

7. AN ASSESSMENT OF THE CHALLENGES FACING AGRICULTURAL FINANCE DELIVERY SYSTEMS AND PROSPECTS FOR IMPROVEMENT*

7.1 Introduction

This chapter assesses the challenges facing agricultural finance delivery in the aftermath of the Fast Track and the prospects for improving the situation. The chapter critiques the various finance schemes by both the public and private sectors, meant to assist new farmers in the acquisition of crop inputs (seeds, fertilisers and chemicals), livestock purchases and provision of irrigation infrastructure. The effectiveness of the schemes is assessed by examining the type of finance and the sustainability of the schemes i.e. the continued availability of the money for lending to other interested parties. The sustainability issue can be split into two parts: First, the 'right' cost of borrowing, which is a balance between what farmers can afford and the regeneration of the finances. It should also be a reflection of balanced commercial and development objectives. Second, the institutional capacity for the administration of the disbursement and collection of money is crucial. Ideally these issues should be captured in appropriate policies as well as rules and regulations.

Agricultural finance usually falls into time-related categories of short, medium and long term finance. Short-term finance is meant for working capital and ensures that the business maintains some level of liquidity. It is usually repayable in a year, at the end of the production season. It can be provided as cash where the farmer will make his/her own purchases, or in the form of inputs as was the case with government schemes reported here. Contract farming is a special form of short-term finance. It is a commercial arrangement between agro-processors/marketers and farmers. The agro-processor/marketer firstly establishes the required quantity and quality of produce for the economic utilisation of its plant, equipment and personnel. They then specify the level of support they will give to farmers, the catchment area where this will be done, and the conditions under which the exercise will operate.

Intimate knowledge of the potential of production areas and the calibre of farmers helps in processing loan applications, monitoring production and co-ordinating transport of produce. The advantages with agro-processors is that they can obtain inputs at a discount and achieve economies of scale during distribution. Commercial banks can partner agro-processors in financing farmers. Such an arrangement is perceived to be of low risk to the parties involved. This concept of finance delivery has tremendous scope for farmers without their own financial resources.

A sustainability issue of various loan facilities is , to a large extent, determined by the interest charged by any financial institution on borrowed funds. Ideally the repayments should reflect the loss of revenue accruing to it adequately to cover the opportunity cost of capital (i.e. the base rate), administration costs (higher for smaller loans), loss due to default (add a risk premium) and inflation.

The sustainability of agricultural finance delivery cannot be achieved without viable institutions. Institutions play a critical role as the intermediaries for the disbursement of the funds as well as collection of repayments. An institution providing financial intermediation services should:

- Develop its staff and operation systems for disbursement and repayment of loans;
- Ensure that loans are processed speedily and timeously, and preferably through decentralised structures;
- Put in place monitoring systems regarding utilisation of borrowed funds;
- Ensure collection of the borrowed money and, in extreme cases, resort to legal action; and
- Put in place client educational services, noting that reliance on fore-closure does not indicate a progressive lending policy.

The other aspect in which institutions are important relates to the setting up of the necessary policies, rules and regulations.

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This is predominantly a public sector responsibility. For example, the state can promote policies that allow complementarities between the private and public sectors in providing finance. However, even private implementing institutions should have their own internal mechanisms. This is one area that will be shown to be lacking in government loan schemes.

7.2 Sources of Agricultural Finance

This section discusses support offered to the agriculture industry by Government through its various agencies such as the Reserve Bank of Zimbabwe (RBZ), Grain Marketing Board (GMB) and Agricultural and Rural Development Authority (ARDA), as well as by the private sector.

7.2.1 Government contribution

Government financial support the agriculture industry has been in the form of direct budgetary allocations to the relevant ministries and departments, and support to input and capital assistance schemes.

With regard to the budgetary allocation, there has been significant restructuring in the Ministry of Lands, Agriculture and Rural Resettlement (MoLARR). Since the Fast Track programme, the existing departments have been reconstituted. A number of new departments were created, such as Lands, Resettlement and Technical Services, Agricultural Research and Extension Services (AREX), Agricultural Engineering (AE), and Livestock Production and Development (LPD). With 19 Directors, the Ministry has become top heavy. There is, however, no evidence that the larger number of personnel is translating into an efficiently-run ministry. In fact, in some cases, there is an argument for streamlining operations.

Allocations to Departments were increased by 101.78% between 2001 and 2002 and by 117.44% between 2002 and 2003. However, the rates of

increase were lower than the rates of inflation, which were 112.1% for 2001 and 198.9% in 2002.

A number of schemes covering financing of wheat, tobacco, livestock and irrigation were set up by the government to provide inputs and finance for newly resettled farmers (see Annex 1). The effectiveness of these is discussed in the next section.

