



Fondation pour l'agriculture  
et la ruralité dans le monde

# **What Can Microfinance Contribute to Agriculture in Developing Countries?**

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Agriculture has returned to being a primary global concern. Prices of agricultural goods, such as cereal and milk, are hitting record highs on international markets. Food security is no longer guaranteed. High food prices are a short-term problem for consumers, especially among poor population in southern countries. On the other hand, high-performing agricultural markets have the potential to stimulate a new wave of investment and innovation. They give struggling peasants in southern countries a chance to earn a decent living. But to take advantage of this historical situation that so many have been waiting for, farmers will need to invest and increase production.

Access to finance is therefore decisive. Yet the majority of peasants in developing countries are still excluded from the banking system. Bank penetration rates in agricultural regions of Africa and South Asia are barely over 5-6% (Bachelier, 2007). In developed countries, agricultural banks played an important role in modernization of agriculture and bankerization early on. In developing countries, microfinance has the potential to play this role, given its advantage in terms of proximity to the client and its frequent association with cooperative approaches. These characteristics are can be found in the approaches originally used by local agricultural banks in France.

The question guiding the conference organized by FARM Foundation and its partners<sup>1</sup> was the following: **under what conditions can microfinance help farmers in developing countries access credit to improve their competitiveness?**

The conference brought together over 350 participants (experts, practitioners, researchers and political authorities) committed to agricultural finance.

This summary aims to synthesize the primary analytical points that came out of the discussions that took place from the 4-6 December 2007<sup>2</sup>.

### 1. AGRICULTURAL FINANCE: AN INSUFFICIENT AND POORLY ADAPTED SUPPLY

The old rural finance paradigm of the 1960s and 1970s was based on public authorities' desire to facilitate access to rural finance. The objective was to promote agricultural development by modernizing agriculture. The most common approach involved direct government intervention via state-owned development banks and direct donor intervention in credit markets with favorable terms and conditions like soft interest rates or lenient guarantees. However, this system was costly and unsustainable, due to poor repayment, and ultimately did not have the desired effect on the development of agriculture production (Meyer, 2007).

In the 1980's, the failure of government-led credit supply gave way to a new paradigm and a renewed approach to rural and agricultural finance in developing countries. State-owned development banks closed, financial sectors were liberalized and microfinance evolved. Based on an approach that encourages financial intermediation, the new rural finance paradigm redefined the roles of the various actors involved in providing financial services, especially governments. Public

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<sup>1</sup> IGPDE, Agence Française de Développement, AREF, CERISE, Groupe Crédiford it agricole, FAO, IFAD, FERT, I.C.A.R, SOS-FAIM, HEC, PlanetFinance, SupAgro. With financial support from Ford Foundation.

<sup>2</sup> Conference presentations are available at: <http://www.fondation-farm.org>

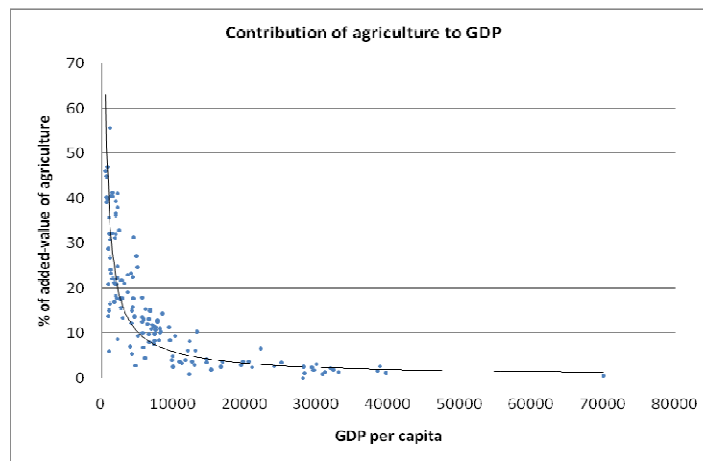
subsidies were redirected towards creating new microfinance institutions (MFIs) that were supposed to achieve financial sustainability thanks to cost-covering interest rates.

Despite the great hopes associated with the strong growth of the microfinance sector, it soon became clear that the supply of microfinance for agricultural activities was marginal at best and poorly adapted. At the same time, with the liberalization of the financial sector, commercial banks did not pick up the slack of former government-led interventions in rural areas; many banks actually closed their rural branches (Zeller, 2003). Finance for agricultural activities became even more rare.

### 1.1. The role of agriculture in developing countries

Agriculture constitutes an important—indeed major—part of developing countries' GDP (FAO, 2006 and World Development Report, 2008) and a large part of rural households' monetary income (Figure 1).

