

SMALLHOLDER AGRICULTURE CREDIT SCHEME

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ABSTRACT

The purpose of this paper is to brief the stakeholders at the NAC on the implications on rural agricultural lending, by the decision of the Government, to corporatise the Rural Development Bank Limited, in 1998. The paper also provides a review of the SAC Scheme since implementation in 1997. The key objective of the review is to highlight the key lessons learned from the perspective of prudent fund management by the Bank and to suggest policy recommendations to the NAC to strengthen and improve the performance of the SAC Scheme, to achieve the objective of self-sustenance of the revolving fund, in the medium term.

The paper seeks a resolution from the delegates at the NAC Strategy Conference to secure an NAC resolution to support a joint submission by both DAL and RDB to seek an additional seed capital from the Government of K20-K30 million in the 2001 PIP to allow for further lending under the SAC Scheme. The paper further recommends the soliciting of donor funds for seed capital for the SAC Scheme, for exclusive lending to women under the theme of pursuing gender quality in business opportunities, in the smallholder agriculture sector.

IMPLICATIONS FOR RURAL AGRICULTURE LENDING BY THE RURAL DEVELOPMENT BANK UNDER CORPORATISATION

Background

The Government decided to corporatise the Rural Development Bank in 1998, under the current privatisation strategy. The decision has wide ranging implications for both the Bank and its key stakeholders, especially farmers in the rural communities.

While the mission of the Bank is to provide affordable financial services for the balanced development of the national economy and the advancement of the indigenous population of PNG, the Government ceased providing annual grants to the Bank, to subsidise the cost of providing cheaper and more accessible banking products and services.

Without operational subsidy the Bank was forced out of necessity to redefine the vision of the Bank. The new vision of the Bank is to position itself to be a viable and self-sustaining Development Finance Institution.

Without sufficient annual profits and adequate cash flow to meet all its operating cost, and sufficient loanable funds to lend each year, the Bank could not survive.

The development role of the Bank, is no longer congruent with the overriding survival objective of the Bank. Strategies were formulated and are being implemented to improve the liquidity position of the Bank, ensure profitability to secure the financial and operational viability of the Bank.

The overriding survival objective of the Bank, has and will continue to have wide ranging implications in the ability of the Bank to continue to play its development role especially in the agriculture sector.

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The following are some of the strategies the Bank has and will continue to pursue to improve the liquidity and profitability of the Bank.

Cost Reduction

The Bank has reduced staffing cost by reducing staff from 470 in 1994 to 210 in 2000, including the reduction of expatriate employees down to only one in 2000. The sale of surplus assets including the sale of houses under the new staff home ownership scheme, will reduce maintenance cost and bring in much needed cash income to improve the liquidity of the Bank.

The profit centre concept was introduced resulting in unprofitable branch operations like Lorengau, Vanimo and Kerema closed to reduce cost.

Increase in Interest Rates

To generate increased income and profitability, interest rates of the Bank were also reviewed with agriculture interest rates increased from 10% to 15%. Commercial and industrial interest rates were also increased to rates similar to commercial banks.

Loan Portfolio Composition

The loan portfolio composition is changing with more and more emphasis on commercial and industrial loans. These sectors attract much a higher rate of interest rate and are less risky relative to agriculture loans.

Quality of Loans

There is a major drive on quality lending with the priority customer strategy of lending to previous customers with good repayment records, aggressively pursued.

Deposit Mobilisation

The Central Bank has declined the application of the Rural Development Bank for a partial banking

license to commerce deposit mobilization by accepting deposits even on a pilot basis. The industry and the Bank should consider a joint collaborative approach to deposit mobilization from farmers, to provide essential capital to lend to farmers.

Arrears Recovery

The Bank embarked on its most comprehensive arrears recovery program this year, with 4 additional staff employed as dedicated Arrears Coordinators in the four regions, along with the assistance of a JICA expert, to assist the Bank on recoveries. The results up to June 2000 has shown a significant improvement in arrears recovery.

Establishment of Credit Schemes

With the emphasis on commercial and industrial loans, the Bank will reduce its loanable funds over time, for the agriculture sector lending. The Bank needs to pursue more credit schemes with external seed capital for exclusive lending to the smallholder agriculture sector, as no other Bank has the experience or the commitment to lend to smallholder agriculture sector in our rural communities. The long-term sustainability of the SAC Scheme is being pursued by the Bank, to provide continued lending to the sector, without which there will be no accessible loan funds and hence the cessation of the flow on benefits to the rural families and the national economy.

