Supporting cooperative marketing and improving farmer-bank relations – experience with a risk sharing scheme

Case Overview

In the past three years (2016-2019), a risk sharing scheme based on a guarantee fund has been piloted in the sesame area in Northwest Ethiopia to enhance cooperatives access to marketing credit and to build trustful farmer-bank relations. The marketing credit was provided during the production season, allowing cooperatives to on-lend to their members. This addressed liquidity problems farmers generally have during the final stages of the production season. When marketing starts, the finance is used for cooperative sesame marketing. The in-kind repayment condition for farmers to cooperatives stimulates members' sesame delivery to the cooperative, allowing for increased cooperative sesame transactions. The risk sharing scheme has been evaluated as prudent and effective by the banks, unions, cooperatives and farmers.

Background

For agro-economic development and farmers' livelihood and cooperative business improvement, agri-finance is a critical issue. Financial institutions are generally reluctant to finance the agricultural sector; they consider the agriculture sector in general, and smallholder farmers and their cooperatives in particular, as too risky and expensive because of high transaction costs and lack of collateral. As a result they do not invest in dedicated staff and do not have much knowledge about agricultural commodity sectors, farmers' cash flows and realities of agricultural markets. Smallholder farmers have the reputation to have a bad loan repayment culture. This explains why farmers mostly rely on informal sources of credit, often at high interest, and on micro finance institutions. The latter generally have a limited reach, both in terms of geographical area and available capital.

This situation is clearly found in the Ethiopian sesame sector. Because of structural debts, generally with informal money lenders and at high interest rates, smallholder farmers are in a permanent cash trap. This is seriously hampering production improvement, as input finance is insufficiently available and farmers do not want to be more indebted. When selling their products, sesame farmers generally do not receive a fair price, because primary cooperatives and unions are hardly active in collective marketing, also because of a lack of finance. For good reasons, stakeholders in the thus perceive 'Finance' as one of the top priorities for sesame sector development and for farmer empowerment and income improvement.

It is in this context that Agriterra and Benefit-SBN, in collaboration with banks and cooperative unions, developed an innovative financing arrangement, based on a Guarantee fund. The idea is that risk sharing induces banks to enter into the agricultural sector and work with farmers and cooperatives. The initiative links marketing credit for cooperatives to cooperative managed production credit for farmer members. The risk sharing arrangement has run for three years (2016-2019), during which it was further developed and fine-tuned.

Objectives

The risk sharing scheme has several complementary and linked objectives:

- Facilitate the access of cooperatives to credit to engage in marketing activities;
- Support cooperatives with internal on-lending to members to realize and improve the final production stages and reduce credit costs;
- Enhance the presence of cooperatives at spot markets, allowing sesame farmers to get a better price for their produce;
- Higher farmer household income to improve livelihoods;
- Improve relationships between unions and primary cooperatives, and between cooperatives and members;
- Build trustful relations between cooperative unions and banks.

Achievements

- During the three-year implementation period 9,195 smallholder farmers have been reached, of which 2,082 female farmers.
- Farmers dependency on informal money lenders has diminished. Almost all participating farmers, who benefitted from internal loans at much lower interest than they would have paid to informal money lenders, have supplied to their cooperatives.
- The sales of cooperatives at spot markets increased significantly.
- For example, cooperatives under Metema union aggregated more than 2,500MT from their members; this was less than 40MT three years ago. Miabale cooperative of Setit union increased its sesame marketing from 900MT in 2017 to 1,340 MT in 2019. Gelego and Sanja have also increased their sesame aggregation, respectively from 10 and 13 MT in 2017 to 55 and 120 MT in 2019.
- Because of profit made by cooperatives, farmers received dividend, which is rather rare for most Ethiopian cooperatives.
- The relationship between unions and cooperatives as well as between cooperatives and farmers improved, mainly because transactions intensified thanks to the access to finance. Farmers observed: “Now we see cooperatives providing great services to us”. The participating cooperatives have welcomed many new members.

