DEVELOPING & OPERATIONALIZING
NATIONAL FINANCIAL INCLUSION STRATEGIES
FOR THE DIGITAL ECONOMY
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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?

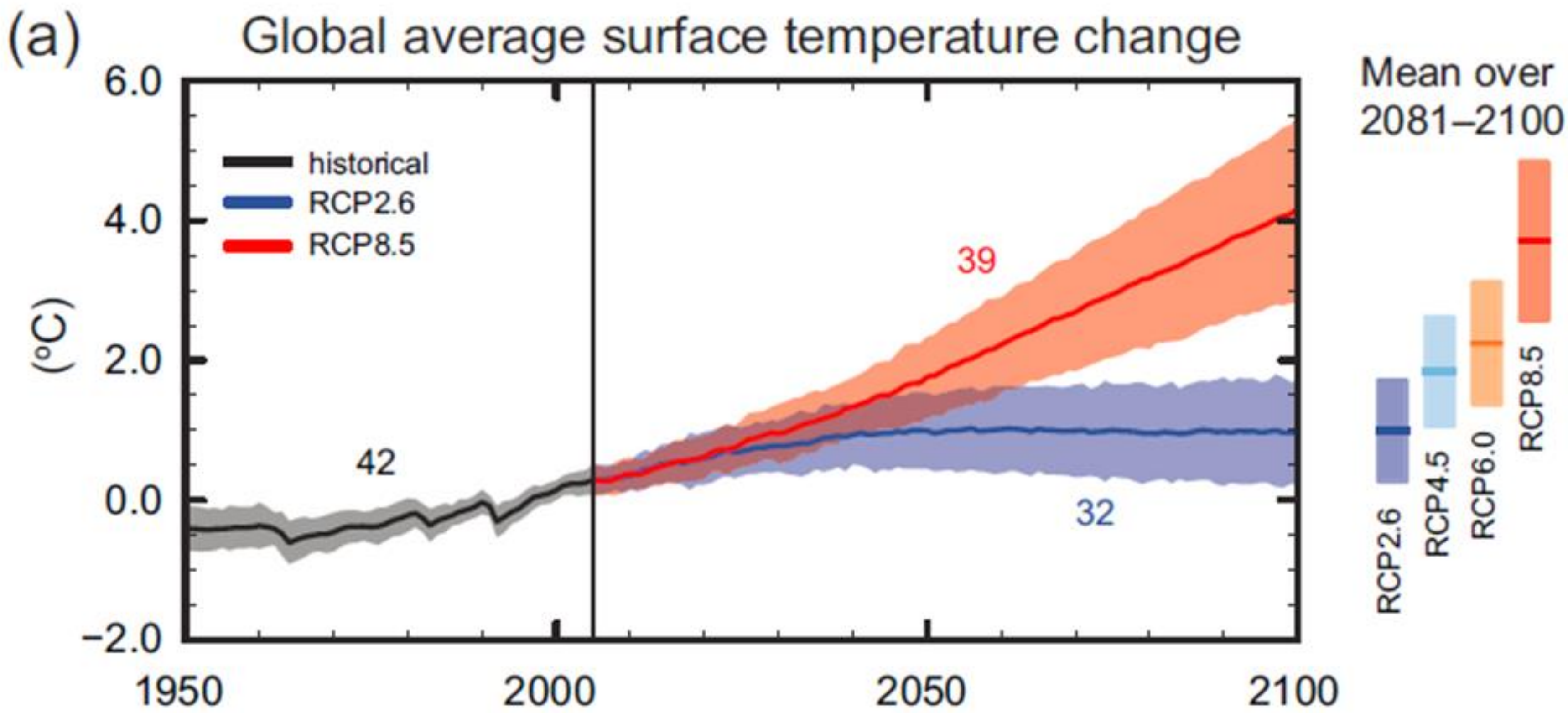
- Less than 10%
- About 1/3
- About 50%
- More than 80%

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**

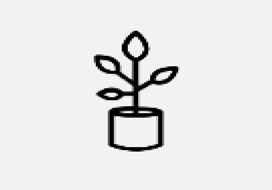
- **Supply side**
  - ✓ **Arable land** coming under pressure
  - ✓ **Climate change** affects production---higher production volatility and uncertainty
  - ✓ **Aging of farmer population-**--rise in the average age of a farmer

