



CHALLENGES OF FINANCING
AGRICULTURE :
a case for Agricultural Bank of
Zimbabwe Limited (Agribank)

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PRESENTATION FORMAT

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- 2. Agriculture Funding Challenges**
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BACKGROUND

1. Agriculture Contribution to the Economy

Agriculture is the economy and the economy is agriculture.

This may not be a mathematical exactitude but is particularly apt for Zimbabwe, with agriculture at the core of the economy. As such support to the sector is critical for the overall performance of the economy.

1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

The surge in agricultural output in 2017 on the back of Command Agriculture and the Presidential Inputs saw the Economic growth targets being revised upwards to 3.7% in 2017 to reflect the immediate impact of agriculture on the overall economy.



1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

Prior to the challenges of the past decade and half, agriculture's contribution to the economy was significant in terms of direct contribution to real GDP, exports and employment.

- i. Agriculture accounted for about 24% of GDP;
- ii. Agriculture accounted for as much as 33% of Exports; and
- iii. Nearly 400 000 (about 25% of total formal) employment.



1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

Accordingly, agricultural production has always had a catalytic role in the economy.

In terms of linkages with other sectors, agriculture output positively impacted on key sectors of the economy, such as manufacturing, mining, construction, real estate, finance and insurance, among others.



1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

As agriculture thrived, post-independence, the manufacturing sector and many other sectors also prospered in tandem.

The manufacturing sector was to a large extent agro based, with several subsectors having direct linkages with the agriculture subsectors. Thus the thriving textiles subsector derived inputs from cotton production; Leather industry, from Beef and Livestock; diary production, canned beef and canned beans were all agro based industries.

1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'


Agriculture, currently accounts for about **9.4%** of GDP (Zimstats 2016 Statistics) and as much as **25%** of exports – about half the previous contribution to both GDP and exports.

Over the past few years, Zimbabwe has been importing food due to shortfalls in domestic production. Direct food imports in terms of maize and wheat averaged **US\$550 million** implying a cumulative total amount of **US\$3.5 billion** since 2009, as per RBZ balance of payments Statistics. This has contributed to the widening trade and current account deficit in excess of **US\$3 billion** every year since 2009.

1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

Since 2009, the cumulative trade deficit amounting to **US\$25.446 billion** (2017), implies that the country is exporting foreign exchange equal to nearly twice the level of GDP, every 7 years.

That is unsustainable and particularly for a small open economy the size of Zimbabwe. Indeed, no country can sustain such a level of foreign exchange haemorrhage – it is a huge constrain for growth of the economy.



1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

Government's focus on Command Agriculture and the Presidential Inputs Scheme is therefore commendable, to the extent that this has underpinned the recovery of the agriculture sector.


Most important would be the need to refine the financing modalities for Command Agriculture to ensure sustainability, beyond the near term.



1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

Over the past decade and half, the trend decline in agriculture production has, in tandem occasioned corresponding decline in related manufacturing sub sectors, and hence the current low industrial capacity utilization.

The hyperinflation in 2007/08 exacerbated and amplified the challenges faced by the manufacturing sector, with industry capacity utilization declining to less than 10% in 2008.



1. AGRICULTURE CONTRIBUTION TO THE ECONOMY CONT'

Some manufacturing subsectors notably textiles and leather were weakened measurably by raw materials shortages and eventually succumbed to competition from abroad and the high costs of doing business in Zimbabwe.

CLARION CALL

There is urgent need for all stakeholders to work together to ensure that agriculture regains its position in the economy to underpin recovery and growth.

His Excellency, President ED Mnangagwa has identified agriculture as the bedrock of overall economic recovery and growth, as outlined in his inauguration speech on 24th November 2017.



1.2 RECENT TRENDS IN AGRICULTURE PRODUCTION

Since dollarization (multi-currency), there has been a discernible pattern in respect of the agriculture recovery and growth – increasingly, the shift towards cash crops, such as Tobacco, sugar cane, horticulture, soya beans, sunflower and livestock – away from traditional cereals such as maize.

This shift has been particularly pronounced. The preference towards cash crops is a distinct feature and shift in the agriculture value chain.



1.2 RECENT TRENDS IN AGRICULTURE PRODUCTION CONT'

A result of the Land Reform program, over 100 000 farmers registered for Tobacco farming and in 2016 contributed to the surge in Tobacco output by more than **30%** to 215 million kgs and realizing **US\$685** million in foreign currency from Tobacco sales.

It is important that we characterize why tobacco farming is particularly successful:


- a. The **Value Chain** is efficient and reliable;
- b. The **Stop Order Payment System** is effective; (side marketing is not as pronounced);
- c. There is **confidence** in the Value Chain



1.2 RECENT TRENDS IN AGRICULTURE PRODUCTION CONT'

Tobacco Merchants have succeeded in securing internal and external financing for tobacco because the **Value Chain** is effective and efficient.

