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**Models of Financing Smallholder Farmers to
Trigger Agricultural Transformation on An
Innovation Platform**

Adekunle AA, Nyikahadzoi K and Warinda P

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Corresponding Author

Adewale Adekunle (w.adekunle@gmail.com)

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Forum for Agricultural Research in Africa (FARA)

12 Anmeda Street, Roman Ridge PMB CT 173, Accra, Ghana Tel: +233 302 772823 / 302 779421 Fax: +233 302 773676 Email: info@faraafrica.org Website: www.faraafrica.org

Editorials

Dr. Fatunbi A.O (ofatunbi@faraafrica.org) and Mr. Benjamin Abugri (babugri@faraafrica.org)

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ABSTRACT

Sub Saharan Africa smallholder farmers are caught up in a vicious cycle of poverty with low output, low incomes, low savings and low investments and have no form of economic activity, which could enable them to make meaningful savings. For smallholder farmers to be effective suppliers of agricultural commodities, it is important to find means of financing the sector. However, Smallholders' lack of access to land ownership deprived many smallholders of the collateral required to mobilise finances. Under these circumstances, lenders shun advancing credit to smallholders, as there is no guarantee to get their return from long-term credit. Where smallholder possess of title the land markets are not well developed to guarantee lenders to convert lands assets into financial assets. In this paper we propose that players in Innovation Platforms can assist smallholder by (a) the promotion of social lenders whose motive is to improve livelihoods and environmental stewardship through better access to finance in the value chain; (b) the promotion of accumulated savings and credit groups where the members (smallholders) of the groups are both owners and users of the facility. (c) assisting smallholder farmers to tap into existing innovative credit facilities provided by governments and/or the central bank and (d) the creation of points of aggregation in the value chain such as warehouse, procurement networks and input providers where farmers can access credit. At the end of the season, the smallholders would then pay back the loan.

Keywords: Innovation Platform, Smallholder farmers, credit, agricultural development

INTRODUCTION

The Challenge Program adopted the Integrated Agricultural Research for Development (IAR4D) to improve agricultural productivity and household income among smallholder farmers. Integrated Agricultural Research for Development uses Innovation Platforms to foster social interaction and learning by embedding agricultural research within a larger system of innovation whereby knowledge from numerous sources is integrated and effectively put into use. Innovation Platforms brings together a range of stakeholders interested in the creation of new knowledge in an area of common interest. The stakeholders involved should have complementary capabilities which, when combined, will allow the new knowledge created in the innovation process to be brought to scale (Hall, 2005). Some of the key capabilities required are in implementation, regulation, policy and legislation, research and learning, and documentation and dissemination. Players in Innovation Platforms include public sector (e.g. line ministries, research institutes), private sector (e.g. agro-processors, marketers and financial services), and civil society players (e.g. NGOs, and unions, advocacy organizations) and the beneficiary communities.

Situating research in a wide set of relationships places it closer to all organisations that need to respond to changing production conditions, market fluctuations and trends, and changing

policy and regulatory environments. Such networks can provide access to such information regarding changing contexts and possible future state of policies markets and technology at the least cost. According to Hall (2005), embedding research in a system of innovation recognises that it is not just knowledge inputs that are missing, but also the processes necessary to make knowledge available and to enable its use are also missing.

Innovation Platforms involve stakeholders that pursue different economic and social agendas. These stakeholders have different philosophies and approaches of working towards achieving their organisational visions. It is therefore important to create incentive structures and provide the necessary resources and policy framework that fosters stakeholders with varying values systems to drive the process of priority setting implementing procedure and progress evaluation. Different stakeholders would require different incentive structures and resource to fully subscribe and participate fully and effectively in innovation platform activities.

