Transforming Smallholder Farmer Access to Finance in Myanmar

Case Study

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DaNa Facility
Empowering Enterprise

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The agriculture sector employs approximately 50% of Myanmar's workforce, with a quarter of the adult population deriving their main source of income from agriculture related activities, making it an essential driver of income and jobs.[1] Despite the importance of the sector, in 2016 agriculture lending amounted to only 2.5 % of total lending by commercial banks. [2]
Limited access to appropriate credit for farming is critically constraining the growth of the agricultural sector and depressing income for smallholder farmers.[3] To address some of the systemic constraints regarding access to finance for smallholders, the UK aid-funded DaNa Facility is piloting an innovative value chain financing model, working with sesame farmers in Magway Region.

This case study explores some of the challenges surrounding agri-finance in Myanmar, describes the financing model supported by the DaNa Facility, and presents lessons learned from the pilot project to make the case for greater investment in agri-finance for both banks and smallholders.

Smallholder Access to Credit in Myanmar

Smallholder farmers are reliant upon credit financing at key points in the growing season, yet only 22% of smallholder farmers with four acres or less of land have access to credit from banks, forcing the vast majority of farmers to rely on unregulated credit sources, often with high interest rates.[4]

> "Normally we get loans from the Agricultural Development Bank, but the bank loan money only comes after the harvest, which is not the right time, so we go to private banks and loan sharks. Government banks have increased the amount they are willing to loan, but the time frame is still a problem."
>
> *Maiw Maw, RFDA female smallholder*

Access to Credit. Farmers access formal credit through three main avenues: the Myanmar Agricultural Development Bank (MADB), microfinance Institutions (MFIs) and financial cooperatives. Credit from MADB is the most common, although MADB predominantly finances rice growers. MADB loans are not adequately tailored to crop cycles and loan disbursements are often late, forcing farmers to source additional credit from MFIs, moneylenders or pawnshops. MFI loans normally require frequent instalments of up to bi-weekly principal and interest payments, even though farmers can only repay loans at the end of the crop cycle when they sell their produce. Commercial banks have also been slow to develop financial lending products that are properly tailored to the agricultural sector, with affordable interest rates and reasonable repayment schedules.

As a result of these constraints, informal financing mechanisms have developed, and it is not unusual for large agribusiness buyers to finance producers during the growing season. Buyers are incentivised to support farmers access to appropriate inputs and labour to produce high quality, consistent crop supplies. Yet through such arrangements, farmers are potentially vulnerable if they are unable to deliver the volume and quality promised, or if they face an unforeseen shock, such as inclement weather or bad harvests.

Banking policy and capacity. Banks in Myanmar lack the expertise to analyse crop value chains, assess agricultural credit risk, and manage a portfolio of smallholder loans. Currently banks require farmers to provide collateral, relying almost exclusively on the Form 7 Land Use Certificate, which grants farmers the right to cultivate land. These certificates are usually registered under the male household head's name and transferring these rights is a complex process. This means that women are often

[1] Making Access Possible Refresh Myanmar Diagnostic, Finmark Trust, UNCDF, the DaNa Facility, 2018, pg. 10; International Labour Organization, ILOSTAT database. Data retrieved in April 2019.
[2] Roger Thomas Moyes, Kenneth Shwedel, Myths and Maths: The Impact of Financial Regulations on Agriculture in Myanmar, Mekong Business Initiative, May 2017, ii.
[3] Smallholder farmer is defined as a farmer with 6 or less acres.
[4] Making Access Possible Refresh Myanmar Diagnostic, pg. 56.

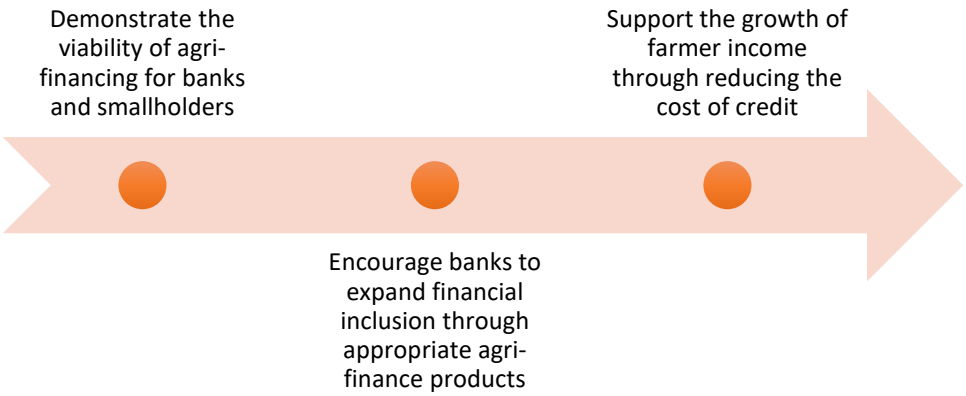
further excluded from financing as they are unlikely to have the forms of collateral that banks require and are dependent upon a husband or male relative to apply for loans.

