Lending to small-scale farmers in South Africa: A case for best practices in formal institutions

by

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DECLARATION

I declare that this thesis is my own original work. Where someone else's work was used (whether from a printed source, the Internet or any other source) due acknowledgement was given and referencing was made according to departmental requirements.

Signature   Date

DEDICATION

"Let me plead with you, lovers of my Africa, to carry with you into the world the vision of a new Africa" Robert Sobukwe

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ABSTRACT

The lack of access to agricultural credit is a constraint to the development of the small-scale segment of the agricultural sector. The challenge for formal financial institutions is to provide agricultural credit that meets the unique demands of the entire agricultural sector (both commercial and emerging sectors). Although small-scale farmers face a number of challenges, lack of capital for investment contributes significantly to the lowering of small-scale farmers' productivity levels. The challenge of access to agricultural credit from formal financial institutions is longstanding. Although some improvements have been made, a large proportion of small-scale farmers are yet to be reached by these institutions. One of the ways in which formal institutions can promote access to credit for small-scale farmers is to adopt best practices in lending. The study sought to establish whether formal finance institutions in South Africa adhere to best practices in their agricultural lending operations for small-scale farmers.

A review of literature indicates that there are countries whose formal financial institutions have achieved some success in improving access to finance for small-scale farmers. Hence, it is important to find out what these institutions have done, particularly the best practices they have adopted in this regard. Best practices in agricultural finance are the innovative methods/techniques/and procedures that address the supply- and demand-side constraints and challenges (from both the finance and agricultural sectors' perspectives) and thus improve the levels of access to agricultural finance. The response of formal finance institutions to the

risks and uncertainties inherent in the sector is to enforce stringent collateral requirements that are restrictive for small-scale farmers.

The study adopted a qualitative approach that utilised primary and secondary information obtained from reports, manuals and other relevant documents in the public domain as well in-depth interviews with key role-players from the major formal finance institutions.

The results of the study revealed that formal financial institutions in South Africa have not found appropriate delivery modalities that encourage and support agricultural finance accessibility among small-scale farmers. There have been considerable developments in terms of product type and product design in order to meet the demands of small and medium enterprises as well as agricultural clients. However, there still seems to remain gaps in terms of the different categories of emerging farmers that can be adequately financed by formal finance institutions. The loan appraisal process in formal finance institutions is based on the bankability of the farm enterprise and there is a heavy reliance on 'traditional' collateral requirement. There are few examples of collateral alternatives and substitutes that are used in practice and are usually of lesser value but also burdensome on the part of formal financial institutions (thus, a need for equity contributions remains necessary). Given the nature of the formal finance institutions considered in the study *viz.* commercial banks and the Land Bank; with their highly competitive and sophisticated corporate environment, and operations underpinned by a strictly business approach – there is little room left for a developmental agenda in terms of their lending practices.

Though private sector institutions play a significant role in theSouth African economy, the role of the state remains quite large with regard to the ambitionof a developmental state. It is within this dynamism that the public-private dichotomy of agricultural finance arises. There is also a gap in terms of providing the much needed non-financial support, such as access to markets, technical skills, or collateral alternatives. The environment within which formal finance institutions provide agricultural credit has changed, and agricultural lenders need to identify the arising opportunities in small-scale farmer development. The current status quo in small-scale agricultural lending best practices in South Africa leaves much room for development.

TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

ABBREVIATIONS AND ACRONYMS

ABC	Agricultural Business Chamber
DAFF	Department of Agriculture, Fisheries and Forestry
NDA	National Department of Agriculture
BAAC	Bank for Agriculture and Agricultural Cooperatives
NMB	National Microfinance Bank
SBP	State Bank of Pakistan
RFLC	Rural Finance Learning Center
GDP	Gross Domestic Product
StatsSA	Statistics South Africa
GATT	General Agreement of Trade Tariffs
WTO	World Trade Organisation
IFAD	International Fund for Agricultural Development
SLAG	Settlement/Land Acquisition Grant
LRAD	Land Reform for Agricultural Development
AgriBEE	Agricultural Black Economic Empowerment
MAFISA	Micro-Agricultural Finance Institutions of South Africa
ACB	Agricultural Credit Board
CIPRO	Companies and Intellectual Property Registration Office
DTI	Department of Trade and Industry
CDI	Cooperative Development Initiative
DGRV	German Co-op Federation
SAMAF	South African Microfinance Apex Fund
MEGA	Mpumalanga Economic Development Agency
FDC	Free State Development Corporation
ICT	Information and Communication Technology
ANED	Asociación Nacional Ecuménica de Desarrollo
CIDRE	Centro de Investigación de Desarrollo Regional
CMACs	Cajas Municipales de Ahorro Crédito
BRI	Bank Rakyat Indonesia
CECAM	Caisse d'Epargne et de Credit Agricole Mutuel
CASP	Comprehensive Agriculture Support Programme
FNB	First National Bank
ABSA	Amalgamated Bank of South Africa
BEE	Black Economic Empowerment
REM	Retail Emerging Markets
FSCC	Finance Sector Charter Council
SAFEX	South African Futures Exchange
DGRV	Deutscher Genossenschafts- und Raiffeisenverband e.V.

CHAPTER 1

INTRODUCTION

1.1 Background

South Africa's agricultural economy is dualistic in its structure when considered in terms of producer types. The two distinct producer types are the commercial (large scale) and emerging (small-scale and subsistence) farmers. The large-scale commercial sector is made up of 39 966 farming units. This segment of the sector covers a production area of approximately 86 million hectares and produces the bulk of South Africa's marketed agricultural output. The small-scale sector consists of 1,292 million farming households and has over 17 million hectares of agricultural land. This segment of the sector is largely concentrated in the former homeland areas of the country (Tregurtha et al., 2010).

The 2010 total farming debt amounts to over ZAR57 million, a figure that is almost double that of 2000. The greater part of this farming debt constitutes loans (and other lending and leasing instruments) that were made available to the commercial segment of the agricultural sector. The largest lenders to the sector are commercial banks (56.9%), followed by the Land and Agricultural Bank (24.9%), agricultural cooperatives (10.0%) and private persons (3.8%) (DAFF 2012).

Bradstock (2005) indicates that the formal banking sector lends primarily to the large-scale commercial farmer and remains disinclined to lend to small-scale and subsistence farmers. Generally, the small-scale sector remains largely underserved, even by public sector agricultural finance institutions, especially with regard to securing finance for operational costs and enterprise expansion. The reluctance of formal financial institutions to lend to the agricultural sector (in particular, to emerging farmers) can be attributed to the generally higher risk attached to agriculture (Tregurtha et al., 2010). Emerging farmers, in general, have low levels of production efficiency (Tregurtha and Vink, 2008) and engage in agricultural production mostly to supplement their non-farm incomes as well as their households' food requirements. As a result, small-scale farmers are regarded as higher agricultural lending risk in comparison to their commercial counterparts.

Agricultural finance in South Africa is skewed in terms of the major role players that supply formal finance to farmers, but also with regards to the type of producer that has access to the services of formal finance institutions. Over 60% of small-scale farmers state that they acquire start-up capital from sources other than formal financial institutions and just above 5% indicated that they had access to credit services from the formal financial sector (Coetzee and Machethe, 2011). About 50% of the small-scale farmers have access to banking services, this in comparison to the 5.6% that access and make use of agricultural finance from financial institutions. There has been a growing concern that formal financial institutions (both private and public) lend primarily to the commercial agricultural sector and, hence, many emerging farmers remain underserved (Coetzee et al., 1996; Weideman, 2004; NDA, 2005; Williams and van Zyl, 2008; and Agricultural Business Chamber (ABC), 2011).

Due to the nature of agricultural production (spatial location of farms, weather risks, commodity price fluctuations, longer investment periods, etc.), financing agriculture is costly. The problems encountered by suppliers with regards to the extensive nature of farming in most parts of South Africa, coupled to the low levels of infrastructure development in rural areas lead to increased monitoring and client search costs. The risks (market and weather) faced by farmers make lending to enterprises in the agricultural sector riskier than other sectors; which places the agricultural sector under undue pressure with regards to competing to secure funds, especially from private sector institutions (Tregurtha et al., 2010). Although there are inherent challenges in agricultural finance provision, access to agricultural finance is considered a major enabling factor for agricultural development (emerging farmer development included). Hence, improving access to such finance is a crucial aspect for both private and public role-players. The adoption of best practices in the provision of agricultural finance (agricultural lending in particular) is an approach that can prove valuable.

Emerging farmer development in South Africa is crucial for the overall growth of the rural economy, agricultural sector, employment creation, and poverty reduction. The inability of formal finance institutions to lend to emerging farmers threatens the existing land reform, rural development and food security scenario of South Africa. It is recognised that market liberalisation in the agricultural sector led to the demise of supply-led mechanisms in agricultural finance. Nonetheless, it remains relevant for the South African agricultural finance sector to carry with it (in part) the overarching development and transformation agenda. The challenge faced by formal financial institutions is to provide agricultural credit that meets the demands of the entire agricultural sector (both the commercial and emerging sector).

Given all these challenges, the strategies that are employed by institutions to manage costs and risks contribute (to a larger extent) to the sustainability component; which to some extent enhances the outreach component (Yaron, 2005). In drawing from international and regional studies; the stage of development of different countries has implications for the stage of development of the overall economic sector – which, in turn, has implications for both the agricultural and financial sectors. Though every country's context will differ from the next, international best practices can serve as guiding principles that contribute towards improved agricultural finance provision. Although there is no blueprint for agricultural lending best practices that can be applied in every country context, the duality of the agricultural sector in South Africa remains a major aspect to consider in contextualising what should be considered best practice guidelines.

There are varying contributing factors that continue to be a challenge for emerging farmer development in South Africa; key among these being the limited access to rural financial services. In view of the land reform targets that the South African government has set for 2015, along with the development of subsistence and small-scale farmers; there is yet a significant gap that is to be filled with regards to agricultural finance provision. In South Africa, access to formal agricultural finance is considered the third most significant factor (after access to markets and access to land) perceived as a constraint to growth by small-scale farmers (Coetzee and Machethe, 2011).

1.2 Research problem

Lack of access to agricultural finance for small-scale farmers is a constraint that impacts negatively on production, productivity and income generating opportunities for rural farm households. Internationally there are formal financial institutions, mostly in developing countries, that have been successful in providing financial services to resource-poor entrepreneurs in agriculture and this has contributed towards the development of the sector (World Bank 2008). Some of these institutions include Agrocapital (Bolivia), Grameen Bank

(Bangladesh), Bank Rakyat (Indonesia), Bank for Agriculture and Agricultural Cooperatives (BAAC, Thailand), NMB (Tanzania), and the Basix Group (India) (Höllinger 2003; State Bank of Pakistan 2009; Yaron 1997). Much of the success of these formal lenders may be attributed to their adoption of 'best practices' in lending to small-scale farmers. In South Africa, it is not known whether the major formal lenders to agriculture have adopted such 'best practices'. Furthermore, the extent to which such 'best practices' have been adopted or applied is also unknown. Hence, it is important to examine the 'best practices' that have been applied internationally and to determine the extent to which formal lenders in South Africa are applying these practices in their lending to small-scale farmers.

Research on ‘best practices’ needs to take cognisance of the fact that these practices in formal lending may be country specific. Studying these is essential not only in understanding the standard practices across the sector, but also to identify and develop guidelines for those practices that improve the effectiveness of institutions in expanding outreach and improving sustainability.

1.3 Study objectives

The main objective of the study is to establish whether formal finance institutions in South Africa adhere to best practices in their agricultural lending operations for small-scale farmers.

The specific objectives of the study are:

- To identify the major formal institutions involved in the supply of agricultural finance to small-scale farmers;
- To examine the criteria and procedures for lending to small-scale farmers by formal institutions;
- To examine the lending operations of formal institutions for small-scale farmers in terms of their sustainability and outreach;
- To determine the extent to which formal lending institutions have addressed the challenge of lack of collateral faced by small-scale farmers; and
- To propose measures that can assist formal lending institutions to improve access to finance for small-scale farmers

1.4 Justification for the study

It has been established that lending to the agricultural sector is difficult, costly and risky for a number of reasons. These include weather and market risks, transaction costs, and lack of collateral amongst others. Over the years, private formal finance institutions have significantly increased their overall share of total lending to the agricultural sector. The terms of business have not been the most favourable to the agricultural sector, and constraints have emerged that threaten to cripple the government's intentions on rural and agrarian reform. Agricultural lending to small-scale farmers has become one of the crucial components of the overall rural and agrarian development agenda. Improving small-scale farmers' productivity has risen to the fore of the agricultural and rural development debate; in light of the recent financial and food crises as well the anticipated climate change patterns.

Research that has been undertaken on agricultural finance (particularly towards small-scale agriculture) in South Africa is limited to the 1990s and early 2000s (Idsardi et al., 2008). Agricultural finance is considered necessary for the development of the agricultural sector. However, in South Africa, the transformation and development of the agricultural sector is crucial for economic, social, and political reasons. There are a number of policies and programmes that are being implemented that encourage a renewed focus on agrarian transformation; such as land reform, rural and agricultural development. Given the scantiness of information on the various forms of institutional configurations that provide agricultural finance sufficiently – especially agricultural lending; the agricultural finance sector provides many avenues of exploration with regards to localised examples of best practices in agricultural finance. This study proposes an approach that seeks to understand the status of the agricultural finance sector in the emerging farmer segment in South Africa. The institutional and operational arrangements that are appropriate for this objective will be incorporated into a set of outlined best practices as the major contribution of this study towards an improved body of knowledge within the field of agricultural development, and specifically rural and agricultural finance.

The potential gain from this study stems from the identification of agricultural financing models that are currently running successfully and sustainably, and have a wide and effective outreach that serves the needs and requirements of emerging farmers in an innovative and quality manner. The major contribution of the study will highlight best practices in terms of institutional design, methodology of service and product provision.

1.5 Key definitions

i) Agricultural finance

Agricultural finance is a subsection of rural finance that is focused on providing finance towards agricultural activities. This can range from input supply, production, distribution, and wholesale, processing and marketing (SBP, 2009). Agricultural finance extends beyond this to cover also the study of financial intermediaries that offer credit funds (and other loan instruments) to the agricultural sector, as well as the financial markets in which these intermediaries obtain their funds. Within the developing country context, agriculture finance can also fall within the ambit of development finance. Development financing in the agricultural sector is defined as provision of credit with the aim of bridging the gap between commercial investments and government development programmes (Deardorff, 2010). In principle, agricultural finance encompasses all socio-economic and financial interfaces between agriculture and the rest of the macroeconomic framework; which also includes lending procedures, rules, regulations, monitoring and controlling of the various formal financial institutions (Rajan et al., 2010). This aspect of agricultural finance is significant as it deals with issues relating to the total credit requirements of the agricultural sector (and segments thereof), the terms and conditions for lending, and the channels of credit allocation for the development of the agricultural sector.

Financial institutions extend agricultural credit to farmers for numerous reasons, such as (i) short-term credit for operational costs; (ii) intermediate credit for investing in farm equipment; (iii) long-term credit for the purchase of land among others. In agricultural lending, land is the most widely accepted asset for use as collateral but there are often problems with title and property rights in rural areas, which makes formal financial institutions lending to emerging farmers challenging. Moveable assets such as livestock and equipment can be used as alternative forms of collateral, but these are risky in cases where there is no proof of ownership and insurance cover (RFLC, 2011). Another aspect of agricultural finance deals with the integration of farm enterprise budgets with that of the household (especially with regards to small-scale and subsistence farmers). Financing for agricultural and non-agricultural activities, household consumption and investments are intertwined.

ii) Agricultural development

Agricultural development encompasses the improvement and increase in agricultural productivity as well as modernising agricultural practices. Agricultural development involves the shift (over years) from subsistence farming towards modern agriculture which leads to increased agricultural productivity, adoption of intensive scientific research and use of technological innovation, and participation in markets. This is largely through investments in irrigation, research and rural infrastructure, technology generation and dissemination, and natural resource conservation (Dethier and Effenberger, 2012). Poulton et al. (2006) state that some of the benefits that result from agricultural development include standard setting and monitoring (in terms of product quality and quantity), reduction of transaction costs (economies of scale), and improving the overall competitiveness and efficiency of agricultural systems. Agricultural development is vital to the challenges of poverty reduction both directly (through farm income) and indirectly (through non-farm income and reduced food prices). The principal social constraints to agricultural development have been unfavourable terms of trade, low levels of investment, technical challenges and unequal access to land and challenges with regards to property rights.

iii) Small-scale farmers

The definition of a small-scale farmer in South Africa can be a confusing task that is filled with many other terms and references. Some of the classifications encompass notions such as resource poor, previously disadvantaged, subsistence, emerging, developing, small-scale and black farmers (Boonzaaier, 2009; Moloi, 2008). In keeping with the definitions by Vink and van Rooyen (2009), small-scale farmer encompasses three categories of farmers (Table 3). These include subsistence, communal and emerging farmers. Subsistence farmers rely on multiple sources of livelihood, as well as the communal farmers whereas emerging farmers rely more on agriculture as their main source of livelihood.

iv) Best practices

In general, best practices are deemed to be innovative methods/techniques and procedures that are developed by organisations through the identification of the key business processes that prevail within that sector; and are identified as key components of outstanding customer service and business processes. The concept of best practices implies with it the comparison between organisation and institutions in view of what are more efficient and effective methods or approaches within the industry itself. "Best practice" on the other hand is understood as the outstanding practice in the particular process or function, i.e. producing the best results, among those in the same industry (SBP 2009).

In this study, agricultural lending innovations are considered "good practice" if such innovations produce positive outcomes in terms of financial sustainability and improved outreach to small-scale farmers. With regards to agricultural lending, best practices are considered as methods that have been proven over time to be efficient in expanding client outreach and establishing long-term sustainability of formal financial institutions.

v) Financial systems approach

This can be considered as the traditional (commercial/finance sector) approach to rural financial intermediation. The savings and credit facilities are provided by the conventional financial institutions (banking and non-banking) via rural branches (stationary or mobile). Within this approach, the institutions are governed by financial sector standards and only interact with the farmer/rural dweller in the exchange of financial capital through some kind of enforceable contract and the involvement of the state is minimal (in terms of regulation of interest rates and enforcement of credit controls) (Pearce et al., 2004). With recent technological advancement, this approach has also made inroad in expanding access of financial services to rural people and enterprises.

vi) Financial sustainability

Financial sustainability means that the organization is able to continue the financial services on a long term basis. Two core measures in this regard are sustainability of operations and fund base (SBP, 2009). Financial sustainability in agricultural lending encompasses the development of loan products and delivery systems that meet client needs, at prices that cover all costs of providing these financial services with growing independence from external subsidies (Rosengard, 2001). Formal finance institutions that are involved in agriculture finance should be able to meet the demands of the agricultural sector (small-scale farmers included) on a permanent basis while managing to recoup its operational costs (with or without profit) (Yaron, 2005; Adancy, 2007).

vii) Client outreach

Outreach gives an indication of the levels of penetration and quality of financial services delivered to the target market (in this case the agricultural sector, particularly the emerging sector); as well as the volume of activity in the designated target areas (largely rural areas in this case) (Lafourcade et al., 2005). Client outreach includes both breadth (number of rural clients serviced and volume of services) and depth (the socioeconomic level of clients that MFIs reach) dimensions (SBP, 2009). Essentially, expanding rural client outreach broadens the financial services that are available to the farming community. Outreach can also be assessed in terms of developmental objectives, scope and depth of progress on the target population (impact) (Okumu, 2007; Conning, 1999).

1.6 Outline of subsequent chapters

Chapter two provides an in-depth analysis of the existing literature on the South African agricultural sector, discussing the different producer types that are relevant in shaping the agricultural landscape. This is followed by a section on agricultural financing, discussing the key role-players that are present within this sector. An overview of literature on the role-players that are involved in agricultural lending is given. Significant trends in agricultural finance that have impacted upon the sector (and largely on the emerging farmer sector) will also be highlighted. The last section of the literature review focuses on the concept of best practices. The relevance of best practices adoption is discussed, as well as international and regional examples that are vital for the objectives of this study are also discussed.

Chapter three presents the key issues on the concept of best practices in agricultural finance, the relevance of the concept in agricultural finance, relevant international examples as well as its applicability to lending to small-scale farmers.

Chapter four discusses the adopted strategy of inquiry and the broad research design utilised for this study. The research method, sample design, and data collection methods used are discussed. The different components of the theoretical background are referred to and the manner in which they improve the soundness of the study is addressed.

The findings of the study emanating from company reports, publications, financial statements, as well as in-depth interviews with key informants are presented in chapters five and six. Chapter seven discusses these findings in light of whether or not formal financial institutions adhere to best practices in lending to emerging farmers. The final chapter summarises the study and presents the conclusions and recommendations.

