

DEVFINANCE

Discussion list on development finance of the Ohio State University
Review October-November 2005 ¹

Subjects of Interest

Agricultural credit discussed on devfinance

During the months of November and December 2005, some interesting arguments were exchanged on Devfinance, criticizing the current situation of agricultural loans in microfinance. Malcolm Harper opens the debate on the suitability of present microfinance products (loans) for crop-farming activities and raises the question what should MFIs do to serve the needs of farmers. His questions refer to his recently published paper "Farm credit and micro-finance – is there a critical mismatch?"¹ where he describes why micro loans are relatively unsuitable for crop farming. For Harper the main reason for this is the **unfavourable ratio between high interest rates of micro loans** - usually above 30% a year - and the **low rates of return from crop farming**. He shows that non-farm activities (micro enterprises) have an average return on investment of 850% a year, while the return ratio for crop farming is below 100% on average. One of his conclusions is that MFIs should become more efficient and lower interest rates.

Mark Bruns suggests MFIs to invest in and make use of **information technology such as mobile phones to reduce transaction costs** and thus to reach geographically isolated customs. Another method to serve rural areas with low population density cost efficiently is mobile banking. Ralph Houtman gives detailed explanations on the mobile banking approach. As an example serves the Grameen approach, whereby a field worker visits a location on a weekly basis to do disbursements and collections. Critical factors for the design of a mobile banking network are the security situation, population density and the distances that

determine the frequency of the visits. Further, good infrastructure and appropriate information technology for data entry and backup are important too.

Linda Mayoux argues that the reason for the unsuitability of loan products for farming is not necessarily the high interest rates compared to the rates of return but rather **insufficient flexibility of financial products for farming**. In her opinion the timing of loan availability (delay of application and disbursement) and the length of repayment schedule are as important factors.

A crucial issue to be considered is the **gender inequalities in the access to loans for agricultural investments** due to women's lack of control over land, especially in Africa. She makes an appeal to make collateral requirements and loan products that enable women to "get out of the debt management role". She argues that small loans make women more and more responsible for household budgeting and men being less responsible for covering basic needs. To overcome these shortfalls, MFIs should consider more social collaterals and integrating trainings on gender, strategic planning of household investments for men and women and establishing links to business development services.

Zvi Galor comes back to the question of the real needs of (crop)farmers for financial services. According to Galor, **farmers need three main types of loans in terms of amount and duration**. First, long-term loans investments in fixed assets such as sheds, machinery or fruit trees. These types of farm credits are rarely available yet. Second, farmers need shorter-term credits to finance agricultural inputs for a production season and thirdly there is a need for subsistence credits that bridge liquidity shortage during the production season.

¹ This publication can be downloaded.
http://www.ruralfinance.org/servlet/BinaryDownloaderServlet/27604_Article.pdf?filename=1129416562019_farm_credit_MF_mismatch.pdf&refID=27604

Douglas Pearce thinks that loans are not necessarily the most important source of finance for rural households. Farmers perceive loans as relatively risky for long-term bulky agricultural investments. Instead they would go for mixed funding from savings, informal borrowing, remittances and a small loan. Dale Adams supports this opinion and adds that **besides credits, rural people would much benefit from attractive deposit products.**

Adams asks the fundamental question whether agricultural credits are an effective way to spur rural development. From a financial perspective, agriculture loans are risky and expensive because of natural risks and geographic remoteness of clients. Adams suggests that MFIs could contribute most to rural development by extending its services into more rural towns thereby **offering financial products also for non-farm enterprises.** In this context, he has some doubts about the recent announcement of the World Bank to stress more on agricultural projects in the future, especially when looking at the short list of success stories of agro projects of the Bank.

Georg Felber, Intercooperation