – in a range of configurations, in different layers and to varying degrees, as appropriate, on the basis of the new technological infrastructure.

Understanding MSME finances and expenditure in local communities

The MAP in-field research as part of the digital finance assessments (Phase 1) focused on five objectives as the basis for co-creating the MAP digital financing framework (see Figure 2).

Figure 2: Phases and main objectives of the research



Understanding community socioeconomic dynamics

In both Lesotho and Eswatini, income vulnerability and variability drive people to set up their own business, and success is measured by achievement of goals like improved conditions of living and being able to afford school fees. This blurring of the lines between the business and personal lives – and finances – of MSMEs is common, with the two often conjoined to the point of being inseparable. As a result, many business owners and smallholder farmers concentrate on maintaining their current operation, with little focus on improving the overall enterprise for growth; their priority is livelihoods stability and, where possible, supplementing their household income to allow them to save for future goals or mitigate anticipated household risks.

Owning land and affording school fees are indicators of business success. A 41-year-old female farmer and entrepreneur from Mohales Hoek, Lesotho has two farming businesses, both producing vegetables. When asked what the biggest success of her vegetable business was, she promptly responded, 'I use the money from the business to buy cement and other supplies for my dream house'. She is proud of this investment and quick to point out how her farming businesses are creating growth to make this dream come true.

Five significant socioeconomic dynamics. The research highlighted five socioeconomic dynamics across both countries that characterise MSMEs within their communities and provide substantive clues to opportunities for supporting MSMEs to grow through access to finance.

There is a striking amount of social cohesion. While there is much income vulnerability and variability, there is little crime. In addition, almost all local economic activity happens in cash, and there are high levels of cross-border economic activity in the form of people from local communities travelling to neighbouring countries to get goods for their business:

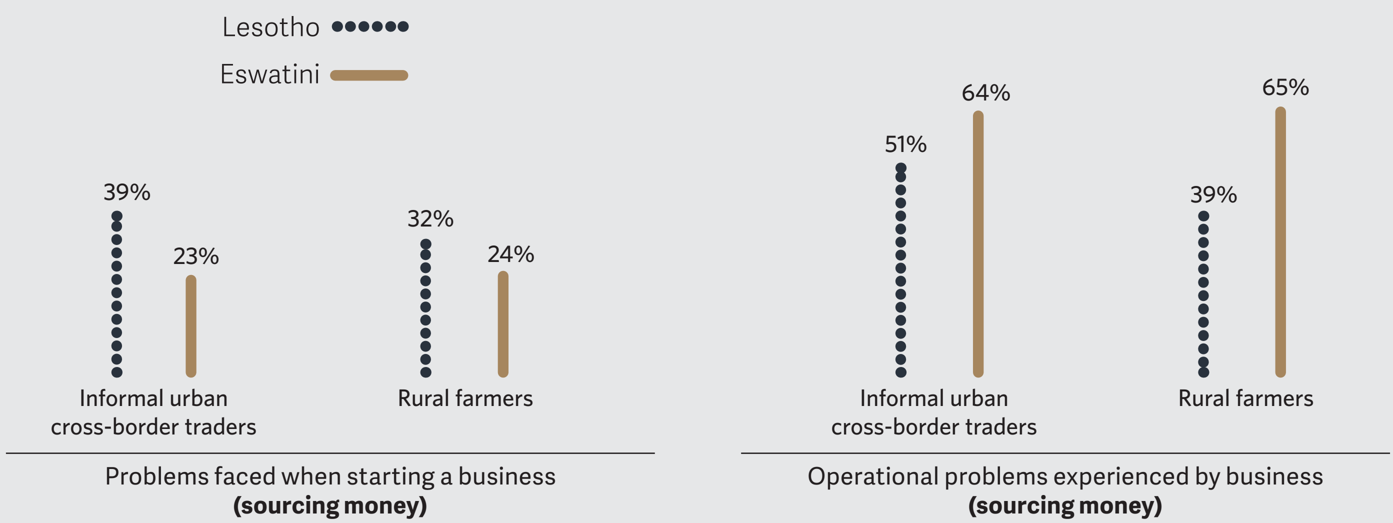
- **Social cohesion:** Most MSMEs rely on family (including extended family i.e. kinship networks) and social capital for raising startup finance and assisting in risk management. Day-to-day running of the business relies heavily on leveraging support from family, friends and neighbours, who collectively share the daily grind.
- **Income vulnerability:** Most MSMEs start a business to improve the living situation for themselves and their families, in the absence of employment opportunities. Achieving household goals such as providing or supplementing the family income would be considered an indicator of success, as would achievement of more aspirational goals such as being able to afford to put children in a better school. In this sense, the MSMEs are not all strictly 'entrepreneurial' but they do tend to be goal directed.
- **Safety and security:** There is little to no evidence of threats to personal or business security (of the order of theft of produce or stock). While risks associated with handling cash are widely recognised, preference for cash still persists.
- **Preference for cash:** Strong preference for cash is reinforced by limited opportunities for digital spend locally – even though, significantly, most spend is in the local environment.
- **Cross-border trading with neighbouring countries:** Despite Lesotho's trade ties with South Africa and Eswatini's trade ties with South Africa and Mozambique, there are limited means for cross-border payments for 'unbanked' MSME segments.