Banks prefer to finance **Tobacco Merchants**, for on lending to farmers because the repayment system is reliable. As such, as much as **55%** of the aggregate lending by banks every year has been channeled towards financing tobacco.



1.2 RECENT TRENDS IN AGRICULTURE PRODUCTION CONT'

This contrasts sharply with what has been happening over the years with some crops such as maize and cotton, where loan repayments have been considerably uncertain.

Government must be commended for the current efforts to enhance repayments by farmers under the Command Agriculture program.



1.2 RECENT TRENDS IN AGRICULTURE PRODUCTION CONT'

Correspondingly, loan servicing has since improved as farmers getting paid under the scheme have direct deduction arrangements.

Financing of **sugar cane** is equally preferred by financial institutions as payment mechanisms are similarly effective = value chain financing plus stop order system with the millers



2. AGRICULTURE FUNDING CHALLENGES

During the AFC period(land bank), Government availed different tenors of agriculture financing as follows:

- Seasonal/Short term working capital financing (1 – 2 years);
- Medium term financing (3 – 5 years)
- Long term Financing – beyond 5 years.



2.1 SHORT TERM FINANCING FACILITIES

- The AFC used to give short term loans to fund both crop and livestock production. The crops supported included maize, tobacco, cotton, soya beans, small grains, sugarcane, horticulture crops such as flowers and vegetables.
- Livestock schemes such as cattle fattening, piggery production and chicken production were covered by these facilities. Such facilities were for tenures of between 9 and 12 months and in some cases 18 months.
- The interest rates for such facilities were highly subsidized and below 10%.

2.2 MEDIUM TERM FACILITIES

The AFC also used to give medium term facilities with tenures of 12 months to 36 months.


These were mainly for cattle breeding, dam construction, establishing fruit trees, fencing farms and for cattle paddocks.

These loans were at even lower interest rates.

Most farm machinery purchases and equipment financing was done through the medium term financing. Farmers were financed for tractor purchases, irrigation equipment, such as center pivots and other systems over a period of 36 months.



2.3 LONG TERM FINANCING

- Long term financing had tenor of between 36 to 60 months. This funding was mainly for infrastructure development and farm purchases.
 - The interest rate was typically below 8%. Most large inland dams were built in this manner, by either individual farmers and or syndicates of farmers.
 - The National Farm Irrigation Fund (NFIF) was one such fund which was used for dam construction.
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3 DWINDLING SOURCE OF FUNDING

Since adopting multi-currency regime in 2009 (dollarization), the banking system has been characterized by **short term** deposits. Over **75%** of the deposits are demand deposits and not readily available for medium or long term financing.

International and regional lines of credit became fewer and subject to a high risk premium, reflecting the perception of Zimbabwe as high risk due to the existing external debt payment arrears and debt overhang.

3 DWINDLING SOURCE OF FINANCE CONT'

From 2000, the international community sharply curtailed both direct budget and balance of payments support to Zimbabwe on the backdrop of sanctions imposed on the country, and a build-up of external payment arrears. Thus, a significant component of agriculture financing ceased to exist.



3 DWINDLING SOURCE OF FINANCE CONT'

The country's access to international lines of credit was also severely limited and in addition, international organizations such as Norad, and many international NGOs/development partners, which actively and directly funded agriculture since independence – dried up. The external financing for agriculture, typically covered both working capital but also capital and infrastructure expenditures.



3 DWINDLING SOURCE OF FINANCE CONT'

- Accordingly, over the past 18 years, Zimbabwe has relied mainly on domestic financing, not only for agriculture but for the overall economy as well, which had implications for inflation, productivity and industry capacity utilization.
- The absence of external lines of credit and medium and long term financing has impinged on agriculture recovery prospects and growth.

3 DWINDLING SOURCE OF FINANCE CONT'

- Though not the only factor, financing has been one of the major impediments to agriculture sector recovery in Zimbabwe.
- High financing costs and the short term nature of deposits, have conspired to deter prudent borrowers, leading to high recurrence of adverse selection and hence high Non Performing Loans.
- As a result of worsening NPLs, the Government set up ZAMCO (a special purpose vehicle), to assume bad debts from banks to allow new lending and these were dominated by agriculture and agro processing manufacturing.

4. OTHER CHALLENGES FACING AGRICULTURE

Beyond financing per se, there are several other challenges discouraging providing funding hence impinging on agriculture recovery and growth. These are outlined in measured detail below:

4.1 Irrigation Infrastructure Challenges

Much of the country's irrigation infrastructure is dilapidated and requires immediate replacement. The Government has commenced a mechanization programme but hamstrung by prevailing foreign exchange shortages, hence financing will not immediately give a return.

