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ASSESSMENT ON THE MECHANISMS AND CHALLENGES OF SMALL SCALE AGRICULTURAL CREDIT FROM COMMERCIAL BANKS IN ETHIOPIA: THE CASE OF ADA'A LIBEN WOREDA ETHIOPIA

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ABSTRACT

Agriculture demands different forms of inputs to be productive, among which, credit is indispensable. The current Ethiopian economic development strategy, Agriculture Development Led Industrialization (ADLI), brings the growth of agriculture at its heart to lead the development of the other sectors as well. Yet, providing the sector with adequate credit has been a problem, especially from commercial banks where the bulk of the country's financial resources circulate. Thus, this study aimed to assess the delivery mechanisms and challenges of agricultural credit from commercial banks to the small holding farmers, who comprise the majority of the farm community. Besides, the role of actors which facilitate the delivery and collection of the loans were studied. To meet the objectives, the study followed the explanatory research method, where certain variables were considered for analysis. Sampling was made at three levels, i.e. commercial banks, cooperatives, and farmers in a bid to access different areas for the sake of data triangulation. To study the matter on the ground closely, Ada'a Liben woreda of East Shewa Zone in the Oromia Regional State of Ethiopia was selected as the case area and sample farmers, who were members of farmers' cooperative associations, were surveyed. Afterwards, the study used both qualitative and quantitative data analysis techniques that included simple statistical tools, such as measures of central tendency and dispersion. Finally, it was found that agricultural credit in the Woreda followed a two-tier delivery approach, where input loans were provided to farmers through cooperatives. The main variable to qualify farmers for such loans was their working land size. Nevertheless, due to the shortage of land in the Woreda, the amount of loans, availed in the form of fertilizers, improved seeds, and chemicals, were inadequate. As collateral for the loans, the Commercial Bank of Ethiopia secures federal government guarantee, which is considered as cash substitute collateral from Ministry of Finance and Economic Development(MoFED) on the Oromia Regional Government's subsidy budget. The main reason for many of the default cases was found to be the lack of farmers' awareness on repayment terms. In a nut shell, the government's role in the small scale farmers' access to bank loans appeared crucial both during loan origination and collection.

Key Words: Commercial banks, Small holding farmers, Agricultural Credit

INTRODUCTION

Background of the Study

Agricultural development is the foundation of industrial development and, consequently, of a country's overall economic development. To attain agricultural development, every government must consider agricultural credit as an important policy instrument. Being one of the sub-Saharan African countries, Ethiopia is not an exception from this reality. The share of the total population engaged in agriculture has been more than 85%. In fact, the government of the Federal Democratic Republic of Ethiopia (FDRE) has formulated an overall economic development strategy that is anchored in the development of the agricultural sector. Agriculture is expected to bring growth in the other sectors as well. In Ethiopia, Agricultural Development Led Industrialization (ADLI) has been believed to transform the subsistence form of production to a commercial oriented one (MoFED, 2002). This shows the level of emphasis that should be given to the sector considering the proportion of the population it supports and the level of income generated from it.

As commercial banks are the main intermediaries for mobilization of a substantial part of a country’s fund, it is reasonable to expect their participation in the process by availing financial services to the development of the sector. However, the reality on the ground has been the otherwise. Agricultural sector has been receiving the least level of credit facilities from commercial banks (Koza, 2007). Especially, the banking sector’s role in the provision of micro credit has been low. In a nutshell, agriculture has been the most neglected sector in the banking business for credit due to the various risks it poses, such as lack of collateral and unpredictable earning structures. Where as, some partially blame commercial bank’s stringent policies and highly formal lending procedures for this impediment. Therefore, the issue merits closer assessment.

Statement of the Problem

Capital has been among the prevailing problems that are frequently raised in relation to the stagnation of agriculture, in general, and small-holder farming, in particular. According to Assefa (1987), the poverty trap in the sector, i.e. the low productivity, low income and again low productivity cycle, can only be broken through the availability of credit for the small holders so that farmers will be fortunate to adopt new technologies, improve productivity, and increase bargaining power to market their outputs at higher prices. On the other hand, commercial banks know the sector for its unique set of risks. Among the predominant problems are the lack of physical assets for collateral and absence of predictable source of income for repayment of loans. The problems could arise from different factors such as changing climatic condition and market fragmentation. As a result, banks usually shift their lending business to markets other than agriculture. Besides other problems, such as lack of infrastructure, high loan administration cost and information asymmetry led to the limited operation of commercial banks (Pearce, 2004). However, there were no recent research works that studied the linkage between

smallholding farmers and commercial banks in the credit market. Therefore, one of the main thrust of this study was to look at the issue closely in terms of its problems and prospects on contextual basis. It intended to give a clear picture on the problems from various stakeholders' point of views, such as commercial banks, cooperatives, farmers, and other institutions.

The general objective of the study was to assess the mechanism of accessing small scale agricultural loans from commercial banks in Ethiopia and closely look at the existing challenges and prospects on contextual basis. The specific objectives targeted:

- Elucidating the existing modes of delivering small scale agricultural loans to farmers from commercial banks.
- Unfolding the challenges and their causes in delivering small scale credit to farmers in the case area. Revealing the role of other institutions in facilitating the credit delivery process.

THEORETICAL AND EMPIRICAL LITERATURE

Need for Agricultural Finance

Pearce (2004) noted the fact that studies in 150 different countries revealed the positive link between a well-functioning financial system and long-term growth, and national savings and economic growth. Especially, development of the rural sector that accompanies the improvement of living standard of the majority who are dependent on agriculture is a prime concern in developing countries. Rural finance, in general, and that of rural credit, in particular, is critical to reduce rural household vulnerability. The availability of agricultural credit helps the poor to smooth the consumption patterns as agricultural income is affected by various factors, such as market prices, weather conditions, and timely availability of technological inputs. The small holding farmer can also build up assets greater than the value of the liability. Hence, there is strong need to provide adequate credit facilities for sustainable operation, growth of the agricultural sector and farmers living conditions.

Related to the contributions is the form of credits through which capital is channeled. Similar to other credit products, agricultural credit can be categorized into various time bands of short term, medium term, and long term credit. Short terms credit is usually meant for working capital and ensures adequate liquidity exists in the business. It is usually repaid at the end of a production season in anticipation of source of income, usually from a certain product **(**Mukwereza & Manzungu, 2003).