The Bank is and will continue to lend more and more of its limited loanable funds to the commercial and industrial sector to achieve its vision of a self-sustaining Bank, at the expense of reduced lending to the agricultural sector in future.

The sector will have to take the responsibility to partner the Bank to continue with facilitating agriculture lending, by assisting the Bank secure additional seed capital for the SAC Scheme, until such time the revolving fund under the SAC Scheme is self-sustaining.

MAJOR IMPLICATIONS

Major implications for the Agriculture sector, as a result of the new vision and the revised strategies, the Bank is now pursuing include:

Reliance on Commodity Agencies

The Bank will rely on commodity agencies to provide all extension, loan processing and credit management especially securing loan repayment from farmers. The Bank role in the SAC Scheme will be restricted to loan administration and the SAC fund management.

Reduction in Provincial Operations

The Bank has reduced its national presence and will not be able to support many smallholder farmers or the agriculture sector in Provinces where the Bank does not have a presence. The Bank will depend on commodity agencies to establish a presence to be able to assist with the smallholder sector in those Provinces.

Reliance on External Seed Capital

Without Government budgetary support the Bank will rely on the sector to assist the Bank secure seed capital, to enable the Bank to continue to provide cheap and accessible credit to our rural farmers.

Table 1. Subsector Seed Capital Allocation

Commodity	Seed Capital	%
Coffee	2,800,000	28
Cocoa	1,400,000	14
Oil Palm	1,200,000	12
Coconut	1,200,000	12
Livestock	1,000,000	10
Food Crops	1,400,000	14
Spice	500,000	5
Rubber	500,000	5
Total	K10,000,000	100

REVIEW OF THE SMALLHOLDER AGRICULTURE CREDIT

Background

Agriculture supports the livelihood for more than 85% of the total PNG population, which live in rural areas. The smallholder agriculture sector contributes an estimated at 80% (K800 million) of the agricultural export earnings annually.

In spite of the vast available land and labour as input, resources many rural villages have not been able to become active participants in the development of the national economy.

The bulk of our potential village-based businessmen and women who are willing and able to participate in the cash economy, to improve their livelihood and contribute to national development, do not have adequate access to rural credit. These potential businessmen and women are unable to provide security of a type or in an amount, which normal commercial banks would, in their normal cause of business require.

These village-based entrepreneurs have been restricted from entry into the cash economy because of inadequate access to rural credit.

The opportunity cost is increased production and exports from the smallholder sector.

Those who already have tree crop smallholder blocks have had no structured program for rehabilitation, to secure increased production, hence the provision of very cheap and very accessible seed capital, under the SAC Scheme is a very strong incentive for the various commodity bodies to encourage farmers in the rural areas, to engage in rehabilitation which will significantly boost future export earnings from our tree crops.

In recognizing credit access as a key constraint, the government allocated K10 million seed capital in 1996 to establish the Smallholder Agriculture Credit (SAC) Scheme, in order to revitalize the smallholder agricultural sector in Papua New Guinea. (Table 1).

The SAC Scheme comes as an integrated package, which consists of: credit finance, extension and other support facilities. The scheme also combines the resource available within the Rural Development Bank (Bank), Department of Agriculture and Livestock (DAL), and various commodity agencies to maximize the benefits arising from the scheme.

In order to ensure effective implementation of the scheme and to minimize the risk of project failure, a Memorandum of Agreement (MOA) was executed by the key implementing partners DAL, RDB and various Commodity Agencies.

The DAL has overall control of the scheme in terms of coordinating and sourcing of further funding for the scheme. The Bank is responsible for managing the funds; administer viable loans and receiving loan repayments, whilst the respective industry bodies and their affiliates are responsible for identifying and appraising viable projects, recommending viable projects to the Bank for decision and ensuring continuity of extension support to the approved projects.

The SAC Scheme operates on a revolving concept, whereby the principal portions of loan repayment are reinstated back into the fund to assist more borrowers.

Commodity Agencies are also responsible for credit management, with the Bank role reduced to accounting support for debt recovery, under the SAC Scheme.

The fund is also structured in such a way that the income generated from the deposits of revolving fund will be adequate to meet cost associated with subsidized interest rates and defaulted loans.

