3.5" 2.5"

OPPORTUNITY International

KNOWLEDGE MANAGEMENT

SPOTLIGHT

Smart Subsidies & Guarantees

April 2025

SUMMARY

The Challenge: Helping financially excluded populations gain access to loans presents higher cost and greater risk to financial institutions and clients, but subsidies and guarantees can have limited scale and sustainability.

Opportunity's Solutions: Opportunity delivers a variety of "smart" subsidies and guarantees, carefully tailored to target populations and markets, designed to provide temporary incentives that stimulate sustainable financial inclusion at scale. Opportunity also provides subsidized client training and capacity building to financial institutions as part of subsidy and guarantee packages.

Ongoing Dilemmas: Through innovation and learning, Opportunity is grappling with challenges in implementing smart subsidies. These include the "moral hazard" of clients and staff not taking repayment seriously when a loan is under guarantee, and sustaining training and technical assistance after a program ends.

THE CHALLENGE: FINANCIAL INCLUSION CAN BE COSTLY AND RISKY, BUT SUBSIDIES AND GUARANTEES MAY DELIVER LIMITED SCALE AND SUSTAINABILITY

To empower people living in poverty to transform their lives, their children's futures, and their communities, Opportunity facilitates financial inclusion for people living in extreme poverty. In Opportunity's model, financial inclusion is delivered by commercial banks and microfinance institutions.[1] For these sustainable financial institutions (FIs), serving people who are currently outside of the financial system presents higher cost and greater risk – whether perceived or actual. For example, when considering serving refugees, Ugandan FIs faced high cost of delivery in remote locations, and perceived high risk because most refugees had no Ugandan identification documents and no known track record of borrowing. In the face of higher cost and risk, a logical solution is to subsidize and guarantee – to cover some of the cost and risk of loans to financially excluded populations. The challenge with subsidies and guarantees is that funding is limited, and may only support a small number of people, for a limited time. The hope is that FIs will use subsidies and guarantees to learn and will then continue to serve the target population after the subsidies and guarantees end. The risk is that FIs will lend to the intended target population while some costs and risk are covered by a program, but go back to business as usual once the program ends.

What are subsidies? In the context of financial inclusion, subsidies are a form of financial assistance that lower the cost of lending to a target population. Subsidies can be directed to the financial institution, the target clients, or both. Subsidies to FIs include grants that may be used as capital for lending; to cover the cost of delivering finance to the target population; low-interest loans; and long-term loans or equity investments that provide "patient capital." Subsidies may be targeted to clients in the form of lower interest rates.
What are guarantees? In this context, guarantees reduce the risk of financing market segments that FIs otherwise find too risky. A guarantee can be delivered after a loan defaults, or guarantee funds can be deposited into a FI to replace collateral that clients would otherwise be required to provide (in the form of cash, land, or other certified property). Ideally, FIs pass the lower risk to clients by requiring less collateral for loans, and/or lower risk-related interest rates.

OPPORTUNITY'S SOLUTION: SMART SUBSIDIES AND GUARANTEES

"Smart" subsidies and guarantees incentivize FIs to serve a previously excluded target population as part of their mainstream business model. What makes a subsidy "smart" is a subject of debate and learning in financial inclusion and an area where Opportunity has experience and lessons to contribute. Opportunity designs smart subsidies and guarantees in response to target client needs and the cost and risk facing partner FIs. In addition, Opportunity actively collaborates with

[1] Opportunity also forms and strengthens community-based savings and loan groups, but in many situations, Opportunity is also attempting to help these groups gain access to formal loans in order to expand lending to members.

public and private providers of loan loss guarantees and innovates in the deployment of credit risk mitigation. Some key principles drive Opportunity's smart subsidies.

- **Tailoring to the target market segment:** Opportunity structures subsidies and guarantees differently according to the market characteristics of different client populations and FIs. For example, Opportunity's Agricultural Finance (AgFinance) program is introducing a set of regenerative agricultural practices to help smallholder farmers against declining soil fertility and the impact of drought and flood related to changing weather patterns. Farmers often take several seasons to implement the practices and to see production and financial gains. Because these practices are new to the region, smallholder farmers and FIs perceive them as risky. For both of these reasons, farmers and FIs need credit risk mitigation in order to invest. Opportunity has created an innovative loan guarantee mechanism in which guarantee funds are deposited with FIs in order to replace some of the collateral required of smallholder farmers seeking loans to finance these new practices. Because regenerative farming is also rather labor-intensive, the fund targets women to enable female farmers to hire workers rather than take on an even higher labor burden than they already have.
- **Shared risk:** In order to incentivize sustainable, commercially viable lending, Opportunity ensures that both FIs and clients are sharing the risk. Guarantee funds therefore cover between 30% and 80% of loan losses, not 100%. Even if the credit risk mitigation reduces client collateral requirements, clients will still be required to come up with some collateral.
- **Lower interest rates (and reduced fees):** In some situations, Opportunity encourages FIs to offer target groups lower interest rates and fees, and facilitates subsidized financing to enable this offering. For example, Opportunity Bank of Uganda, Ltd. (OBUL) offers lower interest rates and fees to youth, people with disabilities, and refugees organized into savings and loan groups. Initially, these subsidies were paid for by Opportunity project funding, raised from institutional and government donors, but, over time, OBUL has incorporated them into their regular business practices as a part of corporate social responsibility and also because these clients become reliable, long-term customers.