Credit policy restrictions discourage banks from lending to clients of perceived higher risk like smallholders. An analysis of six large banks in Myanmar determined that only two have credit options for agricultural producers with the other four focusing on equipment loans or working capital loans for agribusinesses.

Structuring a Value Chain Financing Model in Myanmar

The DaNa Facility has been working with the Interchurch Organisation for Development Cooperation (ICCO) and Network Activities Group (NAG), a national NGO, with the aim of enhancing farmers' use of Good Agricultural Practices (GAP) and enhancing capacity of the Regional Farmer Development Association (RFDA), located in Magway. This work has highlighted the importance of not only addressing farmers' agricultural capacities through training, but also the financing system surrounding agricultural production. The DaNa Facility worked with ICCO and NAG to facilitate an innovative value chain financing model for the sesame value chain that is one of the first of its kind in Myanmar. The DaNa Facility believes that working throughout the entire value chain provides greater opportunities for understanding access to finance constraints and in turn identifying solutions for farmers. By recognising that relationships from the end-buyer down to the input provider are as valuable and "bankable" as traditional forms of collateral for farmers, it is feasible to unlock production finance working capital aimed at supporting investment.

It is expected that through piloting this model the DaNa Facility will achieve the following:



The Sesame Value Chain in Magway Region

The sesame value chain was selected because it is one of the three main crops grown by RFDA farmers in Magway Region and strong regional demand for sesame.

The RFDA is a dynamic organisation with around 10,017 members living in 66 villages across Magway, including 10% female headed households. It has an apex leadership structure with the RFDA overseeing four Township Farmer Development Associations (TFDA), which in turn oversee the 66 Village Farmer Development Associations (VFDA). Membership organisations for farmers are relatively new and still scarce in Myanmar due to the restrictions imposed on organised groups during the military regime. RFDA has grown because of NAG's long-term support, that initiated developing VFDAs in 2011. NAG has helped RFDA build its membership base and technical and managerial capacity, making it an ideal partner with whom to pilot a more advanced access to finance initiative.

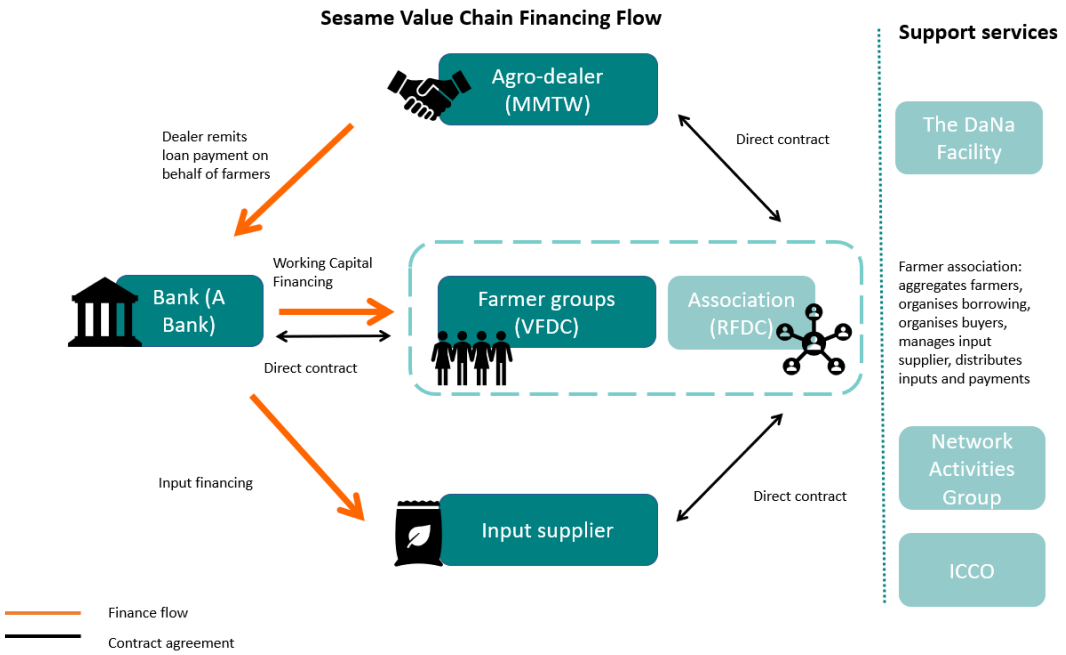
RFDA has a contractual purchasing relationship for sesame with an agro-dealer based in Magway, Myint Myat Taw Win Company (MMTW). In this way crop volume and prices are agreed prior to the planting season for RFDA farmers.