Common to these socioeconomic dynamics is the level of social cohesion found in these communities in order to survive and even thrive. Reliance on family, friends and the wider community becomes a necessity in an environment where opportunities for salaried work are limited and incomes from self-employment variable, and where formal finance has failed to serve the needs of the general population.

Reliance on social capital in the community to meet financing needs. Limited access to formal credit prevents small businesses from capitalising on market opportunities by engaging in trade of higher-value commodities or value addition. Although a substantial portion of the MSME and farmer study groups in both countries are banked (ranging from 46% to 78%), and also save with banks (from 50% to 76% of those banked), very few who are banked have any kind of bank credit (from 5% to 8%). Yet the MSMEs and farmers in both countries list sourcing money or access to finance as the single biggest obstacle faced when starting a business or in growing their business (see Figure 3).

Figure 3: Top problems faced by MSMEs in starting, operating or growing a business

Source: FinScope Enterprise Surveys – Lesotho 2016; Eswatini 2017



Reliance on kinship networks for business startup. A 50-year-old male trader from Eswatini imports fruit and vegetables from South Africa. He was introduced to the business as a young man by his uncle, who is in the same trade. Initially, he would accompany his uncle to South Africa to purchase stock, and his uncle used this opportunity to show him the ropes. In 1995, his uncle gifted him the equivalent of USD 284 to start a business of his own. He used the money to purchase his own stock and start the business and has since grown it, currently also owning a truck.

The financial impediments MSMEs face to getting going and staying in operation place increased emphasis on trust and building social capital so that the threads that knit communities together and the social fabric remain intact and can compensate for lack of financial stability. Formal financing will start to gain traction in these environments only on the basis of a good understanding of options for working with – and enhancing – existing levels of social cohesion.

2 Understanding community assets and mapping the stakeholders

With communities being an important aspect of the reality in which MSMEs operate and live, within communities there are multiple touchpoints that MSMEs rely on to fulfil their personal and business financing needs. Such touchpoints include anything from stakeholders like immediate and extended family members, neighbours, and even tenants or landlords, to informal structures like savings groups, informal savings associations and loan sharks/moneylenders. There are also more formal touchpoints: cooperatives, schools, church groups, sports clubs, local government services provision (via clinics, social grant payment points), value chain players, and financial services providers (via branches, ATMs, agents).

These local touchpoints constitute valuable community assets that are leveraged through social capital, community engagement, and more structured relationships like membership or client-provider relationships. Importantly, for the MAP financing framework, all of these are also potential points of contact for MSMEs to access formal financing and financial services to fulfil their business and household needs.

Social networks as the first touchpoints. Most community assets/touchpoints relate to payments: mostly for ongoing expenses (which are largely in cash, except for paying school fees, utility and pay-TV bills, and taxes) and a few for receiving income. With regard to smallholder farmers receiving of income, value chain players (whether large off-takers, supermarkets, or informal vendors) buy farm output at the farm gate or at cooperative warehouses, or when the farmer transports output to the off-taker. Some instances of income also derive from other (formal) employment. Generally, though, there are very few formal touchpoints that MSMEs can rely on to manage finances, start a business, invest to grow, or rebound from shocks. So, social networks are the first touchpoints for startup capital, credit to manage risk, or a safety net to fall back on in times of sustained risks. The MAP research found little evidence of borrowing – formal or otherwise – for business expansion; rather, following startup (often family funded), businesses use the money earned from sales to manage operational costs and grow the business.

Table 1 provides an overview of the community assets/touchpoints MSMEs customarily leverage for financial mechanisms other than pure payments.