CHAPTER 2

THE AGRICULTURAL SECTOR AND AGRICULTURAL FINANCE: A SOUTH AFRICAN PERSPECTIVE

This chapter discusses the structure of the South African agricultural sector – the overall characteristics of the sector as well as the dualistic nature of producer types (viz. commercial and emerging farmers). This part of the literature review purposively focuses on the emerging farmer segment of the sector and its development as it is pertinent to the issue of agricultural and rural development in South Africa. Literature that highlights the trends that have dominated the development of emerging farmers is reviewed; and this largely points to the numerous challenges that are encountered by the emerging farmers. The latter part of the chapter reviews literature that pertains to the agricultural finance sector – with the intention of identifying the major role players (from both the public and private sectors) and also to highlight some of the major trends that have emerged over the past ten years in agricultural lending.

2.1 Introduction

Growth and development of the agricultural sector is crucial for the overall development of rural areas. The channels through which this can be achieved are poverty reduction, through employment and income generation, increased food supply for urban markets (price effect), conservation of natural resources, and overall economic development. The agricultural sector is the backbone of an economy. Its strategic importance lies in its forward and backward linkages with the rest of the economy, the establishment and maintenance of food security, the economic welfare of rural areas and stabilisation capabilities in relation to the balance of payments.

Rural development looks at the entire rural context, to include farming and non-farming activities, the availability of basic services, infrastructure, health services, as well as equity issues. Economic infrastructure (transport, telecommunication and information technologies) is crucial for the development of economic activities in rural areas, including commercially sustainable farming. Education, skills development and health are the priority drivers for human capital development and welfare; and contribute to increased economic activity (OECD, 2006). The provision of social services and investments in public infrastructure that serves the needs of a knowledgeable, skilled, healthy, economically active society in rural areas remains the fundamental goal of rural development initiatives. The rural development agenda also includes the issues of redistribution of land and the securing of land rights. It however goes beyond the land question to the restructuring of the rural economic space, property regimes and socio-political relations (equity and empowerment issues).

Agriculture and rural development play a central role in stimulating economic growth, reducing poverty, and improving food and nutrition security in Africa. This role might change over time as the economy grows and expands, which broadens the scope of the rural economy. This is part and parcel of the development process.

2.2 Structure of the South African agricultural sector

In 2010, the agricultural sector contributed 2.3% to the GDP of South Africa and employed 4.7% of the total employed adults (DAFF, 2011). Though over 80% of the country's surface area is used for agriculture, South Africa faces climatological and environmental constraints with regards to arable land space (which is limited to only 13.5% of the total land area). The commercial sector, however, has managed to develop (over long periods) the technical and marketing expertise in a number of production systems (maize, deciduous and subtropical fruit, sugar cane, vegetable, and red meat production). This renders South African agricultural products established and relatively competitive in global markets. The South African agricultural sector, primarily based in rural and peri-urban areas, is characterised by a duality comprising a large-scale, industrialised and commercial sector (with an established supply chain) mostly controlled by the white population; and the black population largely participating in the sector as emerging farmers (Tregurtha et al., 2010).

Small-scale farmers face many challenges that can be attributed to the failure of land and agricultural policies in supporting sustainable livelihoods for rural people (largely dependent on land as a natural resource). There are several constraints that impede the growth of small-scale farmers, varying from systems constraints, allocative constraints, to environmental-demographic constraints (Kirsten et al., undated). The lack of agricultural finance remains key among the many other challenges – such as access to land and markets, and high transportation costs. Access to agricultural credit is a critical component of emerging farmer development which has been proven to contribute to improved productivity. The large demand for agricultural finance by emerging farmers remains unmet partly due to the inappropriateness of the delivery mechanisms and inefficiency of institutional and operational arrangements on the part of formal institutions. Improving access to agricultural financial services would contribute significantly toward removing many of the constraints limiting agricultural development in South Africa (Poulton, 2006).

There has been growth in the total farming debt figures over the years. However, the consensus on the gravity of the challenges faced by the agricultural sector (both commercial and emerging) in terms of attracting and accessing appropriate finance from formal financial institutions (e.g. banks, government programmes, finance providing agri-businesses) is growing. This is not necessarily attributable to the lack of agricultural finance institutions, but rather difficulties in reaching the targeted farmers in this current economic climate, with the suitable product types, and using the appropriate delivery mechanisms. Problems of access to agricultural finance remain crippling within the emerging farmer domain and to a somewhat lesser degree among commercial farmers as observed in recent years. In the 2010/11 financial year, about 15% of commercial farmers were anticipated to struggle to secure finance for their agricultural enterprises (PwC, 2011).

Subsequent to the 2008-2009 global financial crisis, the financial sector remains under severe pressure in terms of its lending criteria and practices – making it even more difficult for emerging farmers (who often lack collateral, technical capacity, marketing channels etc.). The financial systems approach is applied broadly in formal institutions that lend to the agricultural sector. There are however, other models of investment and funding that adopt an approach that is more conducive to the nature of agriculture (e.g. value chain financing, contract farming etc.). It is after all, fundamental that formal institutions that participate in agricultural lending adopt practices that not only meet the financial bottom line, but that also recognise the significance of the development agenda that is carried by the agrarian transformation and land reform process at play within the South African agricultural sector. It with this recognition that formal financial institutions can contribute meaningfully to emerging farmer development, which in turn contributes to the growth of the agricultural sector in South Africa.

2.2.1 General trends

Although the importance of agriculture in the South African economy is mainly anchored through its contribution to the national gross domestic product, formal employment, and foreign exchange earnings, there exist also indirect contributions that the sector provides. This is because of the strong backward and forward linkages that agriculture has with the rest of the economy particularly in relation to the manufacturing and agro-industrial sectors. Vink and van Rooyen (2009) state that though the agricultural sector contributes less than 3% to the country's GDP, it accounts for almost 10% of the country's formal sector employment (including the manufacturing and agro-industrial sectors), while more than 8% of the country's merchandised exports are primary agricultural products. As a result, the sector has, by all measures, relatively large linkage effects with the rest of the economy and is a net earner of foreign exchange (Tregurtha et al., 2010).

South Africa has over 100 million hectares of farmland, of which almost 17 million hectares constitute potentially arable land (about 13.7% of South Africa's total area). Land utilised for livestock grazing constitutes over 80 million hectares (about 68.6% of South Africa's total area) (DAFF, 2011). Nell and van de Berg (2001) state that only 1.6 million hectares (as a portion of the potentially arable land) are under irrigation, and contribute over 30% of South Africa's total agricultural output. In general, the large-scale commercial sector in South Africa is both established and advanced and comprises of crop, animal and horticultural production as compared to the small-scale sector. Both sectors are, however, crucial for the growth of the South African economy as well as the food security issues faced by the country.

The sector has experienced a decline in the number of commercial farming units, with growth in the average size of individual farming units as well as farm enterprise diversification mainly into game farming, tourism and leisure enterprises. The number of commercial farming enterprises has steadily fallen from 60 938 in 1996, to 45 818 in 2002 and 39 966 in 2007 (DAFF, 2011) in response to the competitive global market conditions (Table 1). In 2010, the number of farming enterprises was estimated at 37 000 (DAFF, 2011). It must be noted though that the majority of these enterprises are commercially oriented and generally exclude emerging farmers.

Table 1: Commercial farming enterprises by province 2002 and 2007

Province	**1996**	**2002**	**2007**
Eastern Cape	6 338	4 376	3 896
Free State	11 272	8 531	7 515
Gauteng	2 342	2 206	2 378
KwaZulu-Natal	5 037	4 038	3 560
Limpopo	7 273	2 915	2 657
Mpumalanga	4 675	5 104	3 376
North West	7 512	5 349	4 692
Northern Cape	6 730	6 114	5 226
Western Cape	9 759	7 187	6 682
Total	**60 938**	**45 818**	**39 982**

Source: Statistics South Africa (2005, 2009)

Historically emerging farmers were constrained primarily by limited access to land and land ownership. This has resulted in low levels of agricultural development among emerging farmers. Fenyes and Meyer (2003) have estimated that there are between 3.4 and 4.8 million small-scale farmers in South Africa. Emerging farmers utilise about 14.4 million hectares of farmland, of which 2.5 million hectares is potentially arable and 11.9 million hectares is utilised as grazing land (DAFF, 2011). There are however emerging farmers that are commercially oriented, who farm on privately or communally owned land. Ortmann and Machethe (2003) state that there are about 240 000 black farmers that fall into this category. The rest of the smallholder farmers fall into the subsistence and small-scale categories. Other studies however estimate that three to four million subsistence farmers engage in agriculture solely for household food provision (Aliber, 2005; NDA, 2001).

The four largest commercially farming provinces of South Africa are Free State, Western Cape, Northern Cape, and North West (Table 1). The Statistics South Africa General Household survey of 2009 reveals that the four largest agriculturally involved provinces (by household) are Eastern Cape, Free State, KwaZulu-Natal, and Limpopo (Table 2). Table 2 presents the proportion of surveyed households (by province) that indicated some kind of involvement in agriculture related activities. The total number of surveyed South African households, when pooled together also gives an indication of the proportion of households that are engaged in each type of agriculture related activity. What can be deduced from these sources is that there is a significant proportion of South Africans that are involved in agriculture for purposes other than commercial farming. This provides confirmation of the dualism that exists within the agriculture sector in South Africa.

Table 2: South African households involved in agricultural activities by province (1000s)

Activity	Province									Total – South Africa
	Eastern Cape	Free State	Gauteng	KwaZulu-Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape	
Involved in agricultural production	643 (37.3%)	274 (31.9%)	248 (7.1%)	697 (26.8%)	580 (43.4%)	205 (21.1%)	35 (11.4%)	108 (11.4%)	39 (2.7%)	2832 (20.7%)
Livestock production	312 (48.5%)	26 (9.6%)	27 (10.7%)	230 (33.0%)	99 (19.1%)	21 (10.4%)	22 (62.1%)	34 (31.0%)	* (17.5%)	778 (27.5%)
Poultry production	349 (54.3)	35 (12.9%)	22 (9.0%)	256 (36.7%)	146 (25.1)	11 (5.1%)	11 (31.0%)	23 (21.1%)	* (1.8%)	853 (30.1%)
Grains and food crops	389 (60.5%)	21 (7.8%)	31 (12.5%)	316 (45.4%)	465 (80.1%)	128 (62.5%)	* (12.2%)	34 (31.5%)	* (2.7%)	1390 (49.1)
Fruit & vegetable crops	220 (34.2%)	232 (84.7%)	175 (70.5%)	330 (47.3%)	173 (29.8%)	141 (68.8%)	* (25.2%)	40 (36.8%)	30 (75.9%)	1350 (47.7%)

Source: Statistics South Africa (2009)

Vink and van Rooyen (2009) claim that the above mentioned observation (on the dualistic nature of the agriculture sector in South Africa) is to some extent also a broad generalisation. The commercial sector can further be analysed by size of production, unit type and turnover into three sub-categories viz. large, medium, and small (Table 3). The small-scale sector can be divided into three sub-categories i.e. communal-commercial, emerging, and subsistence. Therefore the agricultural sector is not only dualistic, but rather complex as it consists of a number of different economic entities that function within the same dualistic economic framework.

Table 3: Typology of the agricultural sector

Production Unit	Turnover	Ownership & Management	Number of farmers	Binding constraint	Support required
Large commercial on private property	>R2 million	Family owned but incorporated multiple farms Rent in land – professional management	±5 400	Market size Equity capital	Export market access Financial market innovation
Medium commercial on private property	R300 000 to R2 million	Family owned, could be incorporated. Some renting in of land – family management	17 000	Land capital management	Mortgage capital for land access Management training
Small commercial on private property	<R300 000	Family owned, generally part time. Some lifestyle farming (game ranches, weekend farms)	24 000	Management time	N/A
Commercial in communal areas	>R300 000	Communal ownership Development project Private ownership	-	Capital management infrastructure	Grants for land access Property rights Comprehensive farmer support Credit Physical infrastructure
"Emerging" commercial in communal areas	<R300 000	>20 hectares Communal ownership Small farmers in development projects Private ownership	35 000	Land (property rights) Capital labour management Employment opportunities	Grants for land access Property rights Comprehensive farmer support Credit Physical infrastructure Institutional infrastructure
Subsistence farmer in communal areas Allotments Market gardens	N/A	<20 hectares Communal ownership Private ownership Little formal market participation	1.256 million	Employment opportunities	Social welfare transfers

Source: Vink and van Rooyen (2009)

2.2.2 Small-scale agriculture

Within the dualistic nature of the agricultural sector in South Africa; almost all of the country's agricultural output comes from the commercial sector, given the low levels of production by small-scale farmers It is generally accepted that the majority of engage in agricultural production mostly to supplement their non-farm incomes as well as their household food requirements. These and other notions (with regard to farmers' risk profiles and the low levels of success of land reform projects) have contributed to undesirable perceptions associated with small-scale agriculture. The significance of small-scale agriculture in South Africa cannot be overlooked for many reasons including economic growth, rural development, poverty eradication, and food security.

It is generally accepted that small-scale agriculture is a sector that is almost synonymous with rural poverty in South Africa. As a result, there have been no comprehensive studies that focus on small-scale agriculture as an engine for rural economic growth, principally in the former homelands of South Africa. The figures reported above (Table 3) reach to the millions; it is likely that there are many more small-scale farmers in South Africa. Given the inherited legacy of former homelands, customary land tenure and the related 'Bantu' land administration practices, there is generally a lack of clear land ownership and land-use rights. This has been seen as a major stumbling block in terms of agricultural finance provision for small-scale farmers. Household socio-economic status is only a part of the broader picture of the issues and challenges that small-scale farmers are faced with. These include lack of tenure security; lack of reliable and effective farmer support services such as output markets, trade and institutional policies, finance and extension, and inadequate access to the factors of production.

Within the small-scale agricultural sector, there are about 3.4 to 4.8 million people that engage in agriculture for varied reasons. Emerging farmers that rely solely on agriculture as the main source of income constitute 8% of total South African black households. Approximately 6% of total South African black households rely on agriculture as an extra source of income. A large proportion of South African black households rely on agriculture as means to supplement household food supplies (81%), and only about 8% rely on agriculture as the main source of food supplies (Hart, 2009; Statistics South Africa (StatsSA), 2008). In rural South Africa, generally it is estimated that about 10% of the household income comes directly from agriculture-related activities. It is also stated that about 20% of the total food consumption is self-produced (DAFF, 2011).

Aziakpono (2010) states that of the estimated eight million rural and peri-urban households, 1.3 million (17%) of these have access to land for farming purposes, however marginal. Over 95% of these households utilise their land for agricultural activities. The size of land that each household has access to is quite small, with over 80% of the households' land size amounting to one hectare or less (Table 4). Large proportions of these rural and peri-urban households are located in former homeland areas, and would be categorised mainly as subsistence and commercial farmers.

Table 4: South African households' access to agricultural land

Area	Number (weighted)	Percentage
<0.5 ha	831,871	64.5
0.5ha-1ha	235,454	18.3
1ha-5ha	138,196	10.7
5 ha-10ha	38,146	3.0
10-20ha	11,940	0.9
20+ha	34,546	2.7
Unknown	17,556	-
Total	**1,307,710**	**100%**

Source: StatsSA (2006)

In most instances, small-scale farmers who have not benefited from the government's land reform programme have been left out from being able to access funds, technical support, and market access, usually facilitated through organs of the state such as Land Bank, Department of Agriculture, Fisheries, and Forestry. Technically it appears there was a policy shift from resource poor small-scale farmers to better resourced farmers (Adey, 2007). This in turn led to the introduction of emerging black framers without developing the already existing small-scale farmers. In effect this has imposed, upon all categories of small-scale farmers, certain expectations from the side of output and finance markets (in terms of 'terms of loan contracts'). Adey (2007) continues and argues that 'emerging farmers are far easier to assist than the resource-poor farmers; while resource-poor farmers are caught within the poverty trap that makes it difficult for them to make use of the existing technologies and support. However, fact is more effort is required to support this group as most are under-resourced, situated in marginal areas and semi-arid zones and consequently the transfer of technology alone is inadequate.'

The development of the small-scale sector is crucial for the economic and social transformation of the rural economy as well as the agricultural sector in general. Given the strong backward and forward linkages that agriculture has with the rest of the economy, the expansion of rural incomes through agricultural production has the potential to drive demand for inputs, consumer goods and services (Makhura, 2001). This contributes significantly to the structural transformation of the rural economy; over and above the improvement of the rural socio-economic condition. There are industry specific case studies that provide success stories for small-scale farmer comprehensive support. The sugar industry is one, where an integrated system of various institutions was coordinated by the industry body to provide support services (Bates and Sokhela, 2003).

2.2.3 Major challenges in small-scale agriculture

There is a need to address the challenges that face small-scale agriculture. An understanding of the different categories of small-scale agriculture and the respective constraints and challenges is vital. This would assist greatly in the development of appropriate mechanisms of intervention in assisting small-scale-farmers. Mudhara (2010) notes that households involved in small-scale agriculture are largely characterised by poverty, hunger, low-income levels, under- and un-employment.

Hart (2009) categorises the different constraints and challenges encountered in the small-scale agriculture sector into three broad categories viz. institutional, infrastructural, and global factors. Institutional challenges include the corporatisation of the agricultural sector in general (which excludes small-scale participation in the value chain) as well as low government spending in public agricultural research and development. Rural infrastructure constraints emanate as a result of under investment in roads and other transportation, storage, and communication facilities which all to some extent restrict small-scale farmers' access to input and output markets. Some of the challenges with regards to the global market relate to the GATT and WTO trade policies. Van Averbeke and Mohamed (2006) categorise constraints encountered by small-scale farmers into marketing, technical and financial constraints.

2.2.3.1 Access to land

Access to land is certainly one of the most critical challenges that face small-scale farmers – in terms of size as well as ownership and use rights in rural South Africa. The land reform programme of the South African government has been protracted and with mixed outcomes. When the programme was initiated in 1995, the target was to transfer 30% land to the ownership of previously disadvantaged individuals. Greenberg (2010) states that only 6.9% (about 5.67 million hectares) of the initial target has been transferred; though a large share of this land remains unoccupied or under-utilised due the lack of infrastructure, input or technical support.

About 50% of the transferred land was only in two provinces (KwaZulu-Natal and Northern Cape), including both redistribution and restitution programmes (Table 5). It must be noted that only 11.4% of households in Northern Cape and 26.8% in KwaZulu-Natal have indicated any involvement in agricultural production (Table 5). Though this is not an in-depth analysis of the land reform programme in South Africa; there is a stark inconsistency in land reform progress (Table 5) in comparison to provinces that are large commercial producers or even those that record high involvement of households in agricultural production. This can be understood in two ways: (i) that the land reform programmes have redistributed land that is not necessarily highly productive or at least located in those regions, and (ii) that the large share of redistributed land is not within the provinces that have a more prolific use of agricultural land aggregated by individual households. The implication here is that small-scale farmers (whether commercial, emerging, or subsistence inclined) have not received the bulk share of redistributed land.

Table 5: Land reform progress by province and programme (1994-2009)

Province	**Redistribution and Tenure**			**Restitution**			**Total**	
	No. of farms	Hectares	Beneficiaries	Claims	Hectares	Beneficiaries	Hectares	Beneficiaries
EC	675	353357	25633	16201	94834	215201	448191	240834
FS	799	350291	7721	2662	47615	40893	397906	48614
G	286	34513	7328	13159	9476	70179	43989	77507
KZN	690	547414	67761	14752	642447	433168	1189861	500929
L	291	91235	7403	3382	513024	220227	604259	227630
MP	444	322839	3382	2694	399876	225 877	722715	239827
NC	271	952744	2773	3682	539620	100554	1492364	103327
NW	300	268566	40539	3709	373642	172963	642208	213502
WC	223	122304	12750	15546	3769	118165	126073	130915
Total	**3979**	**3043264**	**185858**	**75787**	**2624303**	**1597227**	**5667567**	**1783085**

Source: Greenberg (2010)

2.2.3.2 Marketing and technical constraints

Small-scale agriculture remains under-resourced in terms of investments in infrastructure, technology and research. In view of the small-scale farmers that are land reform beneficiaries (both redistribution and restitution), the planning and support of small-scale farming projects has not been sufficient to encourage and support entry level standards for market participation requirements.

Marketing constraints can be understood along three dimensions: physical access, structure of markets, and farmers' lack of technical skills and knowledge. Physical access to markets refers to the distances that most small-scale farmers, (mostly located in underdeveloped and underserviced rural areas) who largely do not have transport facilities, have to travel for their produce to reach markets. This directly contributes to higher transactions costs in terms of locating markets as well as the transportation and storage costs involved. Constraints relating to the structure of markets relates to the asymmetrical relationship between farmers, market intermediaries, and consumers. Barriers to markets and information flows can be structural in terms of the dualistic nature of the agriculture sector; it is also behavioural in terms of small-scale farmer organisation (IFAD, 2003). Along with the corporatisation of the agricultural sector, participation in the value chain (including agro-processing and food markets) has become difficult for small-scale farmers. Emerging small-scale farmers fall short of meeting market requirements as a result of low levels of knowledge, skills, experience, equipment, and infrastructure among others. The end outcome of technical constraints encountered by small- scale farmers mean that they produce largely for local markets and agro-processing grade produce (Boonzaier, 2009).