The Financial System Approach to Small Scale Agricultural Credit

The past failures to expand financial services in the rural areas and the agricultural sector, in particular, have been attributed to the numerous failures in political, social, and economic endeavors. The political interference by the government was a cause for many of the failures in expanding financial markets in rural areas. Governments, in

both developed and developing countries, have been emphasizing the need for income transfers and extending subsidies to meet social objectives. In most developing countries, governments attempted to bring income transfer to the rural poor through loans. However, past endeavors ended up negatively affecting the credit culture and discipline of the rural population. As a result, financing agriculture through formal institutions becomes difficult. The past experiences of various institutions created myths, leading to the conclusion that the rural financial market is unfavorable to institutional operators. In addition to the obvious external factors that affect both the borrowers and lenders, such as natural disasters, poor markets and unsuitable land tenure system have enormous contributions to the thinning of the rural credit market.

As a remedial solution to the problem, there was need to establish specialized banking and credit institutions dedicated for agriculture only that fits the specific and unique nature of the sector (FFTC, 2007). However, the idea has also been refuted on the grounds of inefficiency problems. Rather, the need to create innovative financial products and delivery mechanism to promote agricultural finance within the financial systems approach has been emphasized (Pearce, 2004). For instance, introducing flexible and more accessible saving facilities reduces risk of seasonal income loss. By the same fashion, credit culture and discipline can also be promoted through client education, use of group collateral, and close and regular monitoring of clients by loan officers.

Further more, the need to establish institutions with specific laws and regulations are crucial. Nevertheless, improvement of agricultural productivity, competitiveness, and income are the most important focal points that can help ensure eligibility and development of credit market and the overall rural economy. This reflects the possibility of using the traditional banking businesses in the development of a credit market in rural areas.

One of the major factors constraining the development of credit market in rural areas has been the lack of proper collateral to be used as lien in case of default by borrowers. Financial institutions are reluctant to venture in rural areas as small holding farmers do not have the capacity to offer collateral eligible in the eyes of such institutions' policies and procedures. Some governments offer financial institutions that guarantee to replenish lost funds in cases of default by designing various loss sharing mechanisms in the credit delivery system. Yaron (1992) raised the importance of diversifying rural credit apart from agricultural credits. Other non-farm activities are important to reduce the danger of loan repayment failures as the agricultural risk is faced with various 'co-variant risks'. Financial institutions operating as intermediaries in rural market should finance all segments of the rural economy, indiscriminately, in order to carry diversified, balanced, and less risky loan portfolio in their assets.

According to Assefa (1987), countries use innovative ways to facilitate the financial service intermediation in the rural areas. Commercial banks' lending mechanisms can be of one or both of the two types, i.e. direct lending

(One-Tier) to the beneficiary and/or through other form of agencies (Two-Tier). Under the former approach, the bank directly extends the credit product to the end user. In such a case, the beneficiary concludes the loan contract directly with the bank and the repayment obligation will be limited to the beneficiary. In the latter case, organization or agencies, such as cooperatives, governments, or other parties make the borrowing from the bank and transfer the fund to the end users, who can also be members of the associations.

Despite the many efforts, FFTC (2007) noted that the financial systems approach to delivery loans in the rural market has not been without challenges. Previous experiences in developing countries in financing agriculture, through commercial banks, exhibited certain features that hamper credit expansion in the rural market, such as strict collateral requirement. As a result, access by small holders to financial institutions has been highly limited. As an alternative to the adoption of innovative methods, Yaron (1992) raised the need for applying mobile banks that can be taken as techniques to reduce administrative costs of delivering financial services. A more recent case study by Gupta and Shroff (1987) in India implied the need for opening satellite branches. It understands the nature of the ecological conditions and inherent environmental risks in drought vulnerable regions and, then, views stationery branches as incompatible in rural areas. Moreover, fixed branches are not functional to reach the population in highly dispersed populations. Through opening of satellite branches that may be available for service periodically, the rural people can meet their credit needs and provide small saving schemes to the bank as well.

There are conclusive ideas on the need to build institutions to create viable rural financial markets. Targeted credit has always been considered to promote dependence on the beneficiary. Thus, interventions in rural financial markets should be temporal and targeted at supporting the institution building. However, the lack of adequate emphasis is the characteristics of supply-led credit institutions (Yaron, 1992). In view of this reality, there is need to consider other lending institutions, such as commercial banks.

The Role of Supporting Institutions in Small Scale Agricultural Credit

Gupta and Shroff (1987) argued that membership based organizations, such as cooperatives, have positive contributions towards credit expansion. They are considered useful in remote areas as their membership is composed of voluntary staffs, which can use their knowledge when making loan assessment, create community peer pressure for loan repayments, and demand low level of institutional set up and infrastructures. These organizations, whether formal or informal, can play a vital role in expanding financial service to rural areas. By partnering different farmers' associations, transaction cost of lending can significantly be reduced as it makes dealings with groups as a single processor, rather than numerous and scattered farmers.

Yaron (1992) also presented empirical evidences that attest the success of credit delivery systems that create and involve other supporting institutions. According to the assessment made in South Korea and Taiwan, loan collection records exceeded 90% through integration with cooperatives. The basic reason for such a higher collection performance was the strong village cooperative systems and social cohesiveness. Despite the fact that agriculture is high risk sector, as compared to other economic activities, knowledge and application of the right incentives and legal enforcement structures help to expand credit delivery and improve the repayment rates.

As a prime actor to realize development of communities through their various incentives, governments also have the responsibility to be involved in such processes. Odhiambo (2007) emphasized the role of the government in terms of the need for public sector investments in rural infrastructures that enhance more efficient performance and less dependence on government subsidies. Kellogg Foundation (2002) noted that rural investments are one of the important contributions that governments should facilitate for the development of the sector. Investments can be in the form of rural roads, water supply, electricity, health, and education. Infrastructural developments improve the economic and financial returns of private investments, increasing the potential of farmers to borrow as it also facilitates improved collection and viability of financial institutions, directly and indirectly. Therefore, the cumulated efforts of the various actors are essential to ensure the survival of financial institutions participating in the rural markets.