**Figure 1: Contribution of agriculture to GDP**

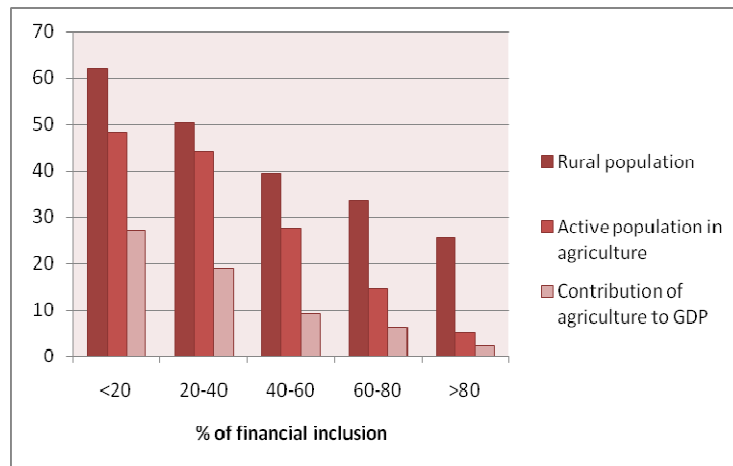


Source: based on data from FAO (2006)

### 1.2. Microfinance's limited contribution to agricultural finance

Yet despite the important contribution of agriculture to the GDP of the poorest developing countries, the supply of financial services to farmers is still limited. As figure 2 illustrates, the more rural populations contribute to GDP and the greater the percentage of agricultural workers, the lower the rate of financial inclusion.

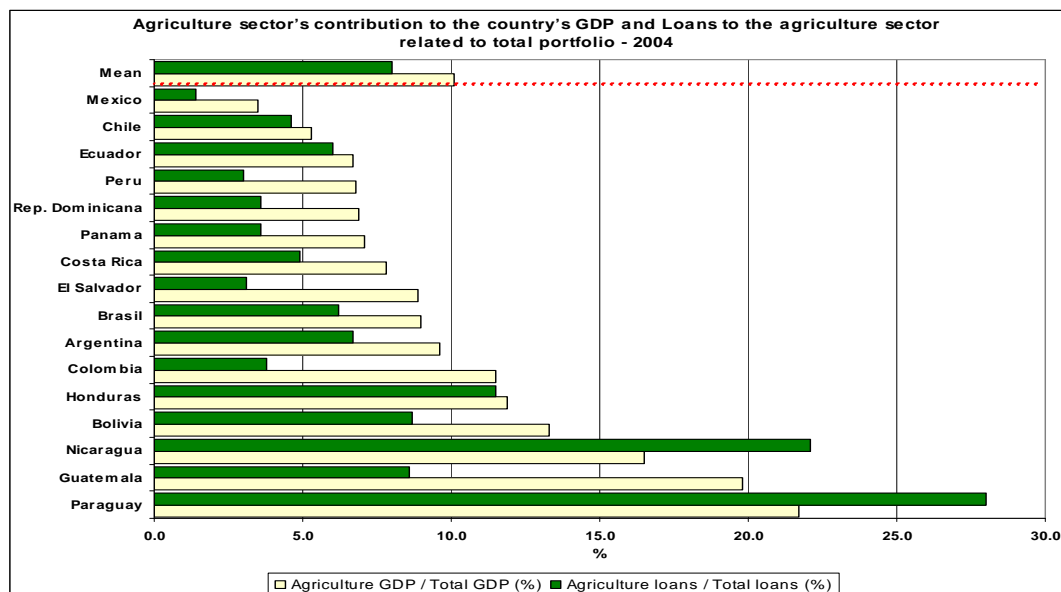
**Figure 2: Contribution of the agricultural sector to GDP and financial inclusion**



Source: Morvant-Roux and Servet (2007)

A regional analysis conducted by Trivelli and Venero (2006) of 2004 data from 16 Central and South American countries illustrates this situation. With few exceptions (Nicaragua and Paraguay), the portion of agricultural loans disbursed was inferior to the overall contribution of agriculture to the country's GDP (Figure 3).

**Figure 3: Portion of credit allocated to agriculture compared to the overall contribution of agriculture to GDP (2004)**



Source: Trivelli and Venero, 2006

It is very difficult to evaluate the volume of credit microfinance institution's disburse for agriculture. Cumulatively, MFIs around the world lend roughly 30 billion dollars, but there are huge territorial differences (between countries and within the same country) in how these funds are allocated. Indeed, despite annual growth of 36% in the number of poor clients reached by MFIs between 1997 and 2005 (Daley-Harris, 2006), most institutions still concentrate on urban and peri-urban areas that are easy to serve. Among rural institutions, the portion of credit portfolio that goes to agricultural activities varies considerably.

