Since policy makers, donors and financial institutions have long been concerned over lending for agricultural production and processing, diligent efforts have been made to finance agricultural exports. Domestic agricultural marketing, however, has never been afforded this kind of attention, possibly due to an anti-trader bias or because finance is not a constraint to the smooth running of agricultural marketing.

This technical brief summarizes results from a study conducted by FAO analyzing 15 case studies during 2005 in Africa, Asia and Latin America to ascertain whether the lack of finance disrupted traders’ marketing activities of grain (primarily rice) and horticultural produce.

What are the major sources of finance for agricultural marketing?
The agricultural trade sector in Africa, Asia and Latin America is financed through a combination of self-financing activities, bank loans, as well as informal credit assistance from friends and relatives, suppliers, customers and moneylenders. There are observable geographical differences in the source and type of finance used by millers, traders and retailers.

In Asia, investment capital requirements of millers are largely met through a combination of personal finance and bank loans. Moneylenders do not appear to be a source of funds for capital investments, presumably because the interest rate would be prohibitive. While investment and working capital loans from banks are important to millers in India, Nepal, Pakistan and Vietnam, accounting for over 60 percent of their finance, bank services are less important for this group in Peru and Ecuador, consisting of only 10 to 30 percent of total finance.
Paddy and rice traders, on the other hand, due to a lower need for investment capital and their inability to offer suitable collateral, are insignificant users of bank finance. To fund working capital needs, traders rely on own funds, advances from millers or wholesalers, deferred payments from farmers, and in times of peak financing requirements, loans from moneylenders.

The importance of financial linkages within marketing chains

The marketing structure impacts strongly on the sources and uses of stakeholders’ funds; those with better access to formal and usually less expensive sources of finance on-lend to those with whom they regularly conduct business. Millers tend to have more fixed assets that can be used as credit collateral. As a result, they have privileged access to finance and the capacity to trade large volumes of cereals, making them a natural on-lender to other players in the marketing chain.

However, this scenario does not hold in all of the three regions studied. In Africa, the main financiers of the marketing chain are wholesalers, whereas millers are mere service providers that do not sell or buy grains. Conditions change in Asia, where millers are the central financial hub of the chain – flowing upwards to farmers and downwards to retailers. In Latin America, there are two types of rice marketing chains: the long and highly fragmented chains characteristic of the Andean countries, and the increasingly concentrated and integrated chains typical of Argentina and Brazil. In the first type, millers and large wholesalers share the role of fund providers. In the second type, the financial needs are provided by the marketing chain actors using traditional credit products and alternative funding mechanisms such as factoring, inventory credit, leasing and trust funds, which however, renders financial linkages between them weak.

Comparison in marketing structures and financial flows

In India, Cambodia, the Philippines, Ecuador and Peru, millers finance the agents who buy on their behalf and offer advances and short-term loans to farmers so that they can purchase inputs. In Nepal, traders use their own funds and credit from their suppliers (farmers) and buyers (retailers) to purchase paddy by the truckload for milling and rice resale. Deferred payments, such as short-term consignment loans, are frequently used. Wholesalers in Cambodia, India and the Philippines often take advantage of 10–15 day consignment credit from millers.

Retailers from the three regions studied usually obtain consignment credit (1–3 weeks) from wholesalers. Conditions of consignment credit vary, but typically improve over time as trading arrangements between actors become more established. In addition, in the countries surveyed, farmers accept deferred payments from their buyers, but such credit is not extended beyond the duration of one trip.

The degree of informality of the marketing structure influences the development of financial linkages within the value chain and the access to formal finance of the chain as a whole. In recent years, Peru and Ecuador have witnessed a proliferation of informal mills. These mills, which need, on average, one-tenth the investment required by a formal business, have very limited access to formal finance and rely almost exclusively on their own funds to meet their needs for working capital. This restricted access to finance constrains their capacity to on-lend to their trading partners.

The effects of food crises on financial linkages in cereal chains vary from country to country. In Ecuador, the crisis of 2007–2008 resulted in the strengthening of financial linkages between the chain partners. Conversely, the crisis of 2001–02 in Argentina, combined with a favourable price conjuncture of grains, flooded the chain with funds, undermining the financial linkages within the marketing structure.