4. OTHER CHALLENGES FACING AGRICULTURE CONT'

4.2 Security of Tenor

- Until recently, prior to the finalization of the 99 year leases, security of tenor was a big challenge for most farmers.
- The Government and banks have now agreed on the 99 years leases which should alleviate the challenges previously faced by farmers in this regard. Going forward, Security of Tenor will be measurably enhanced. (operationalizing this security to stream lined for it is based on improvements on the farm)

4. OTHER CHALLENGES FACING AGRICULTURE CONT'

4.3 Weak Institutional support and Extension Services: skills support

Due to budgetary constraints, the Government agriculture extension services are inadequate and overstretched. As a result, farmers often face inadequate support systems. Other institutions including veterinary services are equally overstretched.



4. OTHER CHALLENGES FACING AGRICULTURE CONT'

4.4 Investment in Research and Development

Reflecting the constrained financial situation in the country for both the Government and the private sector, investment in research and development has lagged over the years. Since independence, Zimbabwe was one of the leading countries in SADC in terms of Research and development.

This has changed significantly since the hyperinflation years in 2007/08.

4. OTHER CHALLENGES FACING AGRICULTURE CONT'

4.5 Collateral Security Challenges

- Most farmers lack collateral security and even fewer have other security arrangements like insurance and credit guarantees.
- Lending, though always on the basis of business cash flows has added risks in the absence of collateral security.
- The 99 Year Lease will assist. Leasehold vs Freehold and security of tenor

4. OTHER CHALLENGES FACING AGRICULTURE CONT'

4.6 Fragmented Agriculture output markets

- Zimbabwe, suffers from fragmented agriculture output marketing arrangements, with the notable exception being Tobacco and Sugar cane, and a few other crops.
- The Government is working with the private sector to create structured marketing arrangements including a Warehousing Receipt System which would create additional avenues for collateral security.

4. OTHER CHALLENGES FACING AGRICULTURE CONT'

4.7 Agriculture Skills Enhancement

Following the Land Reform programme, over 350 000 people became land owners farmers – people who had no knowledge of farming suddenly were utilizing vast tracts of land. The paucity of agriculture skills has been most evident and hence the need for agriculture skills enhancement.



5. POSSIBLE SOLUTIONS: THE IDEAL SCENARIO FOR AGRICULTURE PRODUCTIVITY

There are several intertwined pillars that are important for improving agriculture productivity and viability and hence better financing. These include:


- a. Sustainable Agriculture Value Chain Financing
- b. Affordable and Timely Inputs Management;
- c. Investment in Irrigation Infrastructure;
- d. Availability of Extension Services
- e. Harnessing ICT and Technology For Production;
- f. Investment in Research and Development; and
- g. Effective Marketing of Produce
- h. Financing – Appropriate Tenor and Price

The above are critical ingredients for sustaining agriculture recovery for overall economic growth.




5.1 A CASE FOR VALUE CHAIN FINANCING

Value chain finance is the flows of credit to and among the various linkages within the agricultural value chain, **from production through to value addition and marketing.** The entire value chain is covered, typically most effective when the marketing structure has embedded off taker arrangements for agriculture output.



5.1 A CASE FOR VALUE CHAIN FINANCING CONT'

Value Chain finance offers an opportunity to expand financing for agriculture, improve efficiency and repayments, and strengthen and consolidate business linkages among participants in value chains. This can improve efficiency in financing agricultural chains by:

- i. Identifying the agriculture output flow from production to marketing;
 - ii. Tailoring financial products to suit the needs of the entire value chain;
 - iii. Using value chain linkages and knowledge of the chain to mitigate payment risks.
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5.2 CATALYZING VALUE CHAIN FINANCING

All stakeholders have a role in the success of agricultural value chains. **Financiers must be present at each value chain bridge**

A successful Value Chain should:

- a. Enforce the repayment of loans and advances availed to the farmers by the financial system and other financiers in the value chain;
- b. Have an effective stop order system to ensure financiers are paid upfront;
- c. Eliminate side marketing;



5.2 CATALYZING VALUE CHAIN FINANCING CONT'

- d. Ensure Off taker arrangements are in place;
- e. A well-functioning commodities market is ideal;
- f. An expanded network of effective agro-dealer networks to distribute inputs;
- g. Have a functioning agricultural commodity Warehouse Receipt System to ensure that farmers are able to use the Warehouse receipts as collateral security.



A close-up photograph of a sandy beach. In the upper portion of the frame, the ocean waves are visible, with white foam washing onto the shore. The sand is a light tan color and appears slightly damp. In the lower half of the image, the words "Thank You" are written in the sand in a cursive, handwritten style. The letters are formed by indenting the sand, creating a simple but heartfelt message.

Thank You