SME FINANCE (SMEF) WORKING GROUP

BRINGING SMART POLICIES TO LIFE

AGRICULTURAL FINANCE INTERVENTION IN GHANA

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CASE STUDY

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Cover photo: Cacao beans drying in the sun, Ghana, West Africa.

INTRODUCTION

The average contribution from Agriculture to Ghana's GDP from 2010 to 2015 was 35 percent and SMEs contribute about 70 percent to the same. According to the Ghana Labor Force Report for 2015, of the 9.3 million people formally employed, 3.3 million people, representing 36 percent, were employed in the agricultural sector.[1] Regarding rural employment statistics, 70.6 percent were employed in agriculture. In terms of foreign exchange earnings, agriculture contributes about 45 percent of foreign exchange earnings, whilst the average growth rate of agriculture in Ghana from 2010 to 2016 was 3.5 percent.

Access to financing is vital for the growth of the agriculture sector in Ghana, mainly for working capital such as acquiring inputs (seedlings, farm fertilizer) and for hiring labor, as well as for fixed capital acquisition such as machinery. The absence of financing limits the average acreage of cultivated farmlands and thereby, impedes agricultural growth with consequences for the macro economy as a whole. In Ghana the financial sector players involved in agricultural financing include banks, rural banks, Savings and Loans Companies and Microfinance institutions.

According to Global Findex Database for 2017, and between 2014 and 2017, the share of adults having accounts with a financial institution or through a mobile money service rose from 62 percent to 69 percent. In developing economies, the share rose from 54 percent to 63 percent, making Ghana's level of financial inclusion slightly higher than the average for developing countries.[2]

35%
WAS THE THE AVERAGE CONTRIBUTION FROM AGRICULTURE TO GHANA'S GDP FROM 2010 TO 2015

3.3 MILLION PEOPLE
REPRESENTING 36 PERCENT OF ALL PEOPLE FORMALLY EMPLOYED, WERE EMPLOYED IN THE AGRICULTURAL SECTOR IN 2015

45%
AGRICULTURE CONTRIBUTES ABOUT 45 PERCENT OF FOREIGN EXCHANGE EARNINGS

1 Ghana Statistical Service: 2015 Labour Force Report
2 The Global Findex Database 2017

CHALLENGES

Lack of financing is the major constraint for the agriculture sector in Ghana. Risk mitigating measures are planned to improve access to financing and this is the challenge that falls directly within the domain of the central bank in promoting agricultural finance.

The main reasons why banks have been reluctant in lending to agriculture include:

> High-risk perception of the sector and lack of adequate risk management tools;
> Existential risks such as diseases, pests and changes in climatic factors;
> The sector is not considered strategically important to banks;
> Lack of reach by banks and there are high service delivery and monitoring costs;
> Agricultural sector is largely informal, lacking the documentation and registered collateral required for loans;
> Inappropriate financing models applied by commercial banks for agricultural lending due to poor understanding of agribusiness;
> Perceptions about agriculture's low profit potential; and
> Low levels of farmer education and financial literacy.

These challenges are specifically identified as follows:

I. CHALLENGES WITH INTERVENTION PROGRAMS

Agricultural projects are heavily dependent on well-coordinated public intervention mechanisms, with a top-down approach in planning and implementation, resulting in a less than satisfactory relevance, less cost-effectiveness and poor ownership. Interventions are also not properly harmonized and coordinated, and thus, this should be an area of intense focus.

II. CREDIT DELIVERY CHALLENGES

Weak credit appraisal by banks due to inadequate technical capacity of credit officers in delivering quality agricultural credit, and resulting in banks carrying high non-performing loans in their books remain a major problem. Credit models typically employed by commercial banks do not match loan repayment to cash flows, leading to high default rates. Building technical capacity and fostering the introduction of risk mitigating schemes are essential tools needed to guarantee quality credit delivery.

III. DELAYS IN IMPLEMENTATION, SLOW DISBURSEMENT AND INADEQUATE COUNTERPART FUNDING

The requirements in agreements with donor partners for the Government to contribute upfront counterpart funds before the project accounts are credited for specific projects, causes delays. It therefore becomes important to seek more partnerships and negotiate what the country itself can realistically contribute.

IV. THE CHALLENGE OF LOW ABSORPTIVE CAPACITY

Some projects are designed in such a way that, with prevailing manpower resources at various levels, it is not possible to utilize the funds allocated which leaves some donor funds undisbursed at the end of these projects. This design gap, results in frequent requests for extension of projects, which ultimately causes delays in executing agricultural programs.