Among the member countries of the West African Economic and Monetary Union, a study on rural finance conducted in 200 found that only 14% of overall credit supply goes to the agricultural sector. Remarkably, 92% of this supply came from the commercial sector, largely surpassing the participation of development banks (5%) and microfinance institutions (3%), whose credit supply is essentially characterized by short-term loans (Lesaffre, 2000). In India, between 2000 and 2007, only 8% of credits disbursed by the microfinance sector, dominated by the Self-Help Group model, went to agriculture. The rest went to livestock activities (14%) consumer loans, microenterprises and trading activities (78%) (Pillarsetti, Plenary 1)<sup>3</sup>.

Despite the relatively general and heterogeneous nature of the data available, often only referring to certain geographical areas, there is a consensus that agriculture is inadequately funded and that the supply does not meet the needs of farmers.

This is essentially due to the fact that financing agriculture is generally more costly, risky and less profitable than other forms of financing. Beyond the commonly cited difficulties that come with setting up financial services in rural zones, agricultural activities are characterized by a number of specificities that financing mechanisms must take into account.

### 1.3. Specificities of agricultural finance

The agricultural sector is different from other economic sectors in a number of ways. Activities are generally located in isolated areas with low population density and poor infrastructure<sup>4</sup>. They are dependent on weather and production cycles; income is seasonal and monetary income is limited. Agricultural prices are notoriously volatile and few farmers can offer guarantees that are legally or financial acceptable.

These specificities demand financing mechanisms adapted to the diverse needs and services of rural households (Wampfler and Lapenu, 2002):

- **Short-term:** input financing at the beginning of the crop year (seeds, fertilizers, pesticides), additional labor, feed, storage facilities, processing, etc.
- **Medium and long term:** equipment for intensification, commercialization (transportation), storage (buildings), perennial crops (investment, renewal, maintenance), (re)constitution of herds, land purchase.
- **Family needs:** personal, durable goods, housing.
- **Savings**
- **Non-financial services:** monitoring demand, technical assistance and extension.

Understanding how to best meet these financial needs and finding ways to mitigate the risks associated with them are added challenges that further hinder the expansion of financial services for

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<sup>3</sup> References to conference sessions refer to the presentations available on the website: [www.fondation-farm.org](http://www.fondation-farm.org)

<sup>4</sup> Current pilot initiatives testing new information and communication technologies may result in solutions to the problem of isolation and low population density (Ivatury, 2006).

agriculture. Moreover, as microfinance is increasingly integrating into conventional financial markets, the sector has no choice but to apply cost-covering interest rates. Such rates often contradict the expansion of rural coverage and agricultural finance due to the low profitability of the activities financed. All these factors explain the relative lack of interest in agriculture on the part of urban and peri-urban zones. Consequently, liberalized markets coupled with contractual innovations—elements promoted under the new paradigm—have not fulfilled their promises *vis a vis* rural and agricultural finance.

### 1.4. A deepening of the new rural finance paradigm

The microfinance sector, motivated in part by the broader trend towards financial inclusion, is changing. **New actors are emerging along side the “traditional” ones** (NGOs, governments, development banks, peasant organizations<sup>5</sup>, etc.). In addition to commercial banks, one observes increasing involvement of specialized microfinance funds, international guarantee funds, agro-food industries, as well as other agricultural value chain stakeholders.

Given this context and in light of agriculture’s specificities, there is a need to take a step forward: identify intermediary channels that encourage interaction between the diversity of public and private actors, old and new. Indeed, while recent changes to the microfinance sector have created a certain “imbalance,” they also bring great potential. To take advantage of new opportunities, there is a need for a pluralistic, inclusive approach to the financial sector as a whole and to public/private partnerships (Lapenu, 2007 and Plenary 1).

Conference discussions pinpointed several ways to respond to agriculture’s specificities and improve MFIs’ provision of agricultural finance:

- Initiatives that bring together diverse stakeholders
- Active partnerships with peasant organizations
- Strong public policies

## 2. TESTING NEW FORMS OF PARTNERSHIPS

The need to rethink synergies and coordinate different stakeholders is relevant at two levels:

### 2.1. MFI governance

The idea that one organization model is particularly well-adapted to financing agriculture does not hold up in reality. The institutional type does not appear to be a determining factor of financial access. Indeed, conference discussions identified a variety of models that have proved successful in financing agriculture:

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<sup>5</sup> The term “peasant organization” is used here to refer to all type of rural organizational forms, including producer organizations, farmer associations and professional agricultural organizations.

- Self-Help Groups,
- Development banks
- Cooperative (mutualist)-type MFIs or MFIs funding with private capital

For example, **development banks** are making a comeback in Latin America, where they are once again becoming important players in agricultural finance: 32 of 198 development banks finance agriculture, especially small producers. Among these 32, half allocate 50% of their portfolios to the agricultural sector (Trivelli, Workshop 1). In Mali's Niger Delta region, three MFIs of varying institutional types (FCRMD, CVECA and Nyesigiso)<sup>6</sup> and two banks (BNDA and BMS)<sup>7</sup> finance 80% of all farmers living in the zone (Traoré, Workshop 1). In Burkina Faso, the cooperative network RCPB (*Réseau des caisses populaires du Burkina Faso*) dedicates 25% of its loan portfolio to agriculture (Sawadogo, Workshop 5). Finally, the *Caisses d'Épargne et de Crédit Agricole Mutuels* of Madagascar allocates 80% of its loan portfolio to agriculture (MIX Market).