7.2.2 Private Sector Finance

The private sector has developed new finance assistance schemes. The sector has also participated in various ways, including as investors in raising funds for Agro-bills, disbursing funds directly to farmers using existing arrangements and/or through Agrobills, as well as indirectly through agro-processors.

7.2.2.1 Agro-bills

Seventeen commercial banks participated in the meetings where agro-bills were conceptualised. A major proportion of funds for Agro-bills raised in November 2002 was by commercial banks. For example, Standard Chartered and Barclays Banks between them raised Z\$5 billion (of the total Z\$7.2 billion).

Syfrets Corporate and Merchant Bank (Sybank) was appointed as the lead issuing authority for Agro-bills and Agri-bonds. The target set for Agro-bills/Agri-bonds was Z\$60 billion, but just over Z\$7.2 billion was raised when the first offer closed. The sum raised was inadequate to meet farmers' requirements and the strategy adopted was to mobilise more resources through further issues. Later on, they proved popular because of a 75% return on investment. Consequently, a recent floatation of Agro-bills was oversubscribed, raising Z\$5 billion when the target was Z\$2 billion. The interest rate on the current bills is 75%, a rate considered rather punitive for farming, hence the low uptake. Only one financial institution has requested some funds from the current issue.

To fulfil its supervisory role, Syfrets got returns from participating institutions on a monthly basis detailing how much was disbursed and repaid, as well as the names of beneficiaries. The bills were intended for working capital purposes and were to be repaid in 270 days. Interest on Agro-bills is 30-43%.

A major criticism of the programme is that it was launched late-well into the season. Also, there were a number of policy gaps. For example, although they carried government guarantee, one government owned bank required applicants to provide additional surety to get a commitment amongst borrowers to repay. This was claimed to result in higher repayment rates. The other problem was that one company got 4 out of the 7 billion that was on offer because of lack of water- tight regulations to guide the disbursement process.

Across all sectors, 32 375 farmers were reported to have benefited from Agro-bills through banks and agro-processors. Most beneficiaries were from Manicaland and the three Mashonaland Provinces. It is hardly surprising that a few farmers from the Midlands and even less from Masvingo and Matabeleland benefited. By their design, Agro-bills were not appropriate for the farming systems of low rainfall areas (ranching) as they are repayable in nine months.

7.2.2.2 Overdraft facilities

Existing financial arrangements maintained by commercial banks include overdraft facilities and lease finance. Overdrafts were priced at commercial rates. Another requirement was security, insisted upon in order to provide a fallback as well as to meet the Reserve Bank provisioning requirement. Commercial banks disbursed varied amounts through this facility. This contributed up to 20% to total disbursements to the agricultural sector. The scheme has not been widely popular due to high interest rates. Minimum lending rates (MLR's) were recently revised upwards by all commercial banks to no less than 70% per annum.

Clients exceeding agreed overdraft limits have their interest rates revised upwards to as much as 102% . Banking industry executives are of the view that the upper interest rate threshold for farming loans should be 50%. Agribank is of the view that money sought from the money market should be complemented with disbursements from the government to come up with an acceptable blend cost (interest rate).

7.2.2.3 Lease finance

Four institutions are offering lease facilities to farmers or equipment. The facilities are, again not very popular because of the high interest rates (over 100%) and the high value of assets (the latter is continuously being revised upwards due to inflation). Moreover, farmers are required to put deposits of varying proportions to the value of the leased asset. A major financial institution offering the facility requires leasees to raise 30% of the total value of the asset as a deposit. The leasee is given an option to buy the asset in 3 to 5 years with ownership of the asset transferred when full payment is made.

7.2.2.4 Agro-processors

Most funding earmarked for agro-processors was from Agro-bills, notwithstanding the fact that Agro-bills were intended to augment planned financing arrangements. Amongst agro-processors that assisted new farmers were FSI Agricom, Cottco, DZL, ARDA, Irvine's, Seedco, Ingwebu Breweries and Delta Corporation (Chibuku Breweries). Each agro-processor drew up a contract between itself and its farmers. The contracts differ with a number of them quoting different producer prices of maize, a controlled commodity.

A total of Z\$11 billion was provided by commercial banks to agro-processors. Disbursement of money through agro-processors was considered to be a prudent risk management strategy in addition to reducing transaction costs. Agro-processors have a

strong presence on the ground and are informed of the potential for different enterprises in various parts of the country. Agro-processing companies provide extension services, monitor farmers and assist with produce marketing. Such strategies can result in higher repayment rates.

Commercial banks are of the view that channelling assistance through agro-processors is as an interim measure. They envisage successful farmers being weaned over time to be able to access finance directly.

7.2.2.5 Special Commercial Bank Schemes

The schemes range from those supporting specific strategic enterprises in given geographical areas to those targeting high investment/high turnover farming ventures.