The support given to agriculture during the period before the millennium did not achieve much in terms of the objectives because apart from management problems, farmers lacked innovation, risk mitigating measures and technical capacity to transform agriculture. This is where the need for innovation and risk-mitigating schemes becomes important.

When the Pre-SAP of the 1990 was implemented, specific percentage of banks' credits were required to be allocated to specific sectors of the economy, including agriculture. However, the program was abrogated during the post-SAP, when Ghana adopted market-oriented policies, following financial sector liberalization. The tool used by the Bank of Ghana in this instance was moral suasion.

Besides access to financing, there are other challenges to agriculture, such as climate change, lack of access to input and output markets, lack of basic infrastructure in rural areas, lack of extension services, and the lack of research and development facilities. The problem of gender disparity, where women remain confined to food production, while the cultivation cash crops are preserved for men needs to be addressed over time. Other challenges include customary land tenure systems and litigation, lack of collateral that is usually required for commercial loans, under-developed value-chains, and inadequate infrastructure for storage, transport, and processing.

INTERVENTIONS

The government of the first Republic of Ghana quickly adopted policy interventions in the agricultural sector to boost access to finance, and production for food security and export.

Subsequent governments continued the policy intervention. Notable ones include:

> **The Agricultural Development Bank (ADB)** was set up in 1965 by the Government to provide credit to crop/livestock and small farmers; and

> **Rural and Community Banks** were set up by the policy beginning 1976 to support rural agriculture and other rural activities. Since then, these Rural and Community Banks with their branches have increased to over 500 communities, mobilizing and delivering credit. Subsequently, an Apex Bank was formed to oversee the activities of the Rural Banks in the year 2000;

BOX 1: THE GHANA EXPORT IMPORT BANK (GHANA EXIM) BANK

The EXIM Bank was established from the consolidation of three state-owned institutions namely, Export Trade Agricultural and Industrial Development Fund (EDAIF), Export Finance Company Limited (EFCL) and Eximguaranty Company Limited (ECL), to support the financing of initiatives, including agriculture, in order to facilitate the country's international trade and promote its capacity and competitiveness in the international marketplace.

Its 5-year strategic goals (2017-2022) include increasing revenue from non-traditional exports from its current average of USD 2.4 billion to USD 5 billion, develop crops such as avocado, cashew, oil palm and cassava into major export products and reduce the nation's import bill for poultry by USD 300 million. This makes it a key finance partner for effective implementation of Government initiatives, such as the One District One Factory (1D1F).

As part of the efforts to manage the economy of Ghana in an effective way so as to create wealth for the benefit of all Ghanaians, the Government of Ghana implemented its Poverty Reduction Strategy (The GPRS) in February 2002. The principal objective of the GPRS is to create wealth by transforming the economy to achieve growth, accelerated poverty reduction and the protection of the vulnerable, and excluded within a decentralized, democratic environment.[3] In line with GPRS objectives, successive governments over the years established agricultural financing schemes to increase access to finance. Notable and more recent ones are discussed below.

3 Bank Of Ghana's Agricultural Sector Policy (2004)

People picking oranges at the market in Ghana, Africa.

PLANTING FOR FOOD AND JOBS (PFJ)

The PFJ program aims at contributing to the modernization of the agriculture sector, thereby leading to structural transformation of national economy through food security, employment opportunities, and reduced poverty.

The program has adopted an integrated comprehensive approach to substantially increase the availability of inputs (seeds and fertilizers) and the accessibility to input and output markets. It is national in scope and covers all the 216 districts in the country where the prioritized food crops are grown. Crops under the support of the PFJ program are selected based on their relevance to national socio-economic considerations such as: (a) food security (b) smallholder farm incomes (c) supply of raw material for the livestock and industrial sector (d) reduction in food import bill (e) job creation and (f) economic activity from various actors along the value chain.The selected value chains for the initial support under the PFJ program included maize, rice, sorghum, soya bean, tomato, onion and chili pepper.

THE POLICY IS BUILT ON FIVE MAJOR PILLARS COMPRISING:

1. Supply of improved seeds to farmers at subsidized prices (50 percent subsidy);
2. Supply of fertilizers to farmers at subsidized prices (50 percent price cut);
3. Free extension services to farmers (1200 extension officers from the five main agricultural colleges already enrolled onto the program with additional 4,000 extension assistants to be mobilized);
4. Marketing opportunities for produce after harvest, (arrangements have been made to offer ready markets for farmers who will be participating in the campaign); and
5. E-Agriculture - a technological platform to monitor and track activities and progress of farmers through a database system.

