Malawi 2063 Policy Brief Series

July 2022

FINANCING OPPORTUNITIES FOR A HIGHLY PRODUCTVE AND COMMERCIALIZED AGRICULTURE SECTOR

Key messages

- Agriculture finance is a critical catalyst to deepening of agriculture productivity and commercialization in Malawi.
- Despite efforts promoting access to finance among farmers, the majority still experience access challenges.
- Financial services providers still consider lending toward agriculture risky due to price volatility, climate shocks, limited access to markets and absence of insurance services.
- Commercial banks and microfinance institutions skew financial lending towards non-trade and non-agriculture activities.
- To deal with agriculture finance bottlenecks, policy interventions should focus on among other things:
    - Creating awareness for utilization of existing credit guarantee facilities
    - Piloting of infrastructure finance
    - Strengthening credit reference bureaus

Background

The much-desired shift from the current subsistence orientation of agriculture production to commercial as espoused in Malawi 2063 requires sustained financial investment key to optimum and sustainable utilization of natural resources, technology and infrastructure development, improved extension services delivery and the participation of youth and women in the agriculture sector (National Planning Commission, 2020). However, financing for agricultural investments in Malawi is scarce and unbalanced, even for large-scale investors. Currently, less than 12% of commercial lending goes to the agriculture sector, low primarily because of the risk profile of the sector compared to others in Malawi's economy. Among other factors, dependency on highly variable rainfall for farming, persistent occurrence of climate shocks, volatile prices of agriculture products and inputs, limited access to markets and absence of insurance services and products are faulted for this status quo (CARD, 2014; Vuntade and Mzuza, 2022; IDI,2021). This foregoing deprives the sector's potential to increase production, processing, and marketing, against the aspiration of a highly productive and commercialized agriculture sector, towards the lower middle income status pursuit as espoused in Malawi 2063 first 10-year implementation plan (MIP-1). This policy brief examines agriculture financing issues, proposes policy and programmatic options for consideration, towards the goal of a highly productive and commercialized agriculture sector.

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Context of Agriculture Finance in Malawi

Agriculture finance concerns funding of farm activities for production of agriculture products, especially financial resources required for the farm unit, either at micro or macro level. Macro-finance deals with different sources of raising funds for agriculture, concerned with lending procedures, rules, regulations, monitoring and controlling of different agricultural credit institutions. Hence macro-finance is related to financing of agriculture at aggregate level. Micro-finance refers to financial management of the individual farm business units.

Farmers in Malawi access finance from microfinance institutions, cooperatives, village banks and commercial banks that offer a range of formal and informal agricultural financial services. However, these have not been sufficient in meeting the needs of farmers (Lindsjo, 2021). Part of this insufficiency is attributable to lack of segmentation of the market, where financial institutions fail to offer financial products (primarily loans) that reach the full range of rural and agricultural clients interested in credit. Such inefficiencies limit farmers' access to farm inputs, which contributes to low farm productivity.

Beyond government's direct intervention in agricultural lending, financial institutions' (commercial banks in particular) lending towards the sector ranged between eight to twelve percent from 1996 to 2018, largely attributed to the risks associated with farm activities (Diagne, 2001). Several factors frustrate the development of solid financial services in rural and urban areas. Firstly, transaction costs in rural areas are higher than in urban areas due to poor road infrastructure, low access to mobile financial services and low presence of financial service providers (Allie and Demiryurek, 2020). Commercial banks consider lending to the agricultural sector a risky investment and prefers to lend to non-farm sectors (Malawi Government, 2017). Products and input markets for agricultural growth are still functioning poorly in the country. With respect to product markets, most smallholder farmers are poorly organized and lack of bargaining power over pricing of produce (AICC, 2016:14). As a result, transaction costs remain high due to low traded volumes of agricultural produce and lack of agriculture financing (Malawi Government, 2017).

Geographically, commercial banks in Malawi are also biased towards urban areas and town centers, thereby denying the service to the agricultural value chain activities which are predominantly undertaken in the rural areas by rural dwellers (Malawi Government, 2017:32). Secondly, the risk factors inherent in agriculture often inhibit financial institutions from lending. Among such are natural hazards (such as droughts, floods, and pests), farmers´ weak ability to provide collateral (either because the farmer lack title to land to offer as a loan guarantee or the value of the land may be too low) and volatility of prices. Thirdly, the financial sector is not developed enough in developing countries like Malawi, limiting access to financial resources among smallholder farmers in an extreme case, even large-scale ones.

Again, with poorly defined land rights in Malawi, the ability of rural farmers to offer collateral to commercial banks as a condition for accessing credit is greatly hampered (AICC, 2016:21). Further for Malawi, even if financial services may be available, they may not be suitable for all types of agricultural activities, which have diverse needs and timing for disbursements, different amounts and risks. For example, in seasonal farming, funding may be needed in particular stages of the production process. However, the offer may only be available to large scale farming operations with quality records. Since few farmers have quality farm records that would meet lending requirements, it makes assessment of credit suitability challenging for financial providers. Consequently, farmers fall out of favour with lending institutions, thereby undermining profitable investment in the agriculture sector.