As a model of favorable government intervention in the credit market, Olaitan (2006) remarked on the experience of the agricultural credit guarantee scheme in Nigeria, which was established in 1977 where the Federal Government and the Central Bank of Nigeria created a joint fund with 60:40 ratios to provide guarantee for credits extended to finance agricultural activities. In default scenarios, 75% of the outstanding balances of credits are paid from the allotted guarantee fund to the financer less any realizable income from sale of collaterals. However, the scheme was not without obstacles. The major challenge was the lack of participating banks in the scheme as banks found it unprofitable to borrow short term deposit and extend long term loans.

Pearce (2004) also presented the intervention by NGOs in the rural credit market. It showed evidence that NGOs play roles in rural credit delivery as banks tend to become more risk averse and reluctant to extend credit for agricultural economic activities. These inabilities of banks to meet the financial service needs of rural population have given way to an increased role for non-governmental organizations (NGOs) in the provision of rural finance, in general, and try to fill the gap. CGAP (2005) also presented the role of donors as a crucial ingredient for the success of many financial institutions that are financing agriculture. Flexible and high quality technical assistance to financial institutions helped in adapting loans to rural clients. However, donors should avoid acts that may

distort the market and focus on capacity building of local people. This shows the constraints are not limited to borrowers only, but the supporting institutions as well leading to the need to assess it.

RESEARCH METHODLOGY

Research Method

The basic research method chosen for the study was explanatory. This method was chosen to identify and explain the challenges with their causes of the variables affecting agricultural loan delivery.

Sample Design and Frame

The issue of access to credit requires consideration of different variables as it incorporates the contribution of various stakeholders. With such understanding, the concerned individuals and institutions were contacted to seek expert opinion in addition to collection of data from farmers. Accordingly, selected individuals from commercial banks, cooperatives, and farmers composed the sample for the study. The executives and credit experts from the state owned Commercial Bank of Ethiopia (CBE) and the privately owned Bank of Abyssinia (BoA) were specifically selected to represent the commercial banks. The basis for choosing the two banks was their relative exposure to agricultural credit delivery in the area, as learnt from the literature. As the issue of credit requires access and operational knowledge of bank lending policies and procedures, four individuals (The Commercial Credit Committee Chairman and Credit Assessor from head office, and Bishoftu Branch Manager and Loan officer) from CBE and three individuals (Credit Department Manager and Deputy, Credit Department Manager) from BoA were selected through purposive sampling technique and were subject to professional opinion assessment. From the intermediaries, management representatives of Ada'a Liben Woreda Cooperative Promotion Commission, Erer Farmers Cooperatives Union, and Primary Cooperatives were the subject of this study. Accordingly, heads of both the Woreda's Cooperatives Promotion Commission and Erer Farmers Cooperatives Union were contacted for the key informant discussion. On the other hand, from the 47 Primary Farmers Cooperatives found under the umbrella of the Union, 4 primary cooperatives (Dukem, Godino, Kajima, and Udee) that operate in the Ada'a Liben Woreda were selected using multi-stage purposive sampling. The criteria used to select the sample primary cooperatives include; year of establishment, membership size, and aggregate loan amount taken. Individuals who were responsible for financial matters of the four primary cooperatives were chosen for key informant discussion using purposing sample technique. Finally, considering the limited time and financial resources, aggregate numbers of 100 individual farmers, who were end users of the loans and composed 2% of all members of the four primary cooperatives, were selected for survey to gather data and seek opinion.

Data Collection Techniques

The data collection process was carried out in two ways. First, opinions were sought from the selected individual key informants from commercial banks and the intermediary primary cooperatives, their Union, and the Cooperative Promotion Commission. To conduct the discussion with the informants, two independent interview guidelines were prepared, one for the commercial banks and the other for all the remaining informants. The checklist helped to structure the flow of opinion and to be consistent with the conceptual framework. It also included questions designed to capture description of the institutional approaches followed in the agricultural loan delivery process, in general, and the case area, in particular. Second, structured questionnaires were administered on the sample farmers who were also members of the selected cooperatives. The questionnaire was organized into eight parts to assess the socio-economic profile, asset ownership, and facts about borrowing experience of farmers.

Data Analysis Technique

The research adopted both qualitative and quantitative data analysis methods. The qualitative method was basically used to analyze the descriptive data that were collected in the form of individual opinion. On the other hand, the quantitative methods were used to analyze data that involve numerical values. To analyze numerical values, statistical tools, such as measures of central tendency and measures of dispersion were used, in addition to the simple ratio and percentage analysis. The statistics were used to show the state of variables, such as annual income, expenditure, saving, loan amount, age, land size, yearly production, and stock share.

MAJOR FINDINGS ON THE ASSESSMENT OVER SMALL SCALE AGRICULTURAL CREDIT IN ADA'A LIBEN WOREDA

Small Holders' Access to Bank Loan

The modes of delivering credit services to small holding farmers is dependent on the access to information on banking services and that of the proper credit products. Access to information on banking credit services can be facilitated through the various available media in the vicinity of the respective farm community. As a result, 83%, 73% and 42% of the respondents got banking information through word of mouth, radio, and television, respectively. On the other hand, the role of banks' promotional endeavors, the assistance by government extension agents, and the cooperatives were accepted only by 9%, 9% and 3% of the respondents from the survey, respectively.

Table 1.1: Means to Access Bank Credit Information

No	Means to get Information	Response (%)		
		Yes	No	Total
1	Radio	73	27	100
2	Television	42	58	100
3	Word of Mouth	83	17	100
4	Bank's Promotion	9	91	100
5	Extension Service Agents	9	91	100
6	Cooperatives	3	97	100

Source: Own Survey, 2009

Farmers' ability to access credit information and increase their awareness level on the benefits of using credit can be impeded by numerous factors. Table 4.2 shows that majority of the respondents restrained from commenting that there were critical problems hampering the smooth path to get credit information. Only 19% and 14% of the respondents emphasized the problems of accessing electronic media and other obstacles, respectively. Inadequate infrastructural networking, which involves the absence of telecom and road services, was mentioned by 9% and 1% of the surveyed farmer-borrowers, respectively. The fact that the study area is approximately 45 kms away from the capital, Addis Ababa, showed the existence of a relatively better opportunity for accessing infrastructures so that farmers can seek the necessary market information.

