Microfinance in Agricultural Sector: Selected Issues, Development Effects and Perspectives

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Abstract

Microfinance has been universal tool for supporting wellbeing developing and transition economies. Agriculture became a target sector for microcredit as a needy and important area of an economy. This article studies the current role and architecture of microfinance services for agriculture, and examines the development impact. Policy-oriented recommendations and scientifically-rooted proposals for further improvement are also provided.

Keywords: microfinance, agriculture, developing country.

1. Introduction

Microfinance has experienced a rapid growth over the last few decades and has become a popular development tool among policymakers (IPA, 2009). While the success of outreach by microfinance institutions to entrepreneurs has been remarkable, the evolution of microfinance in the agricultural sector has been limited in many developing economies. Microfinance has been engine for industrial growth in many developing economies by bridging the gap in supply of basic financial services and increasing the funding opportunities. After more than 30 years of experience, the microfinance sector has reached a clear degree of maturity. Considering the inaccessibility of 3 billion people around the world to financial services, microfinance has become a critical tool and a financial mainstream with 200 million clients in last 15 years. Global microfinance market achieved 15 percent growth in 2015.

Microfinance is the key for funding in emerging businesses. Microfinance expansion is wider in developing economies, who are supporting employment and economic growth by creating a sound environment for small and medium sized businesses. Agriculture is a highly dependent sector which small businesses and family farms are spreading at an accelerated rate. They often face the major local need e.g. land, seed, water, fertilization and market which require a sufficient funding. Recent trends show that agricultural sector and agribusiness are the brightest targets for microfinance. Agricultural finance is taking its roots from microfinance, as it has already become a central source of funding for agricultural production. As the spread of microfinance in agriculture differs across countries, its effect in total wellbeing has been positive in all of them. Therefore, microfinance in agricultural sector has been gaining a governmental focus for further expansion and accessibility.

Why for agriculture? Role of microfinance in agricultural development and business expansion is a topic of hot debates among government officials, financial institutions, farmer unions and academia. This is a common scenario in all developing countries in which agribusiness development is supported as one of the promising sectors of economy. Access to finance issue is the biggest challenge in the absence of microfinance opportunities. It is even more challenging, as lack of funding in agribusiness may stop the whole supply chain in the locality. Investing regularly in agricultural sector by external sources like microfinance ensure the survival of the value chain growth in local areas and wider scope in an example of an entire economy. Promotion of agribusiness investments relies on funding by microfinance tools in many economies. Microfinance investing facilitates the transfer of technologies, knowledge and skills. This article studies the essence, impact and perspectives of microfinance in agriculture at international level. It examines the efficiency of diverse small loan programs, business support schemes, lending portfolios offered by microfinance institutions through cross-country analysis.

2. Literature Review

Agricultural financing tools are a controversial research area among practitioners and researchers, as it has been an integrated part of financial studies with agricultural specifics. Recent literatures on agricultural finance mention the microfinance as the latest and accessible tool of funding for agribusiness. Research and working papers of international financial institutions are also paying considerable attention to promotion of microfinance in rural areas where agriculture is common business. Impact of lending by microfinance institutions to agriculture is studied in the context of several countries, especially in developing and transition ones. But cross-country or international-level studies are limited in number and scope.

In 2007 Llanto studied difficulties in developing a sustainable lending service geared toward smallholder agriculture and concluded that overcoming the barriers to agricultural microfinance goes beyond the simple provision of credit, extends outside agriculture, and shuns a “one size fits all” approach. Lal and Israel (2006) examined various methods and tools available to microfinance institutions for mitigating environmental impacts. Their case studies and solutions drew upon the experience of micro drip irrigation, self-help groups,
agroforestry, and sustainable agriculture, for improved watershed management. Girabi and Mwakaje (2013) investigated the impact of microfinance on agricultural productivity by smallholder farmers in Tanzania. Their research findings revealed that relatively better in accessing markets for agricultural commodities, use of inputs and adoption of improved farming technologies. Meyer (2007) analyzed the performance of microfinance, reviewed the constraints to greater progress in serving agriculture, and identified three important lessons with implications for the task of expanding the financial frontier into rural areas. Tenaw and Zahidul Islam (2009) assessed the structure of the rural financial services and the role of financial institutions from the view point of their success in improving the rural population’s livelihoods in Bangladesh and Ethiopia.

3. Global Architecture of Agricultural Microfinance

Microfinance institutions (MFIs) provide financial services to low-income, economically active, borrowers who seek relatively small amounts to finance their businesses, manage emergencies, acquire assets, or smooth consumption (CGAP 2002). They are different in structure and administration depending on the legal status, ownership form and orientation. Current architecture of global microfinance systems is structured under banks, rural banks, non-bank financial institutions, non-government organizations, credit unions and cooperatives.