Table 1: Community assets leveraged for financial mechanisms other than pure payments

	Type of community asset/touchpoint	Financial mechanism/product class
Informal	Home	Savings, money storage
	Family and friends (including tenants, landlords, neighbours)	Credit or gifts
	Business associates	Credit or gifts
	Savings groups	Savings and credit
	Informal associations	Credit
	Moneylenders	Credit
Formal	Cooperatives	Facilitate access to formal credit
	Financial services provider touchpoints (e.g. branches, ATMs, agents)	ATMs/agents, mostly used for withdrawing cash and for payments
	Banks	Mostly payments and savings, little/no credit
	Insurance providers	Payment of premiums, and payments to cover risks when occur
	Microfinance institutions (MFIs)	Some evidence of reliance on MFIs for credit and savings
	Savings and credit cooperatives (SACCOs)	Savings and credit (for those previously formally employed)
	Shops/retailers/petrol stations	Currency exchange
	Money exchangers	Currency exchange

The MAP research noted the following with regard to interaction with these community assets/touchpoints:

- Many MSMEs depend on social networks for credit and capital financing, to facilitate transactions, to manage risk, and to access information that is pertinent to their operation.
- Informal lenders are seen as a last resort in times of need, and are turned to when social networks fail.
- Informal groups provide important financial management mechanisms. More Eswatini MSMEs than Lesotho MSMEs participate in informal savings groups. These groups offer no formal registration or written agreements to secure savings, and are founded on trust and the strength of community relations and mutual obligation.
- Use of mobile money is relegated to bill payments (e.g. utilities, pay TV) and person-to-person (P2P) transfers, with some use of mobile money for funeral cover payments.
- Cooperatives support key business functions, including access to markets, shared investments and shared credit.

- There is little incentive for formalisation for traders, particularly non-fruit and vegetable traders, and use of formal banking is lowest in these segments.
- In Eswatini, fruit and vegetable traders are formally registered and banked, and habitually use bank cards to pay for stock in South Africa.
- Similarly, use of formal banking is high among smallholder farmers. However:
  - In Lesotho, only some farmers receive payments via bank transfer, and withdraw it immediately, preferring to pay in cash (i.e. they use their bank account as a 'mailbox' for encashment purposes).
  - In Eswatini, formal banking is driven by preference for digital payments by formal market actors (whether government, private sector or development).

The simplicity of cash, given lack of other options. The widespread use of and preference for cash for payments, savings and even credit comes as no surprise. In environments/markets where formal financing infrastructure, institutions and oversight are limited or absent, community fills the gap, providing some of the needed structure; and using cash – the most basic possible mechanism (apart from bartering) to fulfil financial needs – allows financial interaction to proceed. Payment or saving in cash does not require any third party, while credit through cash only requires the borrower to deal with one other actor (someone with the cash to borrow from). Where there are few formal financial structures in place, it is also difficult to efficiently manage and protect against risks; people resort to cash-based savings or credit, or participate in risk sharing with peers (although these are less efficient risk-transfer mechanisms than formal insurance).

Current business models and commercial planning locking out low-income growth. The MSMEs and farmers included in the study not only favour payment in cash but also rely on community assets and infrastructure – based on cash – for credit. It is safe to assume, based on the evidence of MSMEs' reliance on community assets and social safety nets to meet their financing needs, that there are high levels of trust closest to the ground. This highlights that the private sector has literally lacked the necessary credentials to gain entry to the community level to spearhead growth.

The MAP study cannot overemphasise the significance of this finding: that, as things stand, business models and commercial planning are unable to connect with the micro-segments in the informal real economy – meaning that growth is unlikely to happen until this mismatch is solved.

3

Understanding resilience and risk management practices among small businesses

When it comes to identifying potential DFS opportunities for enhancing MSME functioning, the specific risks associated with businesses' contexts and their habitual risk management strategies and behaviour (beyond the reliance on social capital already discussed) are crucial to understand and incorporate in business models. It is helpful to identify and understand both the specifics of context and behaviour, and the common, overarching themes.

MSMEs' risk management behaviour limits their entrepreneurial potential. Their limited cashflow and unsophisticated business functioning constrain MSMEs' access to formal financing, in the process increasing their vulnerability to financial shocks. The significant blurring of business and personal expenses and risks, with most MSMEs demonstrating no distinction between the two, means personal/household risks easily threaten business cashflow, undermining the enterprise. MSMEs' credit-averse approach to growth is inextricably linked to household dependency on income, with business owners-households preferring to rely on business turnover or non-credit mechanisms to grow their businesses or to manage a business/personal financial shock. Altogether, MSMEs' risk management behaviour limits their creditworthiness.