The program is estimated to cost USD 7.2 million over a period of four years (2017-2020), with financing from Government and some Development Partners. The PFJ in its first year of implementation produced a total crop value of GH¢ 1.2 billion.[4] This reflected the use of labour, improved seeds and fertilizers combined with increased extension service delivery in the production of an additional 485,000 MT of maize; 179,000 MT of rice; and 45,200 MT of vegetables. Additionally, a total of 745,000 jobs, mainly in the rural economy, were created in 2017.

DEVELOPMENT PARTNERS FUNDED INTERVENTIONS

There are other financing schemes and project supported by development partners. Some of these are highlighted:

THE OUTGROWER AND VALUE CHAIN FUND (OVCF)

Under the OVCF, the German Financial Cooperation through KfW, provided medium-long term refinancing vehicle for investments related to outgrower schemes as well as technical assistance to outgrowers. The activities of OVCF aims to reduce rural poverty through creation of jobs along agricultural value chains and hence, the generation of income for the rural folks. The Fund includes a financial contribution of EUR 10 million and EUR 1 million grants. The fund has enhanced the Integration of small-holder farmers into commercial agricultural development.

THE FINANCING GHANAIAN AGRICULTURE PROJECT (FINGAP)

The FinGAP is an USAID program aimed at improving financing and investment in agribusinesses operating in the maize, soy, and rice value chains in the north of Ghana. Since its inception in 2013, it has enabled agribusinesses to access funds from financial institutions to over USD 85 million, with majority of funds going to agro input dealers, processors and farmers.

THE RURAL AND AGRICULTURAL FINANCING PROGRAM (RAFIP)

RAFiP's objective is to ensure that access of the rural and agricultural population to sustainable financial services is increased through enhanced outreach, sustainability and linkages. It is funded through a collaboration between IFAD (USD 15 million) DANIDA (USD 8 million), Italy (USD 1.5 million), and implemented through the Ministry of Finance. It aimed at strengthening rural financial systems by providing series of capacity building trainings, including technical training on finance and credit operation, as well as management and governance on bank operation, to staff of rural/community banks and microfinance institutions. It also strengthened linkages between financial and agricultural/agribusiness sectors to promote agribusiness investment.

In line with the Government's intervention policies, the Bank of Ghana (BoG) implemented some direct agricultural development schemes. These include:

> **Cocoa Bill Financing Scheme (1958):** A financing scheme for the purchase of cocoa when rapid increases in the volume of the crop made it difficult for the Cocoa Marketing Board (CMB) – now COCOBOD, to finance purchases from its own resources.

4 https://agra.org/ghanas-planting-for-food-and-jobs-rakes-in-gh%C2%A21-2bn-us-270276000-crop-value-minister/

- **Grains Bill Financing Scheme (mid 1970s):** This was a financing package for the purchase of farm produce, particularly rice and maize, during the era of high post-harvest loss arising from the "Operation Feed Yourself" of the then Government. The objectives of the Grains Bill Financing Scheme included: to make funds available for the purchase of farmers' grains, thus ensuring a ready market for their produce at all times; to stabilize the market price of the grains to serve as an incentive for continued production; and to support the purchase of grains for a national food security stock as relief supplies in times of emergency or extreme scarcity.
- **Grains Warehousing Company (1975):** This was a direct effort to achieve the abovementioned objectives of the GBFS. The company purchased and sorted grains, which it sold in the lean season. However, the GWC also failed due to inappropriate policies adopted by the company's management.

The Bank of Ghana undertook various agricultural projects in the 1970s, although these projects were not direct financing schemes to agriculture. Notable amongst them were:

- **The Shai Cattle Ranch (1973)** established to demonstrate the viability of commercial beef cattle ranching in the southern Ghana plains and to train personnel in commercial livestock ventures;
- **The Agricultural Development Company** established to produce cotton on a large-scale under irrigation to feed the emerging textile manufacturing industries in Ghana, and to grow and market other farm and livestock produce;
- **The Wulugu Livestock Company (1979)** was set up to run a ranch for cattle and sheep in the Northern Region on a scientific basis to serve as a model for local ranchers; and
- **The JOFA Project,** which was established and financed through Agricultural Development Bank (ADB) to develop 300 hectares of plantations in the localities within the central and eastern regions.

With the exception of the JOFA project, which was partially successful, the other three projects did not achieve their set objectives due to inappropriate policies adopted by their Managements. In the wake of the Structural Adjustment Policy (SAP), which commenced in 1983, BoG refocused their involvement in agriculture through indirect schemes. It established a Rural Finance and Inspection Department to oversee the activities of Rural and Community Banks, and managed various foreign and Government of Ghana funds/projects on behalf of the Government of Ghana for Food Crops Development Project, Community Banks Refinance Scheme; Ghana Women Fund Scheme; and Special Rural Credit Scheme.