Table 1.2: Obstacles on Access to Bank Credit Information

No	Obstacles	Response (%)		
		Yes	No	Total
1	Absence of Road	1	99	100
2	Absence of Telecom	9	91	100
3	Absence of Electronic media	19	81	100
4	Other Obstacles	14	86	100

Source: Own Survey, 2009

Among other things, farmers' willingness to borrow may depend upon the purpose of the loan to which they want to borrow. The loan purpose is one of the pre-requisites in any lending-borrowing relationship. Lenders opt to ensure that borrowers have specific purposes to which they devote the borrowed funds. On the other hand, borrowers have certain activities for which they require the finance. Accordingly, 25 (81%) of the respondents needed the fund to start both on-farm and off-farm related business activities and 6 (19%) respondents opted to use the fund for the purchase of fertilizers. Farmers' desire to purchase more fertilizers, additional land, and engagement in animal fattening included the on-farm purposes.

Table 1.3: Purpose of Preferring Bank Credit

No	Purpose	Response	
		Number	% age
1	Purchase of Fertilizer	6	19
2	Consumption	0	0
3	Transport Product to Market	0	0
4	Paying overdue rent	0	0
5	Paying Overdue Loans	0	0
6	Other Purposes(Purchase of cart & land, Opening shops and animal fattening)	25	81

Source: Own Survey, 2009

One can prefer to borrow from banks due to the relatively less costly nature of the loans, seeking for the other associated banking services, the trust for work, which is built upon professionalism out of its formal and institutional nature, accessibility to the business areas of the borrower, and other reasons. With this in mind, Table 4.4 revealed 30% of respondents' preferred borrowing from banks due to its accessibility, while 11% of the respondents based their preference on the low interest rate that banks' charge for lending and the trust of farmers on the works of banking institutions. From observation, it was learnt that there had been two branches in the Woreda, the Commercial Bank of Ethiopia, and Construction and Business Bank for a long time. Recently, with the participation of private banks in the financial sector, the number of bank branches in the woreda grew to six. The ratio for the total population to bank branches for the woreda, in general, stood at 41,379 people. According to NBE (2008), the national population to bank branch ratio reached 136,108 people for one branch as of June 30, 2008. Thus, the woreda had the relative advantage in accessing bank branches with wider opportunity to get banking services.

Table 1.4: Reason for Preferring Bank Credit

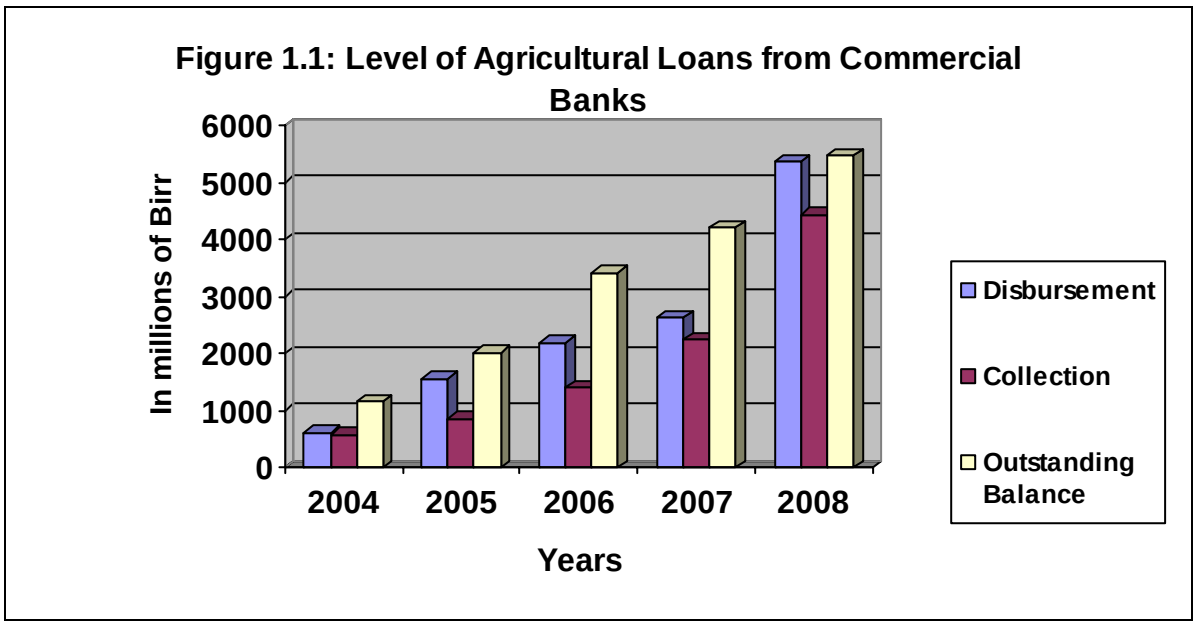
No	Reason	Response (%)		
		Yes	No	Total
1	Low Interest Rate	11	89	100
2	Accessibility	30	70	100
3	Trust for Work	11	89	100
4	Other Reasons	2	98	100

Source: Own Survey, 2009

Origination of Small Scale Agricultural Credit

To begin from the broader picture, consideration of the national credit allocation trend to the agricultural sector from commercial banks in Ethiopia is vital. Hence, figure 1.1 presents the fact that total disbursement for the

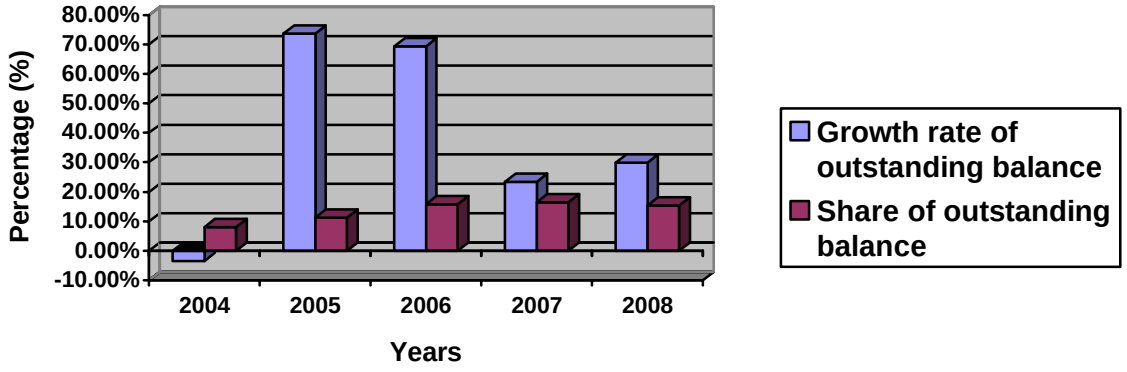
sector shot up from Birr 602 million in 2004 to Birr 5,371 million in 2008. The average annual growth rate over the five years was 72% with the highest growth rates of 159% and 105% registered for the years 2005 and 2008, respectively. On the other hand, collection rose from Birr 572 million to Birr 4,443 million in 2008 with average annual growth rate of 55% and registering marked growth of 97% for 2008. Owing to the more than proportionate growth of disbursements over collections, the accumulation of accrued interest and other reasons, the residual annual outstanding balance grew from Birr 1,162 in 2004 to Birr 5,481 in the year 2008 with annual average growth rate of 39%. However, it is difficult to conclude that the amount of fund allocated to the sector is at an adequate level. Additional variables, such as the yearly arable land increment, the population growth rate, and the number of agriculture related activities that need financing, should be taken in to account.