Each institutional type has its own strengths and weaknesses. However, all must grapple with finding **the right balance of stakeholder participation**.

Development banks, for instance, often deal with government interference, which can become a weakness if not well-managed. Banrural S.A. in Guatemala has been successful in this respect, especially given its profitability and penetration rates. Management has effectively achieved a balance among its different shareholders: government, cooperatives, indigenous and peasant organizations and non-profit associations.

Nonetheless, the level of participation of clients/members in defining products and services in institutional types that ostensibly include them in the governance structure (which is not the case in Chile, Argentina, Peru and Columbia) remains limited. In Mexico, farmer representatives play a political role but are not involved in designing financial services. Again, the experience of Banrural S.A. Guatemala is an exception, having achieved genuine convergence between the involvement of clients in strategic decisions and the commitment of managers to meet client demands as a way to ensure the sustainability of services offered (Trivelli, Workshop 1).

The conference presentations highlighted the **importance of involving clients in the design of financial services** to better adapt them to their needs. In this respect, the cooperative models, which bring together salaried staff and elected officials, are conducive for exchanging information and therefore adapting products more effectively. The success of Agricultural Cooperative Bank of Armenia-Crédit Agricole in Armenia demonstrates the crucial role of farmer-members (Gishyan, Workshop 5). Similarly, the experiences of *Caisses d'Épargne et de Crédit Agricole Mutuels* (CECAM) of Madagascar illustrate the importance of interchanges between users and bank staff (*Agence française de développement*, 2007 and Workshop 1).

However, training elected officials is a critical factor for these types of models, and it comes at no small cost.

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<sup>6</sup> FCRMD: *Fédération des caisses rurales mutualistes du delta*; CVECA: *Caisses Villageoises d'Épargne et de Crédit autogérées*.

<sup>7</sup> *Banque Nationale de Développement Agricole* and *Banque Malienne de Solidarité*.



**Implementing product innovations requires the support of well-trained salaried staff/credit officers who have a thorough understanding of the context in which they work.** It is also important that the MFI is genuinely committed to its mission of serving the agricultural sector, since achieving this goal demands the commitment of all employees. However, training or hiring qualified staff also comes at a cost, and raises the question of how to assume these high human resources expenses while pursuing a strategy of financial sustainability.

There are limits, however, to the extent which institutions are able to diversify products and services. Taking once again the example of the Niger Delta in Mali, one observes that the inability to mobilize funds for term loans results in a lack of products to meet the equipment needs of farmers.

**Savings offers a solution in this context, and deposit mobilization efforts must be expanded.** This calls for MFIs to serve as genuine financial intermediaries, so that deposits can be used not only to guarantee farmers' profits but also to leverage credit portfolios. Rural populations have considerable capacity to save, even if this capacity is not recognized by the banking sector. Microfinance institutions have many advantages (in terms of proximity, knowledge of the client, trust) that they need to consolidate. The cooperative networks in West Africa are particular active in mobilizing saving compare to the rest of the world (MIX Market, 2007).

The current difficulty for MFIs to access medium and long-term credit lines calls for innovative partnerships with private sector players, such as specialized funds. At the same time, while private sector actors can offer solutions, their demands in terms of profitability must be assessed so as not to jeopardize the overall objective of financing agricultural activities.

For private actors to play an important role in agricultural finance and development, there is a need to have a long-term vision. Short-term profitability goals are simply not compatible with financing the agricultural sector.

**Generally speaking, the governance of these institutions must bring together proximity, innovation, diversification and risk management.**

There is a consensus that all the actors in the agricultural sector (financial institutions, producers, buyers, processors) face risks that justify joint efforts to reduce these risks. It is increasingly common to observe the formation of strategic alliances to think collectively about ways to mitigate risk, leverage the comparative advantages of each actor and stimulate knowledge exchange.

### 2.2. Strategic alliances

Discussions during Workshops 2 and 3 revealed that rural financial institutions are using three main strategies:

- **diversification of product lines:** combining different financial products for agriculture, such as leasing and warrantage;
- **diversification of activities financed:** including agricultural, non-agricultural and productive activities as well as "social" and consumer expenses;
- **formation of strategic alliances:** between MFIs, banks and peasant organizations, as well as between MFIs, private sector players and the public sector (government, donors).

These three strategies, which may be pursued in tandem, aim to improve agricultural finance by meeting three important needs: medium- and long-term finance, by increasing credit ceilings for larger equipment loans (thus boosting means of production); long-term partnerships; and the integration of microfinance into rural development dynamics.

