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AN ANALYSIS OF DETERMINANTS OF BANK LOAN DEFAULT OF SMALL FARMERS IN THE REGIONS OF NORTH WEST PROVINCE

BY

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SUBMITTED IN FULFILLMENT OF THE REQUIREMENT FOR THE DEGREE OF MASTERS OF SCIENCE IN AGRICULTURAL ECONOMICS IN THE DEPARTMENT OF AGRICULTURAL ECONOMICS AND EXTENSION IN THE FACULTY OF AGRIC, SCIENCE AND TECHNOLOGY AT THE NORTHWEST UNIVERSITY.

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Abstract

The main objective of the study was to investigate the causes underlining small-farmers default on bank loan repayments in the North West Province. One hundred and sixty farmers were randomly selected to be part of the sample. Questionnaires were issued to both farmers and bank officials. Descriptive statistics, correlation and regression models were used to analyse the data. The overall results indicate that most of the small farmers are in the old age category (58 years on average) with very low educational level. This scenario poses a challenge to the stakeholders in agriculture specifically the succession plan to these elderly people when they leave agriculture due to retirement.

It was revealed by the study that the farmers do not keep either financial or production records. The analysis shows that the small farmers lack skills in financial management therefore, they are unable to execute the prerequisite to modern farming which are literacy and numeracy as indicated by Woohall et. al.,(1985).

Most of the respondents have outstanding debt from Agribank yet they received loans from Landbank. Because of their low production and other many responsibilities, they are unable to repay loan installments thus leading to loan default to their current financial supplier, which is Landbank. Lack of monitoring of loan funds was identified as one of the causes of the farmers loan default.

The analysis also indicates that the small farmers have access to finance but the major problem is lack of financial management skills, more involvement in household responsibilities, and lack of technical assistance from relevant stakeholders like extension officers and project managers from the bank or from the Department of Agriculture. Since the Land bank have no field officers to assist the farmers, it is recommended that the bank should have field officers to assist farmers in their business, especially with production, marketing, financial management and farm management skills. The inability of the farmers to access good value markets for their products was identified as one of the problems, which led to loan default because the farmers are unable to market their products at the right time for good value in excess of their cost. It

is recommended that financial institutions should assist their clients to access better markets for their products for better price which will in turn give them better income in order to repay their loans.

Dedication

This paper is dedicated to my dad and my mom, John Seroke and Alinah Maserame Moshabele, and my grandmother Khutsafalo Rachael Metsileng and other members of the family. Special thanks go to Ms Boitumelo Margret Melato for endless support she has provided throughout my academic career.

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CHAPTER ONE

1.0 INTRODUCTION

The reason behind the worldwide financial support for agricultural production lies in the sectors ability to supply food, industrial raw material, jobs creation and substantial contribution to GDP. The need to provide credit to rural small farmers cannot be over emphasized. The underlining factors are many and varied. Amongst other things, many small farmers do not possess own or equity capital, poor, food in secured, subsistence in production coupled with very low and poor production outputs.

Land and few resources at their disposal for agricultural production are small and also inefficiently utilized. Their contributions to the GDP have always been described as negligible everywhere in the developing world. There is no doubt that any turn around plans for the above situation will require credit. Many governments in Africa and other developing countries since the early 1970's implemented deliberate policies to provide credit to small farmers, especially through the establishment of Agricultural Development Banks, Cooperatives, Corporations and other forms.

Donor organizations including FAO, World Bank, NGO's, and IFAC have also played major roles in the small farmer financing in the past and continue to be in the forefront of this noble course. Credit when transferred to the borrower needs to be repaid after the specified agreed period of use. The picture of the credit repayment ability of the small farmers over the past four decades leaves much to be desired. The reasons behind the high default rate are many and varied ranging from individual characteristics, demographics, culture, and political to Socio-economic factors.

In South Africa the corporations and former Agribank were established to supply credit to the previously disadvantaged small black farmers. The picture of loan repayment rate has been disastrous. Now the question is, what can be done to reduce the high default rate of the small farmers?

Therefore the research seeks to investigate the rate at which the farmers default and the reasons behind their default so that appropriate recommendations can be made to rescue farmers from their debt and to improve the sustainability of financial institutions.

1.1 PROBLEM CONCEPTUALIZATION

Agricultural lenders are becoming increasingly aware of the need to determine how loan characteristics are related to debt repayment and successful loans. If the relationship between loan characteristics and debt repayment could be quantified, it would aid in decreasing the risks to both lender and borrowers. Traditionally debt repayment ability in agriculture has been estimated on the basis of borrower reputation, honesty and collateral offered to secure the loan. With the increase use of credit today, a lender must also be able to evaluate borrowers ability to generate income as well as the borrowers management ability in combining the array of inputs necessary to manage modern farming practices.