Important for financing partners to understand the specifics of MSMEs' risk. Common risks observed for *cross-border traders* include theft of stock, stock damage due to rain, product spoilage, the impact of COVID-19 and, in Lesotho's case, the danger of fire. Common risks for *smallholder farmers* include weather damage, post-harvest losses, crop damage by livestock and, for Eswatini farmers close to urban areas, some theft of produce. In addition, risks experienced by both segments include death of a family member or income earner, family sickness and civil unrest.

Understanding risk mitigation responses. After experiencing a financial shock, the MSMEs mostly use their income and expenditure to manage their cashflow and help them cope; simply cutting back on expenses was found to be a common coping strategy. When the business is non-operational, it is common to fall back on kinship and social networks and then to borrow from the same to restart the business once conditions improve (e.g. easing of COVID restrictions).

Specifically with regard to MSMEs' management of risk, the research found two interesting behaviours: relatively little reliance on social networks beyond immediate family; and some borrowing from informal lenders, but only when family networks fail. When the research categorised MSMEs' customary risk mitigation behaviour by financial mechanism/product class, it was clear the first priority was to avoid incurring costs – even if this meant having no strategy upfront and/or doing nothing once the risk had materialised (see Table 2).

Table 2: Most common risks experienced, and MSME risk management behaviour

	MSME customary risk mitigation strategy and response	Financial mechanism/product class
Business risks for traders		
Theft of cash	ATM (to withdraw cash at destination)	Payments
	Card payments (if accepted at destination)	Payments
Theft of stock	Rent local storage	Payments
Stock damage from rain	None/use tarpaulin or plastic covering	n/a
Product spoilage	None (leftover/spoiled stock gets discarded)	n/a
Loss of income (e.g. due to COVID-19)	None, and cut down on business and personal expenses once risk experienced	n/a
	None, and use turnover to return business to full operations once risk experienced	n/a
	Rely on family members to cover living expenses	Payments
Business risks for farmers		
Weather damage	None (no mitigation strategies were observed)	n/a
Post-harvest losses	None (although, in attempt to mitigate risk, crop is rarely stored)	n/a
Crop damage from livestock	None/attempt to fence fields	n/a
Personal risks for traders & farmers		
Death of a family member	Funeral cover, paid through mobile money	Insurance, mobile money
Family sickness	Rely on government healthcare	n/a
Civil unrest	None (no mitigation strategies were observed)	n/a

- **High vulnerability**: Most small businesses experience income vulnerability and variability, have low cashflow and fail to separate business and personal income.
- **Little or no risk planning:** Beyond a strong preference for resorting to savings (assuming these are available at the time), most businesses do not have any risk management strategies in place.
- **Reliance on social networks for risk management:** Family and social networks provide an important safety net in time of sustained risk.
- **Limited use of formal insurance:** Funeral cover is the most commonly used formal insurance product. Use of other types of insurance is low owing to mistrust of insurance providers.

Unpacking cashflow-related behaviour and considering digital options

Understanding how money flows into and out of a business is important for identifying sources of finance and liquidity and opportunities for aggregated payments or savings. Understanding cashflow can also provide information on the business's ability to take on and repay formal credit. Furthermore, unpacking existing cashflow behaviour and the payment methods currently in use makes it possible to recognise possible opportunities for switching to a digital option. Digitising its cashflow potentially offers a business a number of significant benefits, including facilitating remote transactions; in addition, the increased transparency that ensues in the form of digital records of business transactions can be used by credit providers as a proxy for security, thereby increasing credit options for the business.

The research found mixed use of cash and digital payment mechanisms among the different MSME segments. While, mostly, the need for making payments is fulfilled with cash, there are specific cases of existing reliance on digital that are worth noting as a possible basis for extending adoption of technology.

In Lesotho digital payment is limited to some bill payments. Digital is also used for internal remittance, via mobile money: either sending money to the rural areas, or from a rural area to family in the city. Other local and remote payments are mostly cash based.