Source: The National Bank of Ethiopia, 2008

Another dimension to see the attention given to the sector in terms of capital injection from the banking sector was the share of agricultural loans from the total loan portfolio of banks. Figure 1.2 exhibits the share of the respective loans from the total loan portfolio and the yearly percentage growth of such loans from 2004 to 2008. Accordingly, the share of agriculture loans to the total loans rose from 8% in 2004 to 17% in 2007, though it declined to 15% in 2008. In terms of growth, agricultural loans shot up from -3% in 2004 to 74% in 2005. However, the growth rate for agricultural loans continuously declined to 23% in 2007 and revived to 30% in the year 2008.

Figure 1.2: Growth Rate & Share of Outstanding Agricultural Loan Balance from Commercial Banks

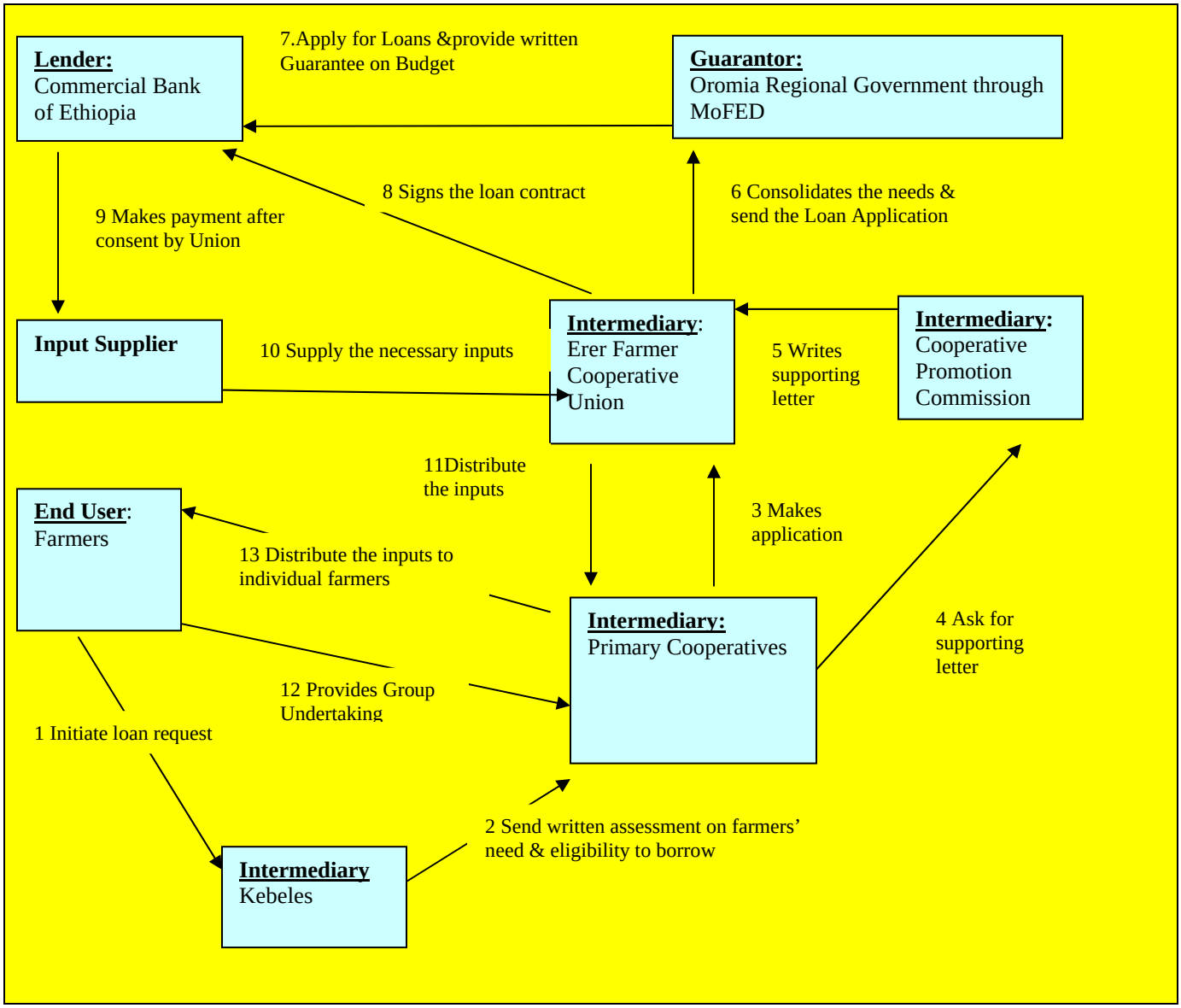


Source: The National Bank of Ethiopia. 2008

To understand the credit delivery process in the woreda, figure 1.3 illustrates the loan origination from commercial Bank of Ethiopia until it reaches the end users, or farmers. The credit need of farmers is assessed by the respective Kebeles and reports are sent to the primary cooperatives. The base of the assessment for input loan eligibility is the size of land a particular farmer owns. After receipt of the evaluation report, the primary cooperatives' loan committees make their own assessment of individual farmer eligibility for loans by considering past track records, land size, and other parameters that indicate creditworthiness. Then, supporting letters are sought from the Cooperative Promotion Commission as testimony of primary cooperatives' eligibility for loan application. In such a manner, the documents attesting the input needs of farmers would be consolidated and sent to the Oromia Regional Finance Bureau for loan request from the Commercial Bank of Ethiopia. The regional government, through its president, makes the application to the bank and, after approval, the Union concludes the loan contract with the bank. The approved fund, then, will be directly advanced to the input suppliers while the unions will receive the inputs. In the two-tier lending approach, the role of Unions, as intermediaries, is limited to the distribution of the purchased inputs to the respective primary cooperatives that, in turn, will pass down the inputs to individual farmers based on the assessment made by Kebeles. The lending bank directly advances the fund to input suppliers upon agreement with the Unions. In other words, the farmers' direct linkage with the original source of fund is highly detached. Before the approval, however, the bank secures a written letter of undertaking from the Ministry of Finance and Economic Development (MoFED) stating the Ministry's commitment to reimburse for defaulted loans from the subsidy budget of the regional government up on submission of claim by the bank. This type of collateral relieves the bank from engaging in collection activities as