The use of credit for financing farm inputs in modern agriculture is increasing. According to a report by the former Agribank, the outstanding debt in the farming sector was standing at 243 billion Rands in the year 2002 and approximately 10553 farmers defaulted. From a social point of view, credit whenever does not bear the mark of public utility, offers the defect of strengthening those already financially strong, as these can give most of the desired securities. Thus it leads to the increase of large fortunes to the detriment of the weaker classes.

Currently in the NorthWest, small and emerging commercial farmers have no option but to make another loans with the Landbank to pursue their production so as to keep on maintaining their families. The debts from Agribank affected their credit worthiness and as a result other banks do not accept them. There is high certainty of some factors, which may be mitigating against the performance of these farmers hence, the continual default, which need to be investigated in order to reverse the trend.

1.2 OBJECTIVES OF THIS STUDY:

The main objective of the study is to determine the factors, which influence loan repayment of small farmers in the North West Province.

The study amongst other things seeks:

- To identify the main constraints and bottlenecks which prevent small farmer's loan repayment and vigorous mobilization of savings.
- To determine farmers access to credit to finance the farming activities.
- To determine the impact of transaction cost to both borrowers and lenders.
- To assess the level of fungibility among the loan beneficiaries.
- To establish the relationship between default rate and the determinants of the loan default

1.3 HYPOTHESIS

It may be hypothesized that some socio-economic factors such as high transaction costs, large family size, lack of technical support and fungibility lead to loan default.

1.4 THE IMPORTANCE OF THE STUDY

The research output will be useful to policy makers especially those policies related to financial assistance to farmers. These will assist them to formulate policies that will increase access by farmers to finance and help them to reduce their bank default. The department of Agriculture can also use the findings as the advisory note to farmers. These findings can also be used as the source of future research.

1.5 DELINEATION

This study concentrates mostly on factors affecting farmers repayment ability and credit availability to farmers as offered by Land bank and the former Agribank in the regions of the North West Province.

1.6 ORGANISATION OF THE STUDY

Chapter one deals with introduction in which the background of loan default is highlighted. The problem conceptualization is also included as part of this chapter. The chapter also included the aims, objective and hypothesis of the study. It also included delineation of the study and organization of the study. Chapter two deals with agricultural credit systems and loan repayment terms, factors affecting farmers default, accessibility of credit by farmers, different financial products available for farmers from Land bank and Agribank was also discussed. Chapter three deals with the method of data collection and analysis. A summary of the model used is also presented in this chapter. Chapter four is dealing with interpretation of result as reflected by pool data. Descriptive analysis was used to analyse demographic factors and regression was also used to determine the significance of some variables. Chapter five deals with summary of results, findings, and recommendations.

CHAPTER 2

2.0 LITERATURE REVIEW

2.1 INTRODUCTION

In this chapter general issues pertaining to farmers financing services, loan default and loan repayment are discussed. This includes various attempts done elsewhere in the world to improve access to finance by small farmers. A brief review of the importance of financing in farming is made. Past and current policies and issues affecting access to financing, and various models of financing are discussed. There is also a close review of formal and informal financial sectors in South Africa.

2.2 RURAL FINANCES AND CREDIT

The need for credit of majority of cultivators arises from the fact that their surplus out of which savings can be made is zero or low. Moreover the income accrues over a limited period of the year. Even if the farmer's income were adequate for consumption and continuous over a year, there would still be a need for credit for meeting certain production expenses of the farm.

Low incomes of a large number of small farmer's force them to borrow for sustenance and such consumption credit forms an important part of the economy of farmers in our country. Thus, credit needs of farmers can be divided into two categories namely productive credit and unproductive credit. Productive credit are used for the purchase of fertilizers, seeds, improvements of land etc., while the unproductive credit are used for purposes such as marriage, death, serious illness and other social events of the family.

For agric financial system to be effective and to service the needs of small-scale farmers Singh (1988) have emphasized certain critics that are needed in agricultural credit system. These are:

- All the credit needs – short, medium, and long term of the farmers should be met.

- Credit should be made available as near to the doorstep as possible and when needed by the farmer.
- It should generate savings and accelerate economic growth
- The borrowers should be encouraged to adopt new technologies without which sufficient capital cannot be generated to repay loans.
- Supply and other services too should be made available to them.
- The lending agency has to ensure that the lending machinery is suitably matched by recovery machinery.
- The lending agency should be geared to financing the entire farming system.
- The credit agency should be in a position to inter-link with marketing agencies to ensure full recovery of loans.

