

Concept Paper



Financial Services for Agricultural Development

**A Concept Paper under the
Economic Regeneration Programme
National Agriculture Development Framework**

Ministry of Agriculture, Irrigation and Livestock

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MAIL Concept note

Background:

Improving farmers', traders' and agribusinesses' access to credit is essential to accelerate growth in the agriculture sector. This is especially true for those farmers whose crop is produced on a seasonal basis or the products that take several years to reach maturity (horticulture and livestock products). To date, several financial institutions and projects are providing specific credit services such as: micro finance, small and medium enterprises (SME), construction, working capital, equipment, trade, equity, loan guarantees, equity and market information. However, access to credit for the agriculture sector remains limited.

It is essential to develop a range of financial services adapted to the needs of farmers, from small to large-scale, as well as investors, processors and traders. MAIL is committed to ensuring that women producer groups and entrepreneurs can access the credit they require as well as men. Credit facilities should also be developed to suit the needs of the Kuchi.

Current challenges associated with microfinance.

IFAD estimates that around 3.5 million clients are still un-served by the micro-finance sector. According to IFAD's Rural Microfinance and Livestock Support Programme (RMLSP) Appraisal Report, "the microfinance sector does not currently provide a broad range of financial services, such as loans designed specially for agriculture or livestock; there is lack of savings services; there are limited insurance products; and little has been done to develop Islamic modes of financing. (...) The IFAD appraisal team, and senior staff of MAIL, are concerned about the effect of current high rates of interest in the microfinance sector, now about 18% flat rate. There seems to be little prospect of reducing these rates until the sector achieves maturity, higher volumes, and more efficient MFIs, thus reducing lending costs."

Credit requirements for middle and large-scale farmers and SME's.

Microfinance schemes would only cover part of the needs for agricultural credit. According to the Master Plan: "while small scale farmers (with less than one hectare of land) and landless livestock producers will potentially be covered by micro finance services, the middle scale farmers who produce 80 to 90% of agriculture output probably has the largest need for credit. The middle scale farmers (who own one hectare to approximately 50 hectares of irrigated land and represent around 60% of all holders of irrigated land) are asking for a credit system designed to serve their needs. Middle level farmers are the backbone for sustainable growth in agriculture but they are by and large without financial services at present." Furthermore, according to the ADB TA 4696 Financial Markets report (completed in February 2007), "large farmers (with more than 50 hectares of irrigated lands) represent 1% of farmers but have 15% of irrigated lands thus are heavily involved in aggregate production. It is widely believed that large farmers can rely on commercial banks for credit but this is still unlikely at present since commercial banks have hardly expanded beyond Kabul and not yet covering the needs of the agriculture commodity exporters."¹

Credit requirements by agricultural sector

The ADB Report also specifies that: "Farms producing and selling horticulture and livestock products in large quantities tend to have greater requirements for finance than units producing traditional cereal crops. Likewise, the processing sector is far larger than these high value crops and in turn requires large volumes of credit, a need exacerbated by the need for export credits."

The role of MAIL in facilitating access to credit for agricultural development

MAIL does not foresee involvement in developing financial structures and directly providing credit or loans to farmers, but rather providing technical assistance in the development of credit products, and assisting credit institutions in mobilizing funds to meet the needs of the agricultural sector. This is in

¹ ADB TA 4696-AFG Financial Markets Report.

line with the conclusions of the ADB Financial Markets Reports: “The recommendation is for MAIL to maximize the potential of existing credit delivery mechanisms provided by institutions that are currently lending and have the capacity to expand.”¹

MAIL and its partners, in cooperation with a number of banks and other credit institutions, are exploring modalities for making credit available in the agriculture sector, not only to rural producers but also to investors with an interest in developing the product value chains “from stable to table.” This work needs to be continued, strengthened and expanded considerably to meet the needs of the agricultural sector, as outlined in MAIL’s sub-programme on Financial Services for Agricultural Development, under the Economic Regeneration Programme.