… with increasing climatic uncertainties

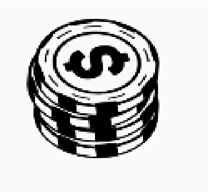


CLIMATE CHANGE 2013 – The physical Science Basis. Summary for Policymakers – Working group contribution to the fifth assessment report of the intergovernmental panel on climate change

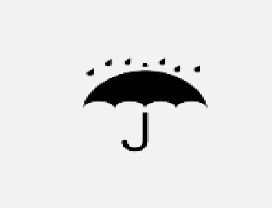
The expected benefits from Agricultural Finance



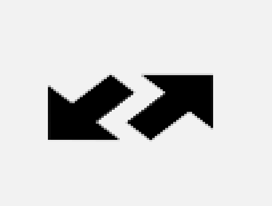
- ✓ **Increasing production and growing income of farms and agricultural SMEs** through access to better technologies and commercialization



- ✓ **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?

	Noncommercial smallholders	Commercial smallholders in loose value chains	Commercial smallholders in tight value chains
Population estimates	**300 million** smallholders 1.5 billion people in households	**165 million** smallholders 825 million people in households	**35 million** smallholders 175 million people in households
Land size estimates	No land or **less than one** hectare	**One to two** hectares	**At least two** hectares
General crop mix	**Staple** crops	Staple crops Some cash crops	**Cash crops** Relatively few staple crops
Engagement with markets	Very little, if any, engagement with any markets as a seller of food	**Reliable surplus of staple crops** sold through relatively informal, local markets	**Cash crops** sold in **regional or export** markets through **contract farming**
Indicative importance of agri-income in total income	**Low**	**Medium**	**High**

