Agricultural finance

Agricultural Finance and Agricultural Insurance
As part of National Financial Inclusion Agendas

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Agenda

• What is agriculture finance and why is it important?

• How can Governments and Central Banks support agriculture finance in an effective manner?
What is agriculture finance and why is it important?
Agriculture is significant in developing countries

- Globally **3.1 billion people live in rural areas**
- Developing countries have **large populations engaged in agriculture** - 41% in total with regional variability:
  - 55% in Sub-Saharan Africa
  - 47% in South Asia
  - 39% in East Asia
  - 25% in North Africa
  - 21% in Central Asia
  - 16% in Latin America/Caribbean

- Agriculture employs **1.3 billion people globally**, of which 97% are in developing countries
- **450 million** are smallholder households
- Demand for finance globally **exceeds $400 billion** annually just for working capital
### Key Features of the Agricultural Sector

| Client features | ✓ Significant informality and lack of information  
|                 | ✓ High concentration of poverty  
|                 | ✓ Large number of very small production units many of which produce for subsistence  
|                 | ✓ Very heterogeneous production units (crops, technologies, profitability)  

| Sector structure | ✓ High importance of value chains (key to access to technology, markets, credit)  
|                  | ✓ High relevance of some key large international and/or regional companies in certain value chains  

| Economics | ✓ Significant geographic dispersion and distances, remote areas  
|           | ✓ Substantial seasonality in income and expenditures  
|           | ✓ High covariant risks (production, prices)  

| External environment | ✓ High importance of Political Economy: politically sensitive sector  
|                      | ✓ Significant environmental and social issues (also gender and youth)  
|                      | ✓ Key role of structural changes as countries develop (e.g. move out of the sector, diversify, change production structures, concentration)  

Question: What percentage of smallholder farmers are estimated to sell their products to secured markets in tight value chains?

- Less than 10%
- About 1/3
- About 50%
- More than 80%
Outlook for Agricultural Commodities

- **Demand side**
  - Increase of population in emerging markets
  - Rising middle class and increasing urbanization
  - Change in diets towards higher value foods, like meats, edible oils and fruits and vegetables
  - Commodities as an investment vehicle

- **Supply side**
  - Arable land coming under pressure
  - Climate change affects production---higher production volatility and uncertainty
  - Aging of farmer population---rise in the average age of a farmer
… with increasing climatic uncertainties

CLIMATE CHANGE 2013 – The physical Science Basis. Summary for Policymakers – Working group contribution to the fifth assessment report of the intergovernmental panel on climate change
The expected benefits from Agricultural Finance

✓ Increasing production and growing income of farms and agricultural SMEs through access to better technologies and commercialization

✓ Increasing financial inclusion in rural areas and the agricultural sector; increasing access to finance through formal financial institutions

✓ Increasing resilience (risk management capacity) through climate smart production, risk diversification and access to financial tools (e.g. savings, insurance, contingent credit etc…)

✓ Smoothing the transition of non-commercial farmers out of agriculture and facilitating the consolidation of farms, assets and production (financing structural change)
Mapping Agricultural Finance

• **Range of Clients**
  ✓ Farmers, SME agribusiness, farmer organizations, etc.

• **Range of Financial Instruments** (or financial products)

• **Range of Institutions:**
  ✓ Financial and Non-financial, private and public

• **Range of Public Policies and Enabling Environment**
What are the various segments among farmers?

<table>
<thead>
<tr>
<th>Segment</th>
<th>Population estimates</th>
<th>Land size estimates</th>
<th>General crop mix</th>
<th>Engagement with markets</th>
<th>Indicative importance of agri-income in total income</th>
<th>Financial needs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Noncommercial smallholders</td>
<td>300 million smallholders 1.5 billion people in households</td>
<td>No land or less than one hectare</td>
<td>Staple crops</td>
<td>Very little, if any, engagement with any markets as a seller of food</td>
<td>Low</td>
<td>Commitment savings, Flexible cash-flow based loans, Investment loans, Catastrophic insurance, Payment systems</td>
</tr>
<tr>
<td>Commercial smallholders in loose value chains</td>
<td>165 million smallholders 825 million people in households</td>
<td>One to two hectares</td>
<td>Staple crops, Some cash crops</td>
<td>Reliable surplus of staple crops sold through relatively informal, local markets</td>
<td>Medium</td>
<td></td>
</tr>
<tr>
<td>Commercial smallholders in tight value chains</td>
<td>35 million smallholders 175 million people in households</td>
<td>At least two hectares</td>
<td>Cash crops</td>
<td>Cash crops sold in regional or export markets through contract farming</td>
<td>High</td>
<td></td>
</tr>
</tbody>
</table>

Source: CGAP
What are some of the financial products?

- Financial Institutions are reluctant to participate in the early stages of supply chains.
- Risks generally decrease as chains move forward.
What are the various institutions supplying agriculture finance?