Project objectives

The **objective** of MAIL’s Sub-Programme on Financial Services for Agricultural Development is: *To facilitate the development and promotion of a viable, adequately responsive and sustainable institutionalized farm credit system in response to the growing needs of the farmers, traders and agro-industry in collaboration with relevant ministries, private sector and donor community.*

The presently proposed project will contribute to the overall objective stated above by focusing on two of the sub-programme’s components, namely:

1. Research and development of loan/credit products adapted to farmer and agribusiness needs
2. Expansion of credit available for agricultural development (in particular microfinance and financial services for SMEs), in partnership with MISFA, AREDP and relevant credit institutions

The project’s **specific objectives** are therefore to:

1. To contribute to the development of a broader range of credit products and financial services adapted to farmer and agribusiness needs, in collaboration with relevant credit providers and government agencies
2. To expand the credit available for SME lending to agribusinesses

Activities

The activities and scope of work required to achieve each objective is described below:

i. Research and development of credit products adapted to farmer and agribusiness needs

MAIL will contribute to the research and development effort undertaken by several institutions (in particular MISFA and associated MFI’s, AREDP, and other credit institutions, etc.) to develop a range of loan/credit products that addresses the needs of small, medium and large farmers and agribusinesses, including women and kuchi, paying specific attention to the stratification of the production systems and the varying needs for credit.

The financial products and schemes to be explored include:

- Shariah-compliant credit products (for microfinance and larger loans)
- Microfinance products adapted to farmers’ and processors’ needs (including women)
- Microfinance products adapted to kuchi’s needs
- Credit schemes for SMEs in the agricultural sector (including producer organisations, cooperatives, processing enterprises, etc.)
- Insurance schemes
- Savings schemes
- Private Sector Agriculture Equipment Lease arrangements to assist agribusinesses in upgrading or replacing required agriculture equipment (e.g. seed drills, cold storage facilities and refrigerated trucks etc.). Such arrangements could target in particular technologies and

¹ ADB TA 4696-AFG Financial Markets Report.

equipment that will optimize water use, soil preparation, high-value crop production, and reduce post-harvest losses (e.g. laser land levelling to enhance efficiency of water use; drip irrigation; large pivot sprinklers, etc.)

- Development of Working Capital for the purchase of raw material products for sale
- Development of Warehouse Receipts⁴ products that include grain, fresh and dried fruit, vegetables and wool.

These schemes will be developed with existing institutions in order to enhance their capacity and efficiency and allow economies of scale to take place which would help bring interest rates down. This also entails taking a concerted step-by-step approach to product development, adapted to the absorption capacity of existing financial institutions, to avoid over-stretching these agencies and losing quality in the implementation.

A number of projects are already contributing to research and development on credit. Through the RMLSP, IFAD is providing MISFA with around \$9 million to develop a range of microfinance schemes, in particular adapted to the needs of the livestock sector. AREDP will also mobilize resources to work with MISFA on developing new rural finance products. Other organisations contributing to / involved in rural finance product development include the Afghanistan Rural Finance Corporation, the Afghanistan Growth Finance, and ASMED. However, these programmes still only cover part of the credit needs for the agricultural sector. Furthermore, specific agricultural expertise is required to participate in current and planned research and development efforts. Finally, there is a need to build the capacity of MAIL to inform product development and advocate for farmers' and agribusinesses' needs to be addressed. In particular, MAIL can play a supportive coordinating role between the various initiatives to ensure they are streamlined and build on all available expertise and resources.