Source: CGAP

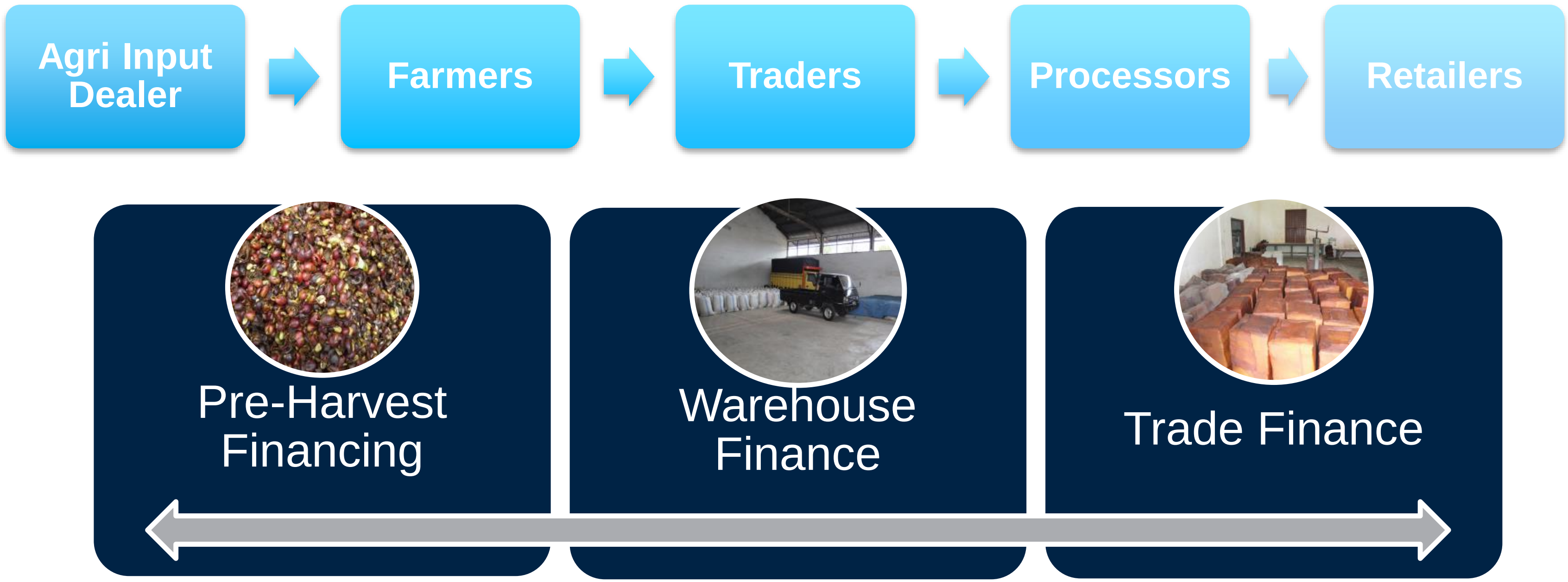
Financial needs

to support growth, resilience and smooth the transition out of agriculture

- *Commitment savings*
- *Flexible cash-flow based loans*
- *Investment loans*
- *Catastrophic insurance*
- *Payment systems*

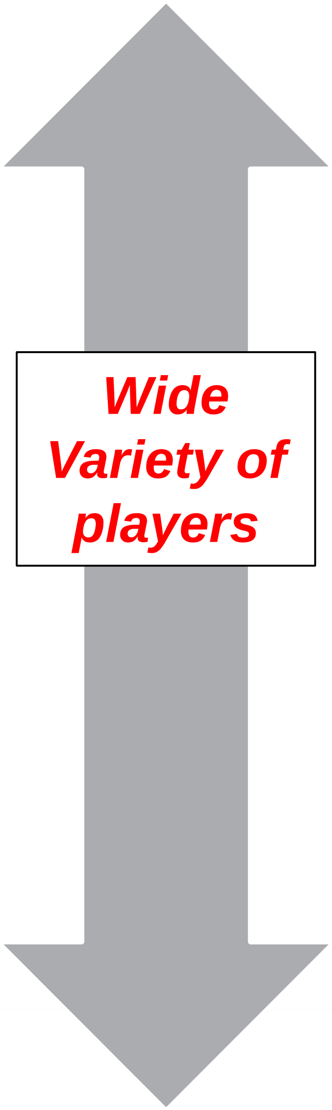
- ***Crop loans tied to agriculture cycle***
- ***Investment loans***
- ***Leasing/factoring***
- ***Value Chain Finance***
- ***Warehouse Receipts***
- ***Commercial insurance***
- ***Commodity exchanges***

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

Sources of Finance	Market shares
Formal Financial Institutions	US$ 14 billion p.a. or 25%
Value Chain Actors	US$ 17 billion p.a. or 30%
Informal and Community Based Financial Institutions	US$ 25 billion p.a. or 45%

Source: Dalberg (2016)

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

Lending by formal financial institutions

Sources	Estimated annual disbursements in US$ billion	% of total
State/Agri banks	9	64.3%
MFIs	3	21.4%
Commercial banks	1	7.2%
Social lenders	0.4	3%
NGOs	0.03	0.2%

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 (ex: 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

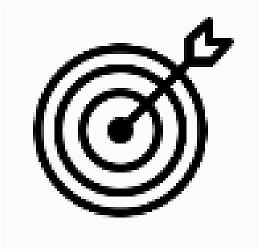
Financial Infrastructure and Data

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

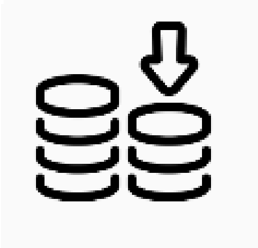
Risk Management

- **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



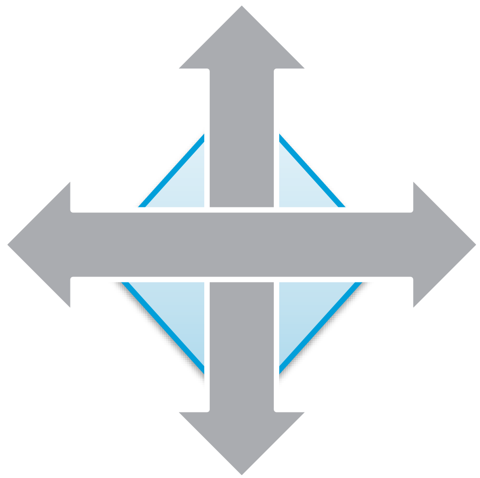
- **Rationalize costs** by better targeting beneficiaries and activities that warrant public sector support.

- **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?