PWD program leader Margaret Namazzi at OBUL *Uganda*

- **"Mainstreaming" financial inclusion within FIs:** Opportunity monitors FIs to ensure that systems are being established to serve the target population and that products and services become part of the FI's mainstream business practices. Opportunity monitors whether new products have been approved by FI boards, policies and procedures are in place, and staff trained. Opportunity tracks whether marketing materials, business plans, and reports include the new population. For example, Opportunity's work with people with disabilities (PWD) with partner OBUL took a mainstreaming approach. Opportunity funded specialized, PWD organizations to train OBUL in disability awareness and funded the adaptation of branch buildings and training materials to accommodate PWDs. Opportunity subsidized promotional marketing like billboards to reach PWDs and position OBUL in the market as a socially responsible, inclusive FI.
- **Temporary nature of the subsidies and guarantees:** When appropriate, Opportunity deploys subsidies and guarantees with a defined end-date and exit strategy that incentivizes sustainability. For example, guarantee funds are available to FIs for one to five years, during which time the FI builds its capacity to serve target clients until it no longer needs the guarantee. This was the case with the Youth Apprenticeship Program at Sinapi Aba Savings and Loans (SASL) in Ghana. Opportunity provided fees for entrepreneur trainers, stipends for marginalized apprentices, financing for interest-free loans, and a guarantee for graduates to obtain start-up business financing. The program is now well established, and SASL not only loans to these graduates, but also pays for the apprenticeship training, considering it a corporate social responsibility activity. In another example, Opportunity funded the establishment of an OBUL bank branch in Nakivale refugee settlement, including capital and operational costs. Opportunity also funded market research and product development, facilitated refugee access to identification, and designed and delivered training to refugee entrepreneurs. After a few years, the branch became financially viable. Opportunity is now financing outreach to additional segments of the refugee populations, including farmers and early childhood learning centers.
- **Capacity building for FIs and clients:** To enhance the impact, scale, and sustainability of smart subsidies and guarantees, Opportunity delivers capacity building to FIs and clients. Through customized technical assistance, Opportunity helps FIs to better understand the target market, to design tailored products and marketing strategies, to establish policies and procedures to better serve these populations, and, often, to train staff, managers and board members to help them adjust attitudes toward discriminated populations such as people with disabilities, refugees, and women. Opportunity also invests heavily in training clients and preparing them for financing. Although Opportunity does not charge fees for training and technical assistance, FIs and clients usually contribute by paying for transportation and, of course, by investing their valuable time. With a view toward sustainability, as much as possible, client training is integrated into FI service delivery so

that it will ultimately be paid for as part of normal banking operations. This is the case with financial literacy training in many situations, for example. In addition, AgFinance which delivers training through community-based lead farmers, is documenting the business case of these trainers to FIs, and testing models of linking these farmers to FIs, with the vision that FIs will absorb and pay for this service as part of their AgFinance business.

By applying these "smart" principles to subsidies and guarantees for FIs serving diverse populations in multiple settings around the world, and through frequent, human-centered innovations in cost reduction and risk mitigation, Opportunity leverages every donor dollar for higher outreach to ever more financially excluded populations.

Refugee client
Uganda

ONGOING DILEMMAS: MORAL HAZARD AND SUSTAINABILITY

Although Opportunity strives to implement "smart" subsidy and guarantee principles in all situations, some populations and situations prove challenging in practice.

- **Moral hazard and incentivizing FI staff:** Especially among populations used to receiving grants or free commodities, like refugees, knowing there is a guarantee for their loan can lead to clients not repaying a loan. Similarly, if loan officers know that some loans, for example, for farmers, are being guaranteed, then they may be tempted to relax lending criteria too much in order to meet loan origination targets. Some FIs do not inform their staff or clients about guarantees. But, how can staff be incentivized to take higher risk required to serve new populations if loan officers are not informed of the guarantee? How can clients benefit from lower collateral requirements if they are not informed of the opportunity of the guarantee? Also, some governments require that FIs disclose guarantees, and, indeed, Opportunity generally promotes FI transparency with clients as part of client protection principles. There are some mechanisms that help address the challenge of moral hazard. Awareness raising and training for staff and clients can help adjust attitudes and inform both parties that consequences of non-payment remain in place even when there is a guarantee. Opportunity also supports FIs to adjust their policies and to train staff to take some high risk with new populations and/or to serve populations they perceive of as higher risk, but not to simply waive FI policies and procedures.
- **Sustaining services for farmers living in extreme poverty:** Opportunity's AgFinance program reaches and serves farmers living in extreme poverty, particularly women and young farmers. To reach this population, who are normally excluded from formal agricultural markets, Opportunity trains, digitally equips and deploys "farmer support agents" or FSAs. FSAs are lead farmers from target communities who reach and train farmer clients and help them access financing either through savings and loan groups or by linking to formal FIs. Opportunity recruits, trains, and pays an incentive to FSAs for this work. Using this strategy, Opportunity reached 385,000 smallholder farmers in 2024, 53% of whom were living in poverty and 60% of whom were women. The challenge, however, is sustaining this network of FSAs once donor funding to pay them a stipend runs out. As mentioned above, the AgFinance team is testing viable business models to address this challenge.
- **Sustaining learning networks:** A similar challenge arises with Opportunity's education clusters. In order to enhance the quality of education offered in affordable non-state schools, Opportunity establishes learning clusters of school leaders and teachers. Through these clusters, Opportunity delivers training and peer support. The challenge is how to ensure sustainability of these clusters once the program in a particular area ends, after some three years.

Through innovation and learning, Opportunity is striving to overcome these challenges in implementing smart subsidies.

AgFinance client,
Ghana