Vertical financial linkages generally seem to be non-exploitative and serve primarily to secure supply, guarantee markets and reduce transaction costs. However, policy makers and officials continue to be biased against certain actors in the chain. For example, in Peru and Ecuador, government officials believe that most traders engage in exploitative and unfair business activities. Also, bankers in the Andean region have a bias against farmers due to their past history of non-payment in times of political unrest.

Meeting traders’ demand for institutional finance

Across all regions, there is still a wide gap between what formal banks offer and what traders actually need. From the traders’ point of view, formal banks have lengthy and complicated loan application and disbursement procedures, are too distant from their point of business, make non-transparent and often corrupt loan
decisions, require stiff collateral, and lack the ability to assess traders’ business proposals. From the bankers’ point of view, traders are risky, small and costly with poor record-keeping systems. The main challenge is to reduce this demand-supply gap.

Banks could address this problem by developing relevant loan products, services and procedures. The potential for greater use of overdrafts or lines of credit, as opposed to loans of fixed sums, could be explored as well as various collateral substitutes, such as the use of post-dated checks and promises of continued access to loans with improved terms and conditions. Banks could also explore the use of new technologies to cut costs, such as debit and credit cards, automatic teller machines (ATMs) and mobile banking systems. Innovative microfinance institutions could be valuable partners for banks as they attempt to penetrate this market.

**Some important insights to promote access to finance for agricultural marketing**

Using the marketing system to provide farmer credit: Some observers have suggested that the marketing system could be a good channel for extending credit to small-scale farmers. The case studies show this to be true when proper precautions are taken and when the available resources for trade credit are inadequate or scarce. In some countries, the competition with structured chains has forced millers and traders in traditional chains to withdraw funds from on-lending to invest in upgrading. In this case, enhancing these firms’ access to finance will probably increase their on-lending to farmers. Also, traders and millers extend credit to the farmers and local buyers they know. This should be taken into account when planning the provision of additional funds for on-lending; otherwise, there is a danger of increased risk of default. Finally, banks, non-governmental organizations (NGOs) or governments targeting farmers through trader finance would most likely demand collateral and require detailed accounting for loans, possibly on a farmer-by-farmer basis, which traders are not in a position to provide.

**Governments’ role in fostering finance to agricultural marketing systems:** Government financing programmes, even when channelled through commercial banks, tend to misallocate resources and to be non-sustainable. Financing problems within marketing systems would be better addressed by examining the best practices of financial institutions, including microfinance institutions, in lending money to traders and millers. One promising area is inventory credit, which permits farmers to use commodity stocks as collateral to secure loans. In several countries, legal problems prevent the use of stocks as collateral, while in others, there are no networks of certified warehouses where the stock is held, thereby undermining perceptions of the safety and security of stocks.

**Information technology and its impact on traditional banking practices:** In countries that have well-connected information and communication networks, and specific laws that permit banks to establish service centres in locations other than branch offices, there is tremendous potential for serving non-traditional clients in remote areas. Recently, Brazil and South Africa have set up banking representatives in post offices, lottery outlets, grocery stores, petrol stations and other retail outlets, thus penetrating a large under-served market that includes remote rural areas, and permitting clients to save, borrow, buy insurance, send and receive money, and pay bills. Good policies need to be developed that govern these new types of agency relationships, ensuring sound measures against fraud, theft and money laundering.

**Future research:** Compared to research on other forms of rural finance intermediation, relatively little research has been conducted on the financial systems governing agricultural marketing transactions. If financial institutions are to consider agroprocessors and traders as potential clients and to develop appropriate products for them, then there is a pressing need to improve understanding of the complexities of financial arrangements within marketing systems. Subjects for further research may include: the effective cost of marketing loans; the degree of borrowers’ satisfaction with the existing arrangements; the extent to which credit needs and the perceived need for other financial services are being met; and the impact of information technology on the expansion of services in non-traditional markets.

**RECOMMENDED READINGS**