There is a great disparity in terms of the quality and yields of emerging small-scale farmers as opposed to commercial farmers in South Africa. The growing trends in terms of the South African food 'quality turn' and changing consumer preferences (along with consumer legislation) poses a challenge for small-scale farmers. Challenges around issues of economies of scale, and recently product quality, has emerged as an issue that small-scale farmers must contend with in order to be able to compete for space in the food market (Louw et al., 2008).

2.2.3.3 Financial constraints

Access to formal finance is a constraint to small-scale agriculture, and has been documented widely in the literature. The formal finance sector faces a number of challenges in lending to small-scale farmers. There is a supposed higher risk associated with lending to the agricultural sector and more particularly the small-scale sector. The rationale to the formal institutions' perceptions can be linked to the rural and sparse location, the relatively small loan requirements, and the associated production risks of small-scale farmers. Lending to small-scale farmers by formal institutions is generally characterised by high transactions costs and risks. Again, the agriculture sector is characterised by low profit margins and low turnover time which poses a challenge for formal financial institutions as the sector has a typically longer term trajectory. Normally, formal financial institutions require collateral (usually in the form of land) to mitigate against information asymmetry, moral hazard and adverse selection and to compensate for default (Pillarisetti and Mehrotra, 2009). There have been other innovations that attempt to fill the gap in terms of meeting the demand for finance by small-scale farmers, such as public institutions as well as farmer organisations and cooperatives (George, 2009).

Agricultural productivity in the small-scale sector can be improved significantly when small-scale farmers are provided with reliable and good quality support services such as extension, finance and marketing (Machethe, 2004). Farmer support services alone are however, not sufficient to turn around small-scale agriculture into a significantly contributing sector to the economy at large or the agricultural sector itself. Other conditions that must be met in order to transform the rural economy include investments in human capital (education and health), improved technologies and innovations, public infrastructure, as well as appropriate policies and regulatory frameworks (e.g. land reform, agricultural finance, marketing etc.).

The factors of production that limit small-scale farmers are in effect rooted in financial constraints (includes credit, information and transaction costs). Access to small-scale agricultural finance is not only crucial for the farming activities of small-scale farmers; but also the overall household socio-economic status (in terms of smoothing consumption, lowering the vulnerability index, investments in human and physical capital). A number of scholars (Okurut et al., 2004; Spio, 2002) argue that formal finance institutions have failed to cater to the effective demand for small-scale agriculture financing due to 'to a combination of high risk, high costs'. This is largely due to the inappropriate design of lending methods and products towards this segment of the agriculture sector. Generally, small-scale farmers face the following challenges in dealing with formal finance institutions:

- High transaction costs:

- Low market prices and high production risks:
- Collateral and assets
- Legal, regulatory and supervisory framework
- Seasonality and agricultural production cycles

2.3 Agricultural finance in South Africa

There are a number of unique characteristics to rural and agricultural markets that constrain both the supply and demand for finance in those areas. These challenges include:

- high transaction costs for both borrowers and lenders;
- high risks faced by potential borrowers and depositors due to the variability of incomes;
- exogenous economic shocks and limited tools to manage risk;
- lack of reliable information about borrowers;
- lack of adequate collateral; and
- unfavourable policy, legal and regulatory frameworks.

The lack of agricultural credit is a constraint to the development of the small-scale sector as it limits investment in productivity-enhancing technology and inputs (which tend to be bulky, once-off investments).In general, lending to the agriculture sector is difficult, costly and risky due to the nature of agricultural production (with the associated production and marketing risks) as well as its predominantly of rural locality. Given the low and sparse population densities, poor infrastructure and general underdevelopment; transaction costs are increased. This increases the monitoring and client search costs for financial institutions operating in these areas. Farmers also have to contend not only with market risks but also with environmental factors such as weather. These challenges place agriculture as a sector at a disadvantage when competing with other sectors for scarce funds, more importantly post the global financial crisis.

A large proportion of small-scale farmers live in remote areas where retail banking is limited and production risks are high. Demirgüç-kunt and Levine (2004) have noted the difficulty that poor farmers experience in financing seasonal input purchases for food grain production as a major problem. Access to appropriate financial services is very critical in improving productivity of agriculture systems, particularly in developing the small-scale sector. Agricultural finance is also essential for commodity marketing, often done through financial or input cooperatives (sometimes referred to as warehouse receipt systems) which offers small-scale rural producers, traders and processors the opportunity to improve household income through adopting better produce marketing and raw material procurement strategies (World Bank, 2004).

Though farmers (both commercial and small-scale) have in the past and continue (post 1994) to receive some kind of assistance from the state in acquiring agricultural land, acquiring credit to cover production costs continues to be a challenge, especially in view of the seasonality of production cycles (Vink and van Rooyen, 2009). Keeping in mind the dualistic nature of the south African agriculture sector, small-scale farmers continue to face constraints in all aspects of the industry – though there have been improvements for some. There are some concerted efforts that seek to improve small-scale farmer's access to agricultural finance. For instance, there are government grants that seek to address financial constraints of small-scale farmers in the democratic South Africa e.g. Settlement/Land Acquisition Grant (SLAG), Land Reform for Agricultural Development (LRAD), and Agricultural Black Economic Empowerment (AgriBEE)). There is also a dedicated agricultural development bank (Land and Agricultural Bank) that offers loans to small-scale farmers, at a preferential interest rate that is lower than that of the financial market. Moreover, there are parastatals that offer a range of services that are geared towards developing small-scale farmers (i.e. offer loans, technical advice, and business development services). The emergence of a publicly funded wholesale fund, the Micro-Agricultural Finance Institutions of South Africa (MAFISA), can be regarded as acknowledgement that there is insufficient supply of credit to small-scale farmers.

Despite all these efforts, limited small-scale access to agricultural finance remains an impending constraint for small-scale farmers. Overall, it is difficult to deduce the real impact of all these programmes on access to finance for small-scale farmers and on agricultural development. It is possible, however that the lacklustre performance of these programmes or institutions points to supply-led mechanisms that have been adopted in their formulation (Coetzee, 2003). Though there is a demand for agricultural finance by small-scale farmers, this has not been necessarily contextualised properly to give impetus to the effective demand for agricultural finance by small-scale farmers. The heavy focus of government programmes on beneficiaries of the land reform programme has also contributed to creating a gap in terms of small-scale farmers on communal land, homesteads etc.

2.3.1 Trends in agricultural finance (since 2000 - 2012)

Prior to the period of 2000 -2010, there were a number of changes in the agriculture sector (institutional and policy environment) that have shaped the agricultural finance landscape of South Africa leading up to and post 1994. There was withdrawal of public support for the agriculture sector as a whole due to the market liberalisation (deregulation of marketing boards, introduction of market based financial system) of the 1980s. This also led to the closure of the Agricultural Credit Board (ACB) in 1999. The agriculture sector was then exposed to fluctuations in market prices and interest rates, which deepened the agricultural financing problem. In post 1994 South Africa, the introduction of land and agrarian reform policies were effected, aimed to introduce 'new' (small-scale) farmers into mainstream (commercial) agriculture. Among the many successes and developments in the agriculture sector in South Africa; the financing of agriculture and rural development remains among the top three challenges that hamper the growth and development of rural South Africa.

Between 2000 and 2010 there have been some interesting shifting trends in terms of the dominance of private stakeholders in agricultural finance provision in South Africa (Table 6). In 2000, the largest lenders to the agricultural sector were commercial banks (37.5%), the Land and Agricultural Bank (32.2%), agricultural cooperatives (15.1%), and private persons (6.6%). Since the total farming debt has continued to grow steadily over the years, notable shifts in terms of major contributing lending institutions took place. In 2005, the contributions were as follows: commercial banks (54.6%), the Land and Agricultural Bank (17%), agricultural cooperatives (12.6%), and private persons (7.8%). By 2011 and 2012, the proportions had shifted significantly to favour commercial farmers in the following manner: commercial banks (56.9%), the Land and Agricultural Bank (24.9%), agricultural cooperatives (10.0%), and private persons (3.8%) (DAFF, 2012). It must be kept in mind though, that these proportions largely pertain to commercial farmers. Weideman (2004) states that access to credit and overall financial support is characterised by the same inequitable dualistic nature that is prevalent throughout the agricultural sector (and arguably across the economy) in South Africa.

Table 6: Total farming debt composition (2000 -2012)

Year	Total	Land and Agricultural Bank	Commercial Banks	Agricultural cooperatives	Private persons	Department of Agriculture	Other financial institutions
ZAR Million (% of annual total)							
2000	29825.9	9606 (32.2)	11172.3 (37.5)	4500 (15.1)	1986.7 (6.7)	860.4 (2.9)	602.4 (2.0)
2001	30826.4	9073 (29.4)	13146 (42.6)	3666.6 (11.8)	2230.8 (7.2)	800.6 (2.6)	676.4 (2.2)
2002	28231.5	7931 (28.1)	11027.1 (39.1)	3807.7 (13.5)	2677.8 (9.5)	495.9 (1.7)	811.9 (2.9)
2003	30891.1	7560 (24.5)	13854.1 (44.8)	3856.8 (12.5)	2785 (9)	451.5 (1.5)	844.4 (2.7)
2004	33286.2	6915.5 (20.8)	16636.6 (49.9)	4121.2 (12.4)	2809.8 (8.4)	398.2 (1.2)	851.9 (2.6)
2005	36443.8	6221 (17.1)	19914.4 (54.6)	4579 (12.6)	2872.6 (7.8)	398.2 (1.1)	871 (2.4)
2006	37773.5	5018 (13.3)	22044.8 (58.4)	5060.1 (13.4)	2898.7 (7.6)	270.9 (0.6)	878.9 (2.3)
2007	41379.8	4797.5 (11.6)	25215.7 (60.9)	5691.7 (13.8)	2925.1 (7.1)	246.3 (0.5)	886.9 (2.1)
2008	57412.4	13835.4 (24.1)	31700.5 (55.2)	6110.5 (10.6)	2951.7 (5.1)	287.9 (0.5)	895.0 (1.6)
2009	63945.9	13218.2 (20.7)	37689.8 (58.9)	7268 (11.4)	2978.5 (4.6)	242.1 (0.4)	903.1 (1.4)
2010	69972.4	14409.3 (20.6)	42152.4 (60.2)	7633.9 (10.9)	3005.6 (4.3)	198.6 (0.3)	911.3 (1.3)
2011	79364.0	19792 (24.9)	45805.6 (57.7)	7954 (10)	3033 (3.8)	183.4 (0.2)	919.6 (1.2)
2012	88779.0	26202.2 (29.5)	48352.8 (54.5)	133.4 (0.1)	3060.6 (3.5)	928 (1)	1691 (1.9)

Source: DAFF (2013)

In as much as lending to the agricultural sector has been growing steadily over the years, farmers still remain under pressure in terms of providing adequate collateral to secure finance from formal finance institutions. The yearly farm debt commitment has continued to increase with the net farm income, while expenditure on inputs has risen to similar levels as the value of fixed assets (Figure 1). These agricultural economic indicators point to the increasingly competitive and aggressive climate in which agricultural financing ought to thrive under; and this to some extent accounts for the increase in 'corporatisation' trends observed in commercial agriculture. It is apparent that small-scale farmers are finding it increasingly difficult to access funding given the debt-to-gross income ratio (economies of scale) of their enterprises that must be diligently considered by formal financial institutions in light of stricter credit-control regulations.

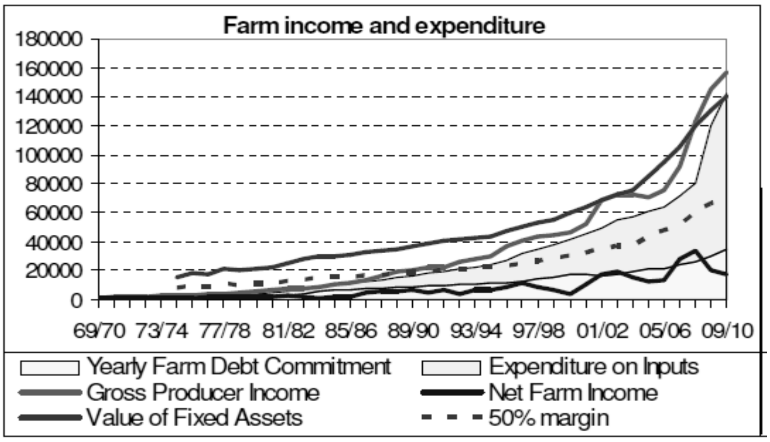

Figure 1: Agricultural economic indicators
Source: Janovsky (2011)

2.3.2 Financing of small-scale agriculture

The issue of improving small-scale farmers' productivity has risen to the fore of the agricultural and rural development debate. This is in light of the recent financial and food crises and the anticipated climate change patterns. Small-scale farmers face a number of challenges, including lack of capital for investment which contributes significantly to the impaired productivity levels of farmers. The challenge of access to agricultural lending from formal financial institutions is longstanding (D'Haese and Mdula, 1998; Machethe, 2004); and though some improvements have been made, a large proportion of small-scale farmers are yet to be reached. Access to credit is ranked among the first three challenges (after access to land and markets) that constrain the development of small-scale farmers. Approximately two out of three small-scale farmers utilize other sources of capital other than formal financial institutions – i.e. own money sources and loans from others within social circles (Coetzee and Machethe, 2011). In fact, provision of finance for small-scale agriculture should be contextualised within the broader investment flows into the rural economy (involving agriculture and rural development).

Admittedly, the proportion of banked farmers is almost at 50%, though the geographical spread across the provinces of South Africa varies (Figure 2). The services and products rendered by formal finance institutions to small-scale farmers are of the savings and transactional type and, to some extent, insurance products as well. Agricultural lending to small-scale farmers is still minimal, with only 5.6% of farmers accessing credit products from formal finance institutions (Coetzee and Machethe, 2011).

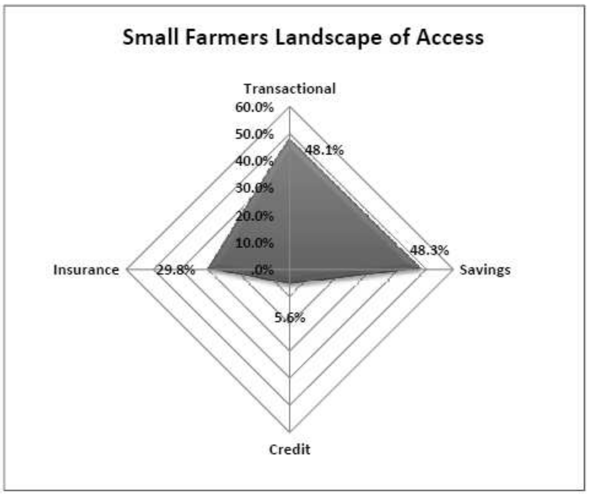

Figure 2: Small-scale farmers' access to financial services and products
Source: Coetzee and Machethe (2011)

2.3.3 Significant role players in the formal sector

Agricultural lending in the formal financial sector in South Africa is dominated by private sector institutions such as commercial banks and agricultural cooperatives. There are public sector institutions that provide agricultural lending to small-scale farmers in order to fulfil their demand for agricultural loans. In keeping with the trends indicated in the DAFF annual agricultural statistics; the main groupings of significant stakeholder are commercial banks, agriculture-related cooperative, Land and Agricultural Bank, and private persons. A small number of commercial banks (Absa Bank, FNB, Nedbank, and Standard Bank) dominate the agricultural finance scene in South Africa. There are numerous agricultural cooperatives that are involved in credit extension. Key among them are Afgri, Senwes, Kaap Agri and Bedryf Beperk.

2.3.3.1 Private sector institutions

(i) Commercial banks

Commercial banks in South Africa are well developed and compare well to their developed country counterparts and provide adequate financial services (Archer, 2008). However, as in many developing countries, lending to the agricultural sector is a much smaller component of the total loans and advances issued by commercial banks. Secondary to this is the fact that commercial banks lend primarily to commercial farmers; leaving small-scale farmers demand for finance largely unmet thus catering only for a segment of the sector (commercial farmers). However inadequate the supply of small-scale agriculture financing, there has been remarkable growth in small-scale agricultural financing by commercial banks in South Africa. This can be attributed in part to the introduction of the financial sector charter AgriBEE ('black agriculture financing' – which is dominated by small-scale farmers) targets that were proposed in 2008.

In some commercial banks, black agriculture financing has continued to show remarkable levels of growth. In 2005, only R11 million was granted towards AgriBEE by the commercial banking sector, which grew to R339 million in 2008, and by 2010 this figure had grown to R408 million (Figure 3). Part of this increase in small-scale agriculture financing can be attributed to 'private-public sector partnerships through collaboration between corporate companies, industry bodies and government' (Nedbank, 2011).

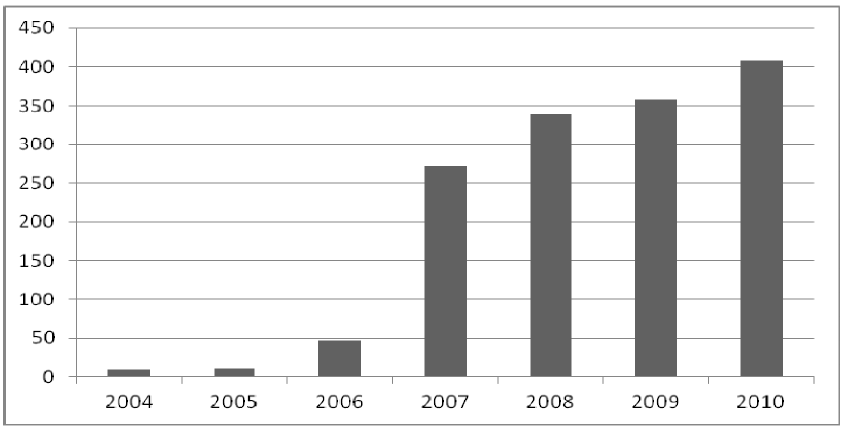

Figure 3: Cumulative black agriculture financing (R million)
Source: Nedbank (2011)

(ii) Agricultural cooperatives

The South African government is in the process of promoting small-scale farmer organisations into cooperatives as a vehicle to enhance agricultural development in rural communities (Ortmann and King, 2007). In 2005-2009, there was an accelerated increase in the number of registered cooperatives in the Registrar of Cooperatives in the then Companies and Intellectual Property Registration Office (CIPRO) of the Department of Trade and Industry (DTI). Though these are still weak and emerging, the enabling environment inculcated by the regulatory framework (Cooperative National Policy 2004) and other government support programmes have been instrumental. By the end of this period (2005 – 2009) there were 22,619 cooperatives registered nationwide; with 38% of them in the province of KwaZulu-Natal, followed by Eastern Cape (19%), then Gauteng (10%), and Limpopo (8%). The agriculture sector dominated all other sectors in terms of the number of registered cooperatives, constituting 25% of the total. The dominance of agriculture can be attributed to the public support with regards to subsidies and tax concessions, and remains the 'traditional' sector for cooperative development. Chikazunga (2012) states that "many have collapsed for a variety of reasons, including in-fighting, free-riding, power dynamics, etc." However, the Department of Trade and Industry (DTI) 2009 baseline study reveals that the national survival rate average is 12%; which translates to just over 2,700 cooperatives that are still in operation. The highest survival rates were recorded in the provinces of Limpopo (22%), Gauteng (17%), and Mpumalanga (12.5%), respectively. Cooperatives in the food and agriculture sector recorded a survival rate of 11% only, a figure below the national average. Food and agriculture cooperatives that were registered with CIPRO were 6086 and the DTI baseline study only found 671 that are still in operation. Out of the 2398 operational cooperatives, about 27% of them are in the food and agriculture sectors (DTI, 2011).

Agricultural cooperatives have a long and rich history in terms of farmer development in pre-democratic South Africa. There are several agricultural cooperatives that are affiliated to the Agricultural Business Chamber (ABC). The transformation agenda of the agricultural sector of South Africa has also been an issue that the Agricultural Business Chamber has attempted to address through the Cooperative Development Initiative (CDI), in conjunction with the German Co-op Federation (DGRV) (Philip, 2003).

2.3.3.2 Public sector institutions

In many developing countries, including South Africa, the state has sought means to intervene in addressing the challenges that are faced by farmers in obtaining agricultural financing. The Land Bank was established in 1912 as the major lender to the agricultural sector (other than the then Agricultural Credit Board). The Land Bank now only contributes about 24.9% of the total farming debt in South Africa (DAFF 2012). There have been other public and private sector programmes that target the agricultural sector, specifically small-scale farmers. In the recent years, following the disbandment of the Agricultural Credit Board in 1999, the private finance sector increased its lending role with capacity largely directed to commercial farmers (Table 6). The Strauss Commission of 1996 uncovered that both public and private sector institutions were oriented largely towards commercial farmers and that many small-scale farmers (subsistence and emerging) remained un-served with regards to formal agricultural finance (Coetzee, 2002).

