

Creating Access to Agricultural Finance

AgriFin (January 2013) | The following is a summary of Creating Access to Agricultural Finance: Based on a Horizontal Study of Cambodia, Mali, Senegal, Tanzania, Thailand and Tunisia (<http://www.afd.fr/webdav/site/afd/shared/PUBLICATIONS/RECHERCHE/Scientifiques/A-savoir/14-VA-A-Savoir.pdf>) published by Agence Française de Développement in 2012.

Lack of access to finance continues to persist especially for smallholder farmers despite recurring interventions attempted both by the public and the private sectors. Lending to the agricultural sector is unattractive due to high costs, high risk, and low returns. A range of issues including geographical factors, production risks, ineffective government subsidies, and banks' inexperience in this sector have constrained access to agricultural finance and stunted agricultural development. However, the authors of this study argue that finance alone will not be enough to create a sustained impact. In order to fundamentally impact this sector, "financial services must be structured to induce farmers to make innovations in their operations." Based on the six countries studied in this paper, there are three key elements to innovative agricultural finance: (1) reducing delivery costs through efficient lending methodologies and the use of technology, (2) adapting agricultural finance to agricultural cash flow cycles, and (3) utilizing value chains to ensure proper loan use and repayment.



The authors argue that maximizing the use of value chains is the key to many innovative developments in agricultural finance. "The trigger in value chain finance is the linking of value chain partners; finance is just the oil in the system." Warehouse receipt financing provides added value that goes beyond merely providing finance to farmers: a secure storage system to help reduce post-harvest losses, manage price risks, and incentivize farmers to increase the quality of their yields because the warehouse grades and certifies their products upon arrival. This in turn opens up new markets for farmers. However, in order for warehouse receipt financing to function effectively, appropriate regulatory and legal frameworks must be put in place.

Another finding from the study is the presence of a robust microfinance industry in all six countries. However, microfinance requires proper support and supervision. Minimalist microfinance is not enough as credit alone is insufficient to raise agricultural productivity. Instead, bundling credit with financial literacy and technical assistance programs is essential not only to increase productivity but also to avoid over-indebtedness. Another innovation in agricultural finance comes from the use of modern technologies, especially mobile phones. Mobile phones are increasing outreach and thereby efficiency to

previously unbanked poor farmers. The use of information communication technology (ICT) carries huge potential to create real and lasting impact on agricultural finance. The authors of this study also concurred on the importance of grouping farmers into cooperatives or associations to take advantage of economies of scale, increase farmers' collective bargaining power, and expand outreach to smallholders in a cost-effective manner.

Many of the innovations in agricultural finance are pioneered by the private sector. However, the role of governments in facilitating and regulating financial services should not be underestimated. Governments should not distort or crowd out the sector with ineffective policies such as interest rate subsidies or price distortions. Instead, governments need to create a legal and regulatory framework that recognize and enforce contractual obligations. "Governments also need to license, regulate, and supervise entities that are custodians of somebody else's money or goods," such as banks, microfinance institutions, insurance companies, warehouses, and weather stations or product weighing/grading services.

The report concludes with some guidance with regard to the role of international development partners in developing innovative agricultural finance. International development organizations should provide technical assistance to assist governments in establishing "an enabling legal and regulatory environment" that recognizes and has the capacity to enforce contractual obligations between lenders and borrowers. Besides governments, international development agencies should also support financial institutions that wish to finance agriculture to build their capacity in agricultural lending, reduce risks, and enhance agricultural productivity with an exit strategy in mind. Support from donors should be extended to providers of extension services and financial education to enhance the effectiveness of agricultural finance.

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