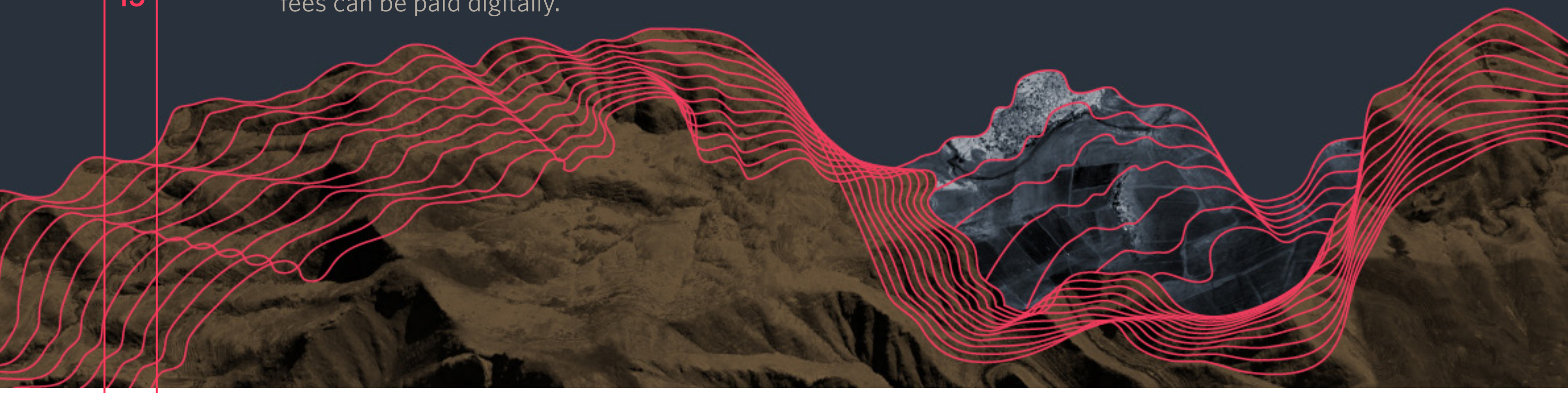
In Eswatini cash also tends to predominate. The research found very limited reliance in Eswatini on remittance sending and receiving, with the few instances using either mobile money (internal) or traditional banking (international). The clothing traders, mostly unbanked, rely heavily on cash for both local and remote cashflow; the exception is border taxes, which are paid using mobile money. By contrast, fruit and vegetable traders in Eswatini show slightly higher DFS usage. However, cash still accounts for over 95% of all payments *received*. For payments *made*, there is some preference for digital: for cross-border payments, for instance, with card payments being used for more than half of the cross-border transactions. Monthly tax payments are also managed through card payments or mobile money.

With the exception of some farmers, generally MSME reliance on digital is limited. Overall, in both countries – and with the exception of some smallholder farmers (see below) – the research found use of digital payments for day-to-day expenses (e.g. food, rentals) to be limited. However, mobile money is commonly used for paying bills and funeral cover.

Limited opportunities for consumer reliance on digital. Currently, the distribution of merchant payment solutions in both countries is low, with limited interoperability disincentivising suppliers' adoption of such solutions. This obviously has a deterring effect on consumer uptake of digital expenditure. In addition, for consumers, high transaction costs for mobile money usage are a major barrier to adoption and serve to reinforce the existing preference for cash. Problems with streamlining of digital payment receipts (e.g. for bill payments) on the supply side have also contributed to consumers' slow adoption of digital payments. Finally, merchants and consumers alike show low levels of product knowledge (although this is not really surprising considering the various current drawbacks and deficits described).

Farmers show higher DFS usage. The smallholder farmers tend to use digital mechanisms more than other segments do, especially to receive payments (e.g. via bank transfer or mobile money). This can be explained by the size of their transactions, the remote nature of transactions, and the presence of large, formal off-takers who prefer to use digital payments. Cash income is limited to transactions with vendors at the start of harvest. Payments made – such as cooperative fees, government-subsidised inputs and tractor payments – are through bank deposits. Input purchases from private suppliers that are small enough (e.g. below the equivalent of USD 284 in Eswatini) are done with cash, with preference being shown for card payments for higher-value transactions. Day-to-day living expenses are mostly managed with cash, though.

- **Income:** Income is dominated by local cash-based transactions – except for farmers, who receive most payments via bank transfer or mobile money.
- **Expenditure:** Stock or input purchases dominate expenditure and are cash heavy for clothing traders, and mixed for other segments. There are limited opportunities for digital spend locally.
- **Local and remote cashflows, including cross-border payments:** These are dominated by cash; given limited opportunities available, use of digital payment is limited to bill payments through mobile money.
- **Role of digital in cashflow:** Less than 5% of traders' income is received digitally, and local expenditure is cash heavy. Mobile money is customarily used for bills (e.g. utilities and pay-TV payments) and funeral cover; while, in Eswatini, border payments (taxes) relating to declaration of stock and import fees can be paid digitally.