It is generally accepted that improving access to rural finance for small-scale farmers can contribute significantly to food security and poverty alleviation by raising the productivity of small-scale agriculture. Although agricultural finance is not a universal remedy, there are other factors that contribute to the constraints of agricultural development in developing countries. With the on-going land reform process in South Africa, agricultural finance remains both a challenge and a priority in responding to the demands of small-scale and emerging farmers with regards to the inherent heterogeneity of farm enterprise characteristics such as size of farm, production systems, as well as the financial support requirements (Ardington and Leibbrandt, 2004).

According to DAFF (2011), commercial banks held the largest source of farming debt owed by the commercial agricultural sector (R40.4 billion), followed by agricultural cooperatives (R7.6 billion) and the Land Bank (R3.2 billion). Small-scale farmers, however, are only receiving a small piece of this pie. A number of reviews undertaken from 2000-2003 demonstrated that lack of finance was one of the major constraints limiting smallholder productivity as well as overall rural economic growth. In 2004, government announced the establishment of a new government agency Micro Agricultural Financial Institutions of South Africa (MAFISA) to help close this funding gap and earmarked R1 billion for this purpose (Tregurtha et al., 2010). The South African government has continued to seek ways to address this situation and an array of policies and institutions have been put in place that seek to address the dire need of demand for financial services especially in rural South Africa. Coupled to these was also the emergence of apex institutions like the South African Microfinance Apex Fund (SAMAF) that is dedicated to serve small, micro and medium enterprises. The Land and Agricultural Bank however, remains the only key development institution dedicated to financing agriculture for both commercial and small-scale farmers nationally.

(i) Provincial parastatals

There are several provincial parastatals that provide financial, technical and business support to small-scale farmers in the various provinces of South Africa. The Mpumalanga Economic Development Agency (MEGA) provides agricultural finance in an effort to contribute to sustainable economic growth in the province. The programme "promotes and facilitates the growth and development of the agricultural sector by providing financial and non-financial support" (MEGA, 2014). The Free State Development Corporation (FDC) is mandated to facilitate economic development, trade, and investment in the Free State Province. The corporation offers development financing in the agriculture and agro-processing sectors amongst the many other economic activities of the Free State province (FDC, 2014).

The most prominent parastatal that is involved in small-scale agriculture financing is the Ithala Development Finance Corporation in the province of KwaZulu-Natal. Ithala has a long and rich history that dates back to 1959. The current institutional arrangement though is as a result of the KwaZulu-Natal Ithala Development Finance Corporation Act of 1999 through which the organisation was mandated to promote, support and facilitate social and economic development in the province of KwaZulu-Natal through the provision of financial and non-financial services to businesses and individuals. One of the achievements of the corporation is the fact that they have financed land acquisitions of more than 26000 hectares of agricultural land. The product range that is offered by Ithala includes credit, insurance, and savings, products through the 51 branches that are spread throughout the KwaZulu-Natal Province (Ithala, 2011).

CHAPTER 3

LITERATURE REVIEW ON BEST PRACTICES IN AGRICULTURAL LENDING

This chapter presents key issues on the concept of best practices in agricultural lending, the relevance of the concept in agricultural finance, as well as relevant international examples and its applicability to lending to small-scale farmers. Though not discussed at length, the concepts of good banking practice, use of technological innovations (ICT) and bundling of financial services with the non-financial are part of the implicit best practices within the broader finance sector. In keeping with Ottens (2010), best practices in agricultural lending should enhance the earning capabilities of small-scale farmers; by providing affordable and appropriate products and services over and above the basic provision of finance services.

3.1 Introduction

Best practices in agricultural finance relate to innovations that generate productive outcomes in terms of financial sustainability and improved outreach to clients (SBP, 2009). These include the following: institutions' salient features; product types; client outreach; sustainability; delivery mechanisms - lending methodologies, modes of operations, recovery mechanisms; etc. The two core concepts that are significant in agricultural lending best practices are sustainability and outreach. Because of the long periods of time that are required in financing agricultural production (e.g. paying off the loan utilised to purchase land), suppliers of agricultural finance need to pay extra attention to the issue of sustainability. Suppliers of agricultural finance must be able to continue with the provisioning of financial services on a long term basis. The two basic measures of sustainability are in relation to the sustainability of operations, and sustainability of fund base. Client outreach is one other concept that is fundamental in studies relating to agricultural lending best practices. In chapter two, some of the challenges facing farmers with regards to accessing finance were alluded to, and expanding client outreach in an efficient manner is crucial for the betterment of agricultural finance provision. This includes both concepts of outreach, namely, breadth (number of rural clients serviced) and depth (how poor the clients are that are being serviced) (Yaron, 2005).

3.2 Why 'best practices'?

The inadequate supply of agricultural credit threatens the success of land reform, food security, agriculture and rural land reform in present day South Africa. Given the challenges and risks encountered in agricultural lending and the recent global financial crisis; the provision of credit has become even tighter and hence the need to explore innovative approaches to agricultural finance has become important (Kloeppinger-Todd and Sharma, 2010). Although this is an economy and sector wide challenge, the agricultural sector (and small-scale agriculture in particular) is for the most part affected. Formal financial institutions have not found the appropriate delivery models that encourage and support agricultural finance accessibility among small-scale farmers. Though the finance needs of individual small-scale farmers appear minute (in comparison to the large commercial farmers), on the aggregate, the demand for agricultural credit by small-scale farmers remains substantial (Doran et al., 2009). Another challenge that small-scale farmers are faced with is the lack of appropriate means of 'traditional' collateral, exacerbated by the rapidly increasing input and operating costs (ABC, 2011).

In light of the challenges faced by the agricultural sector in attracting financial capital, best practices in agricultural finance are the innovative methods and procedures that address the supply and demand side constraints and challenges (from both the finance and agriculture sectors' perspectives). The set of methods and procedures must improve the levels of access to agricultural finance in the sector. Supply side constraints include credit risks (market and weather related risks), technical failure, and moral hazard risks. The response of the formal finance institutions to all these risks and uncertainties is through stringent collateral requirements that are restrictive for small-scale farmers. The sustainability of formal finance institutions is also at risk in terms of portfolio risk management. Given the weather and price related risks in specific commodities and supply chains, the possibility of defaults on loans can have a consequential impact on the loan portfolio quality on the part of agricultural finance supplies. The issue of transaction costs is a challenge at the client level as well as the sector level (finance). The rural and sparse location of most farmers is an obvious constraint, but also the appraisal and supervision costs involved, and thus cost-effective procedures for searching and evaluating information and monitoring borrowers are indispensable (Höllinger, 2003).

3.3. International experiences

This section is largely based on the case studies that were undertaken by Klein et al. (1999) and Höllinger (2003). The work by Klein et al. (1999) is based on three case studies in Thailand (BAAC), El Salvador (Financiera Calpiá), and Peru (Cajas Municipales de Ahorro Crédito). The work of Höllinger (2003) is based on work in seven countries; Bolivia (Agrocapital, Caja Los Andes, CIDRE and ANED), Ghana (Outgrower schemes for oil palm and rubber), India (MRCB and BASIX), Indonesia (BRI), Madagascar (CECAM), Philippines (Rural Bank of Panabo), South Africa (Land Bank), and Thailand (BAAC).These studies considered rural finance institutions that provide agricultural lending to some extent (these range from agricultural development banks, rural banks, NGOs, etc.). Höllinger (2003) states several factors that contribute to the success of formal finance institutions that are involved in agricultural lending and formulates these into a set of main lessons that can be considered as best practices.

3.3.1 Description of international case studies on best practices

The discussion below focuses on some of the case studies mentioned above and tries to highlight some of the unique characteristics, services, and products that promote access to agricultural credit for small-scale farmers.

3.3.1.1 Bank for Agriculture and Agricultural Cooperatives (BAAC), Thailand

'BAAC is one of the few examples of a successfully reformed agricultural development bank which has achieved huge outreach while maintaining financial viability' (Höllinger, 2003). The Bank for Agriculture and Agricultural Cooperatives started out in 1947 providing funding for cooperatives in Thailand. It was then later (1966) expanded to cater for individual framers as well. The bank has a strong rural development orientation, albeit through agriculture development. The activities of the bank remain linked to public and private sector development activities so as to strengthen the technical support available to farmers.

The bank offers deposit (including insurance), credit and banking services (such as transfers, payments to public utilities and bill collections). Application for credit extension to individual farmers is accessed through a local office/branch in the rural areas. The bank requires for farmers to have the necessary skills to plan their agricultural enterprises accordingly and produce a marketable surplus. Another requirement from the bank relates to the social capital that exists in rural communities, as farmers must be of good reputation in the rural communities within which they reside. BAAC provides numerous credit products that range from short, medium, and long term. The short term loans cater for production costs as well as household expenses. The medium term loans are accessible either as asset finance or cash, depending on the needs of the farmer and the intended use. The long term loans offered by the bank cater for land, production, or processing related investments. Credit extension to cooperatives ranges from short term (production oriented) to long term (investment oriented). The bank does however apply more stringent controls in terms of commitment, collateral requirements and guarantees in group lending services and products (BAAC, 2011).

3.3.1.2 Agrocapital, Bolivia

Agrocapital serves small to medium agriculture and non- agriculture based enterprises in rural areas. The organisation provides short and medium term loans to individual farmers who must provide immovable and movable assets as collateral. Loans of less than ZAR50,000 can be secured with personal guarantees and through pledging non–registered assets. The loans are used mainly for investments in production related activities, improvements in land and machinery, transportation as well as agro–processing (Höllinger, 2003). As of 2010, Agrocapital recorded over sixteen thousand borrowers (Mixmarkert, 2012).

3.3.1.3 The BASIX group , India

The BASIX group is a non-bank financial institution that is largely based in rural areas, deals with over 3.5 million customers, and has a staff contingent of about 10,000. The group has a comprehensive strategy that incorporates Financial Inclusion Services (FINS), Agricultural/Business Development Services (Ag/BDS), and Institutional Development Services (IDS) (Figure 4).

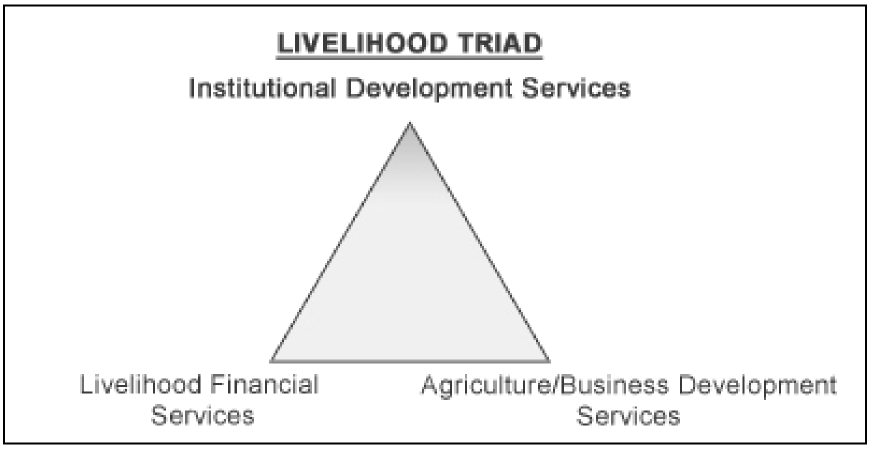

Figure 4: The BASIX Livelihood Triad
Source: BAAC (2011)

The financial inclusion services component provides savings, credit, insurance, transfer, as well as warehouse receipt systems services. The agricultural/business development services component deals with productivity enhancement, risk mitigation, value addition, market linkages and enterprise diversification. These technical support programmes are delivered to organised farmer groups, informal associations as well as agricultural cooperatives. In order to make sure that these groups function effectively, the group has a component dedicated to Institutional Development Services (IDS) (BASIX, 2012).

3.3.1.5 ANED (Asociación Nacional Ecuménica de Desarrollo), Bolivia

ANED is based in rural areas, and grants loans for agriculture and agri-business related activities (75% of loan portfolio). ANED boasts well over five thousand active borrowers as of 2010 (Mixmarkert, 2012). Loans are granted to individual farmers with movable and immovable collateral. Over and above credit extension, the institution makes use of a leasing instrument when it comes to financing of agricultural equipment (Höllinger, 2003).

3.3.1.6 Centro de Investigación de Desarrollo Regional (CIDRE), Bolivia

CIDRE is a non-governmental organisation that offers term finance to groups of farmers. The credit provided to the group of farmers is utilised in addressing production and marketing constraints on a broader scale and serves as a gateway for individual farmers to apply for further credit. The centre provides technical assistance as well as the supervision of group investments.

3.3.2 Lessons drawn from international best practices case studies

The factors considered below (i to xi) contribute to the deepening of rural credit markets but also contribute significantly to the removal of the financial access barrier for small-scale farmers. Overall, the outreach and sustainability of formal finance institutions in small-scale agriculture lending is improved; and the bankability and loan repayment capacity of small-scale farmers are strengthened. The resulting impact benefits the local rural economy, and contributes to the longer term agricultural and rural development goals.

(i) **Extensive branch network:** an extensive branch network and use of mobile banking services is important in reducing the transaction costs encountered by small-scale farmers in accessing formal finance institutions. Klein et al. (1999) asserts that a decentralized delivery structure reduces information costs and thus reduces loan default risk.

(ii) **Suitability of agro-climatic regions:** given the weather related risks encountered in agriculture, a suitable approach towards innovation in agricultural lending (products and services) is necessary. The agricultural potential of certain regions and associated risks of particular production systems should be taken into account in terms of the loan products offered by formal financial institutions. In a Land Bank study (2011), it was found that there was a clear pattern of geographical regions (Tzaneen, East London, North West, Nelspruit and Pietermaritzburg) that 'failed' in terms of loan repayments either as a result of environmental or market conditions.

(iii) **Diverse product range**: it is important for formal finance institutions to offer products and services that are wide ranging in terms of type, purposes, and term. For instance there are complementarities between savings and loan products. Savings allow for a farmer to accumulate funds, which in turn can be used in obtaining and securing a loan or assets (which can be used in expanding farm operations or as collateral). On the side of the formal finance institutions, a farmer who has a savings account provides a track record of business transactions and trends in his income cycles (minimising the moral hazard problem). Flexibility with regards the appropriateness of loan products and loan repayment terms is indispensable, in view of the seasonal nature of agricultural production.

(iv) **Appropriateness of lending instrument:** the three types of lending instruments that are widely utilised in lending to the agriculture sector are term loans, leasing, and equity finance. Term loans are the most popular method of lending, and due consideration must be paid to the issue of repayment schedules. Equity financing has been seen in agribusiness and large land reform projects, though this has not become widely popular. Leasing is the least used instrument in lending to the agriculture sector, especially when considering small-scale farmers. All these three however, present opportunities for developing an appropriate mix of lending methods depending of course on the needs and requirements of the framer.

(v) **Client screening and selection:** in some of the well documented success stories of lending to rural people (including farmer), group lending methods have been championed as the most appropriate lending method (e.g. Rural Bank of Panabo, ANED, BAAC, CIDRE). Depending on the strength of social capital in existence within a community, the use of farmer group lending can be beneficial (in terms of screening, supervision, procurement, and marketing). In conventional term loans, formal finance institutions deal with individual farmers.

Some of the innovations that have been adopted include household income and livelihood pattern assessment. Instead of relying only on farm income data, data on other sources of income that flow into the overall household income and cash flow are considered. It is true that for small-scale farmers, it is sometimes difficult to separate farm income and expenditures from household income and expenditures, thus a rounded approach is more appropriate. South African formal finance institutions (largely commercial banks) provide up to date data on commodity prices, the accessibility of market outlets for loan applicants is an important factor. Formal finance institutions can encourage and support the vertical integration of farmers into the value chain as a means of establishing the repayment-ability of loans.

(vi) **Innovations in collateral requirements**: Compared with conventional banks, the case studies revealed that there is scope for utilising collateral substitutes such as joint liability mechanisms and co-guarantors (through farmer groups, technical service providers, cooperatives, etc.) as well as liens on produce, movable assets, etc. Collateral substitutes are usually of lesser value and burdensome on the part of formal financial institutions (thus a need for equity contributions remain necessary), and perhaps a combination of conventional collateral with collateral substitutes can be used.

(vii) **Selection of viable farming enterprises:** the approval of agricultural loans should be based on the conservative evaluation of the business plans and projected cash flow in a realistic and prudent manner (loan assessment techniques). The technical and economic feasibility of a farm (together with the human capital available) should be considered in great detail. At the farm level, the farm size, farming system as well as the technologies and innovations adopted in production management should be considered in order to improve the bankability of the farm enterprise.

(viii) **Structuring of loan payments:** the flexibility of the schedule for loan repayment should coincide with the cash flow patterns of the farm enterprise and/or household. The length of the repayment term can be structured in a manner that suits the lender and borrower, depending on the economic conditions.

(ix) **Interest rate levels:** The levels of interest rates are influential for both the formal finance institutions as well the farmers. Interest rates have an impact on the financial viability of agricultural investments, and institutions that manage to offer lower interest rates (in comparison to the market rate) such as BAAC and Land Bank, aid farmers by lowering the total cost of debt servicing.

(x) **Non-financial support and technical services:** the availability of non-financial and technical support services plays a significant role in determining the profitability (and risk) of agricultural investments. There is a need for partnerships between formal finance institutions, service providers (farmers support services) and farmers so that there is assurance with regards to the availability and quality of training, inputs etc. as well as adequate monitoring and supervision.

(xi) **Management information systems:** the accurate management of client, market, and production records is crucial in client profiling as well as the management of day-to-day operations. Such systems are essential, as they could even be coupled to loan portfolio monitoring and reporting on loan disbursements and repayment, provided that they are adequately sophisticated and integrated.

3.4 Best practices in lending to the emerging sector

Agricultural lending to small-scale farmers is a challenge that requires careful consideration on the part of formal finance institutions. Small-scale farmers operate under conditions that require specialised interventions in terms of type of products and services, delivery mechanisms, and monitoring systems. Given the larger numbers of small-scale farmers, the levels of outreach to small-scale farmers can be improved significantly in South Africa. Over and above, guided by the agriculture and rural development agenda, agricultural lending should be part of a broader rural incomes expansion strategy. Risk reducing mechanisms (either from household expenses or the farming enterprise itself) are important in lending to small-scale farmers. Agricultural loans and farmer support services that emanate from the public sector particularly should be well coordinated (Coetzee, 2001). The majority of small-scale farmers that have obtained agricultural loans (or some other form of agricultural capital) rely largely on public programmes and projects (though limited in size and impact). Such programmes include CASP (Comprehensive Agriculture Support Programme), LRAD (Land Redistribution for Agricultural Development), AgriBEE Fund, MAFISA, and Land Bank Staircase of Products (Mbetha, 2009). There have been a number of contract farming and sharecropping arrangements that have emerged within small-scale agriculture as a means to attract and secure agricultural loans with various role players in agri-business.

Agricultural lending best practices that address the needs of the small-scale farming sector can be classified as: policy and institutional environment, economic, and production related.

The policy and institutional environment should be responsive such that the turn-around time is reduced, products and services are appropriately designed, loan terms and repayment schedules are flexible, policy and programmes are well designed and fitted, and farmer and enterprise selection is not prohibitive. The macroeconomic environment needs to support conducive interest rates. Agricultural lending best practices should include innovations that offer post production support (financial management, production and market risk management, and business management).

It follows then that the transformation of the agricultural sector is not only a process of access to land and water resources, but also improving means of access to inputs, markets, credit, etc. through institutional infrastructure, programmes and policies that are responsive to the needs and requirements of small-scale farmers.

CHAPTER 4

METHODS AND PROCEDURES

In this chapter, the inquiry strategy and broad research design, as well as the theoretical background underpinning the study are discussed. The description of the inquiry strategy deals with methodological issues of how the study aims to address the study objectives outlined in Chapter 1.

4.1 Theoretical background on small-scale agriculture financing

The decision to use formal finance institutions by small-scale farmers for agricultural credit is largely underpinned by borrowers' characteristics, and the loan terms and conditions imposed by lenders (Kashuliza and Kydd, 1996; Zeller, 1994). Zeller (1994) also indicates that Physical distance of small-scale farmers from formal lending institutions is also one of the factors that limit access to formal finance. There is also a school of thought that is rooted in the premise that the type of formal finance institution and its policies (duration, terms of payment, collateral requirements and the provisions of support services) will often determine access to finance (Schmidt and Kropp, 1987).

There is a limited body of work that attempts to explain the functioning of credit markets within the developing country context and the implications of incomplete markets and imperfect information for the functioning of credit markets in developing countries. Based on the work of Stiglitz and Weiss (1981), it is evident that formal finance institutions are faced with tough choices in terms of lending to small-scale farmers. Formal finance institutions are not in control of the actions of borrowers due to imperfect and costly information, environmental conditions, as well as market prices. Therefore there is a need to formulate the terms of the loan contract so as to induce borrowers to take actions in the interest of the bank and also to attract low risk borrowers. The terms of contract refer to the amount of the loan that small-scale farmers qualify for, the amount of collateral required, time it will take to service the loan, applicable interest rate, lending methodologies and policies and so forth.

Access to financial services by small-scale farmers in formal financial institutions is, to some extent, aided by the institutions mainly through their 'terms of contract'.