The Financial Market Department of the Bank of Ghana administers project loans and grants received by the Ghana Government from donor countries and agencies. These projects include:

- Rural Enterprises Program (REP)
- Private Enterprise and Export Development (PEED)
- Ghana Private Sector Development Facility (GPSDF)
- Japanese Non-Project Type Grant

RURAL ENTERPRISES PROGRAM (REP)

Under the Rural Enterprises Program (REP), Bank of Ghana administered projects under the International Fund for Agricultural Development (IFAD) Scheme. The program commenced in 1990. Key projects include: Smallholder Credit Input Supply and Marketing Project (SCIMP) Upper West Agricultural Development Project; Rural Financial Services Project; and Rural Enterprises Project. Currently, there are only two facilities that BoG is administering under the REP, namely the Rural Enterprises Development Fund and Matching Grant Facility for the procurement of machinery. Low interest rates were charged by Donor Partners to enable Participating Financial Institutions (PFIs) to lend at lower-than-market rates.

PRIVATE ENTERPRISE AND EXPORT DEVELOPMENT (PEED)

The Private Enterprise and Export Development (PEED) was a collaborative and mutually funded project by the by Government of Ghana and IDA. It finances activities such as the production and exportation of handicraft, cashew, cassava, coffee, pineapple, and shea nut. The facility comprised two components - a cedi denominated loan pegged to 180-day Treasury Bill rate, and a US dollar denominated loan pegged at 1.375-percentage point above the prevailing Eurodollar London Interbank Offered Rate (LIBOR). This project has however been discontinued.

GHANA PRIVATE SECTOR DEVELOPMENT FACILITY & JAPANESE NON-PROJECT TYPE

These two projects are funded by the Italian and Japanese Governments through a Coordinating Unit. The loans are commodity loans as they are used to purchase items from Development Partner countries. Both projects lend to SMEs at concessionary rates. Allocations are done in the Ministry of Finance and documents forwarded to BoG to prepare repayment schedule for the PFIs. On due dates for repayment, the clearing accounts of the PFIs, which guaranteed for Rural Banks are debited. The debit is then transferred to the Rural Banks, which also have accounts with the PFIs.

CENTRAL BANKS' ROLE IN PROMOTING A RISK-SHARING SCHEME FOR AGRICULTURAL FINANCE - BANK OF GHANA'S EXPERIENCE

Over time, the BoG has become operationally independent, with a core mandate of ensuring low and stable inflation to support economic activity. The BoG uses an inflation targeting framework of monetary policy as the main vehicle for anchoring inflation expectations. However, in the past decade, BoG, like other central banks, began to look beyond narrow mandates for macroeconomic stability and align the financial system with sustainable development goals. In order for central banks to better promote risk sharing for agricultural finance, it is essential that the nature of the risks in agricultural finance be identified.

The FAO and NEPAD have documented a spectrum of agriculture risks that are common in Africa and have classified these according to the frequency of occurrences, impact and sources. Some of the identified risks common to agriculture in Africa include:

> Variations in market prices of produce and inputs;
> Variations in yields and production losses;
> Natural disasters such as floods and droughts;
> Inputs and Market availability/unavailability;
> Inadequate regulatory measures, policy decisions, weak market information systems and sudden change of government policies;
> Foreign exchange risks; and
> Inadequate access to financing.

BANK OF GHANA'S MOST CURRENT INITIATIVE IN AGRICULTURAL FINANCE

In recent times, the BoG has taken steps, with collaborative efforts with the Ministry of Finance, to promote agriculture. The idea is to support selected agricultural value chains to increase productivity, meet the country's development objectives of generating additional inflows from exports, and also help curb imports to conserve foreign exchange. In 2014, the BoG, through a national stakeholders' forum which resulted in a dialogue on Agriculture financing in Accra sought consensus on how to effectively finance agriculture, under the topic "Boosting Ghana's Foreign Exchange Resources". The outcome led to the collaboration with the Ministry of Agriculture, with technical support from AGRA (Alliance for a Green Revolution in Africa) to adopt the "Ghana Incentive-based Risk Sharing System for Agricultural Lending" (GIRSAL), as a vehicle for leveraging financial institutions' lending to agriculture in Ghana.[5]

5 https://www.afdb.org/fileadmin/uploads/afdb/Documents/Generic-Documents/PANEL_III-_Bank_of_Ghana_Supporting_Agrifinance_Dr._Johnson_Asiamah.pdf

Anyinatiase village, Lake Bosumtwi, Ghana - July 31, 2010 Young african woman selling nuts in a small village Anyinatiase by the lake Bosumtwi in Ghana. Whole area has UNESCO sustainable management plan

The aim of GIRSAL is to provide incentives and risk mitigation instruments to address the constraints that agricultural value chain actors face when accessing credit from financial institutions. This is to be achieved through six inter-related pillars.

