Financing Smallholder Farmers

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Introduction

The smallholder agricultural sector plays an essential role in ensuring food security, economic growth and employment creation. Therefore financing smallholder farmers becomes an important undertaking for poverty reduction in developing countries, especially those in Sub-Saharan Africa.

The smallholder sector is characterized by diversified farming of crops and livestock. Specialization of commodities is minimal, for example some smallholder farmers specifically grow sugar cane under irrigation. Food crops are grown right alongside cash crops, for example maize, cotton and vegetables.

Crops grown and livestock raised by smallholder farmers can be grouped as follows: plantation crops (sugar cane, coffee, tea), horticultural crops (fruits and vegetables), and general field crops (maize, wheat, cotton, sunflower, millets, groundnuts, sugar beans). Livestock is categorized into three major areas of production: beef, dairy and small livestock (e.g., poultry, goats, sheep, pigs).

More technical advice and investments are required in order to commercialize the smallholder agricultural sector. This would boost production and enhance food security at the household, national and regional levels.

There is ample evidence to show that smallholder farmers use land and other inputs just as efficiently as large-scale farmers. This justifies the need to finance and invest in the smallholder sector.

This paper discusses the merits and de-merits of different means of financing smallholder farmers in Sub-Saharan Africa, with special reference to Zimbabwe. This financing includes inter alia multilateral and bilateral agreements with governments and other agencies, micro-financial institutions coming from both the private sector and non-governmental organizations.

Background

A number of problems limit production and marketing of agricultural produce by smallholder farmers.
Production

Production of crops and livestock in Sub-Saharan Africa is characterized by low yields. The average yield of basic crops is inadequate to meet the needs of producers, either for direct consumption or for family income. Low yields are mainly due to factors such as low productivity, low yielding varieties, water problems/droughts, lack of tillage facilities, poor infrastructure, lack of inputs/access to credit, poor health and education, facilities, and inadequate research and extension services.

Livestock production in Sub-Saharan Africa is faced with these same constraints as crop production. The major problem is that natural resources are degraded through over-use in areas with high stocking densities, whereas vast lands with great potential for livestock cannot be utilized because they are infested with disease or lack the necessary infrastructure.

Marketing

The situation of smallholder farmers is further exacerbated by poor infrastructure, namely poor access roads, lack of market information, poor transportation, and poor storage facilities (resulting in post-harvest losses). It is estimated that up to 15% of production in Sub-Saharan Africa is lost between farm gates and consumers, owing to poor roads and storage facilities. All this results in low incomes for smallholder farmers.

Strategies for improved production

More investment is required in order to boost production of smallholder farmers, thereby enhancing food security and raising the income and ultimately the standard of living of the rural population. This calls for financing of programs that directly benefit smallholder farmers. Such programs include financing of the following components:

a. Infrastructure

There is a need to invest in water supplies, i.e., the construction of dams and building the necessary irrigation infrastructure. Supportive infrastructure, such as feeder roads to facilitate marketing of produce, must also be developed. Improvement of educational and health facilities is a major priority. Lastly, we must focus on setting up processing plants to add value to farmers’ products and increase incomes and infrastructure for livestock development.

b. Input supply and credit

We need to set up input supply systems, so farmers can easily access inputs at affordable prices and provide credit facilities that recognize the problem smallholders have obtaining collateral, while at the same time ensuring repayment of loans.
c. Research and extension

There is a need to identify, test and introduce suitable need varieties. Supplying high quality seeds adapted to local conditions is an effective means of increasing yields. Extension is a key success factor for improved smallholder production. More effort in extension services will have a positive impact on smallholder farmers. Financing for the smallholder sector should aim at developing sustainable agricultural systems.

d. Marketing

Apart from providing supportive infrastructure, smallholder farmers need assistance in setting up appropriate marketing information systems so that they have access to market information regarding prices, market demand and other external information. Emphasis on quality of produce and products should be a source of sustainable competitive advantage for smallholder farmers in the long run.

e. Trading policies

Regarding trading policies, increased agricultural production in the smallholder sector should contribute to export earnings in Sub-Saharan Africa. It is hoped that the World Trade Organization will ensure viable and long term trading relationships for agricultural commodities between developed and developing countries. We also hope that regional economic integration does not result in trade diversion away from non-member countries, but rather that it creates more trade.