This is the premise of the theoretical background of the study. A thorough examination of the 'terms of contract' by formal finance institutions and linking these to agricultural lending best practices internationally in institutions that have managed to sustainably lend to small-scale farmers, constitutes the theoretical background adopted in the study.

4.2 Main features of small-scale agricultural lending best practice

The main features of small-scale agricultural lending best practices adopted in the study draws heavily from literature that assesses best practices criteria in rural and agricultural finance institutions internationally. This section is based on prior studies carried out in Asia and Africa by other researchers (Yaron et al., 1997; Klein et al., 1999; Höllinger, 2003; Yaron, 2005; Samuel, 2008; SBP, 2009). Only elements that are relevant to this study and the South African small-scale farmer context are considered. The two main components of agricultural lending best practices discussed at length are performance assessment and mode of operations. The primary factors considered in performance assessment are outreach, sustainability, and growth of small-scale lending operations by formal finance institutions. The key factors considered in mode of operations include management structures and personnel capacity, delivery mechanisms, lending policies, terms and conditions, quality of loan portfolio (loans in arrears), and interest rate policies.

Given the nature of privately owned (commercial) formal finance institutions, it is accepted that small-scale lending objectives differ from one institution to the next. In as much as the institutions are autonomous and differ in some respects, there are some common basic principles that apply across them in terms of assessing the extent to which their agricultural lending practices best suit small-scale farmers. Another significant component that is not discussed in detail in this study is that of considering the macroeconomic framework and policy environment. Given the parameters of this study, and the formal finance institutions studied, it is assumed that the same macro-economic framework and policy environment affect all formal institutions.

4.2.1 Performance assessment

The primary performance assessment criteria, notwithstanding the financial performance (a crucial aspect that remains outside of the scope of this study), are considered. Factors included in performance assessment include outreach levels, growth, and self-sustainability.

4.2.1.1 Outreach

Expanding agricultural lending outreach by formal financial institutions is crucial in assessing agricultural lending to small-scale farmers as the number of small-scale farmers serviced, and the average sizes of loans, give an indication of demand-led growth in agricultural credit provisioning. The number of small-scale farmers serviced is a good indication of market penetration, especially when compared to the national figures of the total number of small-scale farmers. With regard to market penetration, it is also crucial to consider the number of female borrowers – this in line with the head of household status trends observed generally in rural South Africa. The average size of loans that are made by small- scale farmers in comparison to their needs is an important factor to consider as the largest capital requirement for farmers goes into the purchasing of land, fixed assets, as well as bulky machinery. This factor remains crucial as small-scale farmers in general struggle with the affordability issue when approaching formal finance institutions, and the nature of agricultural production requires some threshold level of production (economies of scale) in order to remain profitable as an enterprise. There is a need to reinforce the financial institutions' interface with which the farmer interacts at the local level, i.e. reinforcement of retail level services is critical for enhanced outreach as well as impact.

4.2.1.2 Growth

The rural locality of small-scale farmers (and farmers in general) and the sparse population density of farming communities contribute to the increased transaction costs that are faced by farmers in accessing formal financing institutions. From the side of formal finance institutions, establishing distribution networks and branches in rural areas remains costly and unattractive. The extent to which formal finance institutions are accessible to small-scale farmers contributes significantly to the deepening of the finance sector (locally) as well as the growth and development of small-scale farmers. Given the diverse demand for financial services and products in rural areas, a varied range of institutional types is required to expand the outreach and thus an opportunity for institutional development and expansion.

4.2.1.2 Self sustainability

The agricultural sector remains prone to production and market risks. Depending on the spread of the loan portfolio of formal finance institutions, the prevailing macro-economic conditions, and policies governing the finance sector, it is important for financial institutions to maintain a healthy bottom line. This is important as the continuity of services towards small-scale farmers contributes to the gradual development of small-scale farmers into commercial farmers over a long term period.

4.2.2 Mode of operation

The organisational principles, structure, and policies that contribute to the success of small-scale agricultural lending by formal finance institutions are considered. The needs of the target client (in this case small-scale farmers) must inform the mode of operation in terms of products and services provided as well as the type of lending instruments utilised.

4.2.2.1 Delivery mechanisms

The delivery mechanisms that formal financial institutions employ in order to reach small-scale farmers, and also remain accessible to them such as the number of branches, mobile stations, adoption of technology, are factors to consider. The time that formal financial institutions take in processing loan applications, and the methods of communication of the requirements throughout the various loan stages are critical in promoting accessibility and transparency in agricultural lending. The level of simplicity of the loan process itself should take into consideration the literacy levels of small-scale farmers. There is also a need for monitoring systems (production estimates and commodity price fluctuations) in terms of repayability of the loan within the designated loan repayment term.

4.2.2.2 Lending policies, terms and conditions

Policies that pertain to eligibility of small-scale farmers in the loan application process, the requirements thereof such as business plans, projected cash flow statements, and collateral requirements are considered. This is because, in many cases, small-scale farmers state these as barriers to accessing agricultural credit. Policies that pertain to minimising the information asymmetry problem by obtaining information and risk assessment of potential borrowers are important.

4.2.2.3 Quality of loan portfolio (loans in arrears)

The quality of the loan portfolio (particularly agricultural loans that are in arrears) is important when considering the sustainability implications. The definition of loans in arrears can differ from one institution to another. The flexibility of repayment terms is an important issue when considering the potential weather risks that are encountered in agricultural production. This also has implications for the repayability of agricultural loans by small-scale farmers, which contributes to improving the depth of outreach.

4.3 Description of inquiry strategy and broad research design

This section is based on an in-depth review and analysis of prior studies on formal finance institutions that provide agricultural finance and agricultural lending best practices. The aim is to evaluate the extent to which formal finance institutions apply best practices in lending to emerging farmers. The different arrangements, technologies and innovations that are adopted by these institutions in delivering agricultural credit to small-scale farmers will be studied in relation to what has been reported in the literature as agricultural lending best practices. This involves sequential steps to collect, know, comprehend, apply, analyse, synthesize and evaluate relevant literature in order to provide a firm foundation to the topic under study.

The main limitation of gathering data from secondary sources is that some of the data required to answer specific questions might not be available, making it difficult to address the questions adequately. Another limitation stems from the different objectives and methodologies (and study designs) of previous studies, the data might not be in the right format or specific enough to answer some of the questions in the current study. Lastly, given the free market structure under which formal finance institutions operate, national legislations i.e. National Credit Act, 2005 (Act No. 34 of 2005) and Consumer Protection Act, 2008 (Act No. 68 of 2008), and respective company policies on the level of client data that can be availed to the public are applicable.

4.3.1 Research method

The inquiry strategy adopted for this study relies mainly on literature reviews and semi-structured interviews. It is both evaluative and qualitative. Qualitative and quantitative data are collected on the methods, techniques, and instruments of lending that apply to emerging farmers in South Africa. The applied research approach is relevant to the challenges faced by the agricultural sector (even more so by small-scale farmers) in accessing agricultural finance. The significance and challenges relating access to agricultural finance for South African small-scale farmers have been highlighted in Chapter 2.

The sources of data include research reports, annual reports, general company reports, procedural manuals, articles, journals and other relevant documents that are available in the public domain. Internal and annual company reports obtained and authorised from the relevant stakeholders (both in the finance and agricultural sectors) were used as complements but also to contextualise the results of the study through content analysis. In-depth interviews with key stakeholders were conducted in person and telephonically.

4.3.2 Sample design

The study focuses on formal finance institutions that are identifiable as the major role players (four commercial banks as well as the Land Bank). Emphasis is placedon credit provisioning towards the agricultural sector, highlighting small-scale farmers as a case-in-point. For objective comparison of these institutions, they are categorised according to business types (commercial, cooperative and public enterprises).

4.3.3 Data collection and analysis

The data provided in the Abstract of Agricultural Statistics (DAFF, 2010; DAFF, 2011) are considered for identifying the major lenders to the agricultural sector. However, the data are not disaggregated according to the different categories of farmers (i.e. commercial and small-scale). Nationally aggregated data on the supply of agricultural finance to small-scale farmers are not readily available. Therefore, data obtained from the designated formal financial institutions were utilised as a proxy for the national aggregate, as they are major lenders to the agricultural sector (90% of total farming debt, see Table 6). The data on the total national farming debt as provided by the DAFF can be used to compare and establish the proportion of agricultural finance that is directed to small-scale farmers.

Based on the data availed by formal finance institutions[1], the extent to which their lending operations have expanded outreach towards small-scale farmers was analysed based on the number of professionals that serve the sector, the number of branches that are located in major agricultural districts, the actual number of small-scale farmers serviced, the proportion of the loan portfolio that is dedicated towards small-scale farmers, etc. In view of the constrained financial sector environment (recent financial crisis, credit regulation laws), financial sustainability in agricultural lending of formal institutions has become even more important. Indicators such as loan repayment rate and the proportion of loan portfolio in arrears are considered as indicators towards the financial sustainability of formal finance institutions. With regards to public finance institutions, the fiscal support of such programmes within the existing macroeconomic framework is considered.

All these aspects contributed to the design of the research instrument (Appendix A) which can be used to ascertain the levels of adherence to best practices in small-scale agriculture lending. This provided an indication of the level of adherence to agricultural lending best practices in lending to small-scale farmers by the formal finance institutions considered in this study. This is not a pronouncement on the level of overall performance of the designated formal finance institutions, but rather a tool that can assist formal finance institutions improve their small-scale agriculture lending methodologies (in terms of product types, delivery

[1] The information collected was based publicly available data as well in depth voluntary interviews with key participant from some of the formal finance institutions.

mechanisms, lending policies, loan application processes, etc.) based on contextualised best practices as a guideline.

CHAPTER 5

RESEARCH FINDINGS – MAJOR FINANCIAL INSTITUTIONS AND THEIR PERFORMANCE IN LENDING TO SMALL-SCALE FARMERS

In this chapter, the research findings are presented. Some of the specific indicators that are related to the criteria, procedures, and lending operations that are applicable to small-scale agriculture financing are discussed in detail. Moreover, the chapter tries to establish the performance of formal finance institutions through analysing outreach, growth, and self-sustainability.

5.1 The overall picture

Overall, it appears that formal finance institutions (particularly commercial banks) are lending to 'resource-poor black farmers'. The target set for the sector in the 2004 – 2008 period was to lend R1,5 billion to this segment of agricultural producers (Table 7). Seemingly, this target was well exceeded as the Finance Sector Charter Council reports that R1.8 billion was extended to resource poor black farmers. These figures are inclusive of the following types of financing deals:

- Creating funding products and stimulating access;
- Land reform involvement and support;
- Creation of enabling structures for transformation;
- Policy and programme contribution; and
- Infrastructure and BEE financing.

Table 7: Performance of the finance sector (in lending to resource-poor black farmers), 2004 – 2008

Description	Targets and achieved figure (R million)	Percentage
Target Originations Agricultural loans	150.0	121
Achieved Origination Agriculture loans	181.6	

Source: Department of National Treasury (2008)

The geographical spread of the credit extended to 'resource poor black farmers' in South Africa is shown below (Figure 6). The largest share was in KwaZulu-Natal (23%), with the rest of the provinces ranging between 5% and 10%. The loans categorised as 'unallocated/national' refer to loans granted to farmers throughout the nine provinces of South Africa.

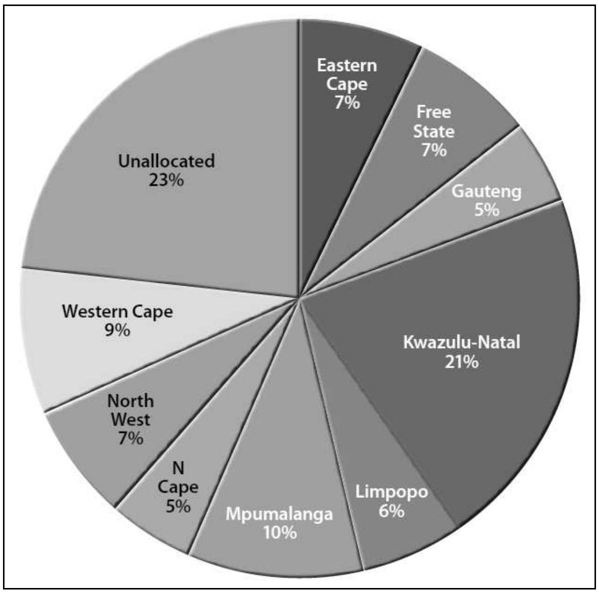

Figure 5: Geographical spread of loans extended to 'resource poor black farmers' by the finance sector
Source: Department of National Treasury (2008)

5.2 Major formal institutions

The main types of formal finance institutions that are participating in agricultural finance provision are grouped according to ownership status as well as type.

5.2.1 Commercial banks

ABSA

Absa Agribusiness, the agricultural division of Absa Bank is one of the largest in South Africa and boasts over 50 agribusiness specialists (Mashatola, 2012). The sole purpose of this unit is to provide financial services to role-players in the agribusiness sector. Noting the existing duality in the South African agricultural sector, Absa Agribusiness targets both the commercial and small-scale segments, though there is an emphasis on maintaining its dominant market share in the commercial side of the sector. The Agricultural Digest 2005/2006 indicates that Absa's product range includes overdraft facilities, mortgage loans, asset finance, insurance and assurance, and contract growing among others (DAFF, 2006). Janovsky (2009) noted that the role of the bank has expanded from the traditional definition (finance and insurance) of banking services to also include brokering, buying, and selling of farm produce.

In conjunction with various public stakeholders (such as DAFF, Khula Enterprise Finance, and Department of Rural Development and Land reform), Absa Agribusiness tries to accommodate small-scale farmer development as it remains key to the transformation and development agenda as well. The business development unit is dedicated to the management and administration issues that deal with small-scale farmers' needs in terms of agricultural financing, business plan development, and structuring of deals (Absa, 2011).

This division that deals with agricultural lending falls under the business banking unit, and is not significantly covered in the publicly available company reports. Part of the strategy adopted by Absa Bank in dealing with agricultural lending aims at further strengthening and leveraging strong agricultural capabilities that will lead to differentiation, market leadership, and competitiveness in the market. The strategic agricultural lending programmes implemented by the bank centre around the value chain approach e.g. procurement, 'see-through-credit concept', trade, and commodity finance.

In 2010, the bank announced its plans to adopt a new approach to agricultural financing. This new approach introduced innovation with regards to the collateral requirements of the bank in granting agricultural credit and adopts a 'holistic approach to agriculture and its downstream value chain'. This in regard to commercial farmers for instance, places emphasis on commodity-based finance products since the value of the agricultural produce can be of significant worth to be considered together with the traditional collateral asset value (land). This innovation is also critical in expanding agricultural credit to small-scale farmers as the value of both their assets and produce will be taken into consideration in the loan appraisal and approval cycle (Janovsky, 2010).

First National Bank (FNB)

First National Bank (FNB) Commercial is a subdivision of FNB, which is part of the FirstRand Group. The business banking division has several specialist sectors, and agriculture is one of them. FNB recognises the importance of the agricultural sector within the broader South African economy. The bank offers overdraft facilities, medium and long-term loans, as well as day-to-day banking facility to cater to the specific needs of farmers. Financing for vehicles, machinery, and plant assets is done through Wesbank (another division of the FirstRand Group). FNB boasts over 650 branches around the country which farmers can access as a contact point and caters for all farmers and farming enterprises in the non-urban and peri-urban areas (FNB, 2011).

The annual financial statements released by the First National Bank do not show the statistics relating to small-scale farmers, but rather the agricultural sector as a whole; even though agricultural credit is extended to ‘emerging BEE agriculture’ as part of FNBs empowerment financing. The publicly available annual financial statements reveal that about 2.9% (13 446 out of 461 503) of the total advances made in the year 2010 were directed to the agricultural sector. This represents a slight improvement in the figures in comparison to the 2.88% of 2009. The number of non performing agricultural loans decreased from 392 (3.24%) in 2009 to 390 (2.90%) in 2010.

The bank also makes available grants to various projects and programmes across South Africa. In 2010, 3730 grants were made towards agricultural livelihoods as part of the WesBank Fund flagship programmes that seek to break poverty. To some extent, this can be perceived as a contribution to small-scale and emerging farmers.

Nedbank

The Nedbank business banking division has agriculture as one of their focus sectors that is based on a client focused approach that is ‘localised, specialised, and customised’ (Nedbank, 2011). There are over sixty regional offices that offer expertise on local agro-climatic conditions as well as supporting organisations and networks. The product range and services that are offered by the bank are tailor-made to the demands of the agricultural sector by agricultural specialists in agronomy, horticulture, and livestock production. Cost effectiveness of the financial products and services offered is ensured through electronic banking facilities, professional approach, competitive, and individualised packages that include lending, investment, transactional, and value added solutions (Nedbank, 2011).

Nedbank's sector focus on agricultural finance hinges around three subsectors, viz. horticulture, livestock and field crops along the entire value chain. The bank offers non-financial support as well in the form of capacity building and mentorship programmes. In the 2011 financial year, a number of small-scale and emerging framers have benefitted from these services, which focused on business skills training and specialist advisory services (Nedbank, 2011).

The annual financial statements do not reflect the amounts that were granted to small-scale and emerging farmers but rather the agricultural sector in its entirety. In 2011, Nedbank has granted the agricultural sector R6903 million. The bank granted loans and advances to the agricultural sector to the total value of R5613 million in 2010, which constitutes about 1.15% of the total loans and advances. In 2011, the total loan and advances impairments amounted to R53 million. The sector had a total loan impairment of R57 million in 2010 which represented a ratio of 1.02%; one that is much lower than the overall ratio of impairments of 2.31%.

Standard Bank

Standard Bank is one of the longstanding and leading agricultural finance institutions in the South African market. The bank focuses on both commercial and small-scale farmers as well as various role players in the agriculture value chain. The services rendered by the bank fall under the AgriPlan programme, which includes advisory services (agricultural managers and advisors) as well as financial products (investment products as well as short, medium and long term loans). Other publicly funded initiatives (LRAD grants and Khula Land Reform Empowerment Facility (LREF)) are leveraged by the bank in order to improve the viability of small-scale farming enterprises. The Agricultural Digest 2005/2006 indicates that the Standard Bank agriculture division also offers price risk management (through trading on Safex markets) to producers, processors and traders (DAFF, 2006).

Standard Bank aims to be the leading bank in agricultural transformation in South Africa, and targets financing the agriculture value chain from pre-production all the way to retail. This includes a funding solution that makes finance and direct procurement of inputs available to small-scale farmers. The bank's commitment to "financing black owned agricultural entities is driven by our need to create economically sustainable in the agricultural sector as the foundation for our growth and profitability" (Mokgojwa, 2012). With regards to agricultural development and transformation, Standard Bank focuses on the following areas (Mokgojwa, 2012):

- Financing small, medium and large commercial black farmers: depending on the size of land that farmers have access to (use rights and not necessarily ownership rights) in order to produce goods to the market. This is done either directly to the farmers or indirectly through intermediary services, and support structures such as a cooperative, agribusiness etc. These intermediaries enhance farming capability (both technical and business management skills) and access to finance through retail financial services, shared services, or any other structure that should be approved by Standard Bank.
- Equity partnerships: in most instances, this happens to be an existing commercial white owned primary producing entity that gets involved in an equity partnership with black entrepreneurs (farm workers or black farmer) to produce goods to the market.
- Value chain financing: an existing agribusiness that wishes to sell equity to black entrepreneurs.

The bank tries to position itself as a provider of 'knowledge, experience and expertise in agricultural banking' in South Africa as well as Africa. Even though the bank is not actively involved in all avenues of the agricultural sector, it does however present links and opportunities to their client base through an extensive network in the value chain – from input suppliers, agribusinesses, machinery and equipment suppliers, to markets (Mokgojwa, 2012).

5.2.2 Public entities

Land Bank

The Land Bank is mandated under the Land and Agricultural Bank Act (Act No. 15 of 2002) to, among others, aid small-scale farmers to acquire agricultural land, enhance productivity and profitability of farms, and promote agriculture-related entrepreneurship. The overall objectives are aimed at growing the agricultural sector (both small-scale and commercial), creating jobs, and leveraging rural development and food security initiatives to foster overall development. In actual fact, the Land Bank is the sole development finance institution that is dedicated towards agriculture and rural development in South Africa (Land Bank, 2011).

The Land Bank is a specialist agricultural bank that is entrusted with extending access to financial services to commercial farmers, agribusiness as well as the historically disadvantaged farmers, particularly the emerging subcategory of farmers. With this mandate, the bank is best described as a development finance institution (retail and wholesale) that aims to serve all farmers equally (Land Bank, 2010). The mission of the Land Bank is to provide appropriate products and services for both commercial and small-scale farmers, leverage private sector investment into the sector, and develop lending techniques that reduce the market- and weather-related risks encountered in the agriculture sector. The programmes of the Land Bank aim to be in line with the government overall land reform as well as agricultural and rural development objectives (Land Bank, 2011).