it is considered as Cash Substitute collateral. In fact, it significantly loosens the relationship between the bank and the concerned bodies when it comes to the collection process, negatively affecting the level of expertise that cooperatives could use on loan collection procedures.

Figure 1.3: Process of Agricultural Input Loan Origination



Source: Own Survey, 2009

Categorically, Table 1.5 shows that 55% of the total respondents took loans between Birr 2001 and Birr 5000 per annum followed by 26% of the respondents in range of Birr 1000 to Birr 2000. On aggregate, 81% of the respondents took loans amounting below Birr 5000. Age-wise, 70% of the total respondents, who were above the age of 36 years, took loans amounting below Birr 5000. On the other hand, 17% of the respondents took loans

above Birr 5000. The survey reflects that the loans are concentrated for respondents who were middle aged and for amounts below Birr 5000.

Table 1.5: Summary of Loans Taken by Age

Age	Average Amount of Loan From Cooperatives Age						
	1000-2000	2001-5000	5001-7000	7001-10,000	10,001-15,000	>15,000	Total
25-30	3(12%)	4(7%)	0(0%)	1(8%)	0(0%)	0(0%)	8(8%)
31-35	1(4%)	3(5%)	0(0%)	0(0%)	0(0%)	0(0%)	4(4%)
36-40	10(38%)	16(29%)	1(100%)	6(50%)	0(0%)	0(0%)	33(33%)
41-45	6(23%)	12(22%)	0(0%)	2(17%)	2(50%)	0(0%)	22(22%)
>41	6(23%)	20(36%)	0(0%)	3(25%)	2(50%)	2(100%)	33(33%)
Total	26(100%)	55(100%)	1(100%)	12(100%)	4(100%)	2(100%)	100(100%)

Source: Own Survey, 2009

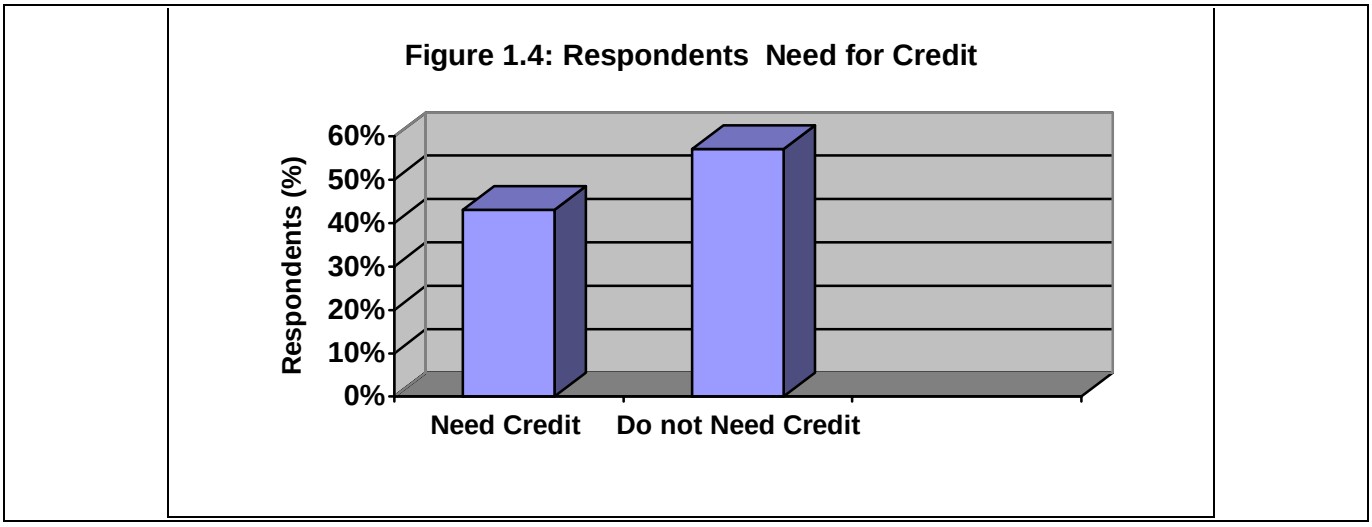
Table 1.6 shows farmers' composition in terms of credit forms, where 97%, 81%, and 77% of the respondents took fertilizers, seeds, and chemicals on loan, respectively. Only 16% took loans in the form of cash. The discussion with chairman of Erer Farmers Cooperative Union revealed that loans were given to farmers in the form of seeds, chemicals, and fertilizers in addition to the other services. Thus, 16% of the respondents who borrowed in cash were presumed to be from cooperative's own funds, as bank originated funds were entirely allotted to the purchase of inputs.

Table 1.6: Forms of Credit

No	Forms	Responses (%)		
		Yes	No	Total
1	Cash	16	84	100
2	Fertilizer	97	3	100
3	Seeds	81	19	100
4	Chemicals	77	23	100
5	Others	2	98	100

Source: Own Survey, 2009

An attempt was made to see farmers' crave for credit in general. Consequently, figure 1.4 shows only 43% of the respondents were in need of credit, in general, while the remaining 57% did not need any credit at all. This is presumed to come either out of the age structure of respondents, where most were above the working age group of 18-25 who tend to be risk averters, or respondents that lack adequate understanding on the benefits of credit.



