Agricultural Finance: Credit Union Focusing on the Socio-economic Empowerment of Farmers

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Background

- Access to agricultural finance and adoption of green revolution technology
- Establishment of Agriculture Development Banks in the 1960s and 1970s in different countries
- Administratively setting interest rates and compulsory lending quotas
- Failure of state-led model of agricultural finance – poor outreach and high loan losses
- Start of financial liberalization since early 1980's
- Opening of new financial institutions – MFIs, NGOs, Credit Unions, etc.

Background

- Presence of MFIs in peri-urban and accessible rural areas,
- Presence of credit union everywhere irrespective of remoteness and under-development,
- Lack of remarkable changes on access to agricultural finance,
- Over 2/3rd of the farmers still lacking access to agricultural finance
- Lack of access to agricultural finance is as pressing as ever

Objectives

General

- Analysis of different dimensions of agricultural finance and credit union with special reference to socioeconomic empowerment of farmers

Specific

- Review the constraints in supply and demand including latest innovations on agricultural finance
- Analyze situation of credit unions focusing on the socioeconomic empowerment of the farmers along with their problems and potentials on expanding the frontier of agricultural finance

Supply of Agricultural Finance

- Commercial banks
- Agricultural development banks
- Microfinance Institutions
- Credit Unions
- Value chain finance
- Leasing
- Informal finance
- Agricultural insurance
- Guarantee funds
- Public and donor funding

Demand for Agricultural Finance

Value chain partner	Role in the value chain	Demand for finance
Input suppliers	Provide seeds, fertilizers, chemicals, fuels, equipment, and sometimes-technical knowledge.	Working capital to buy and stock inputs in adequate amounts and at the right time. Provide these on credit to farmers.
Day workers	Provide seasonal labor.	Want to be paid by day's end.
Farmers	Grow crops and raise animals. May take part in some postharvest processing and marketing.	Working capital to buy inputs and pay seasonal labor. Capital or term loans for investment in equipment, storage, animals and land, including clearing hitherto unused land. Payment services, saving products, various types of insurance including crop insurance.
Farmers' organizations (e.g. associations, Cooperatives)	Bulking inputs and/or farmer outputs to gain economies of scale and better prices. Advocacy, access to technology.	Working capital to buy farm inputs for distribution to farmers. Working capital to buy produce from farmers for delivery to traders or other off-takers. Capital or term loans for investment in storage, transport and (pre) processing facilities.
Rural traders Collection centers	Buy agricultural produce and bulk-sell it. Sometimes testing and quality certification.	Working capital to buy agricultural produce. Capital or term loans for investment in storage facilities, transportation equipment or testing/certification equipment. Insurance.

Demand for Agricultural Finance

Value chain partner	Role in the value chain	Demand for finance
Processors	Transform the product into a marketable commodity or consumer product.	Working capital to buy agricultural produce. Capital or term loans for investment in production facilities. Insurance (calamities, theft, loss).
Distributors, wholesalers	Sell to local retailers, supermarkets.	Working capital to buy processed agricultural products. Working capital to provide stock finance to retailers. Capital or term loans for investment in storage facilities and transportation equipment.
Exporters, importers	Sell to international buyers (commodities or processed products).	Working capital to buy processed agricultural products or unprocessed agricultural commodities. Factoring/forfaiting services (on behalf of suppliers). International trade finance (e.g. L/C). Insurance (calamities, theft, loss).
Retailers	Sell to consumers.	Working capital to buy processed agricultural products. Capital or term loans for investment in shop inventory. Insurance (calamities, theft, loss).
Consumers	Consume the product!	Personal loans or salary advances.

Constraints to Promoting Agricultural Finance

- High delivery cost, proximity
- Weak farming practices and farmers
- Lack of banking technology
- Collateral
- Exogenous risks
- Government intervention and
- Weak collaboration with farmers

Constraints to Promoting Agriculture Finance

Categories of constraints		Type of constraints
Vulnerability	1 2 3	Systemic or covariant risk (the same type of risk occurring at the same time) Market risk (fluctuation of prices) Credit risk (lack of collateral)
Operational	4 5 6	Low investment returns (rural capital turns over slowly, low profit margins, seasonality results in uneven cash flow) Low investment and assets (weak safety net) Geographical dispersal and low population densities
Capacity	7 8 9 10	Weak rural infrastructure Low level of training and technical capacity of the rural population Social exclusion (cultural, linguistic) affects market and financial integration Limited institutional capacity (weak support systems)
Political and regulatory	11 12	Political interference (subsidized and/or directed credit from state-owned banks, debt waivers, interest-rate caps) Regulatory constraints (land tenure laws, banking laws, arbitrary taxation)

Innovations in Agricultural Finance

- Member-owned localized finance such as credit unions, rural banks, microfinance
- Agricultural leasing
- Value chain finance, including contract financing and out grower schemes
- Agricultural factoring
- Warehouse receipt finance
- Processors
- Credit guarantees
- Insurance (index) to support credit
- Price smoothing
- Technology: mobile banking (cell phone, mobile van); biometrics
- Extension services, financial literacy

Approaches to Agricultural Finance

Financial Sector Approach

- Use of financial sector as an entry point
- Emphasis on the important role of financial institutions for facilitating access to wide range of services
- Involves building long-term capacity and finding incentives for institutions to offer financial services to the rural and agricultural sector

