

Policy Briefing

How to kickstart innovative finance for rice value chains?



The AgriTT programme is an innovative trilateral initiative between the UK Department for International Development (DFID), the Chinese Government, the Governments of Malawi and Uganda and the Forum for Agricultural Research in Africa (FARA). The programme facilitates the sharing of successful experiences in agricultural development with developing countries to improve agricultural productivity and food security.

The AgriTT Research Challenge Fund supported two year research projects to generate new thinking and practice on technology transfer and value chain development. Each project had a Chinese, UK, and African or South-East Asian research partner.

Transforming rice production in China, Cambodia and Lao PDR

With rapid urbanisation and the evolution of rice-growing methods, rice value chains (VC) are being transformed in China, Cambodia and Lao PDR, with China leading the way.

A common challenge that constrains their development is the availability of, and access to, innovative financing along the VC. China's extensive experience in this area with various food VCs offers rich lessons for Cambodia, Lao PDR and other low-income countries. This project aimed to summarise the progress and key constraints in rice VC financing in these three Asian economies, and to make policy recommendations for improved VC financing to both governments and financial institutions.

Agricultural transformation – the shift from diversified, subsistence-oriented production towards more specialised production targeting markets – increases demand for VC financing. Transformation of the agri-food VC involves two types of change: in the operational scale of farming and marketing; and in extending the VC from input supply, production and trade to include agro-processing, storage, grading and branding, as well as changes in trading such as e-commerce for both inputs and products.

Two approaches were used to study how rice VCs are financed. Stacked surveys involved a representative sample survey for each segment of each rice supply chain – farmers, wholesale/logistics, processors and retailers. These field surveys included 544 detailed interviews in China, 418 in Cambodia

and 478 in Laos. In addition, 23 randomly selected case studies were conducted to identify success stories in rice VC financing both in the project countries and elsewhere. This provided a baseline to assess rice VC development and gaps in finance based on solid evidence.

Finance may be provided by professional lenders or by actors within the VC. The leading VC players tend to have better information about the borrowers and the industry, and can combine financial services with the provision of quality farm inputs, especially high-quality seeds and technical extension services. Motivations for VC suppliers to provide finance vary, ranging from ensuring the supply, quality and safety of farm goods to expanding their market share. But VC finance tends to exclude smallholders, and VC players have less experience in designing and improving loan products and services, so cooperation between banks and leading VC lenders is valuable. External financing of agri-food VCs is still limited, but appears to be on the rise in China, where VCs are transforming quickly.

Value chain finance is more likely to emerge if the chain has a dominant player who can influence the flow of funds and information, and enforce loan contracts. A number of tools are used by the providers of VC finance in the three Asian economies to mitigate risks associated with output and price uncertainties in farm production and marketing, including innovative collaterals and interlinked market transactions to improve the chance of repayment. Some leading VC players use farmers' cooperatives or other organisations for aggregation.

The main differences between the three countries studied relate to the extent of local and national government interventions, and also the linked regional and local financing options seen in many of the Chinese case studies.

The findings and recommendations were shared with the Ministries of Agriculture in the three countries, as well as representatives of traders, mills and retailers, and farming communities and cooperatives. The project results are disseminated through the Regional Strategic Analysis and Knowledge Support System for Asia at www.resakss-asia.org.

Market signals and market information, albeit often not formalised or verified by official agencies, appeared to be sufficiently robust in the case study countries to support profitable market activity right down to smallholder level. In particular, and importantly because of their position in the chain, those mill owners who had information on prices and demand in the primary and final markets for rice were enthusiastic about expansion and were ready to (re)invest.

Recommendations

- **Sustainable access to credit is vital to enable all resources and skills in the VC to be mobilised.** Most VC financing instruments observed by this study address short-term capital requirements of farmers and businesses; larger investments (such as the purchase of warehouses, processing equipment or agricultural machinery) are difficult to finance and often require considerable injection of a company's own funds. Government mechanisms to encourage commercial banks to provide more financial support to agriculture could include tax concessions, reserve requirements (or cash reserve ratios), and on-lending support such as more targeted loans to microenterprises. Financial institutions need to train more of their loan officials in the specific needs of rice processors and other actors in the VC.
- **Governments, financial regulators and finance institutions need to work together on innovative products accepting a wider range of loan collateral.** These include moveable assets (such as tractors), accounts receivable (money owed) and inventory as collateral. Governments should strengthen law enforcement on loan defaults so as to create a good credit culture and a business-friendly environment. Financial institutions can obtain information about individual farmers from leading VC players for credit screening and monitoring, and use guarantees from leading players to enforce loan contracts.
- **Agri-food insurance services should be made available through commercial insurance operators.** Weather-index insurance pilot programmes demonstrate how insurance products that cover crops, mainly rice paddy and wheat, can manage risk and income volatility and thus increase the likelihood of loans to farmers as the risk of default from climate/weather is reduced.
- **Farmers' cooperatives and other farmers' organisations should be supported to involve small producers in the VC.** This could include technical support to leading VC players and farmers' organisations for improved contract terms and conditions, and reducing the transaction costs for VC financing.
- **Governments should support the VC infrastructure** by providing or upgrading services including irrigation, agricultural extension, production and marketing of quality seeds, and rural roads. Support should focus first on areas where contract farming and agricultural VC financing has been piloted and developed.



Value chain finance is critical to the continued development of agriculture – its focus on market competitiveness augments, but does not replace, conventional finance, increasing access to capital and reducing risk for both clients and financiers.



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