Marketing credit for unions and cooperatives: unexploited opportunity for finance institutes

Executive summary

Access to agricultural finance is a critical problem for farmers and farmer organizations in the sesame subsector. Unions and cooperatives lack the capital to avail inputs on credit or provide loans to member farmers for production activities. Similarly, farmer organisations lack finance for aggregating and marketing the produce of members.

Financial institutions (FIs) are however reluctant to finance farmer organisations due to production and marketing risks; costs of financial service provision and lack of agricultural expertise. To overcome these challenges a risk sharing financing scheme was established with Ethiopian commercial banks. A one-year marketing loan is provided to farmer unions with a guarantee fund as partial collateral. This credit is on-lended to cooperatives for eight months, who can serve smallholder members with input finance during the last stages of the production season. The modality is highly appreciated as it is much cheaper than other sources and extremely successful with zero repayment defaults increasing trust and interest from FIs.

Opportunities and recommendations for action

Opportunities for FIs:

- Huge potential to capture agricultural market share by developing farmer-friendly loan products and generate income from interests.
- Salvaging farmers from the IMLs exploitation by providing loans with reduced interest rates.
- Mobilizing sources of capital through saving and commission.

The vision for 2025 consists of reaching significantly higher loan amounts and lower risk sharing based on long term business relationships between FIs and farmer organisations:

- Lobby banks' boards of directors to invest in agricultural expertise, to develop financing modalities with farmer organisations and allocate financial resources.
- Discuss with National Bank guidelines for FIs to allocate certain percentage of the portfolio to agriculture.
- Establish a revolving fund scheme of 1.2 billion which is managed by micro finance institutes (ACSI and DCSI) for supporting non-member farmers.
- Train farmer organisations on financial and loan management, including internal capitalization to build up alternative means of collateral.
- Promote strong farmer practices through training on good agricultural practices (full package application), financial literacy, saving and credit conditions and benefits.
- Investigate potential sources to establish a risk sharing facility such as government, inter- and national funds.

Problem statement

Sesame is the first export commodity for Amhara and Tigray. Sesame generates around 400-500 million USD/year from 240-250,000 MT of exports. Nevertheless, to double yields and reach the full potential of the sector, access to finance and inputs remains a critical problem to farmers and their organisations.

Most smallholder farmers (SHFs) are depended on informal money lenders (IML's), that demand extremely high 'interest rates' increasing the costs of production. Farmer organizations without working capital cannot provide services to members. Without the presence of cooperatives on spot markets traders can more easily collude.

Thus, access to affordable credit is key for the development of the sesame sector.

Facts, experiences and results

The risk sharing financing scheme is based on collaboration at four levels:

- Risk sharing agreement between bank and guarantor
- Loan agreement between banks and unions
- Marketing credit loan between unions and cooperatives
- Input credit loan between cooperatives and smallholder farmers

Experiences in piloting the risk sharing financing scheme, demonstrated sesame farmers' commitment and willingness of banks to finance agriculture based on the following results:

- Zero defaults from unions to banks; in some cases, union and cooperatives covered for defaulting members, showing their commitment to secure the credit facility and maintain the relationship with the banks.
- Farmers dependency on informal money lenders diminished and credit costs reduced.
- Larger quantities of sesame are supplied to cooperatives and unions; increasing the volume and number of transactions at sesame spot markets.
- The relationship between unions and cooperatives as well as between cooperatives and farmers improved; participating cooperatives attracted many new members.
- Mutual understanding increased between banks, unions and cooperatives
- Banks encouraged farmers to open saving accounts and improved the repayment culture.
- The importance and potential of the agricultural sector is better perceived by banks; ~50% of branch savings and transactions from sesame farmers.
- The banks' reputation among farmers and their organizations, which are often shareholders, improved.

Risk sharing financing scheme data

	2016/17	2017/18	2018/19	2019/20
Banks	CBO	CBO	CBO, Abay, Lion	Abay
Unions	Setit and Metema	Setit and Metema	Setit, Metema and Dansha union, Sanja coop	Metema union, Sanja and Godebie coops
% risk share FIs	50%	63%	67%	80%
Loan amount	4 million ETB	10.7 million ETB	30.5 million ETB	15.5 million ETB
No of coops	4	7	22	10
No of Farmers	1,067	2,995	5,541	2,188

Lessons learned

- Verify the strategic interest of banks in the agricultural sector and ensure the willingness to invest in resources and agri-knowledge.
- Start small and target a year by year increase of the loan amount, risk sharing percentage by banks and scope of borrowers, by building trust and credit history.
- Carefully select unions and cooperatives based on thorough objective assessments.
- Build cooperative capacity, especially on loan management; internal resource mobilization (to replace guarantee fund as collateral); marketing; financial literacy and savings.
- Define the loan contract terms and the loan application process clearly and facilitate the communication between banks, farmers' organisations and farmers.
- Engage bank staff at different levels from decision-making to local branch level.
- Work with different partners, both at the bank and farmers' side for healthy market dynamics and competition.