Lending portfolios vary from types of microcredit providers. Largest share of microcredit is made out by banks and non-bank financial institutions which offer larger size loans to medium enterprises and agricultural producers. Non-government organization and credit unions are also actively involved in microfinance, but they are limited in size and sector of services. The total set of interactions between all of these actors to produce a specific agricultural product is often referred to as a value chain (Figure 1). Commercial banks and non-bank financial institutions are purely profit oriented establishments that work for a considerable interest rate which is often just over key interest rate fixed by the central bank of the country they are operating. Non-government organizations allocate loans for a specific business projects in selected sectors. Despite operational limitations, non-government organizations and cooperatives do not seek profit and their orientation is for development purposes only. MFIs provide a mechanism to smooth the effects of income shocks on consumption, find safe and affordable repositories for their savings, take advantage of profitable investment opportunities, and insure risk. Furthermore, they actively play in international financial markets by injecting capital investments in equity and stocks. Spectrum of microfinance services and lending portfolio volume are increasing due to rising demand and expanding financing horizon (Figure 2).
Figure 3. Portfolio growth of top-100 MFIs in 2012-2015

Source: ResponsAbility, 2015.

Gross lending portfolio of MFIs has a changing volume in parallel with global financial environment. Many funding sectors of MFIs are systemic with global economic trends. But only agriculture has a tricky and risky external factor – climate. Climate condition poses different risks and obvious dangers for farmers and agricultural goods producers. Relevancy of microcredit for agriculture should be assessed with high probability of external shocks. Therefore, architecture of agricultural finance distinguishes with several side-effect bearers of risk. Microfinance for agricultural stability purposes gains a considerable portion of total microcredit market at global scale. In line with commercial banks, cooperatives and non-government organizations, some countries have established their own special agricultural loan programs to help farmers and agricultural enterprises to meet the local market demand for food and related goods. This is an important element of international microfinance architecture although it is not implemented in all economies.


Agriculture is highly dependent on the local conditions: availability of and access to good land, soil, water, climate and market (Busschaert, 2014). Agricultural finance refers to financial services provided in rural areas for agricultural as well as nonagricultural purposes. Agricultural finance, primarily a subset of rural finance, is dedicated to financing agriculture-related activities such as inputs, production, storage, processing, and marketing of goods (Miller, 2013). Difficulties in agricultural finance have a long history and root back to early emergence of market relations in human development. Agriculture still is risky sector which is prone to both economic and environmental risks. Climate conditions, market state for foods and industrial demand often drive the agricultural production to different unavoidable paths. Although modern financial structure offers several risk-mitigation tools such as loans, insurance and hedging to cover farmers’ loss, climate and market conditions regularly affect the output and income level of farming. Insurance is an obligatory case for agricultural producers to recover from an absolute failure. But farmers also need extra financial tools to develop the business, to acquire new technologies and reserves. Insurance is limited and is of emergency losses only. Recent advances in financial architecture penetrated this issue too. In the last three decades microfinance have become the most accessible and available tool for farmers to cover losses, to expand production capacity and to modernize existing technologies.

The aim of microfinance is to build financial sectors that are closely interconnected with the local economy – thus facilitating lending to micro and small entrepreneurs, enabling payment systems to be established and, in particular, creating new savings opportunities for private households (ResponsAbility, 2015). Consequently, it leads to quantitative growth of other areas like decreasing unemployment, rising industry, boosted construction and expanding trade. Positive impact of microfinance in agriculture can be seen in the sample of many developed economies who are welcoming the expansion of financial services for rural areas and farmers. Regular state stimulation and easing in credit obtaining procedures at MFIs become the factor for rapid economic growth and strong position in financial system is some developing countries (Figure 3).
Microcredit for smallholder farms, household peasants, large agricultural production enterprises substitutes the investments from their own sources. In condition of economic transition and reforms, enterprises are used to be small and local-market oriented. Extra financial sources for business development or technological innovation bring wider positive effects in smooth transition to market economy. Moreover, people in developing economies, in which agriculture is a primary sector, are socio-economically vulnerable. Instability and turbulence in global food market and food insecurity bear extra burden, even climate condition is normal for harvesting. Farmers’ loss from these two risk origins requires ad hoc funds to recover and revive the business. Employment, infrastructure and transfer of technology in agricultural sector can be obtained by microfinance.

5. Conclusion

Many researchers studied the agricultural microfinance from different aspects and found diverse results. Econometric evaluations often show contrary results which do not fit the real life proofs, as they are commonly seen as the key tool and method in economic research. Real life impacts of microfinance in agriculture can be observed in Vietnam, Mongolia, Philippines, Bolivia and other developing countries which highly lean on agricultural sector. In these countries, share of employed population in agriculture is very high and breadwinners earn money from farming or peasantry. Financial support opens them opportunities for wider employment, more income and stability. Probably it is the highest level of expected impact, if it serves to enhance the performance of MFIs and its interaction with population.

1. In many developing economies lending procedure is somehow difficult and farmers have to wait longer to obtain loan. Simplification of microcredit obtaining procedure and elimination of bureaucratic barriers increases the outreach of microfinance services.
2. MFIs set upper and lower limits for the amount of microcredit for farmers and households. Sometimes they need more funding to implement their plan or they need less amount below the lower limit. Affordability principle matters here and limits should be flexible.
3. Gender equality is under the focus of global community. Providing more accessibility for women is recommended to improve and to create special lending packages and schemes.

Reference