The maximum loan amount for any one project is K10,000 and a subsidised interest rate of 5% is charged to borrowers. The difference between the Banks usual lending rate and the rate charged to borrowers are taken from the revolving fund to cover the operational cost of the scheme.

OPERATIONAL PERFORMANCE

Lending statistics as at 30/06/2000 are summarized in table 2.

Table 2. Lending statistics of the Bank.

Number of Loans Approved	K 3,116
Value of loans approved	K10,038,986
Total Disbursement since inception	K 8,984,944
Total Repayments since inception	K 1,856,392
Outstanding Loan Balances as at 30/06/2000	K 7,481,865
Total Arrears Balance	K 2,208,448
Arrears %	29%

Loan approvals for various commodity sectors are summarized in Table 3.

The Bank has since implementation in 1997, approved 3,116 loans as at 30/06/2000 valuing more than K10 million and disbursed over K8,9 million already to SAC Scheme loan beneficiaries.

The Bank has committed more than K10 million as loan approvals to 3,116 small holders as SAC Scheme loan beneficiaries.

Coffee is leading other sectors in lending, whilst Spices and Rubber experienced low lending for the reason that there has been no extension arm to facilitate lending to those sectors.

Total repayments collected since inception is more than K1,8 million. On current trends, collections should reach K2 million by December 2000.

There has been significant improvement on Cocoa repayments from deficit cash position of K60,000 in January to a surplus cash position of K7,000 as at 30/6/2000.

Table 3. Loan approvals (in Kina) for various commodity sectors.

Commodity Sector	Number of Loans	Value of Loans	Average loan per farmer
Coffee	793	2,017,327	2,544
Cocoa	684	2,384,631	3,486
Oil Palm	384	1,692,074	4,406
Copra	468	1,490,206	3,184
Livestock	525	1,391,240	2,650
Food crops	215	935,541	4,351
Spices	23	123,828	5,381
Rubber	1	4,139	4,139
	3,116	10,038,986	2,246

Table 4. SAC Repayments (in Kina) - By Sector.

Year	1997	1998	1999	2000 6mth	Total	%
Coffee	3,338	49,308	235,361	41,827	329,834	17.8
Cocoa	2,323	85,840	282,419	138,250	508,832	27.4
Oil Palm	182	40,366	178,591	93,638	312,777	16.8
Copra		43,991	137,521	69,860	251,272	13.5
Livestock	162	103,282	190,987	46,119	340,550	18.3
Food Crops		17,960	70,658	18,936	107,554	5.8
Spices			4,138	1,360	5,498	0.3
Rubber						
Total	6,053	340,747	1,099,574	410,018	1,856,392	100

REVOLVING FUND

The cash position of the various commodities as at 30th June 2000 is summarized in Table 5:

The total fund available in the revolving fund as at 30/06/2000 is K5.54 million. However these balance will be depleted by December 2000 should disbursements be made for applications already approved.

The revolving fund urgently requires an injection of significant seed capital, to sus-

tain lending under the SAC Scheme.

The relatively high balance in the revolving fund, despite disbursement of K8.98 million out of the total of K10 million seed capital is largely attributed to the high interest income earned by the Bank by reinvesting surplus funds in short term money markets.

A total of K4 million has been earned in interest income, without which there will no longer be funds for lending under the SAC Scheme because of both the high arrears by some sectors

Table 5. Cash positions (in Kina) of various commodities.

Commodity sector	Seed Capital	Cash Position as at 30/06/2000	% Seed Capital Utilized	% Seed Capital Available	Status of fund
Coffee	2,800,000	1,672,796	40	60	OK
Cocoa	1,400,000	7,320	99	1	CRITICAL
Oil Palm	1,200,000	885,045	26	74	OK
Copra	1,200,000	427,466	64	36	CRITICAL
Rubber	500,000	685,791	-37	137	OK
Spices	500,000	589,382	-18	118	OK
Livestock	1,000,000	179,234	82	18	CRITICAL
Food Crops	1,400,000	1,094,326	22	78	OK
Total	10,000,000	5,541,360	45	55	OK

like livestock and the extended grace period for most tree crop commodities, who come into production after more than three years after planting (coffee, cocoa & Oil Palm).

EMERGING ISSUES - KEY LESSONS LEARNED

Since implementation of the SAC Scheme in 1997, a number of emerging issues have surfaced in the use and administration of the SAC funds. Useful lessons have been also been learned. From the benefit of experience gained by DAL, commodity bodies and the Bank, necessary reforms must be implemented by all stakeholders, to ensure we are all working towards the self sustainability of the SAC Scheme revolving fund. Some of the key emerging issues and lessons are discussed here.