To plant one acre of sesame, farmers need an average loan of MMK 70,000 (£35). Financing is needed for inputs like fertilizer, applied before planting, and for working capital to cover labour costs during the growing season. RFDA farmers were borrowing directly from MMTW (the buyer) at a rate of 2% interest per month, repayable after the planting season. Whilst this financing arrangement works, it is not sustainable as MMTW does not possess the required licenses to provide financing at a large scale, nor the scope for broader financial inclusion of smallholders.

An Inclusive Access to Finance Model

The DaNa Facility aided the introduction of a financing model that inserted a formal credit provider into the value chain: the Ayeyawaddy Farmers Development Bank, (A Bank), a commercial bank established in 2008. A Bank is interested in expanding its agri-finance portfolio and agreed to provide credit to 3,405 farmers in 59 VFDCs at an interest rate of 1.47% per month for six months. This is lower than the interest rate currently offered to farmers and is an important step in connecting largely unbanked smallholder farmers to a commercial bank. The value chain financing is set up in three steps:

1) At the beginning of the sesame planting season in May, A Bank pays the input supplier directly, although the contract and price for inputs is negotiated by RFDA. Farmers' loan accounts are credited to reflect the value of the inputs they receive from the input supplier, with input amounts given based on farmer acreage and a standard amount per acre ("parametric" approach).
2) Halfway through the planting season, A Bank issues the second tranche of financing to the VFDC's. Each VFDC has opened a collective bank account with A Bank. The VFDC's distribute loan proceeds in cash to individual farmers to allow them to hire labourers to cultivate and harvest the sesame crop.
3) After the harvest, farmers take their sesame to the agro-dealer's warehouses. The agro-dealer pays RFDA, minus the cost of the farmer's loan, which is directly paid by the agro-dealer to A Bank. The RFDA then distributes to the farmers the revenue made from the growing season, subtracting the value of their respective loan repayments.



Sharing Risk Across the Value Chain

Adopting a financing approach that considers the entire value chain has resulted in reducing the risk of loans defaulting by sharing risk across value chain actors. The bank is not actually holding loans with individual farmers, but a collective of farmers, and because there is a confirmed buyer, A bank is able to offer more affordable interest rates to what are typically considered high-risk borrowers.

Alternative Ways of Assessing Collateral and Risk

A Bank realises that not all farmers have land use certificates readily available and, therefore, has adjusted the way it recognises farmer collateral by verifying Form 7 Certificates with the land registration office. Notably however, A Bank's main form of reassurance of repayment lies in the purchasing contract with the agro-dealer and the organisational strength of RFDA itself that reduces the risk of lending to individual smallholders.

Building the Case for Formal Access to Finance

If farmers are accessing credit, even informally, what is the added value of promoting access to credit for farmers through commercial banks? The DaNa Facility's experience highlights five key areas that prove the case for lending from formal institutions is beneficial for all of the parties involved.

> "RFDA is good because other associations only set up one year ago. RFDA has been going for three or four years and so they have the capacity to lead the farmers."
>
> *Saw Dino Ku, Executive Director of A Bank*

1) More Inclusive Growth

> "I feel proud of the RFDA as the RFDA are the first association to do this with a bank…even the government is encouraging this finance project."
>
> *U Han Nyant, RFDA Chairman*

Access to appropriately priced and structured credit provides farmers with the ability to generate higher income from their crops, potentially expanding their production and tackling poverty amongst farmers. This is the first loan of its kind where RFDA worked directly with a commercial bank. Reducing the cost of credit, even marginally, allows farmers to achieve savings that can be used to expand their production through investment in technology.

2) Stronger Smallholder Organisations

The important role played by RFDA cannot be underestimated, both for the farmers it serves, as well as providing an example to other regions of the value of farmer organisation models. Through this experience with A Bank, RFDA is developing institutional experience in agri-financing mechanisms and more effectively serving its members.