1 Risk Sharing Fund;
2 Technical Assistance Program — for banks and private economic agents involved in the agricultural value chain;
3 Integrated Insurance Policy - for farmers and agribusiness operators;
4 Financial Institutions' Rating System;
5 Bank Incentive/Reward Mechanism; and
6 Digital Financing

GIRSAL's medium to long-term goal is to double the percentage of lending by the banking sector to the agriculture sector in five years, from 3.4 persent (as at September 2015) to 6.8 percent, and to quadruple the total lending to the agricultural sector by 13.6 percent in 10 years.

The BoG and its collaborators have already indicated their commitment to initially start with a seed capital of USD 100 million for the establishment of GIRSAL by the end of 2018.

The Bank believes that its involvement in the sector can help change the perception of risk in agriculture and motivate more investments in the agriculture sector of Ghana. The BoG and its collaborators are already in bilateral consultations with development partners that have gone far in this risk sharing business.

LEVERAGING OTHER ON-GOING INITIATIVES

In order to institutionalize GIRSAL on the basis of current on-going Government of Ghana initiatives, the BoG has arranged discussions with the authorities of the following two entities:

1 First is the newly established Ghana Commodity Exchange (GCX), which has been set up to address the constant and significant losses in farm produce, much to the detriment of farmers and society at large. This will benefit the BOG-initiated GIRSAL because addressing the post-harvest losses by the ready market with professional market institutions will strengthen the activities of value chain actors. Some of the initial crops to be featured on the GCX may be the same as some of GIRSAL's, e.g. Maize, Soya and Paddy rice.
2 Second is the Savannah Accelerated Development Authority (SADA 2), which is an independent agency for coordinating a comprehensive development agenda for the northern Savannah ecological zone in Ghana. There is currently a private sector proposal seeking to partner with the government to set up 50 Farm Centers as one-stop shops in the SADA 2 region, to primarily provide an umbrella package to local farmers in the form of crop inputs, advisory services, farm machinery rental and produce buy-back. It essentially aimed to de-risk the agriculture value chain to make it very attractive to banks.

WAREHOUSE RECEIPT SYSTEM

Ghana has also launched a Warehouse Receipt System, which GIRSAL is leveraging on to reduce the risk of post-harvest losses of farmers and improve the possibility of better pricing for them. The Warehouse Receipt System is a tradable financial instrument that provides proof of ownership of commodities (e.g., maize, cocoa, copper) that are stored in a warehouse, vault, or depository for safekeeping. The receipt may be negotiable or non-negotiable and allows for the transfer of ownership of that commodity, without having to deliver the physical commodity. The receipts are mostly issued in a negotiable form, making them potentially eligible as collateral for accessing loans from financial institutions.

OUTCOMES OF INTERVENTION

The agricultural sectors contribution to GDP between 2006 and 2016 was at an average of GHS 6.7 billion, reaching an all-time high of GHC 8.4 billion in 2017.[6] However, there has not been any scientific study to attribute this growth to the poslicy interventions in the agricultural sector.

The various government interventions, Bank of Ghana programs, and development partner support for agricultural financing have been positive, albeit with limited results. Support for agriculture led to the establishment of the National Buffer Stock Company (NAFCO) in 2010 to store strategic food stocks and release in times of emergency to stabilize domestic prices. In 2016 for example, a total of 2,820 metric tons of yellow maize, purchased in the previous year, was sold at GHC 55.00 per 50kg at a period where the general market price was GHC 60.00. Even though this quantity was not enough to stabilize the general market prices, it helped government institutions which benefitted from these purchases to make some savings[7].

With the formation of the GIRSAL by the Bank of Ghana and its collaborators, public discourse on the need for better agricultural finance and protection has been escalated to include critical issues such as the inclusion of agricultural insurance in the National Insurance Act, with the expectation that it would facilitate agricultural insurance product development, create competitive agricultural insurance market and provide incentives to financial institutions to lend more to agriculture.

6 Tradingeconomics.com| Ghana Statistical Service

7 Planting For Food and Jobs Strategic Plan for Implementation (2017-2020), Ministry of Food and Agriculture, Ghana

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