In order to address these issues, the following activities will be implemented:

- Establishment of, and facilitation of, a Technical Working Group on Financial Services for Agricultural Development Credit, including MISFA, AREDP, AICF, and other institutions engaged in such activities. The tasks of this working group will include:
 - a) sharing information on relevant studies and pilots
 - b) pooling resources and expertise to fill any research gaps identified;
 - c) capitalizing on lessons learnt through the research and developing recommendations for policy and strategies related to agricultural credit;
 - d) mobilizing resources to expand appropriate credit schemes for agricultural development.
- In collaboration with other members of the Technical Working Group, identify information gaps, for which agricultural expertise is required and which MAIL can address.
- In line with the identified gaps, conduct research, in particular value chain analyses, market studies and feasibility studies to inform the development of specific credit products, according to various agricultural subject matters. And/or provide technical expertise to the agencies conducting such studies.
- In collaboration with relevant institutions, conduct, or provide technical assistance to, pilots designed to test the feasibility and replicability of selected credit products.
- Inform policy and the development of legal frameworks related to financial services for agricultural development, based on the research and pilot results, in collaboration with relevant agencies and Ministries (e.g. Finance, Economy and MRRD)
- Capacity-building of relevant MAIL staff, as well as other partners, will be an integral part of all activities, through on-the-job learning, regular in-country trainings and study tours.

⁴ Warehouse receipt financing is the use of securely secured goods as loan collateral. These programs allow producers to deposit a finished good or agricultural product in a secure warehouse where the producer receives a receipt certifying the deposit of goods or a particular quantity, quality and grade. The farmer can use the receipt as portable collateral to request for a loan from a financial institution.

ii. Expansion of credit availability for agricultural development

In addition to developing new products, there is a need to expand the coverage of existing products, and future products once they are developed. This entails mobilizing additional funds to be made available through credit institutions, and building the capacity of financial institutions for them to expand their coverage, and build their financial sustainability. For example, the ADB Rural Business Support Programme plans to provide \$2,1 million to MISFA to expand microfinance available for rural development.

Credit availability for middle-scale farmers and SME's is of crucial importance given their key role in production and agribusiness development and employment creation. Currently, MISFA runs a "SME window" with support of the USAID-funded ARIES programme. However, this funding is coming to an end, therefore further on-lending funds would be required to build on the success of this program and to provide resources specifically targeted towards the SME agriculture sector as none are currently available via the SME window nor generally within the guidelines of the ARTF funding.

In addition to increasing the amount of available funds, there is a need to ease the fund transfer process, by reducing the number of intermediaries between the donor and MFI's or relevant credit institutions, the transaction costs, and the time required for fund transfer.

MAIL will therefore work in collaboration with relevant credit institutions, in particular MISFA, on the following activities:

- Mobilization of donor funding and private sector funds to be made available to relevant credit institutions, so as to support agribusiness development effectively. The results of the research and development work carried out under component (i) will inform the allocation of funds.
- Identification and implementation of mechanisms to limit the transaction costs and time required for fund transfer between the main donor and the credit providers.

Implementation strategy

The project will be supported by a technical assistance team, which will work with MAIL's Private Sector Development Project, under the supervision of MAIL's Programme Implementation and Coordination Entity.

Project activities will be designed and implemented so as to complement and support ongoing work, mainly by playing an important coordination and facilitation role, and by providing relevant technical expertise and information as required. All activities will be implemented in close collaboration with other Technical Working Group partners (e.g. MISFA and its partners, AREDP, AICF, ASMED, ARFC, and AGF) and relevant ministries, namely Ministry of Finance and Ministry of Commerce. The project team will also ensure linkages are made between relevant agricultural development projects and credit providers.

Capacity-building of MAIL's Private Sector Department and other relevant partners will be an integral part of all activities. The mobilization of funds to expand credit opportunities for SMEs will be done in close collaboration with MISFA, through joint advocacy to donors and relevant institutions and proposal preparation.

Inputs / resources required for 3 years

Input	Amount required USD
Technical assistance (international and national)	800000
Trainings & workshops	100000
Equipment	50000
Research for product development	1000000
Travel	144000
Operational support (10%)	209400
TOTAL costs	2,303,400