Demand for SAC Loans

The fast depletion of the seed capital, within the three years shows the popularity and demand for the SAC loans by the smallholder farmers. The initial seed capital of K10 million is insignificant to meet demand. The nature of cash crops which require grace periods of up to three years before loan repayments can flow back into the revolving fund, does not assist the liquidity of the

revolving fund account. To date there are up to K5 million of loaned funds, which are not due for repayment yet; hence seed capital is tied up and not revolved, to sustain continuous lending.

The initial seed capital of K10 million is seriously insufficient to secure the sustainability of the revolving fund.

Arrears Trend

A disturbing trend is the level of arrears, which is greater than the acceptable level of around 10 percent. Livestock, cocoa and food crops are sub sectors of concern. Table 6 provides a summary of the status of the arrears owed by commodity type.

The level of arrears for each commodity is directly related to the efforts of the commodity bodies, in terms of both the focus and ownership at all levels of the organization including top management, and the structure, processes and the resources provided by these commodity bodies, to ensure there is repayment of loans.

Lending Outside Commodities Bodies

Livestock (28%) and food crops (22%) have high arrears reflecting the not too well coordinated extension system.

Table 6. Status of arrears owed by various commodities.

Commodity	Loan Balances outstanding	Areas @ 30/6/2000	%
Coffee	K2,041,875	K 173,000	8
Cocoa	K1,808,567	K 575,752	26
Oil Palm	K 757,337	K 33,072	2
Coconuts	K1,067,986	K 315,806	14
Livestock	K 878,002	K 609,753	28
Food Crops	K 820,712	K 485,072	22
Spices	K 106,221	K 15,894	1
Rubber	K 1,164		
Total	K7,481,865	K2,208,448	100

There is no accountability for those loans that are recommended by DAL staff. The Bank has experienced great difficulty in recovery, because of the high turnover of DAL staff (no continuity). DAL does not have the extension resources and the resources and expertise in credit management.

The arrears from lending to smallholders using commodities bodies have shown superior loan repayment performance in nearly all cases.

The Bank has learned that lending must be tied to commodity bodies with the resources, management commitment, processes and expertise to ensure there is security of loan repayment.

Best Practice

In three years the Coffee Industry Corporation, has clearly established itself as the most effective and efficient commodity body in the total SAC Scheme management and delivery. The basis of the Bank assessment is both qualitative and quantitative. On the basis of the quantitative measures like the level of arrears and the production of quarterly physical reports, CIC is superior.

The Oil Palm Industry Corporation despite severe resource constraints has developed very

harmonious working relationships with the milling companies, and farmers. The milling companies, which are monopolies, make loan repayments directly to the Bank, hence in credit performance to date (1% arrears) there is relatively little risk in lending SAC seed capital to farmers in the oil palm industry, other than future drop in export prices.

Distribution of SAC Loan by Provinces

Since the inception of the SAC Scheme, loans under this scheme has been distributed to 18 provinces in PNG except Western Province. Lending has not occurred in Western Province because there is no Extension arrangement in place to facilitate lending in that Province.

There is such a wide spread dispersion of penetration of lending to various commodities and the flow on benefits to various Provinces, depending on the spread of commodity bodies presence in respective Provinces, the up take by the various Provinces and the physical presence of Bank operations in Provinces.

RECOMMENDATIONS

After three years of valuable experience in managing the revolving fund, the following recommendations are made to strengthen and improve the financial performance of the SAC Scheme. These recommendations are consistent with our objective of achieving self-sustainability of the scheme, in the medium term.

POLICY RECOMMENDATIONS

Role of DAL

All future lending under the SAC Scheme are to be provided in partnership with commodity bodies and the Bank. No loan funds should be provided with DAL as the extension body. DAL function to be restricted to the lead agency roles of policy formulation and implementation, com-

Table 7. Loan approvals to various sectors in each Province as at 31 December 1999