### 2.2.1. Product innovation is necessary but roll-out capacities are still limited<sup>8</sup>

Implementing innovative financial products and, more specifically, term finance involves a number of challenges: client guarantees, trained MFI staff, availability of refinancing (because members' savings are not always enough to finance short- and medium-term loans)<sup>9</sup> and regulatory issues regarding sanctions in case of default (seizure of property or goods, etc.).

Medium- and long-term loans require guarantees that reflect the specific nature of assets held by rural households. Microfinance institutions need to be able to **analyze the medium-term repayment capacity of rural households** and profitability of agricultural activities. This requires skills in risk and market analysis as well as access to information that is not always easily available.

The issue of profitability is key, because it relates to the **securization of agricultural revenue**, which involves the stabilization of agricultural prices (Faivre-Dupaigre *et al.*, 2008). Reducing price volatility makes it possible to predict prices, thus removing one of the causes of non-repayment and eliminating one of the risk factors in agricultural finance.

Trying out new products and services thus requires MFIs to work collaboratively with a variety of actors and think in terms of synergy and alliances.

The conference revealed that sector players have a genuine interest in meeting these challenges by creating synergies that pool skills and reduce risks. This objective requires a holistic vision of the agricultural sector and involves a wide variety of actors: not only MFIs, peasant organizations, banks and governments but also the private sector (agro-industries, guarantee funds, etc.).

### 2.2.2. Current partnership dynamics

Overall, most new partnerships revolve more around innovative processes than innovative products.

They are emerging at different levels (Workshop 2 and Guérin, Plenary 2):

#### a) *Financial services: funding, guarantees and dissemination*

Whether a peasant organization or MFI, guarantees are necessary to access financial markets. The FOGAL (*Fonds de Garanties pour l'Amérique Latine*) was created precisely to meet this need (Necochea, Workshop 2). Created with support from the Belgian cooperation agency and European Commission, the fund is invested in a European bank and guarantees loans taken by actors in Bolivia, Equator and Peru.

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<sup>8</sup> For an analysis of innovation in agricultural finance, see Christen and Pearce (2005).

<sup>9</sup> Ce point a notamment été souligné par les intervenants de l'atelier 4. Voir notamment l'intervention de Najirou Sall, FONGS-Sénégal.

### **b) Non-financial services: technical assistance, information**

The effectiveness of financial services partly depends on the non-financial services offered to improve agricultural production. One successful way to better support rural and agricultural populations is to create alliances with other actors (NGOs, governmental entities, peasant organizations, etc.) to set up complementary services like training and technical assistance (TA). Training possibilities are endless, ranging from management or financial advisory services to farmers to capacity building for elected representatives of MFIs.

The agricultural package model of DECSI (Debit Credit and Savings Institution) in Ethiopia is an example of an institution offering TA, market information and producer networking services along with its financial services. The approach federates a variety of actors to help boost the development of activities financed. (Kiros, Workshop 2).

### **c) Market access: processing and distribution channels**

In recent years, it linkages between the microfinance and agro-industrial sectors have become increasingly common, in order to consolidate the comparative advantages of each and encourage exchange.

- MFIs have the expertise, systems and technology required to sustainably provide a range of financial products.
- Agro-industrial firms know the end-consumers, culture, prices, markets and production constraints. Sometimes, they already have input distribution networks in place (involving credit) with farmers.

Several initiatives aiming to strengthen interaction between these two sectors are underway. The objective is to build long-term relationships and **reduce risk** for the different actors: producers, borrowers, buyers and processors.

These partnerships come in different forms.

- Some focus on one link in the value chain (for instance, partnerships between MFIs and storage facilities or MFIs and exporters).
- Others address the chain as a whole (Danone's business model in Bangladesh).
- Partnerships may be direct or indirect, *i.e.*: incited by a third party, such as an NGO, who plays the role of catalyst, facilitator and sometimes service provider.

There are recent examples of value chain actors playing the limited role of "virtual guarantor", in which case a producer's mere association with a large buyer or processor, for instance, serves as a sign of creditworthiness in the eyes of financial institutions. The value chain actor may also be directly involved in financial transactions, providing producers credit services, a more traditional approach (Gonzales-Vega, 2006).

Many examples were presented at the conference, including:

### **Multi-party contracts between MFIs, producers, input suppliers and buyers**

This approach was pioneered by the *Caisse d'Épargne et de Crédit* (CECO) of Côte d'Ivoire, MFI created in 1991 currently with more than 5000 members. To limit its risks while guaranteeing rice and cashew nut producers' access to inputs and markets, CECO adopted the following strategy. The institution selects partners from profitable agricultural value chains that will contribute to the system and lend it credibility (input suppliers, service providers, processors, etc.). Borrowers do not have direct access to credit but any services and inputs provided by the partners are directly billed to CECO, which reimburses the provider once the harvest is sold (Touré, Plenary 2).