To achieve this, the bank has developed a unique set of products in order to provide world class service at competitive rates. The bank has 27 branches and 45 satellites that spread over the nine provinces. In keeping abreast with technological innovation in financial services provision, the Land Bank has established mobile banking facilities in each province and is operational in 64 areas. The task of rural development in the country, by Land Bank as per the mandate, must therefore be seen as that of raising the levels of productivity and income in order that the rural communities, and the country in general, achieve self-sufficiency in food production, general employment as well as adequate export potential (Land Bank, 2010).

5.3 Overarching trends

5.3.1 Outreach

There is an extensive branch network (physical access points) that covers most of the formal finance institutions (i.e. private banking institutions) in South Africa. There is a physical access point within a 15km radius all across 75% of South Africa. However, small-scale farmers in rural areas still remain underserved, as a result of poor public infrastructure, low levels of financial literacy, and no collateral assets. Overall, there is an apparent increase in the total loan amounts approved for agricultural loans. However, these are not indicative of the disbursement rates as well as the disaggregation between individual and corporate clients.

There is an increase of corporate companies that make use of a number of funding models in agricultural financing in South Africa. These relate to value chain financing, contract farming, and share cropping. There is enormous untapped potential with regards to these and other funding models and how they improve the levels of formal finance institutions'' outreach to small-scale farmers. This however must be taken into consideration within the agricultural development context that seeks to transform the rural economies of South Africa. There is extensive coverage in terms of outreach by formal finance institutions, though the impact is limited in many ways in providing small-scale agriculture financing.

5.3.2 Growth

There has been considerable growth in the total value of loans that have been granted to small-scale farmers by formal finance institutions. However, given the limited scope of small-scale farmers that are deemed to be eligible (in terms of categories), the majority of small-scale farmers still lack access to agricultural finance. However, figures that are publicly available include commercial farmers, and must be understood in light of the ever increasing input costs.

5.3.3 Self sustainability

All the formal finance institutions considered in this study are well performing financial institutions and have been in existence for long periods and adhere to sound financial principles. The strict loan approval and assessment criteria serve as gate-keeping mechanisms with regards to small-scale farmers that generally do not have a credit history. However, in some instances the figures for loans in arrears regarding small-scale farmers' remain slightly higher (Land Bank, 2011 & Mashatola 2012). The formal finance institutions considered in the study have managed to be self-sustainable and continue to attract investors into the respective entities. However, self-sustainability should not be maintained at the expense of excluding small-scale farmers.

5.4 Conclusions

The major challenges in agricultural finance are around some of the concepts that are used as indicators to measure agricultural finance best practice, viz. outreach, growth, and self-sustainability. There is an indication of a mixed bag results in the overall performance of formal finance institutions in providing small-scale agricultural finance. Few institutions have a dedicated fund that is targeted for small-scale agricultural finance provision. Generally; there is growth in terms of the small-scale farmer total loan book or dedicated fund, largely due to widespread implementation of the AgriBEE principles. Again though, this only represents a small fraction of total 'agriculture-related loan book' in the various institutions.

There are few documented cases of small-scale-farmers that have graduated to the commercial segment of the sector as a result (direct or indirect) of the role these formal finance institutions play in the development of small-scale farmers. This is contrary to the fact that formal finance institutions are particular about the category of small-scale farmers that are granted agricultural loans; generally small-scale with the potential of getting commercialized farmers are financed by formal finance institutions. This points to the flawed notions with which small-scale farmer development is approached, and also the disjuncture between the finance sector approach *vis-a-vis* the agriculture development approach.

CHAPTER 6

RESEARCH FINDINGS – MODE OF OPERATIONS

This chapter presents the findings of the study on the mode of operations of the financial institutions included in the study.

6.1 Criteria and procedures for lending to small-scale farmers

ABSA

The loan assessment process of Absa bank primarily evaluates the following three aspects: loan repayability, collateral, and management capacity. Regarding repayability, the bank takes into consideration the financial statements of the agricultural enterprise (projected and/or audited), non-farm income assessment, business plans, relevant technical skills, as well as general livelihood patterns. The bank has adopted strict collateral requirements – given the higher risk associated with lending to the agricultural sector.

As a general rule, the bank requires a 50% collateral value to the required loan amount, and only immovables can be considered in this regard, with a few exceptions depending on the merits of the loan application (e.g. off-take agreements). Non-farm income is considered as a bonus with regards to sources of collateral and cash flow considerations. However, this poses a threat on management capacity as it can imply that the farmers' interests are split. The management capacity of the farmer is a crucial aspect of the loan assessment process. It is important to verify the technical competencies of the farmer in light of the production operations requirements as well as the business management side of things. In accordance with the geographic region in which a farmer is based and the industry within which the farmer operates, varying levels of management capacity are to be expected (technical and business related). The bank can however consider mentoring programmes as proof of capacity building, and farmers can be afforded the opportunity of enterprise development programmes that can enhance their agricultural enterprises (Mashatola 2012).

The terms of agricultural loans can vary from one to ten years, depending on the amount and intended use of the capital. Normally, the repayments are scheduled according to the cyclic nature of that particular enterprise or industry such that payments are required quarterly or annually. In the event that a farmer defaults on the loan repayment, the bank institutes a collection process that can take up to 90 days before the loan is handed over to the legal department. There are however allowances to restructure debts up to a maximum of two years, depending on the projected recovery of the enterprise or industry (Mashatola, 2012).

Mashatola (2012) states that, depending on the risk associated with the enterprise or industry there are varying levels of interest rates applicable to loan amounts. The factors that are considered to mitigate risk on the part of the farmer (i.e. technical skill and knowledge, access to markets or contracts, as well as management capacity) are considered in the determination of interest rates charged on loan amounts.

Land Bank

The Land Bank offers a number of loan products and services to the agricultural sector – from corporate clients, commercial famers, and small-scale farmers. Land Bank reaches both small-scale and commercial farmers all over South Africa through a retail business division that has twenty-seven branches. In line with the dual nature of South Africa's agricultural sector, the bank classified its operations according to the targeted clientele, viz. small-scale and emerging farmers, established and commercial, and established and emerging agribusinesses and cooperatives (Figure 7).

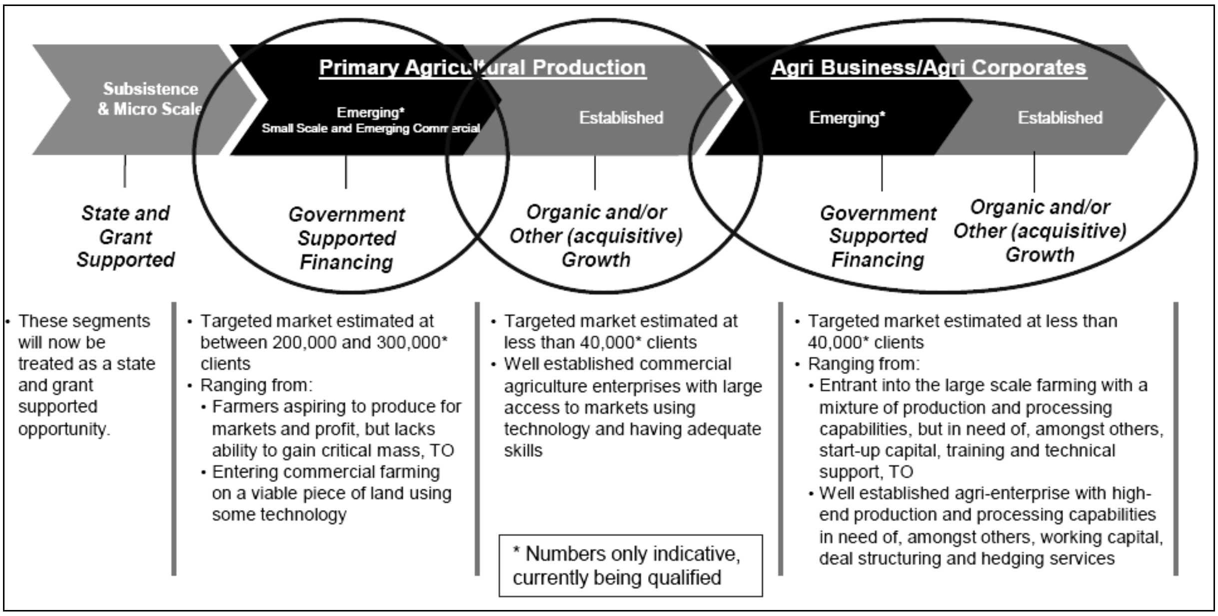

Figure 6: Target operating model

Source: Land Bank (2008)

The bank offers short term loans (production related) with some innovation with regards to collateral requirements. Some of these products are offered on the basis that the assets purchased (livestock, farming equipment and implements, vehicles) with the loan amount, belong to the bank up until such time that the entire loan amount has been paid back to the Land Bank. The terms and conditions associated with this product are also tailor made, depending on the projected lifespan of the assets, suitable repayment plans (monthly, quarterly, six-monthly or annual basis) and can be extended to individual farmers or a group of farmers. In its efforts to support the efforts of government with regard to improving access to land, providing support for emerging farmers (subsistence, small-scale and commercial) and raising rural incomes, the bank offers special mortgage loans (with reduced interest rates) that are aimed at individuals and groups of people who were previously disadvantaged and whose endeavours are agriculturally inclined.

In 2011, the bank introduced a new banking division that is aimed at providing products and services (non-financial) to small-scale farmers that aid the development and transition of these farmers into commercial farmers, the 'retail emerging markets'. The bank has also developed a wholesale finance facility in order to expand its lending to agri-businesses and agricultural cooperatives that are oriented towards small-scale farmers. The bank is planning to introduce a comprehensive framework for small-scale farmer support which is aimed at dealing with the technical, allocative and systemic challenges that are faced by small-scale farmers (Land Bank, 2011).

Kau (2011) states that the Land Bank has adopted a business-like approach regarding the strict criteria followed when it comes to the requirements for successful loan appraisal. The loan application and approval process includes ITC checks, collateral requirements, authenticity checks, and property and asset evaluation. Loan applications must clearly state the nature and type of project to be financed. The financial viability of the project, and economic and social merits of the project/enterprise are some of the issues that must be included in the proposed business plan.

Some of the components that are considered for a farmer/project/enterprise to qualify for finance by the bank are the following:

- Assessment for credit worthiness;
- Companies that are registered in South Africa or have a South African majority shareholding;
- Understanding of the Land Bank development mandate;
- Risk profile - control and mitigation measures;
- Operational capacity;
- Proven experience in agriculture development;
- Profitability and viability of enterprise; and
- Sustainability project/enterprise.

Standard Bank

Standard Bank approaches small-scale farmer lending through a value chain financing model that involves public and private partners that enhance financing of farmers' production and working capital. These public-private-partnerships involve institutions that can provide good education, training and extension services, and skills and knowledge on production techniques and technologies. There are partnerships with insurance companies that are in place to mitigate the production risks associated with the particular industry or production system. The partnerships that involve private sector agribusiness are geared at provision of inputs in bulk (economies of scale), access to markets, processing, storage, and mechanisation requirements. The role of public institutions is also solicited with regards to weather and information services, roads and energy infrastructure, etc., as well as risk sharing guarantees in some cases (Mokgojwa, 2012).

Standard Bank primarily provides finance for small-scale farmers, but is also aware of the need to align the finance with provision of inputs, mechanisation, market access, mentorship services and advice (on technical and financial aspects). The bank focuses on the small-scale farmer's potential to develop and become commercially viable, which can serve as leverage for all the other stakeholders' participation.

Access to finance is only one component of the farmer development and support structure, which requires the participation of several other stakeholders and services that are provided by private and public institutions. It is through the implementation of this holistic approach that the success and growth of small-scale farmers is guaranteed, thus minimising default risk by mitigating production and price risks, as well as smoothing out of marketing, technical, and financial constraints.

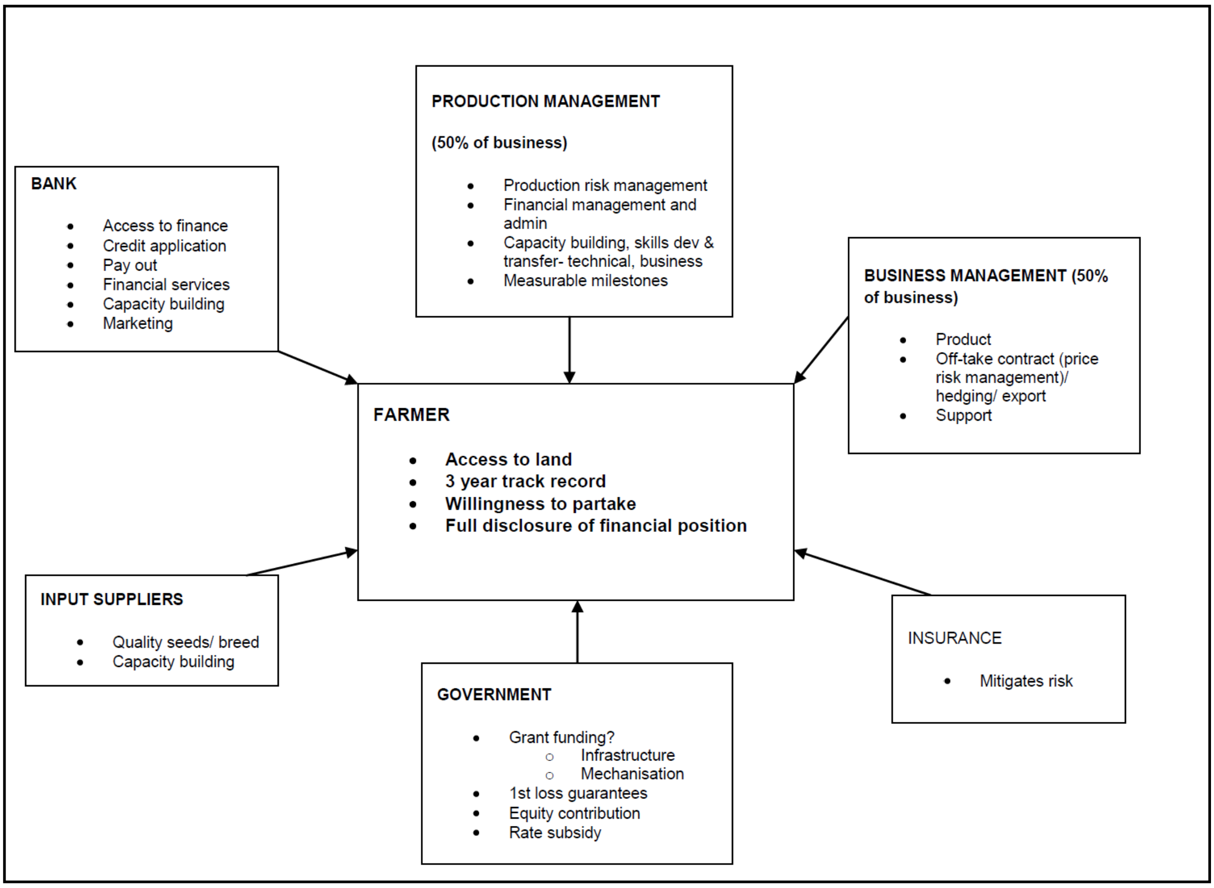

Figure 7: Risk sharing partnerships
Source: Mokgojwa (2012)

The criteria used to assess the eligibility of small-scale farmers for agricultural loans centres around four key aspects (Figure 8). The first is access to farm land – the size of the land, its productive potential, and security of the use rights are considered. Communal land can be considered although private land ownership is the most preferred system of land rights. In instances where the land sizes are too small to produce a marketable surplus, innovations such as clustering of the adjacent farms is employed – so that farmers can produce a fairly homogenous quality of product whilst reducing the production costs involved. The second issue is mitigation of production risk – which has both production and business management aspects. If at any point the farmer is seen as not possessing the necessary skills or knowledge, then the input of a mentor/advisor can be outsourced. Further from this, production risks are mitigated through comprehensive insurance cover. The third issue is mitigation of price risk – and this is mitigated though off-take agreements that guarantee a minimum level price at the least. The last issue is infrastructure, implements, and mechanisation requirements. Small-scale farmers must have the necessary implements and mechanisation that are required by the type of production system.

6.2 Lending operations focusing on small-scale farmers

ABSA

The default ratio associated with the bank's agricultural loan portfolio is just below 3%. This figure, however, is inclusive of the commercial farmers and it would be expected to rise slightly when considering small-scale farmers (Mashatola, 2012).

Land Bank

The Land Bank development loan book reflects the aggregate loan amounts (across the retail and corporate finance units) that have been dedicated (disbursed and approved loans) for emerging (largely small-scale and commercial) farmers. The size of the development loan book (total debt owed by small-scale farmers) amounted to a sizeable R3 billion in the 2009 financial year. Land Bank experienced a considerable decrease in the size of the development loan book of 23% in the financial year 2010 coming in at R2.3 billion. The bank has placed emphasis on growing and improving the development loan book, and has set to improve its outreach to small-scale farmers by increasing rates of approval and disbursements of loans by setting a R450 million per year target in the 2010 financial year. 63% (R282.5 million) of the target was realised. In 2011, however, only 48.6% (R281.7 million) of the target amount was approved. The disbursement rates are still lagging behind as only 23% (R105.6 million) of the targeted amount has been disbursed. This figure is an improvement (in comparison to the 2010 financial year) of about 38.4%, which represented R172.7 million. The bank extends loans to a number of corporate clients (largely agricultural cooperatives) to the total value of R65 million; these in turn have major small-scale farmer membership (Land Bank, 2010).

An additional R1 billion was made available in 2011 to meet the large demand for agricultural credit amongst small-scale farmers. As part of their commitment to small-scale farmers, Land Bank and other public entities (Departments of Agriculture, Forestry and Fisheries; Rural Development and Land Reform; and the National Treasury) have developed specific funding channels viz. value chain financing and curatorship models. The value chain financing model (Figure 9) is designed to provide a comprehensive set of financial and technical assistance to farmers, agribusinesses and agricultural cooperatives and intermediaries. The role of the Land Bank in this regard will be to provide farmers, agribusinesses, and agricultural cooperatives and intermediaries with finance and also to negotiate partnership deals for additional technical support with the relevant government departments, parastatals, private companies, and universities.

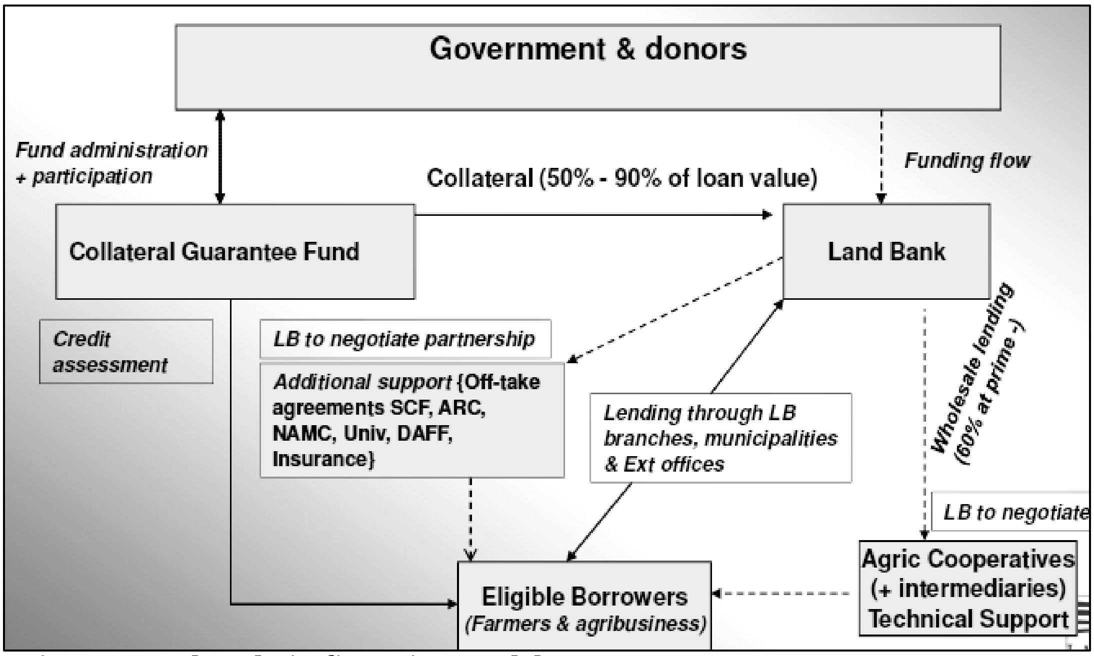

Figure 8: Value chain financing model
Source: Land Bank (2008)

The curatorship model is designed to assist small-scale farmers who are indebted to the Land Bank and are struggling to pay back the loans as a result of unviable farming enterprises (Land Bank, 2010). The value chain financing pilot projects are said to receive finance to the value of R208 million. Both these delivery channels will serve to improve the size and quality of the developmental loan book.

All these facilities allow for multi-stakeholder involvement in providing comprehensive support to small-scale farmers who are land reform programme beneficiaries. The reinforced emphasis on small-scale farmers has led to the establishment of the 'Retail Emerging Markets

(REM)' banking division; which promotes small-scale farmer development into commercial farmer status (Land Bank, 2011).