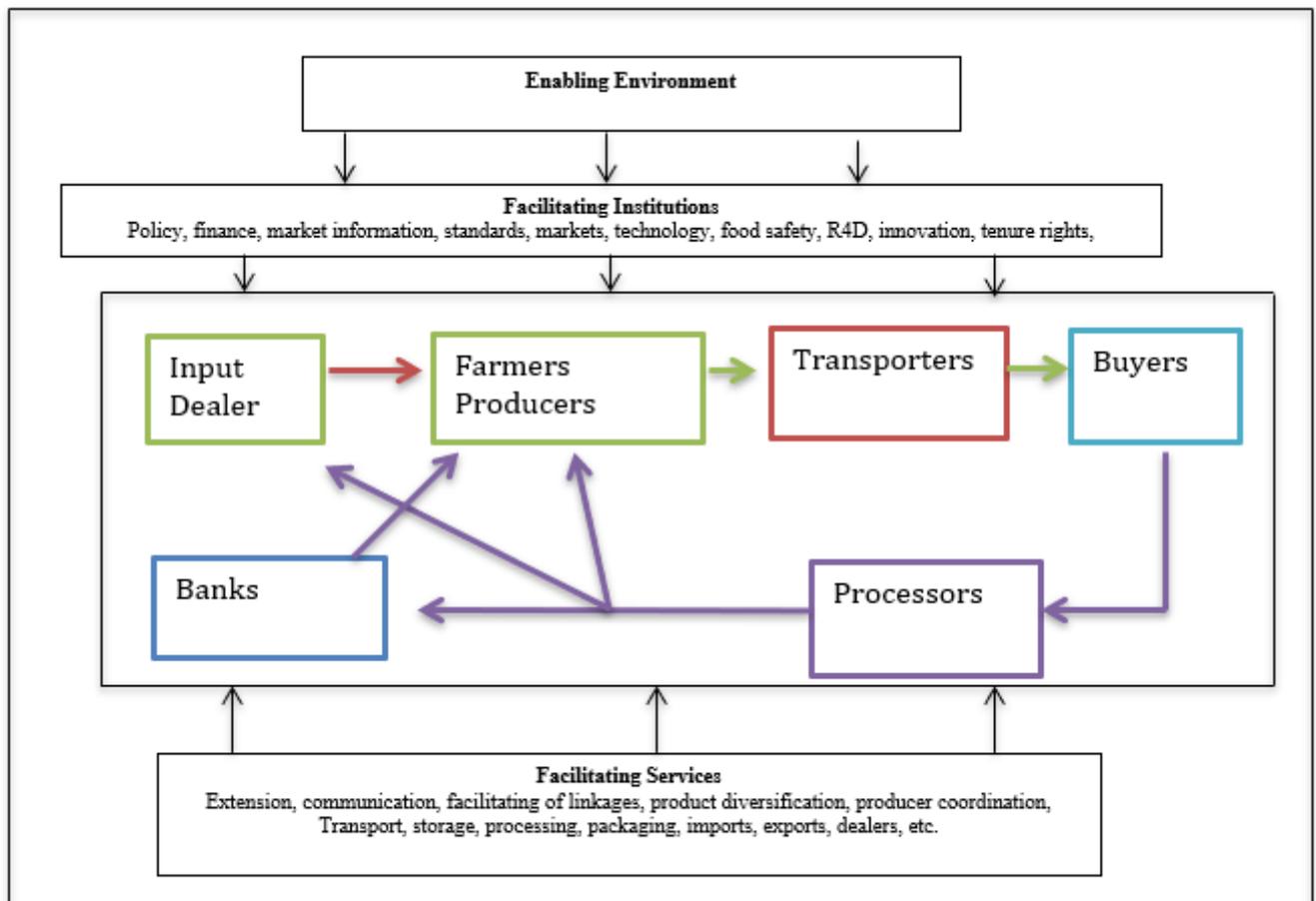
Private sector players are typically more conscious or critical of nominally unproductive activities, and thus often might be difficult to engage with. As long as the IP activities guarantee that the private sectors' profit motive is addressed, their participation will also be guaranteed. As long as the IP continues to act like a goose that lay the golden eggs, private sector actors are likely to actively participate in IP activities. Public sector and civil society organizations tend to be more readily available to attend stakeholder or participatory meetings as long as the activities of IP are within their mandate. In many cases, the participation of public sector actors in IP activities is funded through the national budget. Smallholders are driven by the desire to meet their household food, nutrition and income security.

In order to participate and benefit from the innovation platform activities, smallholders would require financial resources to buy inputs and services. Financing agricultural production is a huge challenge within most Sub Saharan Africa. Smallholders have small landholdings and therefore cannot produce enough surpluses for sale. Their inability to produce larger volumes of crops means that they receive much lower prices from traders who would pay for bigger quantities. Consequently, most Sub Saharan Africa smallholder farmers are caught up in a vicious cycle of poverty with low output, low incomes, low savings and low investments. In many countries, smallholders are excluded from ownership of means of production and have no form of economic activity, which could enable them to make meaningful savings. For smallholder farmers to be effective suppliers of agricultural commodities, it is important to find means of financing the sector.