The points mentioned above were expressed as an alternative to the then existing system of financing and financial institutions' services in India in a quest to refocus these institutions to finance small businesses including small scale emerging farmers. As a result the financial institutions had to be restructured to reorient them to provide credit friendly service to the farmers. The criteria of financing and financial services mentioned above appropriate that is relevant to empower small-scale farmers or other large-scale farmers in general.

Unfortunately most of the elements mentioned above are lacking in rural financial markets of the developed and underdeveloped countries including South Africa. In terms of policy and legislation in other countries around the world, efforts have been made to address the issues of rural financing. South Africa is no exception. Among others, the purpose of the Strauss Commission, the White Paper in Agriculture and many other South African land and Agricultural policies sought also to make financing and other services conducive to the development of the previously disadvantaged farmers, but instead most farmers are getting out of farming because of no financing or poor accessibility to funding.

Within this context, the subsequent literature review is therefore directed at bringing forth factors that have direct and indirect influence on financial services in rural areas. Farmers in developing countries are generally hampered by high interest costs for short-term crop loans, usually from small-scale private moneylenders, and by complete lack of sources from which they can borrow the longer terms loans. High cost of loans constitutes a major charge against their current income and depresses their living standard.

Unavailability of long-term credit prevents farmers from improving and expanding their output. Both limitations can be overcome by well-designed agricultural credit programme, at the core of which would be an agricultural bank. As land title is the most commonly accepted form of collateral, access to formal credit has been extremely difficult for black people, who have been historically disqualified from owning agricultural land. Transmission facilities for rural people are generally expensive and unreliable, while the available saving facilities and instruments do not meet that recognize their unique needs.

White agriculture has been cosseted by grants, subsidies and cheap credit provided by the state (Agricultural policy document, 1999). These benefits have distorted the spatial profile of rural areas, the form of rural towns, rural job opportunities and agricultural production to their present unsustainable forms. State credit has funneled huge amounts of taxpayers' money mostly to subsidize well-off borrowers, and to induce them to take dubious farming decisions. From 1970 to 1986, white farmers borrowed at lower than the inflation rate, these subsidies encouraged borrowing and increased financial vulnerability.

Through the mechanisms of the Marketing Control Boards, the agricultural Credit Boards and other statutory creations, black people were effectively excluded from involvement in co-operatives and lost access to rich sources of agricultural finance. Agricultural credit legislation protects farm borrowers from certain rules of their creditors, making commercial banks reluctant to lend money to all but the bigger farmers who fulfill their rigid collateral requirements.

Non-government organisations have recently started to offer various forms of rural finance, but many are blocked by banking and deposit-taking legislation designed to accommodate large corporations rather than a multiplicity of targeted service providers. Stokvels, informal lenders and community-based organisations lack financial skills and/or are too few or too small to fill the gaps left by the formal sector. However, these financial actors play an important role as part of the fabric of rural financial markets (Agricultural policy document, 1999).

A wide range of financial institutions currently serving or attempting serves the poor demands for savings and loan services. However, very few of these operate in lower density rural areas, the products offered by these few institution do not adequately address farmers needs for seasonal finance for crop production. Loan products are often structured in the ways that make them particularly unsuited to seasonal lending, unless households have access to alternative cash sources which are not related to agriculture seasonality.

For the poor household who spend large amount of their income on basic commodities, the distinction between productive and consumption expenditure can often be blurred by their need to invest in minimum levels of consumption to maintain the household's human assets. Such households also have a greater need for insurance substitutes. It is important, and then, in considering financial services for subsistence farmers that due attention is paid to a mix of services (saving, borrowing and insurance) and livelihood strategies in farm and non-farm activities supporting consumption smoothing and insurance as well as productive investment (Van Zyl, *et. al.*, 1999).

2.3 CREDIT IN MODERN AGRICULTURE

Modern agricultural as distinguished from subsistence agriculture requires large infusion of credit to finance, use of short-term cash inputs such as improved seeds, fertilizer, insecticides etc. medium and long-term investments for land improvement, irrigation etc. also become much more essential for increasing agricultural production. Because saving in subsistence tend to be relatively small, increased demand for working and fixed capital

must form the function of transferring savings between sectors, between regions and between income classes. Traditional credit system is often unable to meet these requirements of a co-coordinated approach in a modernizing agriculture and therefore necessitate the introduction of an institutional channel credit (Singh, 1988).