3) Greater Women's Empowerment

Around 10% of RFDA's members are female headed households, mostly widows or elderly women, whose names are not listed on land use certificates. For women headed households, A Bank is accepting the RFDA's confirmation of the women's right to cultivate the land, empowering women to also benefit from loans. For women farmers, this initial engagement

> "The benefits of this loan are a lot, this is the right time for when we need the money, and this is the first time we get this type of loan."
>
> *RFDA Female Committee Member*

with a commercial bank is a vital first step to the longer-term goal of developing a banking profile and a credit history in their own name.

4) Broader Financial Inclusion

Accessing a group loan from a bank is one of the first steps on the pathway to greater financial inclusion for smallholder farmers, and the initial exposure to the banking system enables farmers to acquire financial literacy and eventually open their own bank or saving accounts. These farmers will increasingly participate in new credit scoring approaches, which should open the door to further access to other financial products, including savings, transaction, and insurance products.

5) Commercial Feasibility of Smallholder Lending

This financing model provides a critical opportunity for banks, farmer associations and agro-dealers to witness a new form of agricultural credit financing that generates both social and commercial returns. It addresses the perceived risk of lending to unsecured groups and encourages more flexible, value chain driven approaches to lending that move beyond a traditional, asset-based lending model. Agri-finance is the entry point to a potentially vast customer base. A Bank hopes to grow their agri-lending portfolio to 40-60% of their entire lending portfolio. The Executive Director of A Bank's remarks are indicative of their awareness of the potential of agri-finance, stating: "We are sure agri-financing can be done if it is structured properly and if other banks come in. It will be a huge market."

Lessons Learned and Recommendations for Expanding Smallholder Access to Finance

Banks' institutional capacity is essential: This pilot project emphasised the general lack of capacity among banks to identify business opportunities in the agricultural sector. Even A Bank noted they have not yet developed internal standardised policies and procedures that are simple for farmers. Neither do they have a specialised unit with staff knowledgeable about the agricultural sector.

> "Banks have no knowledge on what is going on in the agriculture sector, banks need to have good staff who are interested in agriculture SMEs and they have to feed this back up to the management, that the agriculture sector is good for the country."
>
> *Saw Dino Ku, Executive Director of A Bank*

Commercial banks need support to develop their agricultural lending expertise and the appropriate policies and procedures allowing them to lend to the sector with greater confidence, and to dispel the myth that farmers are high risk clients. Working with senior leadership in banks to design new models of financing and building internal capacity will be essential in achieving these goals.

Invest in farmer associations: The farmer association's ability to organise and mobilise groups of farmers is a significant factor in building trust between the agro-dealers, banks, and farmers. In Myanmar, a lot of donor attention has been focused on production training. It is also essential to promote developing commercially-oriented farmer organisations and strengthening their capacity in organisational and financial management.

> "Associations need to be strong because individual farmers will not get a loan from a bank on their own, farmers should work together"
>
> *RFDA Committee Member*

Farmer associations also have a critical role in encouraging farmers to maintain records of crop volumes, acreage, production patterns, quality of production, GAP certification, sales and financial transactions. This kind of data can support new credit scoring approaches and help banks develop alternative ways of calculating borrower risk. Currently, information is principally kept in paper form; there is a need to digitise the agricultural sector, from the ground up, farm household by farm household. Farm associations are well placed to drive this digitisation.

Value chain financing models work: Agricultural value chains offer scope for innovative credit models. Value chain lending enables risk to be shared across actors resulting in the overall reduction of risk for each actor; it also allows banks to allay traditional concerns about collateral and leverage the existing commercial relationships between farmers and buyers. It is important to remember, that value chain financing works where there is a strong market demand driving the value chain, and in the case of sesame, a high demand for improved varieties of the crop regionally. The focus, therefore, should be on value chain financing for high-value commercial crops.

Policy advocacy: The current policy framework in Myanmar is not conducive to flexible lending in agriculture. Reforms are needed to relax interest rate restrictions to help banks take on the risk of agri-financing. Furthermore, cash transactions in rural areas need to be replaced by digital forms of money and payments. Physical branches may not be feasible in remote areas and policy frameworks need to support banks to operate remotely—or digitally—and to help banks move beyond traditional asset-based lending approaches. Credit guarantee mechanisms are highly limited and agricultural insurance is not available—both of which might help facilitate more bank lending to agriculture.

A Bank providing the loan for sesame farmers in Magway Region

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