A lot of scholarly work has gone into understanding the functioning and impact of integrated research for development (Nyikahadzoi et al 2012). However, very little work has been done focusing on financing smallholder farmers. Financing the smallholder farming system opens up greater opportunities for the acquisition of inputs (Stringfellow et al. 2012). It also helps in developing downstream and upstream value chains and catalyses the growth of the smallholder farming systems and set farmers on the path out of poverty (Hillenkamp et al

2014). Figure 1 shows an ideal system of financing smallholder farmers in an Innovation Platform. Nevertheless, smallholder farmers face numerous challenges in accessing finances.

Ideal functioning of Innovation Platform



EXPERIENCES OF SMALLHOLDER IN ACCESSING CREDIT

Smallholders face a number of challenges when they want to access credit finance. Bruce et al (1994) argue that the lack of access to land ownership deprived many smallholders of the collateral required to mobilise finances. In most countries, smallholders have insecure tenure rights to land. This compromises the creditworthiness of their agricultural projects and reduces land's collateral value (Bruce et al 1994). Under these circumstances, lenders shun advancing credit to smallholders, as there is no guarantee to get their return from long-term credit.

However, possession of title is a necessary but not sufficient condition to induce credit expansion. In most developing countries, land markets are not well developed to guarantee lenders to convert lands assets into financial assets. According to Place, Roth and Hazel (1993), unless lenders can convert land assets into financial assets through land transfers, land title would not guarantee access to credit. Even in situations where farmers have title to their land, usury laws prevent lenders from raising interest to mobilise capital (Migot Adholla and Bruce, 1994). Poorly developed financial systems may result in exorbitant administrative charges and poor delivery of credit to rural areas (Stringfellow et al. 2012).

The smallholder financing markets is at infancy and is underdeveloped, fragmented and undercapitalised. Roth, Cochraine and Mugerwa (1993) note that some farmers fear debt from formal credit institutions. They fear to lose their collateral, especially land.

Empirical evidence has also shown that the loan repayment rate among smallholder farmers is very low. This makes formal lenders perceive lending to the agricultural sector as a higher risk with low expected returns. Therefore, without access to credit, many smallholders are confined to suboptimal inputs and methods and therefore low productivity, Bruce et al 1994. Unless smallholders can continuously bring their products to the markets, the innovation platform risks collapse. It is important therefore to develop smallholder-financing models in order to stimulate sustainable production. The purpose of this paper is to discuss the various options of advancing credit to smallholder farmers. The study is based on experiences from other best practices of financing smallholders. The paper then tries to suggest how Innovation Platforms assist smallholders to take advantage of credit systems that are already there.

MODELS OF FINANCING FARMERS IN AN INNOVATION PLATFORM

As discussed earlier, smallholders lack access to resources necessary to optimise production. Such resources include high performing seed varieties, fertilisers, irrigation and other equipment. Working from the point that Innovation Platforms will be used, we propose some models for consideration.

Social lending model

The Sub Saharan Africa Challenge Programme innovation concept is premised on increasing productivity in response to market pull on the spine of sound natural resources management. Social lending popular among cash crop production systems can be one option of financing smallholders in an innovation platform. The social lenders generally accept lower market return in exchange for social and environmental sustainability. Their motive is to improve livelihoods and environmental stewardship through better access to finance in the value chain. Social lenders focus on producer organisations and other value chain or IP actors.

With little collateral or credit history, the risks of social lending are higher than those of commercial lenders. However, social lenders tend to reduce their risks through rigorous credit due diligence, complemented by financial capacity building for the clients. To manage the risks, social lenders use a purchase contract with the buyer as a form of collateral. Repayment of the loan is sent directly from the buyer to the social lender after the product has been delivered. In an innovation platform, social lenders can work in tandem with technical assistance providers from academic research institution and extensionists, that conduct training on financial literacy, certification and farming methods. The model has

worked well with the cash crop produced for export markets. In this regard, the IP helps in reducing social lender's risk by ensuring that farmers use update agronomic practices and appropriate inputs to produce the required quantity and quality demanded by the buyer.