- Private banks
- **State Banks and agriculture funds** (second-tier)
- **Cooperatives**:  
  ✓ financial cooperatives  
  ✓ agricultural cooperatives
- **Microfinance Institutions** (MFIs)
- **Finance companies**  
  ✓ leasing companies, non-bank financial institutions, factoring
- **Value Chain** providers:  
  ✓ Input suppliers  
  ✓ Processors  
  ✓ Aggregators  
  ✓ Traders
- **Informal** credit sources:  
  ✓ e.g. family, local money lenders, village level funds, etc.
Question: Who are the largest finance providers for smallholders in the developing countries?

- Agribusiness companies (inputs providers and buyers etc.)
- Governments and public programs
- Commercial banks
- Microfinance institutions
- Informal and community based financial institutions
## Sources of finance for agriculture

<table>
<thead>
<tr>
<th>Sources of Finance</th>
<th>Market shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Formal Financial Institutions</td>
<td>US$ 14 billion p.a. or 25%</td>
</tr>
<tr>
<td>Value Chain Actors</td>
<td>US$ 17 billion p.a. or 30%</td>
</tr>
<tr>
<td>Informal and Community Based Financial Institutions</td>
<td>US$ 25 billion p.a. or 45%</td>
</tr>
</tbody>
</table>

**Estimated Demand:** US$400-450 billion p.a.

Source: Dalberg (2016)
## Lending by formal financial institutions

<table>
<thead>
<tr>
<th>Sources</th>
<th>Estimated annual disbursements in US$ billion</th>
<th>% of total</th>
</tr>
</thead>
<tbody>
<tr>
<td>State/Agri banks</td>
<td>9</td>
<td>64.3%</td>
</tr>
<tr>
<td>MFIs</td>
<td>3</td>
<td>21.4%</td>
</tr>
<tr>
<td>Commercial banks</td>
<td>1</td>
<td>7.2%</td>
</tr>
<tr>
<td>Social lenders</td>
<td>0.4</td>
<td>3%</td>
</tr>
<tr>
<td>NGOs</td>
<td>0.03</td>
<td>0.2%</td>
</tr>
</tbody>
</table>

Source: Dalberg (2016)
How can Governments and Central Banks support agriculture finance in an effective manner?
Range of public policies affecting agricultural finance

### Legal and regulatory framework
- **Lending quotas** (priority sector lending)
- Interest rate caps
- Regulation of **bank branch** expansion
- **Prudential regulations** impacting agricultural lending (e.g. cash-flow based loans)
- **Warehouse receipt** financing frameworks and other relevant finance services
- **Alternative dispute mechanisms** for contract farming

### Financing and incentives
- Public banks and second-tier funds
- Lines of credit
- Matching grants
- **Subsidies** (interest rate, cash collateral)

### Capacity building
- **Supply** and demand side capacity-building
- TA to farmers
- TA to Financial Institutions
- **Financial literacy** programs
- TA to farmers and agri MSMEs to develop bankable projects

### Financial Infrastructure and Data
- **Financial infrastructure** (e.g. credit bureaus, moveable collateral registries)
- **Agriculture data** (e.g. yield, weather, price etc...)

### Risk Management
- Partial Credit Guarantees
- **Catastrophic risk** coverage
- Support to commercial **agricultural insurance**
- Support to **price risk** management
- **Loan restructuring** programs
Global trends around agricultural finance policy reforms

- **Clarify the objectives** of the agricultural finance policies
  ✓ usually within the context of agricultural development and financial sector development

- **Rationalize costs** by better targeting beneficiaries and activities that warrant public sector support.

- **Focus policies on “levers”** rather than direct interventions by the public sector to provide credit.
  ✓ **Risk management** in 3 key risk areas: production, market, credit
  ✓ **Reduce costs** for financial institutions doing business in agriculture, particularly small holder farmers
  ✓ Create an **improved enabling environment** for financing agriculture by focusing on stimulating both the demand and supply side
Successful public policies have the following features:

- Tailored to level of development of the financial and agricultural sectors
- Private sector leverage
- Link to agricultural sector policies and priorities
- Cater to the needs of various segments of agricultural clients:
  - Agribusiness MSMEs, commercial farmers, subsistence farmers, etc.
The World Bank’s agrifinance diagnostic tool helps governments define strategies aiming to strengthen agrifinance markets, by:

A. Carrying out a **detailed diagnostic** of demand and supply for agrifinance services as well as of existing public (and private) policies / programs

B. Proposing a **comprehensive action plan** and coordination mechanisms to:
   A. Reform public policies and institutions so that they do not distort markets;
   B. Implement market-friendly regulations and policies; and
   C. Strengthen suppliers and users of financial services

The diagnostic and action plan can be an **important contribution to the National Financial Inclusion Strategy**. (e.g. In Sudan, the diagnostic study is conducted to support the NFIS development)
Thank you!

Questions?