Given consumers' low uptake and usage of digital, the analysis identified that the required mechanisms of *trust* – in digital but also in financing providers and products generally – are also missing. Leveraging existing social infrastructure and community assets/touchpoints to facilitate technology uptake through creating trust mechanisms will be crucial.

5

Mapping the potential for formalising and digitising financing

Considering a combination of community socioeconomic dynamics (including high levels of social cohesion and mutual reliance on social capital) and MSME financial behaviour highlights different opportunities for and usage of finance; in the absence of formal records, such an exercise provides insight into businesses' realities linked to their specific needs, as well as barriers to and enablers of adoption of digital financial mechanisms. In undertaking such an exercise, it is important to root insights in both the specific local context and the larger, macro socioeconomic context (i.e. country, region). To this end, the insights gained via the study will be instrumental in informing and driving provision and uptake of DFS at community level.

At a political level, increasingly, regional economic and political blocs are coming together to spearhead more cohesive growth; the development of the Africa Continental Free Trade Area (AfCFTA) is an example. Such developments offer small business a unique opportunity to contribute to a country's trade balance and, especially in countries with small economies, help government reduce dependence on larger economies. For instance, South Africa accounts for 85% of Eswatini's imports and 65% of its exports. Small businesses stand to benefit from the AfCFTA as it offers invaluable prospects for growth, providing them with an opportunity to integrate into the regional and global economy. However, most MSMEs are at risk of not benefitting from this regional development owing to their informality and limited access to finance.

Figure 4 demonstrates the spectrum of different uses of finance, plotted in terms of where they fall on a combination of level of digitisation, on the one hand, and reliance on informal mechanisms that strongly leverage social capital vs formal engagement on the other.

Figure 4: MSME and smallholder farmer adoption of financial services for different purposes