Advance credit through Accumulated Savings and Credit Groups

Accumulated savings and credit groups are common among many smallholder farmers in sub-Saharan Africa. Members of the groups are both owners and users of the facility. The social fund provides credit to its members when they experience social and economic shocks (<http://www.cfsp.org/node/599>). Over the years of operating, the groups have perfected strategies of ensuring that loans are timely serviced. Large financial intermediaries can take advantage of the organisational arrangements of the accumulated savings and credit groups to channel excess loanable funds to smallholder farmers. The fact that members have intimate knowledge of each other and have experience of enforcing loan recovery system is likely to reduce the risk of defaulting.

Tapping into existing innovative credit facilities

Innovation Platform actors derive their benefits from smallholders' farmers. It is in their own private interest also to assist the farmers in tapping into credit facilities designed for other national strategies. In most cases, this could include risk-sharing mechanism, which uses public sector resources to leverage private sector investment and increase commercial lending to agriculture. This could be done in a number of ways including:

Regulation mechanism is asset allocation and pricing by working through the Central Bank requiring Commercial Banks set multiple pricing structures for their portfolio by the cost of fund. In some countries, eg Gambia etc the matching grant mechanism is used to lower cost finance and leverage additional private sector investment to agriculture. Through regulation IP, particularly at the national level, can influence the asset allocation distribution of banks to set aside a certain percentage and dedicated for agricultural lending.

Innovative financing mechanisms for youth and women 'Agripreneurs'

This approach is common in most Sub Saharan Africa as an initiative to empower young people with the right skills, improved access to credit and an enabling environment, so they can contribute to agricultural transformation and job creation. This mechanism identifies trained youth having gone through rigorous training curricula and graduated to benefit from a revolving fund managed by the bank.

A Replica Fund

A Replica Fund could be set up dedicated for agricultural lending at the level of the Central Bank to support and guarantee lending to the sector by Commercial Banks. The seed money for such a Fund could be sourced from unclaimed deposits lying in the vaults of banks. Participating Commercial banks could be asked to allocate a portion of their portfolio as matching funds to that of the Fund for direct lending and/or guarantee. Philanthropists and the Business community can help capitalize the Fund through their Social Corporate Responsibility Windows. The Fund may also be managed by a special fund for agricultural development.

Warehouse receipt lending/Guarantee

Non-aggregated smallholders fail to satisfy collateral and credit historical worth requirements. They pose high transaction costs, which include the cost of originating, managing and collecting small loans for a large number of dispersed farmers. Financing for smallholders can be channelled through points of aggregation in the value chain such as warehouse, procurement networks and input providers. This works by using grains deposited in specified warehouses as collateral for granted loans. Typically, the warehouses could be operated either by the Government or by interested Private Sector players or both in partnership. Grains are taken from farmers as deposits against the loans they want to take. Grains are taken from surplus farmers and distributed to deficit farmers on loan or grains are purchase and sold and profits used as price stabilization for future purchases. At the end of the season, the smallholders have an option to pay back the loan, withdraw the crop and sell it to another buyer or to sell to the warehouse buyer.

Financing to inputs and output dealers

One option of facilitating advancing credit to smallholders is through ICT platforms. The crux of this policy is to facilitate farmers' access to inputs and outputs markets through a subsidy mechanism driven by the private sector. The E-Farmers registrations can assist this process and ensure success by eliminating elite capture of subsidies through the vetting and registration process. The e-Farmer Registration is a holistic digital ICT platform to link farmers and agri-traders in the supply and distribution of agricultural inputs supply chain as well as finance and marketing of inputs and farm produce. This structure will help reduce information asymmetries and transaction costs associated with financing the agriculture sector. Dealers either compete through the auction process as agents of government in the distribution and selling of donated inputs and equipment or access bank line of credit to facilitate direct financing of the operation of the agric-business. The e-Farmer subsidy

mechanism helps in the proper beneficiary targeting identification and reduced cost of operation.

CONCLUSION

Financing smallholder farmers is a prerequisite for the success of IAR4D to deliver benefits to farmers and all the actors of the Innovation Platform. It is important therefore to create banking institutions that accept greater risk associated with loaning to smallholders, while at the same time craft innovative strategies of reducing the risks. The success of rural financing also depends on whether the government provides an enabling regulatory and policy framework that supports sustainable market delivery system.

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