Financial Services for Smallholder Farmers

Multilateral and bilateral aid

Multilateral and bilateral aid have been the most common forms of financing smallholder farmers in the developing world, either as grants or loans. This form of aid has come about through the recipient governments signing multilateral or bilateral agreements with aid agencies. Through this aid, farmers benefit from large investments, such as dam construction, irrigation facilities, machinery and other equipment. They also benefit from the transfer of technology and other ‘softer’ sides of financing, such as management and organizational skills.

Regarding the problems encountered with donor aid I would make the following observations:

- Loan granting usually depends upon some macro-economic policies, as stable political and social environments of the recipient country.
- The moment these conditions are perceived by the aid agencies to be lacking, the aid is either suspended or withdrawn, regardless of whether the programs have been completed or not.
There have been some cases where rural development projects have been prematurely and inefficiently terminated because of misunderstandings between donors and the borrowing institutions. These problems exist at both the policy level and the operational level.

Some smallholder projects have collapsed when the donor pulls out. The farmers then fail to sustain the operations and good projects end up being abandoned because management skills are lacking among the farmers.

Important issues pertaining to sustainability and institution building may not have been adequately addressed during project design or implementation.

Central and local government financing

Central governments have the role of ensuring that there is an equitable allocation of resources for development, especially of marginalized people. Apart from allocating funds from aid agencies, governments in developing countries have made efforts to assist smallholder farmers by financing from their own resources programs such as:

- Essential infrastructure for agricultural development, including dams, irrigation, roads and provisions of inputs.
- Credit has been subsidized, to some extent, for smallholder farmers, whereby the interest rates are lower than those charged for commercial farmers. In the case of Zimbabwe, the credit has been provided through the Agricultural Finance Corporation. This institution provides short term, medium term and long term credit.
- In most developing countries, and especially in Sub-Saharan Africa, the government provides research and extension services for smallholder farmers.
- Decentralization of functions to regional levels has resulted in the empowerment of the local authorities, including the allocation of resources for development projects. However, more often than not, the local authorities lack the necessary capacity to generate more income and finances in order to meet demand from their communities. In the end, they still rely on the central government.
- In most cases, both central and local governments are constrained in terms of resources and are unable to meet the financing requirements of the majority of smallholder farmers.

Commercial financial institutions

Commercial financial institutions comprise the conventionally accepted financial service sources, such as commercial banks and financial houses. The loans offered by these institutions are charged at market related interest rates and require loan guarantees in the form of immovable assets, shares, savings, land, etc. Due to these conditions, most smallholder farmers are not eligible for the loans, and they are considered a high-risk group in terms of repayment.

Micro-financial institutions

There are a number of self-help groups at the local community level that offer financial services in the form of savings and credit to the smallholder farmers. In
Zimbabwe, these organizations include the Self-Help Development Foundation (SHDF). Apart from the savings contributed by members, the institution is capitalized through loans and grants from donors. Only members have access to the loans, since their savings are used as collateral and the amount which members can borrow is severely limited. A number of non-governmental organizations operating at local community levels fall into this category of micro-financial institutions and most of them are funded through donors. They are also constrained by inadequate resources and are usually confined to offering short-term credit and technical assistance to farmers.

Commodity specific financing

Some companies engaged in certain agricultural commodities have resorted to financing smallholder farmers for a specific crop. One example is the Cotton Company of Zimbabwe, which operates an input-credit scheme for cotton farmers. Loans are recovered from the proceeds of the next season’s crop. This method of financing has proved to be effective for farmers.

Conclusions and Recommendations

There are several forms of financing for smallholder farmers in the developing world, from the aid agencies at the international level to micro-financial institutions at local level. The major source of financing has been through multilateral and bilateral agreements with individual governments. But the issue of sustainability has not, in most cases, been adequately addressed. Some of the farmers have failed to realize the intended benefits of a program after the aid agency pulls out. Other forms of financing have been severely limited in terms of resources. Though several groups of farmers have benefited from micro-financial services operating at the local level, the magnitude has not been wide enough considering the populations involved.

Government agencies are also constrained by inadequate resources to meet the financial requirements of the smallholder sector. Commercial financial institutions such as banks and financial houses cannot effectively service the needs of smallholder farmers due to their high interest rates and other limiting factors such as collateral.

No one system of financing smallholder farmers can be perfect; rather the different sources have positive elements that can be built upon for the benefit of farmers. It is the role of national governments to come up with effective, efficient and sustainable systems of financing smallholder farmers in order to transform this sector into one characterized by fully commercialized production.

