


Benchmarking the Business of Agriculture

A joint program by the Agriculture and Environmental Services (AES) and Global Indicators and Analysis Department (GIA)

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Snapshot - Access to Agricultural Finance[1]

Access to Agricultural Finance: relevance and main constraints

The demand for credit by smallholder farmers was very roughly estimated to be nearly as high as $450 billion. There is an unmet demand for credit in the agriculture sector, while the credit is needed to address the growing demand for agricultural commodities and shifting preferences towards higher value food sources.[2]

Access to Agricultural Finance will contribute to moving farmers from subsistence/semi-commercial into commercial farmers and improve the livelihoods of those farmers that are already commercially oriented. This commercialization of farmers is crucial to respond to:
(i) Increased demand for agriculture commodities due to the increase of the population and the change in dietary habits,
(ii) Climate change impacts that are straining the supply of agriculture commodities, and
(iii) The emergence of new markets for niche products, higher value crops and certain crop/food products with characteristics valued by consumers, such as certified products.[3]

Financial constraints are more pervasive in agriculture and related activities than in many other sectors, reflecting both the nature of agricultural activity and the average size of firms. Financial contracts in rural areas involve higher transaction costs and risks than those in urban settings because of the greater spatial dispersion of production, lower population densities, the generally lower quality of infrastructure, and the seasonality and often high covariance of rural production activities. So banks and other traditional for-profit financial intermediaries tend to limit their activities to urban areas and to more densely populated, more affluent, more commercial areas of the rural economy.[4]

Proposed focus of the Agricultural Finance indicators

Benchmarking has proved to be an effective tool for policy makers, to establish a baseline, define best practices and identify opportunities for improvement in selected areas. The BBA Access to Agricultural Finance indicators will specifically focus on <u>access to agricultural financing for smallholder farmers in rural areas</u>. It sets out to provide policy makers with a tool to inform their discussions in areas that have been identified as important to promoting more Access to Agricultural Finance in rural areas.

The indicators will build upon previous benchmarking efforts – the Doing Business – Getting credit indicator, USAID Pilot Report Agribusiness Regulation and Institutions (AGRI) Index – Access to Finance index, and the Agribusiness Indicators piloted by the Agriculture an Environmental Services Dept. ; broadening their scope and addressing additional areas.

[1] This indicator will focus on Access to Agricultural Finance, from formal sources, for smallholder farmers in rural areas.
[2] IFC & GPFI, November 2012, p. 17
[3] IFC & GPFI, November 2012, p. 18
[4] World Development Report, 2008

BBA is constructed as a hybrid with two complementary sets of indicators: The Doing Business in Agriculture indicators (DBA) - which will measure the legal and regulatory framework - and the Deep Dive studies (DD) which aim to provide a more in depth synergetic statistical information and country analysis on agriculture finance. The DD indicators could also help keep track of impact of policies over time.

Sub category a. Access and Availability of finance for agriculture

Small scale farmers need credit to expand their production, purchase seeds and other inputs, as well as to harvest, process, market and transport their crops. Yet most farmers lack access to a range of financial services they need or the formal financial services available to them are relatively costly and with rigid terms.[5]

This section of the indicator analyses the policies and regulatory framework that can affect the agricultural lending of financial and non-financial institutions. It also analyses policies and new innovative mechanisms that financial and non-financial institutions could use to broaden their outreach and grant more financial access to small holder farmers (agent banking, mobile banking, lending to farmers organizations and credit guarantee programs.)

Provision of finance through Commercial Banks	**Doing Business in Agriculture regulatory indicators** • Legal Indicator: Measuring how flexible/inflexible is the legal and regulatory framework in adequately taking into consideration the specificity of agricultural finance: i.e.: High limitations on financial ratios, capital-to-asset ratios, minimum liquid asset ratios.	**Deep Dive topic areas and indicators** • % of commercial bank lending to agriculture • # of commercial banks • # of staff working in the dept. • # of staff trained in agriculture • MIS System that captures different agricultural products • Avg lending rates (disaggregated by size of loans, type of borrowers, if possible) • # of commercial bank branches per 100,000 rural adult populations • Schemes that include capacity building of local financial institution staff to support and develop targeted agriculture loan products. • Guarantees targeting longer-term loans to boost finance for equipment and other productivity-enhancing investments.
Provision of finance through Financial Cooperatives	**Doing Business in Agriculture regulatory indicators** • Legal Indicator: Measuring the legal & regulatory framework for financial cooperatives - Obligations and powers of financial cooperatives - Regulatory and supervisory framework that addresses the special characteristics of financial cooperatives as financial organizations (e.g. tiered supervisory system)	**Deep Dive topic areas and indicators** • # of financial cooperatives registered. • Types of financial cooperatives that exist (financial cooperatives, credit unions, cooperative banks).
Provision of finance through Agent Banking	**Doing Business in Agriculture regulatory indicators** • Legal indicator: Measuring the regulatory framework enabling agent banking.	**Deep Dive topic areas and indicators** • # of Banks that use agents, geographical outreach, types of agents