### ***Integrated production and commercialization model***

The Grameen Danone Foods Ltd. Project in Bangladesh is a partnership between Grameen Bank and Danone (Ardouin, Plenary 2) designed to produce and distribute yogurt locally, and incite local consumption of the product. Danone is responsible for building the factory and producing the yogurt.

The MFI, Grameen Bank, facilitates financial access at two levels:

- Upstream, with milk producers who supply the factory, thus guaranteeing a stable supply for Danone, and
- downstream, with the women in charge of distributing (retail sales) of the product and creating a new commercial niche.

### ***Fair trade***

The fair trade model offers producers not only **viable and predictable commercial channels** for selling produce at prices that cover production costs (investment and labor), but also financial support. However, according to Cécile Lapenu (Plenary 1), this support does not fully satisfy the financial needs of fair trade producers: volumes are low, guarantees are insufficient, and management problems in peasant organizations are recurrent.

An alliance with the microfinance sector could help improve the supply of financial services to peasant organizations and their members. Coordination with MFIs can guarantee importers good management, enable a diversification of funding sources and help finance needs not covered in the fair trade relationship.

Nevertheless, these “new” alliances will not take the place of peasant organizations when it comes to providing agricultural finance.

## **3. THE CONTINUED IMPORTANCE OF PEASANT ORGANIZATIONS<sup>10</sup>**

The liberalization of agricultural production that has come in the wake of several decades of government intervention has led to a dismantling of state-run agricultural extension, financing and commercialization services. The government's withdrawal has created a gap in the provision of intermediation services and support to farmers, to help them better adapt to the new economic context. **Professional agricultural organizations (PAOs) have thus emerged, organizing their**

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<sup>10</sup> This section draws on Wampfler and Doligez, (2007).

**activities around two major issues:** 1) advocacy of agricultural interests and farmer's rights and 2) provision of support services to their members (Wampfler and Doligez, Workshop 4).

### 3.1. Strategies used by professional agricultural organizations

Access to finance is crucial for professional agricultural organizations (PAOs), constantly confronted with financial constraints. Yet PAOs face major challenges, as financial institutions are reticent to lend to them, or are altogether absent from agricultural regions. To address this situation, PAOs are using a variety of strategies to improve their financial access:

- 1) Internalizing credit operations;
- 2) Creating a "sister" microfinance institution;
- 3) Partnering with existing financial institutions<sup>11</sup>

Of these three, the **partnership strategy** appears the most common among PAOs in Africa (particularly Madagascar) and Latin America, and is worth exploring further.

Partnerships between PAOs and financial institutions, especially MFIs, offer great potential for agricultural finance. But in practice, relationships between PAOs and MFIs are difficult. Cost of services, for instance, remains a point of contention between the two. To achieve sustainability, MFIs have no choice but to charge cost-covering interest rates. Farmers consider these rates too high, however, given the low profitability margins of their agricultural activities.

Strengthening partnerships between PAOs and MFIs thus requires both parties to overcome a certain number of challenges, not the least of which is determining the type of governance structure to set up, given the diversity of actors involved. Regardless of the approach (territorial or according to activity), the challenge is for MFIs to adopt a governance style that enables all the stakeholders to meet on common ground. This requires an understanding of the differences between each group of stakeholders. PAOs and MFIs work with populations whose expectations and capacities differ. Moreover, within a group of PAOs, there are variations in terms of capacity to negotiate, interact and be involved with an MFI. Similarly, MFIs do not constitute a homogeneous group, either.

It is also important that the governing stakeholders in these partnerships understand the risk of mission drift and find ways to ensure the MFI's long-term commitment to serving small producers. In this respect, a well-designed governance structure can help avoid abuse or infringement of the different stakeholders' rights.

This strategy effectively "outsources" the financial service, thus raising the issue of how to sustain the non-financial services offered by the PAO. Conference discussions emphasized the importance of these services in the development of agricultural activities. A mix of non-financial production factors is required for finance to be successful (Workshop 6, particularly Ratohiarijaona). The question that is still unanswered is: who should pay for them?

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<sup>11</sup> See Wampfler and Doligez (2007) for a more detailed discussion.

### 3.2. An operational guide to strengthen PAO/MFI partnerships

Generally speaking, capacity building of the various actors—elected officials, managers and extension officers—is a critical success factor for PAO/MFI partnerships. This observation incited the development of an operational guide to help strengthen such partnerships). The guide is being finalized by members of the CERISE network, with the financial support of FARM Foundation.

The guide has been designed on the basis of three hypotheses (CERISE, 2008):

- Partnerships between PAOs and financial institutions (FIs) can improve outreach of agricultural finance;
- Due to the distance between these two types of entities, partnerships are not spontaneous and must be actively built;
- Consolidating the knowledge and skills of the two institutions can help foster partnerships.