7.2.3 Factors affecting finance delivery

There are a number of factors, relating to the FTLRP and the environment in which it has taken place that affect the delivery of finance. These are discussed below:

- **Institutional linkages:** By and large the various financial assistance schemes outlined above are not centrally co-ordinated. Liaison between institutions is not compulsory even amongst government input schemes.

The position of ARDA as both a beneficiary and administrator of government assistance schemes requires close scrutiny. As at June 2002, ARDA had been 'allocated' 15.58% of the Irrigation Support Fund. This was the third highest allocation, with six provinces getting less than 10% each and one province receiving nothing at all. A preferable arrangement would have been a non-interested party assessing the applications and administering the Fund.

There has also been inequity of distribution across geographical areas. For example, agro-processors funded specific commodities and confined their activities to specific, high-potential geographical areas (Manicaland and Mashonaland Provinces). Farmers settled in primarily ranching areas had little financial support. Almost all finance was for seasonal requirements.

- **Competence of farmers:** Most applicants for financial assistance (project proposals, gross margin budgets, cash flow projections) made by newly resettled farmers have not been satisfactorily prepared. Up to 20% of former large scale commercial farmers needed assistance in preparing proposals for funding and commercial banks are of the view that as many as 80% of applications by new farmers are falling short of acceptable standards.

7.3 Assessment of government schemes

7.3.1 Recommendations

The specific recommendations that are discussed below hinge on macroeconomic stabilisation, especially interest rates and inflation.

7.3.2 Need for co-ordination

The Central Bank, and the Ministries of Finance and Agriculture should formulate comprehensive strategies on agricultural finance.

7.3.3 Institutions

7.3.3.1 The Land Bank

Critical to the success of the land reform programme is the expeditious establishment of a Land Bank, as well as adequately capitalising it to meet short, medium and long term finance needs for all major enterprises and across all agro-ecological regions.

Once the Land Bank is established, 3 things should happen. The RBZ should redirect some of the finance it has been providing through commercial banks to the Land Bank, loan portfolios of government schemes should be transferred to the Land Bank, and the repayments from different farmer assistance schemes will form the seed capital for the Land Bank.

7.3.3.2 Public-private sector partnership

In view of the high demand for finance, public-private sector partnerships need to be promoted. For example, commercial banks and agro-processors could finance farmers under commercial arrangements with funds made available on the basis of competency and yield prospects. Commercial banks have confirmed that they can provide funding to new farmers with no title deeds provided the projects are viable, the farmers agree to market produce through agreed channels and there is some measure of security.

7.3.4 Financial gearing

There is a need for financial gearing in the agriculture sector. The following are some of the options that exist for funding agriculture:

- All existing government credit schemes could be collapsed into the Land Bank. The GoZ has to institute an audit (technical and financial) for each fund before hand-over to the Land Bank and all funds disbursed have to be accounted for.
- Government could make inputs available to A1 farmers through agro-processors and vouchers redeemable through approved agro-dealers. A2 farmers not yet established are better financed through the proposed Land Bank with payments made direct to providers of goods and services. The number of seasons for which new farmers are allowed to access low interest finance from the Land Bank needs to be specified,

- Relative contributions by the public and private sector could be varied by enterprise. With food crops (cereals, beef, dairy), the government could have provided 50% of the required finance. For A1 farmers, disbursement could have been best handled as vouchers redeemable through agro-dealers. 70 to 100% of the costs of financing industrial and export crops could be provided by the private sector. Discussions between the government and the private sector on sharing financing for various enterprises should be preceded by a review of some policies (e.g. pricing of outputs and processed goods, marketing arrangements – especially the role of GMB, scope of private sector to export agricultural products, the exchange rate, etc).
- Money could be obtained from the market and blended with very low or no interest to money provided by the GoZ through the RBZ.
- Low interest finance could be availed to farmers in formative years, particularly for infrastructure developments. As balance sheets strengthen through farmers redeeming their loans, they should be weaned off to access finance from commercial banks. In discussions with bankers, it was established that new farmers could sustain interest rates of up to 50% for seasonal requirements and no more than 20% for capital investments, including ranching.
- Distinct commercial and development divisions should be set up in the proposed Land Bank. Farmers could borrow from the development unit at concessionary interest rates in earlier years, after which they would be directed to the commercial division where borrowing will be on the strength of balance sheets under market interest rates. The profit margins from the commercial unit could be used to partly subsidise the development division. Lending to small agriculture units is however done at little or no profit.

- Extensive livestock production areas deserve special consideration. Consolidation of farms may be necessary, as viable breeding herds cannot be supported on current average farm sizes (see Technical Paper No. 1). Significant investment in fencing, stock watering, dipping facilities and purchase of breeding stock is required. Special finance schemes should be made available.