Agriculture financing policy and programmatic problems in Malawi

Liquidity Management is one policy option in which the Reserve Bank of Malawi plans to stimulate liquidity creation for private sector financing and even agriculture lending. The bank has been reducing liquidity reserve ratio (LRR) to below 4%, as a way of creating liquidity and stimulating lending to the productive sectors of the economy. However, this has not translated into increased lending to the agriculture sector, as high interest and inflation rates exacerbate low agriculture lending.
As highlighted in the National Agriculture Policy (NAP), agricultural financing initiatives involve numerous interconnected activities, to ensure different financial instruments must be connected to different needs of the sector. Admittedly, agriculture encompasses a broad range of activities from farming to infrastructure projects, research, and development. As such, any policy trying to address agriculture finance, must accommodate

these key clusters in order to address the demands of the sectors, amongst which are needs of farmers and entrepreneurs, transactions among actors along the value chain, infrastructure (production and marketing) and generating knowledge (through research and innovations) to support the sector.

Besides the formal financial lending institutions like commercial banks, cooperatives and micro financial institutions, development partners such as USAID and UNDP through the (Malawi Innovation Challenge Fund) as well as Agriculture Commercialization (AGCOM) project have been administering matching grants and credit guarantee as a way of stimulating access to credit in the sector, albeit with mixed results. Figure 1 shows financial flow in the sector, originating from development partnerships.

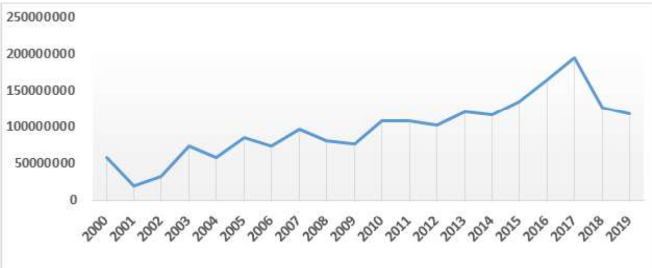

Figure 1. Total disbursements for agriculture from development partnerships (US$ 2019) (Source: UN food and agriculture organization (FAO), 2019)

The partial credit guarantee facility remains largely untapped due to continued low risk appetite for lending by the banks, while matching grants have not been fully up taken by smallholder farmers due to lack of matching resources or collateral. Further, in the case of programs such as AGCOM, excessive focus on smallholder farmers has evidently left out medium scale-farmers and private entities in the financing of agriculture investments. In the case of Malawi Innovation Challenge Fund (MICF), there has been an increased perception that the key beneficiaries have been companies not owned by indigenous Malawians, who were the prime targets, because they often times have no collateral. Instead, Malawians of other origins have veered their way to access such finances for their investments in the sector. Policy considerations in this area need to ensure that interests of smallholder farmers who have no collateral with which to access loans are ably supported with favourable financing conditions for their agricultural investments.

Among other financing options for Malawi's development are initiatives such as the export development fund (EDF) and the Malawi Agriculture and Industrial Investment Corporation (MAIIC), which were established to act as catalysts for agricultural finance. The latter was to operate on syndicated finance, a condition which has affected its operations and growth. The low capital adequacy levels have contributed towards its low lending levels. For EDF, perceived politicization in its lending decisions have hindered potential beneficiaries from making use of the facility. Promotion of Village Savings and Loans (VSLs) by different ministries as well as strengthening implementation of Financial Corporative Act have also yielded results below expectation, where proceeds are rarely channeled towards agriculture investment and inputs by beneficiaries. Other experiences regarding Malawi's agriculture financing include:

a. Skewed lending towards Agriculture Trading and not production

Agriculture is a conduit of several value chain actors and processes. It entails a sequence of interlinked activities, transactions in a chain that starts from the supply of seeds and fertilizers and finishes in the mouth of the consumers. There have been minimal financial instruments specifically designed to strengthen these links between the actors along the value chain. Excessive focus has been on lending towards agriculture trading, presumably because of its low risk level.

b. Minimal lending towards Rural infrastructure

Financing needs to be concentrated on the infrastructure needed to carry out agricultural activities. The agriculture sector depends heavily on infrastructure such as rural transport systems, irrigation systems, water supply, sanitation, electricity, storage and telecommunication facilities. Implementing projects in such sectors of infrastructure development is costly and require significant financing. Currently, rural infrastructure deficit stands at 90 percent, but the policy and programme instruments available have not focused on ensuring that investment towards such infrastructure development is increased, enough to reduce the rural infrastructure deficit.

c. Minimal Investment towards Research and Development (R&D)

The financial sector has not developed instruments that would finance research and development in the agriculture sector. Major funding for research comes from government and large seed companies. As of 2021, funding towards research stood at 13% of total funding requirements, indicating that there is more funding requirement in the sector's investments.