Source: Own Survey, 2009

Table 1.7 shows a related finding on farmers' preferred form of creditors. Accordingly, 66% of the respondents opted to take loans from cooperatives, while 25% of the respondents preferred that of banks. Only 3% of the respondents preferred micro-finance institutions for borrowing.

Table 1.7: Farmers' Preferred Source of Credit

No	Source	Response (%)		
		Yes	No	Total
1	Suppliers	0	100	100
2	Banks	25	75	100
3	Microfinance	3	97	100
4	Cooperatives	66	34	100

Source: Own Survey, 2009

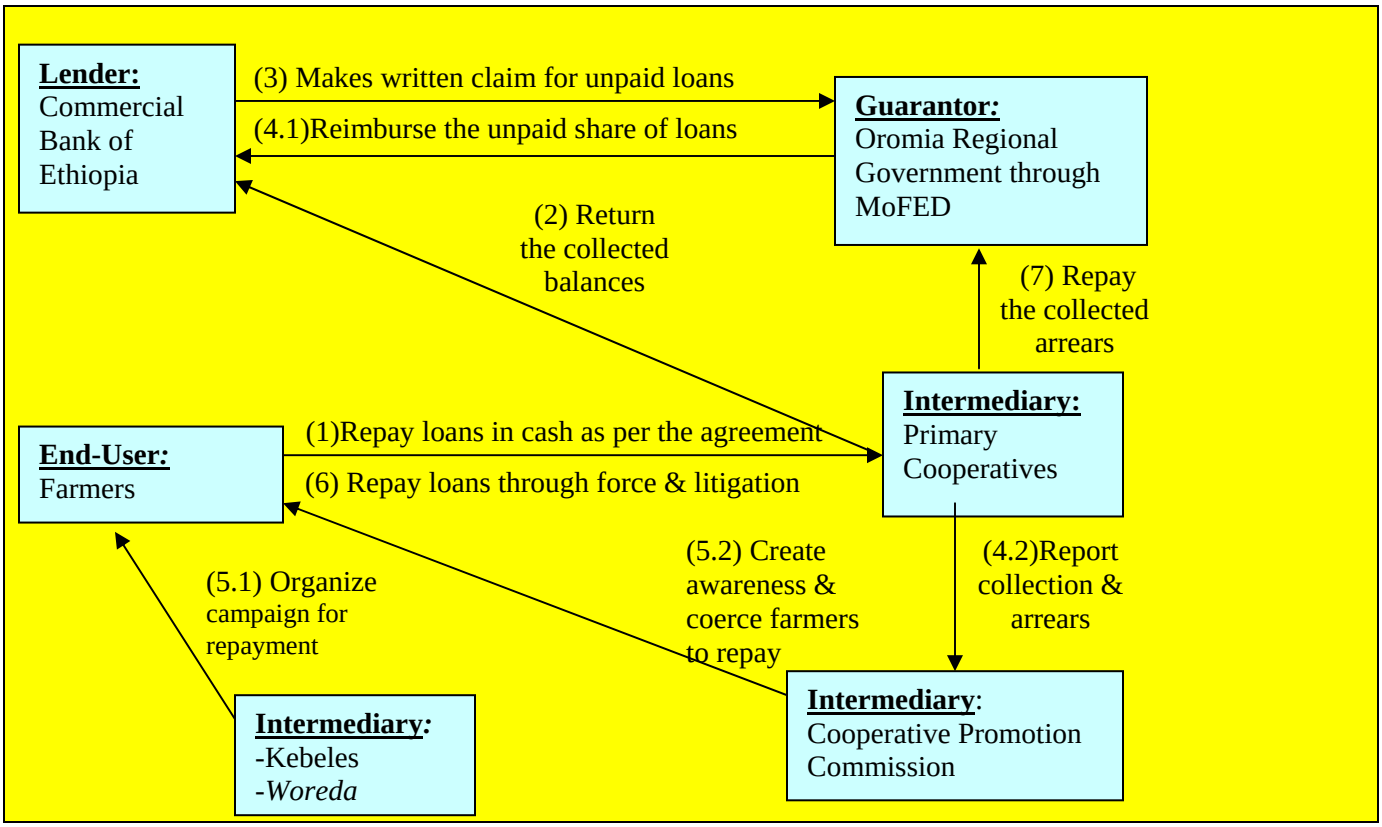
Collection of Small Scale Agricultural Credit

A crucial stage in the lending process is the repayment phase. Borrowers are expected to honor the contractual agreements by which they are committed to return the borrowed funds through the scheduled stream of payments. It is a stage where most lenders are highly concerned so long as the lending process is concerned. In fact, proper mechanisms to ensure the safe return of the extended funds have been at the heart of all the worries.

Figure 1.5 reflects the cycle, the actors, and the process involved in the repayment of agricultural input loans back to the Commercial Bank of Ethiopia. Individual farmers are expected to repay, in cash, the value of borrowed

inputs to the corresponding primary cooperatives since the beginning of every harvesting season. The primary cooperatives, in turn, pay back the collected sum to a nearby branch of the bank. However, after waiting for certain time to ensure for the repayment of loans from farmers, the bank claims MoFED for reimbursement of the unpaid sum. In such a manner, the bank recovers the unpaid balance of the input loans. The National Bank of Ethiopia, which is a responsible organ for the regulation and supervision of banking business in Ethiopia, defined guarantee by the Federal Government of Ethiopia as 'Cash Substitute' collateral. This implies that the bank is safely protected from risk of loss arising from such type of loans. Thus, for loans not repaid in time, the regional government's concerned organs, including the Regional Finance Bureau, intervene to pressure farmers towards the repayment as the respective loan balance is transferred from the bank to the region at this juncture. After recovering the unpaid balance from the Ministry, the bank withdraws itself from any activity of the repayment process. Besides, various efforts are exerted, such as sending messages at 'Idir' meetings and organizing conferences at various levels in the Kebele and woreda, on yearly basis. It is important to note that the campaign is intended to create farmers' awareness and begins a couple of months before the due date of the loan cycle so that adequate time would be allotted for early repayments.

Figure 1.5: Process of Agricultural Input Loan Repayment Process



Source: Own Survey, 2009

From individual farmers' point of views, the number of months taken to repay total borrowed funds was around 11 months, with standard deviation of 2 months. On the other hand, the fourth and fifth loans, chronologically from the latest years, took mean number of 9 months and 8 months, with standard deviation of 4 months.