Loan Type	20/- Coffee		21/- Cocoa		22/- Oil Palm		23/- Coconut		24/- Livestock		25/- Food crops		26/- Spices		27/- Rubber		Total Approvals	
	No. of Loans	Value of Loans	No. of Loans	Value of Loans	No. of Loans	Value of Loans	No. of Loans	Value of Loans	No. of Loans	Value of Loans	No. of Loans	Value of Loans	No. of Loans	Value of Loans	No. of Loans	Value of Loans	No. of Loans	Value of Loans
Province																		
Central	15	38,122	-	-	-	-	2	2,330	8	68,230	5	34,370	2	18,581	-	-	32	161,63
Milne Bay	4	5,223	1	4,990	120	478,049	30	88,905	18	42,705	1	920	-	-	-	-	174	620,79
Oro	5	18,126	46	152,106	9	58,055	3	2,400	9	32,704	-	-	-	-	-	-	72	263,39
Gulf	5	10,842	-	-	-	-	3	6,910	12	49,171	-	-	2	10,621	-	-	22	77,544
Western P.																		
W.H.P.	66	319,003	-	-	-	-	-	-	276	603,109	66	329,285	1	2,692	-	-	409	1,254,28
E.H.P.	228	637,647	-	-	-	-	-	-	21	33,103	83	278,658	3	5,189	-	-	335	954,59
Enga	91	133,350	-	-	-	-	-	-	6	25,642	5	34,000	-	-	-	-	102	192,99
Simbu	134	342,863	-	-	-	-	-	-	89	276,636	20	62,044	8	35,500	-	-	251	717,04
S.H.P.	69	138,028	-	-	-	-	-	-	48	167,401	33	177,769	-	-	-	-	150	483,19
Morobe	35	65,612	31	118,500	-	-	34	66,350	-	-	-	-	-	-	-	-	100	270,46
Madang	37	58,741	126	484,924	-	-	119	434,317	-	-	-	-	1	10,000	-	-	283	987,98
E.S.P.	70	98,860	40	145,533	-	-	22	63,853	-	-	-	-	-	-	-	-	132	308,24
E.N.B.	-	-	284	1,049,960	-	-	80	234,527	-	-	-	-	3	19,500	-	-	367	1,303,98
W.N.B.	-	-	15	59,695	251	1,144,291	57	247,659	26	47,390	-	-	-	-	-	-	349	1,499,03
New Ireland	-	-	44	100,631	1	3,373	102	269,740	8	17,781	-	-	-	-	1	4,139	156	395,66
Bougainville	-	-	31	110,319	-	-	3	7,729	3	17,358	-	-	-	-	-	-	37	135,40
Manus	-	-	43	70,000	-	-	5	10,607	-	-	-	-	-	-	-	-	48	80,60
Sandaun	-	-	20	75,594	-	-	3	9,000	-	-	-	-	-	-	-	-	23	84,59
Total	759	1,865,417	631	2,372,252	381	1,683,763	463	1,464,327	524	1,381,230	213	917,046	20	102,283	1	4,139	3,042	9,791,46

pliance auditing, coordination, impact assessment and stakeholder management roles especially the Government through the Ministry of Agriculture and Livestock.

Criteria for Seed Fund Allocation

Future loans from additional seed capital should be allocated on the basis of the repayment, actual arrears performance and compliance with other obligations under the MOA signed between the Bank and the various commodity bodies.

Use of Best Practice

All commodity bodies are to adopt the CIC model for the management and implementation of the SAC Scheme, as a requirement to secure additional seed capital for future lending. DAL to ensure compliance by commodity bodies and where necessary assist with PIP or other assistance, to secure compliance.

Equitable Distribution of Accessible Credit

In order to get more smallholder farmers to participate in the SAC Scheme and thereby spread the benefit of cheap accessible credit to a greater proportion of our rural population, a policy for farmers to benefit from SAC loans only once is required.

Those who are successful in paying their loans should graduate to the normal agriculture loan of the Rural Development Bank, where interest is not subsidized like the current SAC loans. These customers will be treated as priority customers of the Rural Bank under the Bank's priority customer lending strategy.

A policy on gender composition is recommended in order to encourage and support more women farmers to access the SAC loans.

Recommendation for Additional Seed Capital

DAL and Rural Development Bank to jointly submit an NEC information paper on the status of the

SAC Scheme since implementation in 1997.

The paper to include a submission for an additional K20 - K30 million seed capital in the 2001 budget, to allow the Rural Bank to continue lending under the SAC Scheme.

Recommendation for Exclusive SAC Funds for Women

DAL, the National Council of Women and the Bank should collaborate to seek seed capital to supplement National Government seed capital for exclusive lending to women under the SAC Scheme, using the theme of gender equality as the catalyst in marketing the concept to potential donors.