Scaling Up Access to Finance for Agricultural SMEs: Policy Review and Recommendations

AgriFin (January 2013) | This article is a summary of Scaling Up Access to Finance for Agricultural SMEs Policy Review and Recommendations (http://www.gpfi.org/sites/default/files/documents/G20_Agrifinance_Report%20%28FINAL%20ONLINE%29.pd was published in 2011 by the International Finance Corporation (IFC) as the lead technical advisor to the G-20 Global Partnership for Financial Inclusion (GFPI).

The importance of agriculture, especially to the economies of developing countries, cannot be overstated. In low-income countries, agriculture accounts for 60 percent of total employment and 20 percent of GDP. Unfortunately, however, this sector suffers from low productivity. Without a concerted effort to increase productivity, few countries will be able to achieve the Millennium Development Goals. The surge of food prices in recent years has brought renewed attention to the issue of agricultural finance, especially for underserved agricultural SMEs and smallholder farmers. This summary highlights some key recommendations from agricultural finance experts (convened under the G-2O Global Partnership for Financial Inclusion) that are intended to guide policy makers in developing countries on how to increase access to agricultural finance.

“Developing Country Specific Diagnostics and Strategies”

Governments should gather relevant information regarding the supply and demand of agricultural finance at the national level. Establishing country-specific diagnostics is essential in order to understand and develop strategies based on this contextualized information. Segmenting agricultural sub-sectors into smallholders, commercial farmers, and agribusinesses is also necessary since each sub-sector has different needs. The process of assessing the needs and developing strategies to meet them with appropriate financial products should be a participatory process that includes key stakeholders from agricultural organizations and private sector representatives.

“Developing a Supportive Legal and Regulatory Framework”

In order to develop a coherent legal framework that intersects both finance and agriculture, appointing a single coordinating body as an advocate for agricultural finance is highly recommended to ensure proper coordination between various ministries. An independent and well-functioning judiciary that has the capacity to enforce contracts between lenders and borrowers is essential to facilitate the flow of finance to all participants. Under certain circumstances, policy makers should consider promoting secure forms of land tenure to enable farmers to collateralize their land to gain access to finance. In the presence of secure property rights, banks might be more willing to disburse larger and longer-term loans. Designing a supportive legal framework to facilitate warehouse receipt financing is another key recommendation. Warehouse receipt financing provides broad benefits by giving farmers a more favorable price, reducing post-harvest losses, and increasing access to finance in the supply chain.

“Designing Effective Government Support Mechanisms”

Public money should be used for investments in financial and physical infrastructure with systemic benefits. Subsidies should be used carefully so as not to distort a functioning market and therefore should be time-bound, limited, decreasing over time, and focused to support the institution instead of the borrowers. The government should be prepared to reform, privatize, or close state agricultural development banks if they are deemed ineffective. Infrastructure investments with broad benefits, such as weather stations, irrigation systems, and storage facilities ideally should be financed through public-private partnerships and/or the private sector to ensure sustainability.

"Strengthening the Financial Infrastructure"

Policy makers should look into extending the reach of credit reference bureaus into rural areas to facilitate increased lending to the agricultural sector. Another key recommendation for increasing access to agriculture finance is to improve registries for movable collateral and alternative forms of collateral. Movable collateral registries are essential to support long-term investment in agricultural production because it allows borrowers to pledge assets and creditors to register their claim to these assets in case of default. A strong financial infrastructure can only be built with a diverse mix of financial institutions, financial services, platforms, and distribution channels to best serve the various needs of agricultural clients.

"Building Consistent and Reliable Data Sources"

Governments can play an important role in the collection and dissemination of reliable data regarding agricultural finance, agricultural production, supply chains, and market pricing information in order to overcome the problem of asymmetric information that often prevents banks from lending to the agricultural sector. Reliable data sources will not only benefit financial institutions by providing them information about prospective clients, it will also supply farmers and agricultural SMEs with a better understanding of commercial banks and other financial providers. In addition, such information is also important for aiding policymakers in crafting sound policies.

"Building Capacity of Financial Institutions and Their Clients"

Commercial banks often need technical assistance to enable them to design financial products and services tailored to the agricultural sector. Bankers who serve agricultural clients need "specialized credit skills and policies, credit scoring and rating tools, and portfolio monitoring practices." Meanwhile, the capacity of farmers and farmer-based organizations need to be strengthened in order to make the best use of available financial products and services. Financial literacy, business management, organizational skills, and governance are some key issues that must be addressed. Development partners can play a key role in assisting financial institutions to enhance agricultural lending capacity.

This paper concluded with a brief overview of innovative models and instruments, which will be expanded upon in a separate report that will be published as a companion piece to follow up on the innovative solutions introduced in this policy report.

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