Significant part of the problem of non–repayment in the area dates back to the loans granted between the years 1996/97 -1999. The then intermediary primary cooperatives were inactive and disbursements were made without proper need and capacity assessment on farmers besides the absence of written agreements. In the worst case scenarios, loans were taken in the name of infant children, in the name of unknown personalities, the nickname of farmers' cattle and name of rivers. Moreover, in some cases, there were no records of borrowers barring the options to legal acts in times of default. Thus, for such types of defaulted loans, attempt has been made to pursue obligors through the elders and using the social networking. However, in the recent years, the predominately prevailing source of loan non-repayment was the influence of primary cooperative leaders where they use their authority to take more loans and delay repayments.

In the extreme default cases, the primary cooperatives use two levels of legal actions. For loans amounting to Birr 1,500 and below, the Kebele's 'Fird Shengo' handles the litigation process. For amounts greater than Birr 1,500, the respective courts in the woreda resolve the cases. In most instances, however, defaulters serve their commitments before the legal sue reaches the court.

Table 1.8 shows the fact that the majority (63%) of the respondents who reported to have defaulted did not know the terms and conditions of the loan. Problems related to climatic conditions attributed to repayment failure by 25% of the respondents. Only one of the respondents declared to have failed to repay by giving priority to other purposes. This implies that most of the problems arose from the lending institutions or the intermediaries' failure, in their part, to execute the responsibility of ensuring the adequacy of borrowers' know-how on the terms and conditions of the loan agreement. Even if the educational level of most respondents (88%) is below 8th grade, techniques of informing farmers that match their level of education could be used to ensure their understanding of the obligations.

Table 1.8: Farmers' Reason for Default

Reason for Default	Resp.	Frequency of Rescheduling	Resp.	Type of Rescheduling	Resp.
- Not knowing Terms and Conditions	5 (63%)	- One Time	6(75%)	- Waiver of Repayment	2(25%)
- Diversion to other Purpose	0(0%)	- Two Times	0(0%)	- Additional Grant	0(0%)
- Giving Priority to other Matters	1(12%)	- Three Times	2(25%)	- Reduce Interest Rate	0(0%)
- Climatic Conditions	2(25%)			- Waiver of Penalty	1(12%)
				- Extension of Period	5(63%)

Source: Own Survey, 2009

Small Scale Agricultural Credit Collateralization

Collateral based lending in the banking sector has been the dominant regime. The majority of commercial banks' loan portfolio is backed by collaterals of various properties. A minute share of the portfolio is allotted to clean based loans. Credit policy and procedures of the two banks considered for the study make no provisions for clean based lending and for requests based only on business feasibility. The Commercial Bank of Ethiopia requires regional governments, providing guarantee on behalf of the small-holding farmers, to present a letter of undertaking from the MoFED to use their subsidy budgets as collaterals. The key informant of the bank discussed the advantage of using such collateral for the full recovery of loans. The type of collateral, which is considered as 'Cash Substitute' as per the National Bank of Ethiopia's directive number SBB/43/2007 on loan classification and provisioning, seemed to relieve the bank from all the effort and costs involved in the process of loan recovery. Even though the loan contract is signed by the Cooperative Unions, the main binding document is the pledge agreement i.e. the regional government's letter of undertaking to surrender part of its budget in proportion to the unpaid sum of outstanding loan. The same was true in the case of loans extended by Bank of Abyssinia, before the expiry of the guarantee scheme pledging the USAID's fund as security on 50%-50% basis for loss sharing. The bank extended the loan using the cash deposited by the guarantor with the intention of securing the loans. However, the discussion with BoA's officials reflected on the repayment track record of the borrowing cooperatives where 100% of the loans were recovered during the time. A single loan is secured by both the federal government and farmer's group undertaking, revealing the prevalence of double security. First, farmers have to approach cooperatives to ask for input loans in group. The group would serve as collateral as the individuals are cross-collateralized on each others' loans. The group, then, will elect a leader who should be more known and responsible in the community and is economically better than the remaining. It is assumed that the leader will use his influence to prevent farmers from defaulting. Besides, the spouse of each individual borrower, if there is any, commits for the family's liability. The survey also discovered that 82% of the respondents offered group undertaking to take input loans from the primary cooperatives, while 19% gave a personal guarantee that took account of their spouse, too.

CONCLUSION

Regarding farmers access to credit information, respondents revealed their ability to get information through electronic media, such as radio and TV, besides the words of mouth. Respondents also played down the impact of possible infrastructural hindrances to access bank information. Thus, farmers do not seem to be affected by lack of information. In terms of mode of delivery, farmers get agricultural input loans using the two-tier approach where the government and cooperatives play intermediary roles to ensure the repayment and proper usage of loans obtained from Commercial Bank of Ethiopia. The regional government offers full guarantee for the unpaid sum of

loans taken each year through the Ministry of Finance and Economic Development on its subsidy budget. This helped the bank to reduce the credit risk emanating from the default of individual farmers and the operation costs related to the loan collection process. The existence of regional government guarantee for loans by offering the subsidy budget, sought from the federal government, has built the Commercial Bank of Ethiopia's confidence to extend credit to small holding farmers. In other words, the government was a key player to enhance credit access to small scale farmers. Contrarily, the guarantee scheme contributed to the withdrawal of the bank from the collection process. The Commercial Bank of Ethiopia extends no technical assistance to the intermediaries in the process of loan collection. Despite the bank's willingness to lend to farmers, its role in the expansion of related banking services seems to be weak.

RECOMMENDATION

The loan delivery process in the Woreda, under consideration follows a two-tier approach, where other governmental and membership organizations intervene and facilitate the flow of funds from Commercial Bank of Ethiopia to the small scale farmers. However, the bank, which has all the expertise in the lending task, is not involved in the collection process as it secures its loans with cash substitute collateral. Thus, the bank should exert efforts by assisting the intermediaries in the collection process to discharge its social responsibility in addition to its profit making motives. Moreover, agricultural credit in the Woreda is limited to the provision of input loans, among the various financial needs of the sector. Even though the default rates and their causes need further study, it appears that banks should endeavor to provide more types of loans that are both on-farm and/or off-farm, in nature. This is hoped to supplement the personal income base of farmers and serve as a tool for development.

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