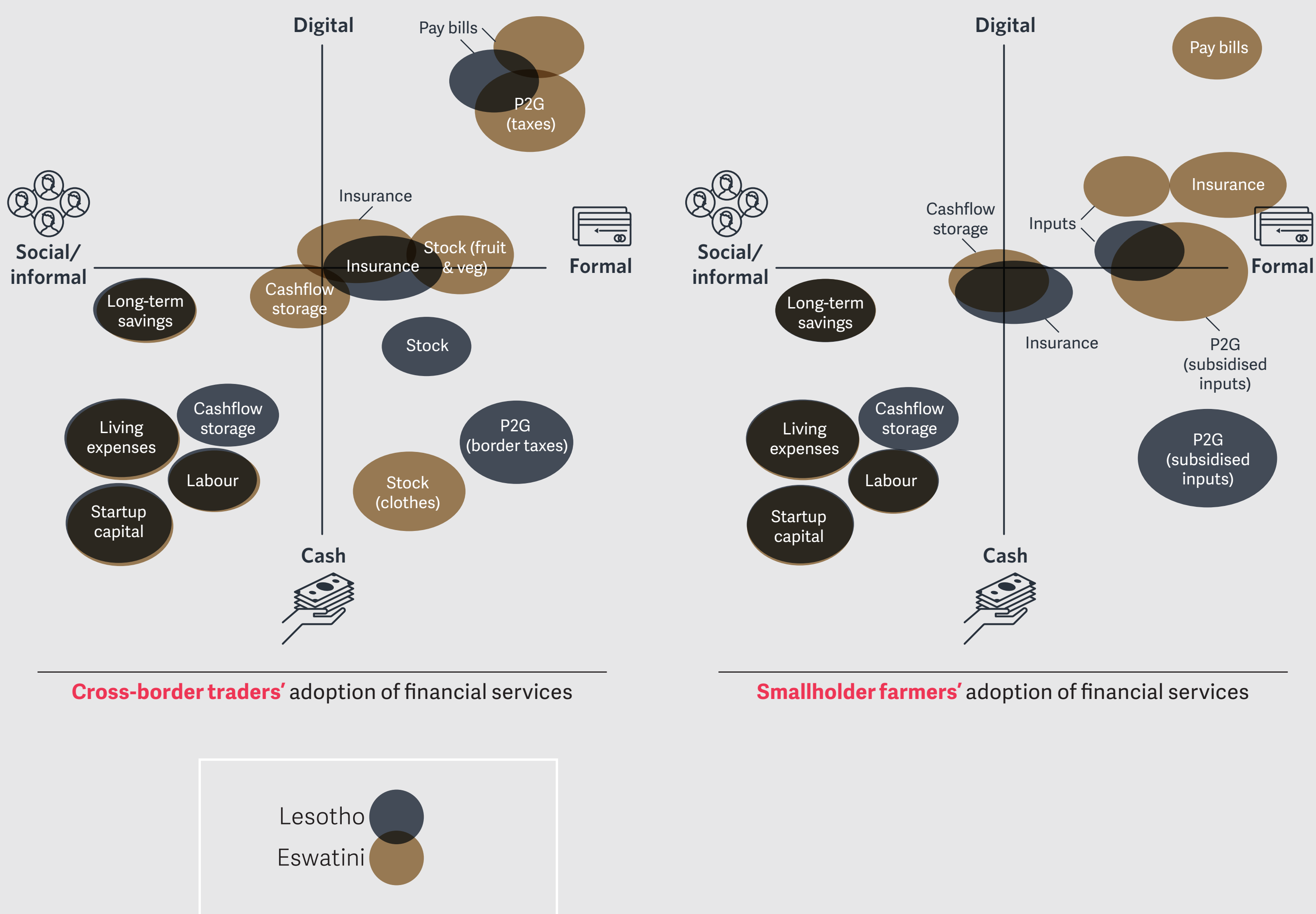


Figure 4 highlights MSMEs' strong preference for informal, cash-based financial mechanisms. It also highlights, given the businesses' range of needs relating to finance, that there is significant space for growth into both the formal sector and DFS. It is worth noting that the adoption of cashless person-to-government (P2G) payments by the Eswatini government has yielded positive results in incentivising formal financial services usage. However, there is still room for further digitisation of P2G payments, particularly for smallholder farmers (e.g. P2G payments for subsidised inputs).

- **Government policy and regulation:** Access to government-led financing initiatives has supported the development of small businesses and promoted formalisation and the use of formal banking.
- **Digital infrastructure:** Direct integration between some banks and mobile money providers allows for interoperability between channels and is driving uptake and usage of digital.
- **Formality:** Formal small businesses and businesses affiliated with formal cooperatives have very good access to both government-led and private sector (bank) financing through grants and loans.
- **Tailored products:** Mobile network operators offer tailored savings and loan products; however, there is limited awareness of these products among MSMEs.
- **Value chain-supported adoption of digital:** The use of digital payments by large value chain actors (especially in the agriculture sector) has contributed to the adoption of formal banking by smallholder farmers.