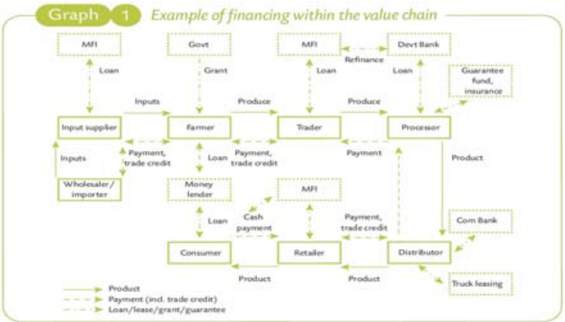
Value Chain Approach

- Use of production chain as an entry point,
- Examines the financial services that could be proposed all along the value chain from input supplier, processors, intermediaries to buyers, etc.
- Combine commercialization activities and even technical assistance,
- Secure guarantees and an integrated approach
- Reduce risk of non-repayment

Agricultural Finance: Fulfilling an Unmet Need

- The right finance at the right time can mean greater efficiency, improved product quality and increased incomes
- Many financial institutions have been hesitant to work with value chains because of the complexity of relationships and the risks, costs and partnerships associated with financing them.
- Credit unions, however, make promising partners in value chain finance due to their deep community ties, presence in rural areas and lending experience with low-income individuals and small firms
- Farmers diverse geographical location and ensuring access to finance to farmers means fully inclusive finance.

Integration of Several Financial Providers within a Value Chain



Innovations in Agricultural Finance: Constraints Targeted and Applicability

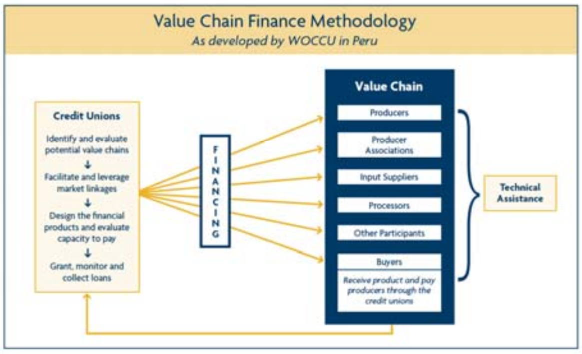
Innovations	Constraints targeted						
	High delivery cost, proximity	Weak farming practices and farmers	Lack of banking technology	Collateral	Exogenous risks	Government intervention	Weak collaboration with farmers
	1	2	3	4	5	6	7
Member-owned localized finance (e.g. Credit Unions), rural banks, microfinance	✔		✔	✔			✔
Agricultural leasing			✔	✔			
Value chain finance, including contract financing and out grower schemes	✔	✔	✔	✔	✔		✔
Agricultural factoring			✔	✔			
Warehouse receipt finance		✔	✔	✔	✔		
Credit guarantees				✔			
Insurance (index) to support credit	✔			✔	✔		
Price smoothing					✔		
Technology: mobile banking (cell phone, mobile van); biometrics.	✔		✔				
Extension services, financial literacy		✔			✔		✔
Total	4	3	6	7	5	0	3

Comparative Advantages of Credit Unions on Agricultural Finance

Credit union can address following constraints

- High delivery cost, proximity
- Lack of banking technology
- Collateral
- Weak collaboration with farmers

Credit Union in Value Chain



Risk Management in Agricultural Lending by Credit Union

- Ensure Market Demand for Crops
- Create Proper Policies and Procedures
- Assess Real Financing Needs
- Establish Appropriate Guarantees on Individual Loans
- Diversify the Loan Portfolio
- Adapt Loan Terms According to Crop Seasons
- Distribute Loans in Vouchers
- Encourage Farmers to Diversify Crops
- Monitor Crop Performance
- Receive Payment through the Credit Union

Credit Union and Socioeconomic Empowerment of Farmers

- Access to finance and agricultural commercialization,
- Access to market, raw materials, technology and social mobilization is very important for finance to be productive,
- Despite poor farmers' major role in agriculture and other rural activities, higher barriers in education and training limit their participation in more productive and remunerative work, perform managerial and leadership roles and participate fully in the development of their communities,
- Credit unions has greater roles to play bringing targeted poor farmers as shareholders and works on enhancing access to finance (savings, credit, payment, insurance) to expedite their socio-economic empowerment,
- Improving rural productivity, employability and income-earning opportunities,
- Enhancing food security,
- Promoting environmentally sustainable rural development and livelihoods options and empowerment.

Conclusions

- Despite a well-developed credit delivery structure of banks and financial institutions, the pace of agricultural financing is slow, regional imbalance is widening and share of small farmers in banks and financial sector is declining.
- Access has not been expanding pursuant to demand due to constraints such as high delivery cost and proximity; weak farming practices and farmers, lack of banking technology, collateral, exogenous risks, government intervention, and weak collaboration with farmers.
- Past government policies have not been able to remedy these constraints.
- Recent innovations in agricultural finance such as value chain finance approaches involving traders, processors, warehouse receipt finance, agricultural (index) insurance, and (rural) microfinance, among others, have created renewed interest in this front.
- Access to finance through credit union can have a positive impact on the cash position of rural households, enhance the smoothening of their consumption and to a certain degree strengthen their resistance to economic shocks.
- Ability of credit union finance to stimulate household accumulation process and to contribute to productive investment especially in agriculture is always questionable.

Conclusions

Credit unions

- Provide hassle free formal credit without any collateral security and simultaneously improve their thrift habits,
- Operate in isolated pockets and provided financial services to their shareholder farmers at the doorsteps,
- Address four out of seven constraints of agricultural financing namely: high delivery cost and proximity; lack of banking technology, collateral, and weak collaboration with farmers.
- Suitable to enhance access to agricultural finance to producers, producers associations and input suppliers – layers of the value chain.
- Builds upon the self-help potential of the target group
- Potential for economic empowerment of the farmers by positioning as an intermediary with different service providers such as such as watershed development, livelihood promotions, organic farming, agriculture extension services, environmental impact assessments, training and capacity building, education, skills development and financial literacy

Thank You Very Much