- Through the risk sharing scheme and organizing space for banks to discuss with cooperatives and unions, mutual understanding increased. Banks encouraged farmers to open saving accounts and explained the importance of savings. Many farmers opened saving accounts with the banks.
- The number of participating banks increased from one in 2016-17 (CBO) to three in 2018 (CBO, Abay and Lion). The amount of money disbursed reached 30.57 million ETB. The risk sharing percentage of Benefit-SBN reduced from 50% to 30%. These are indicators for the growing interest and increased confidence of the banks in their partners.
- The importance of sesame sales, which are better perceived because involvement in the sector, and possibilities to increase saving accounts are pull factor for banks. The bank reputation among farmers and their organizations, is also an important incentive. Some have become shareholders.
- Up till now, the repayment rate of Unions to banks is 100%. In some cases, union and cooperatives have covered for defaulting members. This shows their motivation to secure the credit facility and to continue the relation with commercial banks. Cooperatives and unions are also increasingly aware that they need savings, buildings, machines or other hardware that can serve as collateral to replace the guarantee fund.
- Benefit-SBN efforts in the area of agri-finance (risk sharing scheme, financial literacy training, bottom-up planning) raise a lot of interest of banks and micro-finance institutions, government agencies and other projects. This may create opportunities to expand efforts and find sustainable solutions.

Experiences, lessons learned and recommendations

During the past three years, Benefit-SBN, as a proximity facilitator, has experienced in day-to-day practice what worked well and what didn't, and has reflected on risks and what could have been done differently. The points below are recommendations based on this experience.

Verify the strategic interest of commercial banks. The key question is if banks have objectives that go beyond the scope of the risk sharing scheme, which is meant to initiate, facilitate risk-share the connections between banks and farmers' organisations. If not, there is a serious risk that the bank-farmer relation will not be sustainable.

Start small and target a year by year increase of loan amount, risk sharing, scope of borrowers. Building the relationship and trust between the banks and borrower unions is a gradual process. It is important to move step by step and build track record.

Select cooperatives carefully. This requires tailored tools for cooperative profiling and assessment, based on eligibility criteria, that are underscored by both the banks and the farmers' organisations.

Build capacity on loan management. This requires modules for training unions and cooperatives on, loan application, disbursement and repayment processes. Thorough borrower assessment, loan product adjustments, phased disbursement and repayment monitoring enhanced the technical capacity of farmer organisations in managing loans and reduce risks.

Build capacity for internal resource mobilization to build up alternative means as collateral to replace the guarantee fund. For sustainability, it is important to start early with awareness raising and capacity building of borrowers to strengthen internal resource mobilization, so as to build up collateral.

Engage bank staff at different levels. Borrower assessment and selection, training and coaching, monitoring and evaluation should be done in close collaboration with banks. If banks leave the selection of borrowers, training and monitoring to a third party (such as Benefit-SBN and Agriterra) and do not recruit of nominate dedicated staff, there is risk of limited sustainability. This risk also exists when local branches are committed, but not sufficiently supported by higher management.

Work with different partners, both at the bank and farmers' side. Some level of competition among banks induces improved loan product offers. Also, competition among cooperatives induces improved loan use and repayment.

Define the loan contract terms and the loan application process clearly and facilitate the communication between banks and farmers' organisations. Each bank has policies and regulations regarding loan duration, required collateral and other subjects. These have to be clearly communicated to the borrower and facilitator. The requirements and timeline of the loan application process should also be clear. Long negotiations may delay loan provision and the loan may not reach farmers at the peak production season for weeding and harvesting. If these terms and steps are clear, loan application and provision can be more participatory, providing unions and cooperatives the opportunity to decide to a certain extent on the loan conditions.

Invest in strengthening the capacities at different levels at the borrower side. Topics may include: supportive role of unions, financial management of cooperatives, internal communication, marketing strategies and compensation for the role of unions and cooperatives, farmers financial literacy and saving culture, internal resource mobilization and others.

BENEFIT Bilateral Ethiopian-Netherlands Effort for Food, Income and Trade

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