[5] CGAP & IFAD, 2006

	• Is agent banking allowed? • Are there restrictions on the locations for agent banking?	(post offices, retail stores)
Provision of finance through Mobile Banking	**Doing Business in Agriculture regulatory indicators** • Legal indicator: Measuring the regulatory framework enabling mobile banking • Is mobile banking allowed?	**Deep Dive topic areas and indicators** • # of institutions that provide mobile banking services • Mobile Subscriptions (per 100 people) • # of institutions that provide mobile banking services
Cooperatives & farmers associations/organization	**Doing Business in Agriculture regulatory indicators** • Legal indicator: - Measuring the regulatory framework enabling the formalization of a farmers group - Regulatory framework enabling to lend to a farmers group.	**Deep Dive topic areas and indicators** • # of registered FBOs/ cooperatives working in agriculture finance • Organizational and technical capacity of the FBOs/ cooperatives providing financial services
Availability of Credit Guarantee Program for Agriculture	**Doing Business in Agriculture regulatory indicators** N/A	**Deep Dive topic areas and indicators** • Existence of a Credit Guarantee Program • Government's role in the Guarantee Program (direct implementation or through commercial banks?) • # of Banks participating in the program • Value ($) of the Guarantee Program • # of farmers benefiting from the Program

Sub category b. Use of Movable Collateral to obtain financing

In order for smallholder farmers to obtain financing and in the absence of access (or ownership) of land they must be able to pledge the assets that they have readily available. Accordingly the enabling regulatory framework must be flexible and adapt to these types collateral. i.e.: leased machinery, inventory, accounts receivables, warehouse receipts.

This section will analyze the flexibility of the legal framework pertaining to the different types of assets that can be accepted as collateral in order to facilitate borrowing by smallholder farmers.

Warehouse Receipts (WHR)	**Doing Business in Agriculture regulatory indicators** • Legal indicator and looking at other aspects of the enabling environment: - Availability of credit and market information - The appropriate legal environment - Licensing and inspection system for the warehouse industry - Standards and grades of stored commodities	**Deep Dive topic areas and indicators** *Depending on the findings of the initial pilot countries, it would then be determined if accompanying DD indicators will be developed*
Leasing	**Doing Business in Agriculture regulatory indicators** • Legal indicator: - Is there a leasing law enabling to lease farm machinery. - Can leased assets be used as	**Deep Dive topic areas and indicators** • No. of Leasing Companies (w/ products for agriculture) • Types of equipment (tractors, pumps, processing equipment; • # of tractors leased (and for what

	collateral and registered in the collateral registry.	periods)
Value Chain Financing	**Doing Business in Agriculture regulatory indicators** • Legal indicator: Measuring the regulatory framework enabling value chain financing. - Can a bank or cooperative accept a purchase contracts as collateral?	**Deep Dive topic areas and indicators** N/A
Secured Transactions Law	**Doing Business in Agriculture regulatory indicators** • Legal indicator assessing the secured transactions framework for non-possessory security interests favoring agricultural lending: - Types of movable collateral that can be pledged to secure a loan. - Who will accept a loan using them: financial and/or non-financial institutions? - Possibility of out of court enforcement.	**Deep Dive topic areas and indicators** N/A
Collateral Registries for Movable Assets	**Doing Business in Agriculture regulatory indicators** • Legal indicator measuring the structure of the collateral registry based on best international practice: - Is it searchable by debtors name etc.? - Must there be a general or specific description of assets?	**Deep Dive topic areas and indicators** • Types of movable collaterals registered (tractors, livestock, other agriculture equipment) • # of searches conducted in a month • Types of users (Banks, FBOs, MFIs) • Time and cost to register collateral in the registry.
Sub category c. Credit Information Credit markets in general are imperfect, and most notably for the rural poor. One fact that contributes to the imperfection of the credit markets is the asymmetry of information between lenders and borrowers. Some bureaus and registries do not collect/distribute alternative data from retailers, utility providers (telecom, electricity, and gas and water companies) and trade creditors. This is important because most rural borrowers are unbanked and have no access to the traditional lending institutions but do, for example, pay utility bills. Collecting such information allows the unbanked borrowers to create "reputational collateral" i.e. a credit history about their repayment behavior and that in turn becomes information that financial institutions can have access to.		
Credit Registries/Credit Bureaus	**Doing Business in Agriculture regulatory indicators** • The Legal indicator on credit information sharing systems would look at how much do the existing bureaus or registries extend their scope of data that is being collected and distributed to rural finance and then specifically to agricultural finance (if possible).	**Deep Dive topic areas and indicators** • Depending on the findings of the initial pilot countries, it would then be determined if accompanying DD indicators will be developed.

	More details: 1. Do credit bureaus or registries collect alternative data; i.e. data from retailers, utility companies (telecom, electricity, and gas and water companies) and trade creditors? 2. Do credit bureaus and registries expand the range of information distributed to include credit information from other smaller lending institutions: financial cooperatives microfinance institutions, farmers associations, input providers? 3. What kind of information do these institutions provide (positive and negative). 4. Is the data disaggregated by type of loans including 'agricultural loans'? 5. Is it mandatory for lending institutions to consult the credit bureaus/registries prior to issuing a new loan? 6. How easy is the access to the credit bureau data by small lenders? e.g. cost structure of credit reports. • Coverage of population in rural areas.	
Sub category e. Areas researched but not included in the indicators		
Land	• Broad consensus among agriculture finance practitioners to not focus on the use of land as collateral due to the issue of tenure security for smallholders. • Direction towards use of movable assets or group guarantee as collateral for small holders	
Agricultural insurance	• Agricultural insurance is heavily subsidized by Governments in the places where it is successful. • Variation in the success of the products based on country circumstances.	
Microfinance	• Microfinance has typically tended to gravitate away from rural borrowers (with the exception of Bangladesh and Indonesia).[6] • Microfinance works well in peri-urban areas and for a few rural economic activities. Difficult to succeed in agriculture due to seasonality and low population densities. • Not suitable for larger loan amounts and longer maturities that are typical for agricultural finance.	

[6] CGAP & IFAD, 2006, p. 6