A study conducted by the Land Bank (2011) among emerging farmers indicated that there are over 5600 loan accounts opened by small-scale farmers since 2007. In total these accounts amounted to R780.1 million, with the loan per account averaging R140 000. Figure 10 shows the spread according to credit risk of these accounts. 57% of these loans not performing well with 25% in arrears and 32% referred to legal department. The study indicates that the largest proportion of non-performing loans are already with the legal department, and these tend to be of larger value.

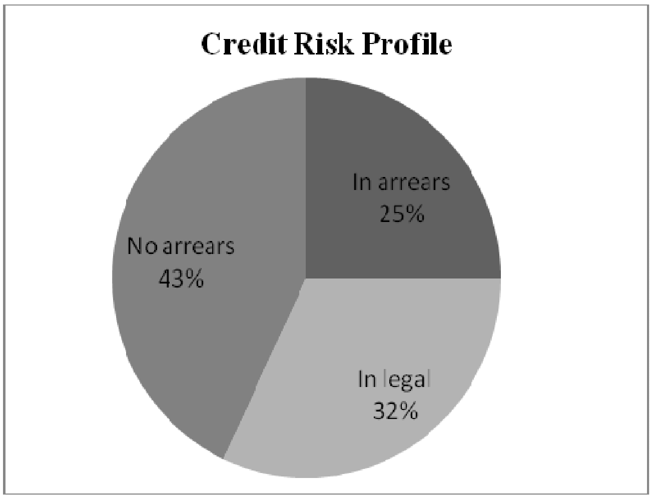

Figure 9: Accounts according to credit risk
Source: Land Bank (2011)

The issue of performing and non-performing loans also showed a marked geographic distribution in the different regions in the country. Figure 11 shows the worst ten regions in terms of non-performing loans (accounts referred to legal department). Though the explanation for the variances as per geographic region cannot be thoroughly explored in this study, it does however point to the many aspects that contribute to loan repayability.

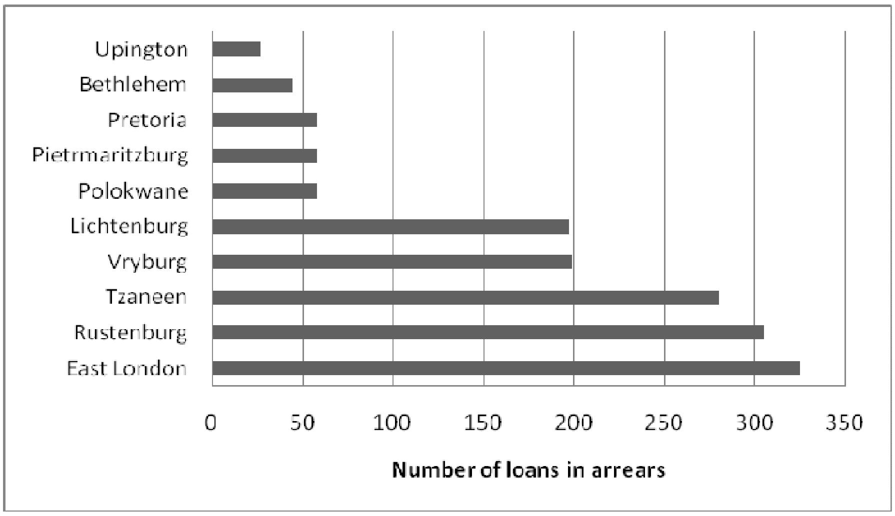

Figure 10: Number of accounts per branch in legal department
Source: Land Bank (2011)

Mmbengwa et al. (2010) confirm that the Land Bank experiences problems with loan repayment, especially by small-scale and emerging farmers who are beneficiaries of the governments' land reform programme. The quality of the developmental loan book has however improved significantly in the period of 2000 to 2010. The percentage of accounts with no arrearsimproved from about 13% at its worst in 1997/98 to 100% in 2007, as recorded in Tables 8 and 9. This indicates a significantly positive repayment rate by small-scale and emerging farmers. However the trend has shown a dramatic reversal from 2008 up until 2012 (DAFF, 2012). This, however, reflects aggregate figures, and no clear patterns can be drawn with regards to small-scale farmers or even the drastic change between these periods. This though, must be viewed together with the fact that the Land Bank has gone into a number of partnerships with government departments and programmes that offer financial assistance to emerging farmers broadly

Table 8: Age analysis of the loan book (number of accounts)

Year granted	Accounts in legal	Accounts in arrears	Accounts with no arrears	Total
Before 1994	5	1	14	**20**
1995/96	33	7	13	**53**
1997/98	676	118	122	**916**
1999/00	605	219	295	**1119**
2001/02	339	298	467	**1104**
2003/04	120	497	744	**1361**
2005/06	10	243	685	**938**
2007	0	0	98	**98**
Total	**1788**	**1383**	**2438**	**5609**

Source: Land Bank (2011)

Table 9: Age analysis of the loan book (%)

Year granted	Accounts in legal	Accounts in arrears	Accounts with no arrears	Total
Before 1994	25	5	70	**100**
1995/96	62	13	25	**100**
1997/98	74	13	13	**100**
1999/00	54	20	26	**100**
2001/02	31	27	42	**100**
2003/04	9	37	55	**100**
2005/06	1	26	73	**100**
2007	0	0	100	**100**
Total	**32**	**25**	**44**	**100**

Source: Land Bank (2011)

Nedbank

Nedbank has a number of targeted areas of investment and black agriculture financing is one of them. In the financial year 2009, the bank invested R20 million in agriculture development – a figure that grew to R70 million in 2010. This represents a 71.43% growth from the investment made in the previous year in spite of the challenges related to investing in small-scale agriculture. In 2011, the bank granted R164 million towards 'black agriculture' in loans as part of Nedbank's Black economic empowerment transaction financing.

The business banking segment of the bank has exceeded its targets of agricultural loans made to small-scale and emerging farmers as well as small and medium entrepreneurs in the agricultural sector. As part of the 'empowerment financing' strategy of the bank, there has been an increase in the number of agricultural loans that were offered to previously disadvantaged farmers. In 2011 the loans amounted to R164 million, a significant increase from R70 million in 2010, and R20 million in 2009 (Nedbank, 2011).

Standard Bank

The bank has committed itself to developing agriculture in emerging markets and thus provides extensive support to small-scale farmers through specialised business managers and agricultural advisers. The bank extended over R10 million in loans and advances to the entire agricultural sector, representing 1.84% of total loans and advances. The agricultural sector accounted for 2.6% (R259 million) of the total credit impairments for loans and advances (Standard Bank, 2010). In 2010, the bank partnered with the Mngcunube development agency in a programme that seeks to expose and establish links between black farmers and the various stakeholders in the agricultural food value chains in order to improve their access to output markets (local, regional, and international) and increase opportunities for farmer development and commercialisation. The bank has invested R2.3 million into the programmes of this partnership. Furthermore, the bank has invested R5.5 million in an economic cluster development programme in five provinces (Eastern Cape, KwaZulu-Natal, Limpopo, Northern Cape, and Western Cape) in which agricultural cluster areas are to be developed (Standard Bank, 2010).

Through its Enterprise Development initiative, the bank seeks to support small-scale farmers by addressing three key issues – access to finance, business development support, and market access. With regards to access to finance, Standard Bank offers the solutions for working and growth capital, cash management options, and innovative transactional products (cheaper and user-requirements oriented). For business development support, the bank focuses on mentoring and capacity building initiatives. With regards to market access, the bank assists with identifying opportunities, input and output suppliers' development and strengthening, as well as off-take agreements support (Mokgojwa, 2012).

In 2010, Standard Bank committed R500 million to support small-scale and emerging farmers through providing holistic solutions that cater for the demands of small-scale and emerging farmers, especially in the livestock, citrus, grain and sugar industries. This will take the form of a tripartite structure between the farmer, the bank, and a cooperative that will provide technical support. Moreover, the bank provides a team of specialised business managers and agricultural advisers to the small-scale and emerging farmers. The bank has already financed over 2000 farmers in the sugar industry through this fund (Standard Bank, 2010).

Standard Bank, in partnership with the University of Stellenbosch, have launched a programme that provides training to potential mentors to small-scale and emerging farmers that seek 'to support sustainable agribusiness development, land reform and transformation' (Mokgojwa, 2012).

6.3 Delivery mechanisms and channels

Absa

Absa Bank lends primarily to commercial farmers and, to some extent, accommodates a section of small-scale farmers whose agricultural enterprises are deemed financially viable and sustainable. This category of small-scale farmers are labelled as commercial emerging and can be characterised as 'large commercial on private property' according to the Vink and van Rooyen typology of small-scale farmers presented in Table 3. Absa Bank has over 1000 branches all over South Africa and farmers can directly approach a designated business manager who can upon request solicit the involvement of an agri-specialist in the regional offices. The number of small-scale farmers that are financed by the bank ranges between 1000 and 2000 (Mashatola, 2012).

Absa Bank is one of the dominant stakeholders in agricultural lending and boasts a loan book of about R29 billion and has been growing at about 10% annually. Janovsky (2011) claims that Absa has a 47% market share when it comes to agricultural lending by private sector financial institutions in South Africa. These statistics, however, are inclusive of the commercial and small-scale sectors in agriculture. The bank also has a SAFEX trading desk as well as insurance services that are offered by sister companies that are under the Absa group. Farmers can utilise these services though they are treated as a separate business from the business of the bank. The bank also provides technical information with regards to commodity prices and in essence monitors the performance of key industries within the agricultural sector (Mashatola, 2012).

Land Bank

The involvement of the Land Bank in aiding the development of small-scale farmers has been adequate through its stated objectives of growing ‘emerging’ farmers into commercial farmers and through its designated developmental loan book. Growth in lending to small-scale and emerging farmers by the Land Bank has been somewhat constrained, and the high levels of non-performing developmental loans (in arrears and in legal department) compound this problem. .

In 2011, the bank partnered with the departments of Rural Development and Land Reform, and Agriculture, Forestry and Fisheries in developing a farmer development programme that is in line with the bank’s stratification model (Figure 12). This programme aims to assist land reform beneficiaries in creating sustainable farming enterprises by providing credit and other support systems, along with access to markets. There are plans to extend non-financial support to already distressed clients who are either in the developmental or commercial book. All these efforts seek to improve the performance of the loan book, so as to strengthen the longer term sustainability of the bank.

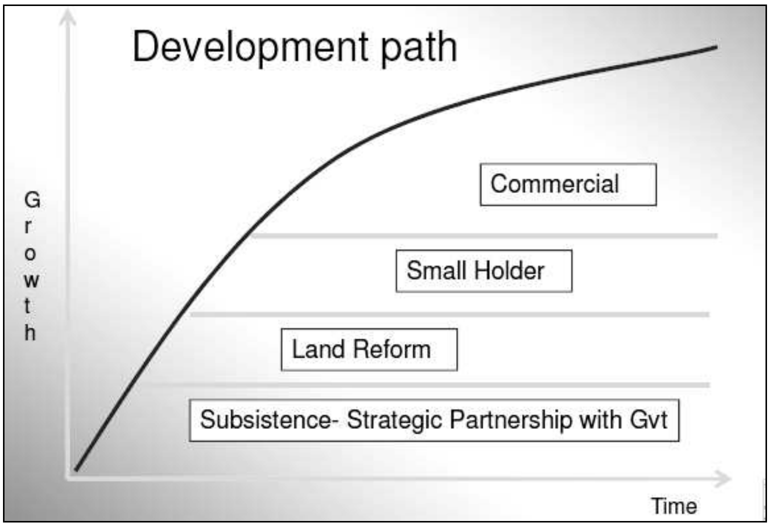

Figure 11: Land Bank stratification model
Source: Land Bank (2008)

6.4 Conclusions

Overall, the research findings indicate that there are serious challenges regarding the adherence levels to best practices in agricultural finance in South Africa, particularly by formal finance institutions. There are limited major developments with regard to innovations that are being implemented by formal finance institutions that are involved in financing agricultural activities – particularly in small-scale agriculture. Generally the operations of the formal finance institutions relating to small-scale agricultural finance are part of the retail and business banking units. There is an overbearing dominance of short term agricultural finance that is focused on production related expenses. However, there is also still limited access to longer term agriculture finance that is focused on capital investment. There are some innovations that formal finance institutions have developed regarding the loan products that are well specified in terms of intended purpose.

6.4.1 Lending policies, terms and conditions

The policies, terms and conditions under which agricultural financing is undertaken are solely aligned with finance sector practices. There are stringent requirements that must be met by loan applicants (e.g. ITC checks, collateral requirements, authenticity checks, and property and asset evaluation etc.). More often than not, small-scale farmers are not eligible to qualify for agricultural loans. This is largely due to the inappropriateness of the loan assessment tools (e.g. repayability, collateral, and management capacity). Generally, the loan term varies according to the risk profile, experience, and available collateral as per the individual case of farmers. There has been minimal adoption of some of the best practice innovations that enhance the extent to which the demand for agricultural finance is converted to effective demand through the development of appropriate loan products and services, proper structuring of the lending policies, and terms and conditions aligned with the needs of small-scale farmers.

6.4.2 Quality of loan portfolio (loans in arrears)

Emanating from the abovementioned issues, on the mode of operations adopted by formal finance institutions in rendering agricultural finance, the quality of loan portfolios across the board is good with default rates that are below 5% for most of the private banking institutions. The situation differs significantly when considering public formal finance institutions though. Specifically for small-scale agricultural finance, the default ratio is slightly higher, and this in turn affects the levels of interest rates that are charged on agricultural loans granted to small-scale farmers.

CHAPTER 7

DISCUSSION OF THE RESULTS

This chapter discusses the results of the study in light of whether or not formal financial institutions adhere to best practices in lending to emerging farmers. It must be stated that it was difficult to obtain the relevant information as all formal finance institutions are guided by a set of corporate and business ethics that restrict the extent to which information on clients can be shared. There was also a reluctance to share the relevant statistics on small-scale farmer finance, as probably this information could implicitly portray the institutions in question as unwilling to support the transformation process of the agricultural sector. Some of the underlying themes that are presented in the results of the study are explored within the context of best practices in agricultural lending.

7.1 Introduction

The study focused on the formal finance institutions that are dominating agricultural lending in South Africa, the majority of which are private banks. There are public and parastatal institutions that are involved in agricultural lending, albeit to a limited extent. Given the duality of the South African agricultural sector, a similar pattern was expected regarding small-scale farmer financing. The majority of the private institutions discussed in the study operate under a highly competitive environment and have taken great care in maintaining levels of reporting standards that are non-compromising of their position in the industry – which translates into rather limited availability of information. However, for the purpose of the study, the relevant available information was considered. The results of the study are summarised according to the main concepts of agricultural lending best practices i.e. assessment of the institution's performance in lending to small-scale farmers, as well the mode of operation that is adopted to suit the nature of this segment of clientele. Generally, there are much fewer instances in which formal finance intuitions are applying innovations that are enhancing small-scale agriculture financing.

7.2 Key issues emerging from the major formal finance institutions

The issues that emerged from the study in terms of the major formal finance institutions that are involved in small-scale agriculture financing were related to the heavy presence and participation of private sector commercial banking institutions. Given that the role of public institutions (particularly the Land Bank) remains vibrant, and when analysing the accompanying objectives of these institutions, there is an apparent private-public dichotomy.

7.2.1 Dominance of private banking institutions in agriculture finance

It has been stated in this report that private banking institutions are the significant role players with regard to agricultural lending in South Africa, and also that most of these institutions place significant focus on the commercial segment of the sector. The finance sector in South Africa is well developed and is thus capable of meeting the demand for credit that exists in the agricultural sector in its entirety. Though banking institutions dominate the national statistics of agricultural lending; there is a certain asymmetry that favours commercial farmers as compared to small-scale farmers. It can be inferred then, that the growing trend in increasing dominance by commercial banks contributes to the unevenness of the agricultural sector with regards to the producer types (viz. small-scale and commercial farmers).

Given the levels of sophisticated business orientation of commercial banks (and the associated services and product types), commercial farmers are also inclined to be well conversant with the sophistication of the banking environment. Small-scale farmers on the other tend to have low literacy levels and, therefore, often get excluded by commercial banks. Though some of the commercial banks do have financial literacy programmes as well as business development programmes, none of the institutions covered in this study indicated such programmes directed to the small-scale farmer segment. In fact, some commercial banks are not active in agricultural lending to the small-scale farmer segment. Nonetheless, lending to the agricultural sector has been growing steadily over the years, but there has not been a significant shift in sectoral agricultural lending policies that can encourage and support successful small-scale farmer financing.

Although private sector institutions play a significant role in the economy of South Africa, the role of the state remains large with regard to the ambitions of the developmental state. It is here that the public-private dichotomy of agricultural finance arises. Institutions that are publicly owned tend to focus more on small-scale farmers and their overall development, whereas privately owned formal finance institutions carry a largely commercially oriented farmer contingent. Also, there is a gap in terms of providing the much needed non-financial support such as access to markets, technical skills, or collateral alternatives. The environment within which formal finance institutions provide agricultural credit has changed, and agricultural lenders need to identify the opportunities arising in small-scale farmer development.

7.2.2 Public-private dichotomy in agricultural finance

It emerges from the study that publicly owned/financed entities tend to focus on agricultural development and make provisions (structure of products and services) for small-scale farmer agriculture. On the other hand, most privately owned entities tend to focus on commercial agriculture and thus structuring their products and services to suit only this segment of the market – effectively excluding small-scale farmers. These characteristics are to some extent inherent to the nature of the institutions (public vs. private), but also there could be beneficial trade-offs between them. Public institutions are deemed to have low levels of efficiency and profitability in their agricultural financing programmes, granted the developmental objective that such institutions carry. Private institutions on the other hand carry with them a profitable bottom line as an objective, and this means that only financial/business principles are applied. This points again to the uniqueness of the agricultural sector in the South African context as it requires a concerted effort from both public and private institutions. For small-scale agriculture to thrive, both these types of institutions need to be strengthened in terms of their outreach and impact, but more with regards to the lending methodologies that are employed.

7.3 Criteria and procedures for lending to small-scale farmers

One of the key considerations that formal finance institutions remain resolute on relates to the viability (financial, business, and physical) of enterprises. There are other requirements that must be fulfilled prior to successful lending to small-scale farmers; however, this aspect has proven critical (on the part of formal finance institutions) and yet difficult (on the part of small-scale farmers).

7.3.1 Viability of farming enterprises

In most cases, formal finance institutions require that small-scale farmers produce business plans, financial statements, off-take agreements, etc., as evidence for the financial viability of the farming enterprises. There are formal institutions that do not fund 'green projects' (new farming enterprises that have not had at least one production or financial cycle) at all; and for some of the formal finance institutions studied, audited financial statements are required. The assessment of the viability of the farm enterprise involves many aspects such as income levels and financial security, farmer credit scores, levels of literacy and financial literacy, technical knowledge and experience, agro-climatic regions, levels of household income and expenditure, etc. At the root of this assessment, is production capacity as well as access to markets. Formal finance institutions can only grant loans to small-scale farmers when there is some level of certainty that the expected yields and product quality will be realised, and the expected market price will be obtained. Given the low levels of capacity and skills that small-scale farmers have, it is extremely difficult for them to meet this criterion set by most formal finance institutions. It is worth mentioning here that there were no clear guidelines that specified how technical capability and management capacity were assessed. This ranged from history of relationship, proven farming record, general impression of bank agent on farm visit, etc. There is some level of support with regards to business development for all small and medium enterprises (including agriculture); however the technical support is limited except for cases in which there is a mentor or strategic agribusiness partner involved.

Formal finance institutions have continued to rely on the conventional lending methodologies that emphasize on collateral security, capacity to repay, character of the borrower, capital outlay, and business track record – the five Cs of credit ratings. From the results of this study it emerges then that 'emerging commercial' farmers are considered by formal finance institutions as viable; thus leaving a huge gap still within the small-scale farmer finance demand. This not only has implications for the status of small-scale farmers, but also for the status of agricultural development in general in South Africa. Broadly, it can be stated that formal finance institutions do need to develop a revised role in terms of the uniqueness of the South African scenario in agricultural financing, and hence the delivery methodologies practised.

7.4 Critical factors in the lending operations of formal finance institutions

Generally, formal finance institutions operate on economic return of investments and the agricultural sector is under the same levels of stringent scrutiny in terms of the inherent costs and risks. There have been some innovations that have developed over the years in mitigating some of the risks, however much can still be achieved.

7.4.1 Risk mitigation strategies

In general, the small-scale agriculture loan book has a default rate that is higher than that of the commercial loan book within the same formal finance institution. This has also contributed to the higher risk profile that is associated with small-scale agriculture. In recent times, formal finance institutions have become increasingly involved in trying to control market risks, mainly through hedging (insurance, contracts, futures contracts, etc.). However, there has been limited involvement on the side of controlling production risk, other than loan assessment procedures. Though all farmers face some level of asset risk (theft, fire, damage), it has become standard practice to recommend an appropriate insurance cover as part of reducing the risk profile of farmers.