The specific objectives are:

- To improve PAOs' and FIs' capacities to analyze the financial needs and constraints of POs and their producers;
- To help PAOs choose efficient and viable ways to access financial services;
- To give PAOs and FIs the tools to build partnerships and improve POs' access to financial services.

Although building partnerships between PAOs and MFIs represents progress, **a number of issues remained unresolved**: finding ways to mobilize resources adapted to agricultural finance, especially equipment needs; managing agricultural risk; developing financial services in particularly isolated zones and addressing what are perceived to be relatively high interest rates, compared to profitability levels.

None of these issues can be effectively or equitably resolved by the market or negotiations between economic actors. They call for well-adapted redistribution policies and incentives (see below).

FONGS's decision to become a shareholder in the Caisse Nationale de Crédit Agricole du Sénégal (putting up 4% of capital) was guided by the desire to have a seat on the Board of Directors so as to secure the only agricultural finance mechanism available, and influence lending policies. This strategy has led to a number of victories, including:

- Expansion of CNCAS's network and increased proximity to rural producers;
- Reduction of interest rates from 18% to 7.5%;
- The beginning of a dialogue regarding linkages between CNCAS's network and decentralized endogenous savings and credit cooperatives.

It is an example of how the joint collaboration of actors at various levels can help ensure financial access for farmers (Sall, Workshop 4).

Most partnership attempts between the financial sector and agro-food value chain actors are relatively recent and thus it is too early to judge their effectiveness. Do they really reduce risk, or at least distribute risk more equally among the MFI, agro-food industry and producer?

These partnerships **do not offer any solutions to the issue of profitability of some agricultural activities**. The level of organization of a value chain is a success factor for financing (Sawadogo, Workshop 5). **Unprofitable activities are therefore excluded** from the new emerging partnerships in more secure chains. Moreover, some experiences reveal an approach that segments the types of activities financed based on profitability (as in the case of CECO). While this sort of segmentation is legitimate, given how it aligns the MFI's goal of financial sustainability with a desire to achieve maximum impact on the activities financed, it does not address the issue of whether or not to finance less profitable activities. Although experience shows that farmers surviving on low profit margins are just as capable of repaying loans as those with higher profit margins, credit access does not necessarily result in higher profits. It is therefore necessary to **distinguish between the MFI's performance indicators and the true profitability of activities financed**. The issue of financing activities with low profit margins is unresolved and requires further debate in the international development community and government authorities.

#### 4. RENEWING PUBLIC POLICY INCENTIVES

The withdrawal of government interventions in developing countries has not resulted in expanded banking services in isolated areas, nor has microfinance been able to fill the vacuum. Supply is still insufficient. In rural and agricultural regions where favorable conditions render some agricultural activities profitable, MFIs are more likely to achieve sustainability, and are thus open to financing agriculture. Inversely, MFI penetration is much more limited (or altogether absent) in marginalized regions where running a cost-covering institution is more difficult (Doligez and Wampfler, 2007).

There is a growing consensus that market mechanisms are not enough to encourage a well-adapted supply of rural, and especially agricultural, finance and the debate on the role of public authorities in improving financial access for farmers is once again open (Demirgüç-Kunt and Honohan, 2007).

Beyond “the supply of ‘public goods’ like infrastructure, and a regulatory framework” (Doligez and Wampfler, 2007), are targeted rural and agricultural finance policies desirable? What are the ultimate objectives of government intervention in terms of rural finance? What tools are available, and how effective are they? In other words, is it reasonable, given the current context, to expect governments to compensate for market failures either by incentivizing private actors, intervening directly (interest rate subsidies, direct or indirect public financial intermediation), or encouraging public-private partnerships?

There are many reasons to be reticent about direct public intervention in financial markets, not the least being market distortion and its consequence on the private, associative and cooperative sectors that are trying to meet the demand for financial services in marginalized zones. Still, a targeted agricultural finance policy is necessary because it is at the heart of other so many other public policies (economic, labor, poverty and local development, for example). But how to fund government

intervention? Can something be learned from the Patmir experience in Mexico, involving specialized support from international donors, or perhaps specialized tax policies?

There is no one answer, and it is essential to take into account cross-country differences. Public interventions can be made more effective by fostering innovative partnerships between the public and private sectors. As Carolina Trivelli noted during the conference (Workshop 1), experiences in Latin America with the rehabilitation of development banks on the basis of lessons learned from past failures are promising, especially the case of Banrural S.A. in Guatemala.

Different approaches are possible:

- A sectorial agricultural development approach that aims to compensate for the difficulties productive units have to access capital.
- A social approach that aims to improve financial access for marginalized populations.
- A territorial approach that aims to address territorial inequalities that may stem from environmental factors such as climate, topography, isolation or distance (the approach adopted by the rural microfinance TA program in Mexico).

Among the various tools available (see Doligez and Wampfler, 2007), each country must find its own path.