Policy Recommendations

The policy that supports agriculture finance needs to enhance local financial institutions; foreign banks, development banks, governments and other actors, and promote innovative finance packages with sustainable and vibrant risk sharing elements. Some issues to be considered include:

a. Stimulating increased usage of Credit guarantee schemes

As earlier indicated, despite several credit guarantee schemes, financial institutions appetite for lending is still low. This suggest a structural failure which shows that lending is unattractive, perhaps even in instances where surety is provided. A deliberate incentive to financial institutions that provide agriculture lending would therefore be crucial. There is need for government and relevant stakeholders to collaborate on efforts towards creation of a policy and programmatic environment that would stimulate lending, especially to small-scale farmers.

a. Piloting Infrastructure Finance

A well-functioning agricultural sector needs appropriate infrastructure such as road networks, to link isolated rural areas to markets; irrigation technology to reduce farmers' dependence on rainfall; storage facilities to protect harvests from weather and pests; telecommunications to ensure efficient trading, water supply and energy; among others. However, infrastructure such as roads in the rural areas are under-financed in Malawi. Traditionally, large-scale infrastructure is largely funded by the public sector. However, governments have increasingly been experimenting with different funding options to finance infrastructure, by enlisting the active participation of private sector partners and financial institutions. The participation of the financial sector in these initiatives requires a completely different set of skills from other types of lending, because it entails financing public assets, which could have high risks. Therefore, government might consider reviewing the policy environment to ensure pilot of agriculture finance that will include public, private sector and development banks. In the present gap, MAIIC should be further capitalized to assume a more infrastructure funding role.

b. Improving capacity on demand and supply side of agriculture finance

To access finance from financial institutions, farmers are supposed to have proven track record of banking. Engaging the farmers in banking activities and transactions will be critical in creating tract record of banking. This could be achieved by support efforts towards financial inclusion of smallholder farmers and creation of banking tract records. This will require that commercial banks in Malawi become innovative enough to produce financial services and products that reach out to farmers in the rural areas. In this regard, the use and integration of mobile banking and other digital finance initiatives will accelerate efforts towards building banking tract records. Government should therefore enhance its incentives towards financial institutions through tax exemption (among others) that are introducing innovative digital services which can increase farmers knowledge and awareness, thereby stimulating demand for banking services and products.

c. Improving credit supporting facilities

Farmers need to have enough requirements to qualify for a bank loan. This requires deliberate efforts by government by among others increasing capacity of credit bureaus. The current scope of credit reference bureaus is still narrow. Government and development partners need to invest and develop initiatives that support capacity of the credit assessment institutions by developing a policy and legal environment that will ensure relevance of the credit bureau. On the other side, access to finance depend on farmers' ability to posses' collateral to access financial services and products. Government and development partners should therefore implement initiatives that will support farmers access to collateral efforts towards registration of assets with office of the registrar. This can largely be done through improving orientation of farmer cooperatives and associations on importance of asset registration to farmers' access to finance.

Conclusion

Access to finance is a vital part of any developed agriculture sector. Drawing farmers and small entrepreneurs in Malawi into the financial system needs collaboration from public, private sector and development partners including civil society organizations. This requires a combination of good laws, a specialized financial sector and profitable businesses of small and large farmers and companies in the agriculture sector. A requisite policy needs to ensure credit guarantee is fully utilized by farmers, foster adequate rural infrastructure development, access and registration of collateral, and create demand for agriculture finance.

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Innovation in finance to solve the needs of the rural sector should not be limited to financial institutions.

The government can play a proactive role by promoting laws and regulations with new financial instruments or even raising awareness of existing ones, to bring them to the attention of the financial and agricultural sectors. There is need for government and private sector to specialize in agricultural finance through strengthening of existing institutions, research, and relevant policy interventions.

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FURTHER INFORMATION

NPC

The National Planning Commission was established through an Act of Parliament in 2017 with two main mandates.

1. To coordinate the development of long and medium term national development plans for Malawi including the flagship projects that would operationalise them.
2. To oversee the implementation of those plans and coordinate the efforts of different stakeholders in achieving common objectives defined in the overall national development agenda.

Foresight and Anticipatory Governance project

This is an initiative that seeks to introduce and mainstream innovating ways of development planning by making sense of events occurring and likely to occur in the country's development space, and scanning the horizon of global, regional and local trends on key development issues in order to build agility among planning agencies, with which to respond to unforeseeable events taking place in the country's development space. The project relies on data and information generated through sustained research across economic and social development spheres. The policy briefs series are produced to provide information for consideration in government planning units.

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Funded by UNDP, under the Foresight and Anticiptory Governance Project implemented by the National Planning Commission in collaboration with the Department of Economic Planning and Development, in the Ministry of Economic Planning and Economic Affairs (MoFEA)