7.4.2 Production related risks

Many factors predispose small-scale farmers to higher risks in production; such as lack of technical skills, inputs, access to water and land (i.e. high potential). Given the natural predisposition of the agricultural sector to weather related production risks, there is only so much that can be done to mitigate the risk. Formal finance institutions generally maintain that some of the components that lead to higher production risks are outside of the scope of their business and public institutions and initiatives should contribute by creating an ‘enabling’ environment (access to resources, improved human capacity) for small-scale agriculture to thrive. Because of the prevailing poverty levels of small-scale farmers (centred on family labour), there is an inherent human/personal risk (shocks to livelihood) that may be disruptive to the farming activities which has not been innovatively considered.

7.4.3 Market related risks

The dominant tool used by formal finance institutions for managing market related risks is hedging, specifically trading on the futures market and contracting for agricultural produce. Contract farming has been on the increase for small-scale agriculture, especially in the domestic markets as agro-processors and some supermarkets seek to fulfil their AgriBEE preferential procurement quotas. Formal finance institutions have adopted this approach as part of the loan assessment process for agricultural credit in order to reduce price risks. In as much as formal finance institutions are embracing the value chain approach in agricultural financing, there are limited cases of input financing through contracts.

7.4.4 Transaction and information costs

The information age has influenced greatly the data management systems, and to some extent has made accessing and corroborating client information much more competent, thus reducing the cost of client search. This has also made market and price information readily available in real time for both formal finance institutions and farmers; a service which has proved beneficial in managing market related risks.

7.5 Collateral requirements and innovations therein

Commercial banks remain very strict with regards to collateral requirements when dealing with small-scale farmers. The general rule of thumb is that small-scale farmers must be able to provide collateral up to 50% of the loan amount. In this case, only immovable assets can be considered and, therefore not much innovation in lending to small-scale farmers has been observed. Contrary to the emerging trends in lending to commercial farmers, who no longer use only immovable assets as collateral, the banks have started to consider agricultural produce as part of collateral. The argument presented by some of the commercial banks is that the quantities and quality produced by small-scale farmers are insignificant and inconsistent, respectively, such that it becomes difficult for the commercial banks to consider small-scale farmers' produce as collateral. Another point of contention here is the low level of technical skills and farming experience that small-scale farmers have, thus making their success rates relatively low. This increases the levels of risk that commercial banks attach to small-scale farmer lending. Publicly owned institutions on the other hand (e.g. Land Bank) have considered other alternative forms of collateral. These include value chain financing and curatorship models, as well as asset-based finance that lists assets purchased as assets of the Land Bank until such time that the loan has been paid off. The Land Bank is involved in both financial and technical assistance to small-scale farmers, and thus reducing the production related risks faced by these farmers.

Given the stringent requirements that formal finance institutions have in terms of loan security, and the now stricter credit rating and screening of individuals and businesses, it has become increasingly more difficult for small-scale farmers to be granted agricultural credit. The regulatory framework in place is necessary but this has effectively resulted in small-scale farmers being excluded from the formal financial system as they cannot meet a majority of the requirements.

7.6 Models in agricultural financing

The stark reality that remains evident from the results of the study is the disjuncture between the approaches from the finance sector and approaches from the agricultural sector. Both are necessary, even though at times they can seemingly have contradictory objectives. Agriculture (as a primary industry) carries with it a largely developmental and socio-economic role with regards to land rights and ownership as well as food security issues. Finance on the other hand, is associated with a highly sophisticated business environment and functions as part of the tertiary industry of the economy focusing on financial profitability. The uniqueness of the South African agricultural sector lies in the dual dynamism that polarises agricultural finance between the commercial and the small-scale farmers. The common ground between the agricultural sector and the finance sector lies in innovative approaches to risk management, and recently this has led to the emerging of value chain based lending. This, however, still poses a limitation for small-scale farmers, as they generally still lack access to output markets and formal finance institutions find the quantities and quality that are produced by small-scale farmers not sufficient for market standards. Given the current economic climate, declining farm income to expenditure ratios, increasing corporatisation trends, distress of small-scale agriculture; seemingly the current financial approach to agriculture is not serving the sector well. There are emerging trends in adopting value chain financing and contract farming, however, small-scale agriculture has not benefited from it significantly. There are few examples of deals that are structured within the public-private-partnership domain (risk sharing and support based partnerships) and, in general, formal finance institutions point to the low levels of efficiency in government programmes as well as the drawn out turn-around times in bureaucratic processes.

Based on the prevailing approaches to agricultural finance in South Africa, segments of small-scale agriculture are excluded from accessing finance. The small-scale agriculture categories (as defined by Vink et al., 2009) that are effectively excluded include all small-scale farmers who are on communal land, part of a development/land reform project, and have limited access to farm land. Again, this is clearly illustrated in the target operating model developed by the Land Bank (2008) that estimates this un-served segment of the market to have about 200 000 to 300 000 clients. However small the demand in this segment of the market, it is important to consider it as part of agricultural development and transformation in South Africa.

CHAPTER 8

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

8.1 Summary

In this chapter, the major themes and concepts that emerged throughout the study are revisited with the aim of reconnecting the narrative and arguments presented.

The introductory chapter laid the foundation of the study by giving context to some of the key concepts applicable to the study, defining the research question and emphasising its relevance and importance in the agricultural sector broadly but more specifically in South Africa. Having established from literature the significance of the small-scale agricultural sector as well as the financial constraints, the study set out to identify the major formal finance institutions that are dominating agricultural finance in South Africa. This would include an analysis of the lending operations with regards to small-scale farmers, innovations around collateral requirements, and proposing measures that can enhance formal finance institutions' provision of small-scale agricultural finance.

As part of the literature review, the unique attributes of the South African agricultural sector were explored, and some of the challenges were highlighted with the focus remaining on the small-scale agricultural subsector. Trends in agricultural finance in South Africa were presented from the emerging literature and some of the key stakeholders in the public and private domain were identified. The private sector institutions were dominated by the four major commercial banks in South Africa: Standard Bank, Absa Bank, First National Bank and Nedbank. There was a suggestion from literature that cooperatives were also key stakeholders in agricultural finance, though most of them sourced their funding from commercial banks and private persons. The major public institutions that emerged from the review of literature are the Land Bank as well as some provincial parastatals (with low levels of impact reported).

The concept and significance of best practices in agricultural finance were explored and a few international cases were presented. From these cases, lessons were drawn that can greatly advance agricultural finance especially within the South African small-scale farmer context. Given the duality and unevenness of agricultural financing in South Africa, formal finance institutions generally do not have tailor-made products and services that directly cater for the unique challenges and opportunities that small-scale farmers are faced with. Based on the available literature, six case studies (BAAC, Agrocapital, BASIX, ANED, and CIDRE) that provided examples of best practices in small-scale agricultural finance were drawn upon, and briefly summarised. Some of the key issues that came out of the review of literature that speak to best practices in small-scale agricultural financing are (i) extensive branch network in rural areas; (ii) diverse product and service range that is appropriately designed for the different groupings and needs of small-scale farmers; and (iii) a comprehensive approach that is includes non-financial and technical support services, as well as socio-economic conditions of small-scale farmers. Again, it emerged throughout all the case studies that there can be an effective use of collateral alternatives by using joint liability mechanisms, co-guarantors, liens of movable assets, etc.

The research design relied largely on secondary data and in-depth interviews with key informants. Given the nature of the institutions involved in the study (financial institutions), no detailed client records or company records could be accessed other than those that are already in the public domain. It has been found that the reporting standards vary among institutions and making unbiased comparisons became difficult. The research findings were reported in line with some of the issues that were identified as key in contributiong to best practices in agricultural finance. Needless, to say some of the institutions reported satisfactorily while others did not provide sufficient information.

The main results that emerged from the study are the following:

- The main formal finance institutions that are involved in lending to the agricultural sector as a whole are the commercial and private banks (dominated by the four large banking institutions in South Africa), agricultural cooperatives, and the Land Bank. In lending to small-scale farmers in particular, the commercial and private banks and Land Bank indicated that they were involved in small-scale agricultural financing. It also emerged that private persons as well as the Department of Agriculture, Fisheries and Forestry are regarded as major stakeholders in agricultural finance.

- It emerged from the study that the loan application process and its requirements for small-scale farmers were no different to the general process that is followed when assessing all other agricultural enterprises' loan applications. To some extent, it was apparent that the process was in fact more stringent in the case of small-scale farmers than their commercial counterparts, i.e. a small-scale farmer with little or no experience would have to prove his technical and management capacity as part of the loan application process.
- Generally, the two main types of formal finance institutions that were part of the study revealed that sustainability is emphasized and regarded as extremely important due to either the nature of ownership of the institutions or the primary source of funds from which the bank itself is financed. In terms of outreach, the Land Bank only has twenty-seven branches, and the commercial banks reported to have 75% coverage by a full service point (branch) within a 15 km radius in areas that were categorised as 1-5 LSM residential areas. In as much this sounds adequate, it is possible however that many small-scale farmers still remain outside of these areas.
- The issue of collateral requirements by formal finance institutions involved in small-scale agricultural finance is a key concept in small-scale agriculture best practices. Generally, there was little or no innovation with regards to collateral alternatives especially when considering private sector formal finance institutions. From the side of the Land Bank, there are some innovations that should be considered for wider use such as the liens on movable assets.

8.2 Conclusion

The study can be concluded through the emphasis of the relevance of small-scale agriculture in South Africa and the importance of best practices in small-scale agriculture finance, and are further discussed below.

8.2.1 The case for small-scale agricultural finance

Agricultural finance for small-scale farmers is critical for the growth and development of the agricultural sector. However, agricultural finance alone is not sufficient and, therefore, it must be accompanied by other measures that address all the challenges that are faced by small-scale farmers. Although there is a general perception that it is difficult and unprofitable to service the small-scale farmer segment of agricultural producers, small-scale agricultural financing should be prioritised as it directly contributes to household food security, income generation and expansion of income streams which all contribute to the growth and development of rural economies. Generally, there has been an increase in participation of public sector institutions in providing agricultural credit to small-scale farmers in South Africa. However, there is still room for increased participation by private sector institutions, particularly commercial banks.

The economic environment within which small-scale farmers operate is characterised by limited access to factors of production, high transaction costs, high input costs, and little or no access to finance. The social conditions that many small-scale farmers operate under are dominated by poverty, unemployment, and limited access to food and water. The environmental conditions that small-scale agriculture contends with is at the cross-roads in terms of conventional agricultural practices and sustainability in view of the climate change developments. Generally small-scale farmers are said to have low production levels. It is important to understand this within the context of the conditions (economic, social, environmental, and institutional) under which they operate. However constrained small-scale agriculture is, there has been a constant stream (in millions) of small-scale farmers that continue to participate in agricultural production – either for home consumption or to supply local markets.

Given the high levels of poverty that continue to be pervasive in rural South Africa, small-scale agricultural financing is key in realising agricultural development as a conduit of poverty reduction at a higher level of impact. Developing small-scale agriculture can impact positively on the economy, environment and social status of the households and communities concerned. Although there are other conduits of poverty alleviation and economic growth through expanding agricultural credit, impact investment gives a much clearer depiction of the significance of small-scale agricultural financing and development. It is a given that formal finance institutions are focussed on the economic returns of investments; small-scale agriculture also impacts on the social and environmental spheres, thus giving a more holistic impetus for development and growth.

The role of agriculture in poverty reduction is well established, and the deepening levels of poverty in rural South Africa continue to grow unabated. Coincidentally, there are higher poverty levels recorded in the provinces of Limpopo and Eastern Cape, whilst the statistics indicate that the highest proportions (21% to 27%) of black people that are involved in agriculture are found within these provinces. Given that public financial support (supported through government programmes such as CASP) thas flowed towards provinces that reported the highest numbers of land reform projects (such as Northern Cape and KwaZulu-Natal), the majority of existing small-scale farmers, that are not beneficiaries of land reform have benefited little from publicly funded agricultural financing initiatives.

Though the small-scale farmer segment of agricultural producers is neither homogenous nor continuous in development, there is potential in streamlining the scale of activities to the required economies of scale. About 4%-8% of small-scale farmers (including subsistence, emerging, and commercial on communal) regard agriculture as an economic activity (main or alternative) depending on the level of analysis (household or individuals). Resource-poor farmers experience major challenges in financing seasonal input purchases. There has been a strong focus on land reform beneficiaries while there is little intervention on behalf of the existing small-scale agricultural sector – pushing the effective demand for small-scale agricultural financing to private sector institutions.

8.2.2 The case for best practices in small-scale agricultural finance

There exists a variety of forms of institutional organisations for agricultural financing (commercial and small-scale). Because of the varied nature of agricultural finance organisations, a rather diverse approach to financial intermediation has emerged. The institutions cited in this study as international case studies for best practices in small-scale agricultural financing have provided the essential financial services, including savings, credit, and insurance required by small-scale farmers. Though there are institutions (both formal and informal) that have been successful in providing financial services to the resource-poor farmers, the effective demand for small-scale agricultural finance remains unmet. This is largely due to reasons of physical access, stringent requirements, assessment procedures and the cost of borrowing. Formal finance institutions in particular are more oriented towards conventional finance sector policies and practices. The agricultural sector in South Africa has experienced several major shifts (e.g. withdrawal of state support, liberalisation of markets) in terms of policy and practice. Formal finance institutions (particularly banks and bank-like institutions) have not made any shift in terms of lending methodologies that suit the current mix of farmers as well as the varied demands. Formal finance institutions that are to be successful in adopting best practices in small-scale agricultural financing need to be more client-oriented in identifying segments and niches that can contribute to the growth of the agricultural sector but also development of rural economies.

The design and product development process for financing the agricultural sector is always a complex issue. Issues such as the type of services and products, information asymmetry, lack of collateral, environmental and market risks are always to be considered. The current agricultural financing models in South Africa are running successfully and sustainably, and have a wide and effective outreach that serves the needs and demands of established commercial farmers in an innovative manner. This includes a sophisticated array of borrowing, lending and insurance instruments. However small-scale farmers continue to remain underserved by formal finance institutions (particularly commercial banks).

Best practices in small-scale agricultural financing can be utilised in areas of technology and innovation adoption, lending policies and terms, collateral requirements, management of environmental and market risks. Best practices in technology and innovation adoption is valuable in lowering transaction costs through reliable information systems on client searches, loan application processes, payment systems, disseminating technical and market information.

The product range that is offered by formal finance institutions can be better tailored to suit the economic and social needs and demands of small-scale farmers. The preferences and socio-economic conditions of small-scale framers must be considered in the product and policy development processes as small-scale farmers' present an untapped segment of the market. From the loan amounts and repayment terms that are offered, small-scale farmers can better thrive and graduate into commercial farmer status which guarantees the repayment of loans and sustainability of lending operations by formal finance institutions. Currently, the loan repayment terms, conditions of payment, collateral requirements and lack of technical and business support services do not fit the needs of small-scale farmers and, thus, potential borrowers are not served – leaving a huge gap between the supply and effective demand of small-scale agricultural financing.

Adopting best practices in small-scale agricultural financing can positively impact on managing the complex agricultural risks (weather related and market related) through risk sharing models between public and private entities. The value chain approach has an element of managing and reducing the productions risks which are usually shouldered by the farmers alone, and adoption of best practices that package technical and business training. Formal finance institutions that provide technical and business training can contribute significantly to reduced business risk; improve incomes, cash flow and debt servicing capacity as well through improved yields and product quality.

8.2.3 Are formal financial institutions applying best practices in small-scale agricultural lending?

There is a strong emphasis on the financial approach to agricultural lending that applies generally throughout the agricultural sector of South Africa. This leads to the exclusion of small-scale farmers (particularly subsistence and communal farmers) from accessing finance from formal finance institutions. Moreover, the efforts towards developing small-scale agricultural lending best practices have been limited. There are pockets of small- scale agricultural lending best practices that have been discussed in this study; nonetheless these are too few and with limited impact, given the extensive scope of small-scale agriculture in

South Africa. The industry specific targets that have been set by industry bodies such as the Finance Sector Charter Council with regards to 'black agriculture' financing are commendable, though not sufficient as this does not cover the entire scope of best practices as outlined in this study. It is important for formal finance institutions to develop financing models and policies that seek to include small-scale farmers whilst remaining risk-averse.

8.3 Recommendations

The study recommends a paradigm shift with respect to the conventional financial sector approach that dominates agricultural finance in South Africa. Formal finance institutions can continue to serve the commercial segment of the agricultural sector without side-lining small-scale farmers. Given the unique needs of small-scale farmers in South Africa, there need to be better aligned (to the development of small-scale agriculture) products and services from formal finance institutions. To some extent, there is an acceptable level of availability of finance but the terms and conditions under which it can be accessed are, in many instances, not appropriate for small-scale farmers. Again, there is also a mismatch in terms of the types of agricultural loans i.e. the product design or services being offered do not match the needs of the sector.

The following are proposed for consideration by formal lending institutions to improve access to finance for small-scale farmers in South Africa:

- A high level coordination of agricultural and finance sector policy is needed to create a conducive institutional environment for small-scale agricultural financing, given the fact that agricultural finance is regarded as a 'policy orphan' and this is more apparent in the small-scale farmer segment.
- Piloting of small-scale agricultural financing models that are tailored to the specific needs of small-scale farmers should be undertaken - which might differ slightly among the different segments of small-scale farmers (i.e. subsistence, emerging, communal), regional climatic conditions, production systems, etc. Such pilot schemes could be in partnership with strategic partners who can provide technical skills and training and public entities that can serve as guarantors to the financing of small-scale farmers.

- Financing models that can be beneficial for small-scale farmers should be considered. This can occur within the framework of cooperatives (as a legal/registered business entity) in order to improve the economies of scale as well as raising of funds for meeting the formal finance institutions' collateral requirements.
- Alternative collateral options should be considered, especially within the value chain approach or in cases where there are off-take agreements in place. There are some good examples in this regard from institutions such as the Land Bank in which loan amounts used to purchase implements, equipment, and livestock are deemed the property of the bank till such time that the loan amount has been fully paid off.
- Reporting standards across the finance and agricultural sector should be improved. This can improve the management of knowledge and information with regards to the agricultural potential of land, land ownership status, origination of agricultural loans, monitoring and evaluation of public farmer support programmes, and annual production yields. Improving the availability of such information at no extra costs to formal finance institutions can significantly improve the lending operations of formal finance institutions towards small-scale farmers.

8.4 Considerations for further studies

The study was constrained by the lack of publicly available information on the extent of small-scale agricultural financing in South Africa. Formal finance institutions operate under stringent regulations, but also a competitive market. There is a standard reporting framework that has been developed by the Finance Sector Charter Council (FSCC); however the details remain scanty on the sub-sector level. Due to this lack of sufficient data and information; the analysis of the key aspects such as performance assessment (outreach and self-sustainability indicators) and mode of operation (lending policies, terms and conditions, and quality of loan portfolio) were covered in a broad manner, and not necessarily at the institution level. As a result, the levels of adherence to best practices in small-scale agricultural lending could not be suitably developed. Potential areas of future research could focus on the following:

- How the legal and legislative framework in place impacts on small-scale agriculture financing.
- Evaluating how the existing information technology infrastructure and information systems can be managed and accessed from a centralised domain.

- The intricacies of public vs. private domain in agriculture development finance. Whose role is it anyway?
- Case studies of small-scale agriculture lending in South Africa based on best practices pilot projects.

APPENDIX

Appendix A: Research instrument

Summary of performance and operating methods of formal finance institutions					
General					
Institution	Institution A	Institution B	Institution C	Institution D	Institution E
Year of establishment					
Objectives					
Type of institutions					
Ownership					
Financial services					
Other services					
Target clientele					
Loan (agricultural) products					
Key outreach indicators					
Clients and staff					
Number of clients					
Agriculture or related loan (%)					
Total target clientele serviced					
Female borrowers (%)					
Staff headcount					
Number of branches					
Mobile banks					
Loan outreach					
Number of loans outstanding					
Volume of loans outstanding (annual average)					
Minimum loan size					
Maximum loan size					
Average outstanding loan size					
Savings outreach					
Average annual volume of savings					
Number of savers					
Value of average savings account					
Nominal annual deposit interest rate (%)					
Loan extension					

Terms and conditions of loans					
Types of activities finance					
Eligibility criteria					
Determinants of loan size					
Farm size					
Farmer experience/training					
Bankability of farming enterprise					
Collateral requirements					
Group lending methods					
Turnaround time in loan application processing					
Loan approval process					
Designated official:					
Loan assessment:					
Repayment term					
Frequency of payment					
Repayment method					
Monitoring of loan repayment					
Flexibility of loan repayment terms					
Loan repayment incentives or penalties					
Debt restructuring options					
Disciplinary measures for loan repayment default					
Penalty interest rate					
Access to loans in future					
Foreclosure /repossession					
On-lending interest rates					
Nominal quoted lending interest rate (%)					
Effective (nominal) annual interest rate (%)					
Real interest rate (% per year)					
Typical loan maturity					
Loan performance					
Definition of arrears					
Portfolio at risk (%)					
Non - financial services					
Market support					
Information (prices)					
Trading					
Technical support					
Farmer development programme					
Financial literacy programme					
Institutional support					

Source: Yaron et al. (1997) and Samuel (2008).

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