### 4.1. Subsidized interest rates

Going against the dominant rural finance ideology, the Malagasy government opted to subsidize interest rates as a part of the new agricultural development policy launched in 2004 (Ratohiarijaona, Plenary 3). The policy has been implemented through a contractual partnership between the government, MFIs, peasant organizations, input supplies and TA providers. It is still being adjusted,<sup>12</sup> but the initial results are encouraging: an increase in rice production, improved coverage of financial needs, and improved usage of inputs, thanks to TA.

In Brazil, the federal government intervenes directly by promoting credit access among family farmers via the PRONAF program (a national program to support family agriculture). Despite considerable progress in terms of financial inclusion, the program still faces a number of difficulties and distortions (Abramovay, Plenary 3).

Subsidy policies and, more generally, direct government intervention in finance, were definitively banished in the new rural finance paradigm. Nonetheless, in its most recent World Development Report, **the World Bank underlined the importance of agricultural sector growth in poverty reduction.**

*“(...) GDP growth originating in agriculture is at least twice as effective in reducing poverty as GDP growth originating outside agriculture (...)” (WDR, 2008: 6).*

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<sup>12</sup> Discussed by Ratohiarijaona (Plenary 3).



And yet the interest rates of MFIs do not reflect the profitability rates of most agricultural activities.<sup>13</sup> Nonetheless, interest rate ceilings are not the answer (Workshops 1 and 5). Rather, there is a need to rethink the role of public intervention in meeting the financial needs of the sector.

### 4.2. Adapting regulation to agricultural finance

In Bolivia, rural finance actors joined together to lobby for changes to financial sector regulations to account for the specificities of their activities. **Adapting regulatory frameworks is crucial to improving financial access for farmers, and the overall effectiveness of finance.** Key issues include norms for qualifying and evaluating agricultural portfolios, provisioning for agricultural portfolios, recognizing the agricultural sector as both strategic and specialized, and ensuring participation of producers in the ownership structures of MFIs (Marconi, Plenary 3). In the current context of **revisiting methodologies and public/private partnerships** based on lessons learned from past failures, it seems reasonable not to exclude *a priori* public sector intervention.

This observation holds true for interest rate policies, which under certain conditions (namely including in the program the range of actors that finance agriculture), can be effective.

Regardless of the approach, it is critical that targeted policies:

- are rooted in a solid institutional framework and good public governance;
- coordinate consistently with other public policies: financial, poverty reduction (including donor policies), agricultural, commercial.
- are formulated and implemented in a coordinated way with the various actors involved. This type of coordination requires not only a forum where dialogue can take place but capacity-building of the various actors.

## 5. CONCLUSION

As a whole, the conference participants affirmed in their testimonies and analyses that microfinance can play an important role in agricultural finance and is capable of mitigating the many challenges associated with the sector.

To do so, **several conditions must be met:**

- Organization of the agricultural sector;
- Professionalization of the various actors, at all levels;
- A supply of diversified and well-adapted financial services;
- Access to non-financial services that promote agricultural development;
- MFI access to medium- and long-term refinancing, at affordable rates;

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<sup>13</sup> A study conducted in Bangladesh shows that Grameen Bank and BRAC's effective interest rates are around 26% and 40% *pa*, respectively (Ahmad, 2008).

- Diversification of regions and types of activities financed, keeping in mind the primary objective of financing rural and agricultural sectors;
- A regulatory framework adapted to the challenges of agricultural and rural finance.

These various factors underlie the fact that meeting the financial needs of farmers on a sustainable basis requires governments to support the microfinance sector, as was the case in the creation of agricultural credit institutions in France.

**Given the limitations of both the state-only and market-only models, there is a need to study new alternatives.**

The current international context has made agriculture, especially agriculture in developing countries, a **primary global concern**. Agricultural prices and population pressure are increasing, and food security is no longer ensured.

In light of this, the primary challenge is for developing countries to meet their food security needs by relying on regional producers: but under what conditions can rural populations meet this increasing demand?

For southern peasants, the present context offers a great opportunities; however, to benefit from it, they need to be able to invest and increase production. This implies access to appropriate forms of credit and insurance (Diouf and Severino, 2007). The government must therefore support agriculture finance.

Some new initiatives experimenting with partnerships and public policy tools are promising, but most are too recent to judge their effectiveness on meeting the diverse needs of farmers.

Most analyses until now have been limited and are not generalizable. Those that do examine the role of government rarely take into account the specificity of agricultural activities. Cross-analyses at a regional level are particularly useful because they go beyond a normative national analysis, making it possible to identify experiences that offer solutions and thus guide decision-making.

Hence, to both deepened and broaden the new rural and agricultural finance paradigm, there is a need to further study public policy tools as well as private initiatives such as guarantee funds and strategic partnerships, so as to identify the most promising experiences that will help push agriculture in developing countries forward.

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