Progressing priority opportunities towards a collaborative financing framework

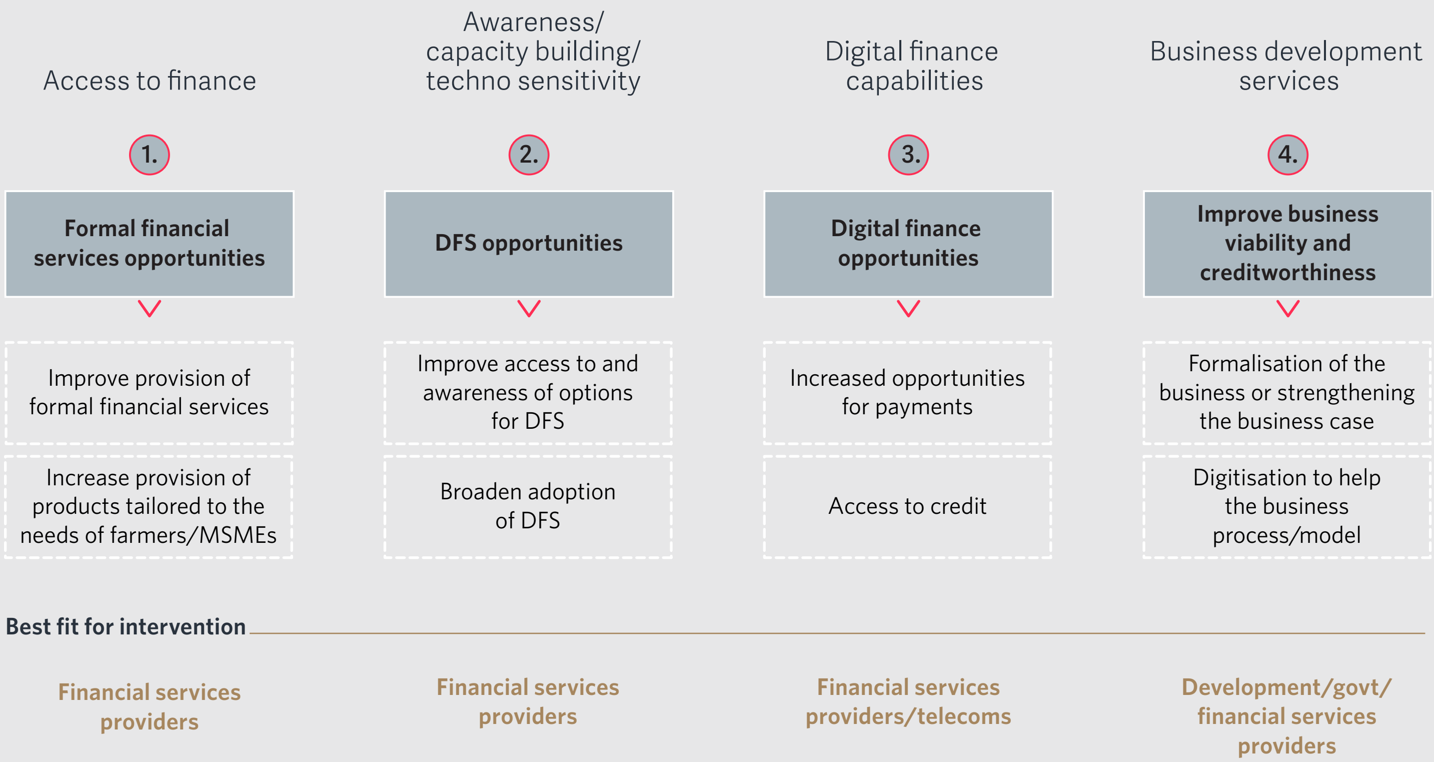
The research identified practical opportunities to move the needle on access to and usage of *digital* financial services – especially for MSMEs and smallholder farmers – taking into consideration the significant progress made in both countries in increasing access to formal financial services more generally. With large increases in mobile money/e-money services usage – including increased *depth* of usage (meaning use of multiple products or services) – options with regard to channels for providing financial access have increased, including through partnerships with retailers. Also evident is increasing interoperability between systems, and innovation on the part of traditional banks for digital products and remittances.

Given the complexity and multi-layered nature of the challenge, focused interventions that address multiple pain points simultaneously will definitely prove most effective. For instance, the following interventions would address multiple pain points while focusing on enhancing a single avenue of support – in this case, increasing the impact of *government-led credit mechanisms* for use by smallholder farmers:

- Strengthen collaboration with grassroots organisations (cooperatives, associations, other) to increase the reach of government-led initiatives.
- Increase farmer awareness (through digital channels) of existing government initiatives and how to access them.
- Provide ancillary services to farmers to competitively apply for credit: e.g. support in developing business proposals and completing applications.
- Consider adding benefits/features to the main financial service: e.g. information on agricultural support services.
- Work with government and development partners to expand access to joint investment products through farming cooperatives: e.g. group purchase of a tractor.
- Work with mobile money providers to develop payment products that include both government-provided services or subsidised inputs (e.g. hiring of tractors) and non-government payments (e.g. cooperative member fees) as well as offering the potential to attach value-added services to the product: e.g. the product should also create a track record for farmers, which could be used for credit applications and feed into automated business record-keeping services.

The opportunities identified can be grouped into four market building blocks, to prepare low-income markets to increase access to finance by leveraging digital (see Figure 5), which is the start of Phase 2 of this project: a multi-stakeholder process of identifying the interventions for collaboratively building more robust markets in these sectors.

Figure 5: Opportunity mapping for an improved digital financing environment: market building blocks



The different market building blocks suggest the value (and certainly the unavoidability) of multi-stakeholder engagement. Many of the partners are already committed and active in the field, and the digital financing framework will help to codify an approach, suggesting helpful contemporary configurations for engagement to significantly extend the boundaries of market formalisation.

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About the design: Note 2 follows on from the first publication by looking at the financial interaction of informal communities. When we step outside of the centralised financial sector, the movement of money becomes an organic process led by human interaction and movement rather than a systematic one led by algorithms. In this note we look at two areas offering a unique perspective that have evolved because of where and how people live together. The threads of the cover represent the topography that defines their way of life and the organic paths of people and their money. However, this still needs to be distilled and interpreted for digital access, as represented by the binary typography, which makes use of on/off states to transform the grid into the clarity of type.