This conclusion is based on a simple model, where development is the product of a multitude of activities initiated by individuals and the community voluntarily, as well as by governments using public means. If properly harnessed, these two driving forces can bring about the desired results.
Appendix I: Donor and Government Funded Projects Implemented by ARDA

The following is a sampling of some donor- and government-funded rural development projects implemented by the Agricultural and Rural Development Authority (ARDA) in Zimbabwe.

Horticultural Development Projects

Mashonaland East Fruit & Vegetable Development Project

The main objective of this project was to strengthen the production and marketing capabilities of the horticultural producers in the communal areas of the Mashonaland east of Zimbabwe. Financing was geared at extension, providing transport, establishing marketing networks, and institutional strengthening through training of farmers. The annual volume of produce transported to major markets is now over 10,000 tons.

The project also embarked on an export program of mange tout peas and baby corn. This project was funded by the European Union and was handed over to the farmers’ associations in the respective areas.

Manicaland Smallholder Coffee and Fruit Project

The purpose of this project was to increase household incomes through smallholder commercial production and the marketing of coffee and fruit in the Honde Valley and Rusitu Valley respectively. The project transformed a number of “backyard orchards” into commercial orchards. By the time the project was handed over to the farmers in 1996, more than 9,000 tons of fruits such as banana, citrus, pineapple, avocado, and more than 300 tons of green coffee were being marketed. The European Union funded the project.

Livestock Development Projects

Model “D” Matabeleland Livestock Development Project

Some ranches covering 10,000 hectares in Tuli and 57,000 hectares in Dodieburn/Manyolo were developed with paddock, game fencing and water facilities. The ranches were used for relief grazing of cattle from the participating areas. Village paddocks and other infrastructure for livestock were put up in the participating communal areas to enable rotational grazing in the ranches and the villages. Improved breeds were also introduced and farmers have been getting good prices for their cattle. The project was funded by the Government of Zimbabwe.

Dairy Development Program

The aim of the program is to widen the country’s milk production base by assisting smallholder farmers in the communal, resettlement and small-scale commercial
farming areas to be involved in producing and marketing milk commercially. The program emphasizes effective animal health and breeding systems, as well as marketing systems. The smallholder farmers produce more than 2,000,000 liters of milk per annum. NORAD and the Government of Zimbabwe financed the program, although Africa Now (UK) has also been assisting the farmers in the processing of dairy products, like yogurt and cultured milk.

**Land Use Projects**

*Development Program for Communal Areas in Kariba District (Kanyati and Gastshe Gatshe Land Use Project and Omay Land Use Project)*

This program was preceded by the eradication of tsetse in the area through the Regional Tsetse and Trypanosomiasis Control Program. The aim of the Land Use Program was to assist the farmers and fishermen in the area to develop sustainable and rewarding methods of resource use in arable cropping, livestock management and the exploitation of wildlife resources. The main components included implementation of a land use plan, development of appropriate farming systems, and development of infrastructure, such as roads, boreholes, stock water dams, and paddocks. The European Union financed the program.

*Integrated Rural Development Program*

The aim of this program was to establish viable production and support systems in the below average rainfall areas of Gutu and Zaka Districts in Masvingo Province. The major components were agricultural projects that converted land use, agroforestry, crop development, and livestock development, including small livestock; agro-services development that covered marketing, credit, group savings, and input supply; and development of infrastructure that covered rural sanitation and rural water supply. It also included rural technology developments, like fuel-saving cooking stoves and improved granaries to reduce post harvest losses, and institutional capacity strengthening through the rural district councils and program-implementing institutions. The German Agency for Technical Cooperation (GTZ) and the Government of Zimbabwe funded the program.

*Irrigation Development Projects*

*Dande Smallholder Irrigation Development Project*

The main objective of this project is to increase and stabilize the agricultural production of smallholder farmers through the establishment of an irrigation scheme covering 4,300 hectares. The project includes the construction of a dam, tunnel and associated structures, irrigation networks and drainage systems, and supportive infrastructure, such as roads, water supply, health and education facilities. It also included the provision of credit and mechanization of tillage services. The main crops to be grown are cotton in summer, and sugar beans and vegetables in the winter. The project is funded by the African Development Bank (ADB), Arab Bank for Economic Development in
Africa (BADEA), Organization of Oil Exporting Countries (OPEC), and the Government of Zimbabwe.