Amongst the common uses of credit, the following are the most important

Production loans

- Buy seeds and fertilizers
- Buy feeder for livestock
- Carry or buy range of livestock
- Buy dairy cattle
- Buy machinery, equipment or tractors
- Finance commodity storage
- Refinance any one or combination of the above.

Real estate or long-term loans

- Purchase the farm
- Purchase additional land
- Finance building, drainage, irrigation and other improvements

Farmer cooperative borrowing

- Paying operating costs
- Finance patrons
- Finance commodity storage
- Finance building, drainage, irrigation and other improvements

2.4 ESSENTIAL FEATURES OF AGRICULTURAL CREDIT SYSTEM

The system of credit for modern agriculture should have the following essential features as highlighted by Aguilera in 1990:

- ✓ It must integrate credit with services so as to ensure the provision of inputs and services along with credit. Facile credit is even more dangerous than the absence of credit.
- ✓ It should reach all areas and all farmers and more particularly emerging farmers.
- ✓ It should lay emphasis on loans for production and although the loans for consumptions expenditure may not be ruled out altogether, this should be discouraged. It follows that the basis for lending is anticipated production or incremental income after development and not so much the tangible security of existing income, so that the smaller farmers are enabled to raise their plane of cultivation.
- ✓ It should ensure that the cost of handling credit and services is low, otherwise the majority of farmers will hesitate to make investments in their business by resort to borrowing, lest the burden go beyond their repaying capacity
- ✓ It should be in position to mobilize adequate resources to finance the investments needed to modernize Agriculture.

2.5 AGRICULTURAL CO-OPERATIVES AS A SOURCE OF CREDIT

The cooperative supervised credit scheme in which collateral is demanded but the criteria are not as rigid as in commercial banks is another form of financial servicing in Nigeria. The cooperative authorities have to satisfy themselves mainly of the viability of projects. Law decrees the relationship between the agricultural credit cooperation and the ministry of agriculture. The extension workers have to assist cooperative officials by helping prospective borrowers to prepare farm plans, provide technical advice to credit officers and farmers. The responsibility of loan approval rests with the cooperative authorities. The extension services should inform the cooperative as to the amount of capital required for each technical innovation (Quattara *et.al.*, 1996).

In South Africa credit that agricultural cooperatives extend to farmers is mainly short term in nature and is for the purpose of buying production inputs. The source of funds of these cooperatives comes from the Land Bank, which is a specialized financial credit institution and also from commercial banks (Van Zyl, *et al.*, 1999).

Cooperatives, particularly in South Africa have an added advantage since they serve as a one-stop shop where the farmer would acquire credit and all the production inputs he needs. Black farmers have historically been discriminated against both in terms of formal and informal access to agricultural co-operatives, established in terms of the Co-operatives Act of 1981 and the legislation that the Act repealed, which in the commercial farming areas have served the interests of the white commercial farming constituency. Co-operatives have been featherbedded with soft loans, favourable tax treatment and other statutory supports. White farmers enjoyed financing on favourable terms from the Land Bank and the Agricultural Credit Board, much of which was supported and channelled by co-operatives.

Their function was to serve as agents for some of the Control Boards as marketing organizations in their own right, and as a channel for agricultural credit. Co-operatives are also fully represented in the South African Agricultural Union. The founding ideas of co-operative ownership, production, control, credit, access to information, access to skills and markets for the mutual benefit of members have generally fallen away. Co-operatives are big business and the 249 currently in existence have come to form a crucial part of South Africa's commercial agricultural economy. Their assets total some R14-billion, while debts owed to them amounted to R3.9-billion, or 23 percent of total agricultural debt. Since 1976 there have been no statutory bars to black membership of co-operatives, but the Land Acts, Agricultural Credit Board Act, and discriminatory practices have largely excluded them. The government policy on commercial agricultural co-operatives is dependent on the broader sectoral policies and practices with regard to farmers unions, marketing, provision of agricultural support and agricultural credit/finance. (Agricultural policy document, 1999).

Financial condition in agriculture has deteriorated considerably. From 1975 to 1987 total agriculture debt increase from R2 billion to an estimated R13 billion. This means an average growth rate of 17,1% per annum over the period. Even allowing for the influence of inflation, this increase in total debt remains disturbing. In the report by the state

President's Economic Advisory Council on an investigation into the restructuring of the farmer's increased debt burden in the period 1980 to 1985. On the other hand interest rates and the drought contributed 31,4% and 21,8% respectively.

2.6 INFORMAL FINANCING

2.6.1 Group Financing

Due to the risks involved in extending credit, financial institutions have come up with innovative ways of encouraging clients to repay their loans. In this mode borrowers would organize themselves into groups of five where two members of the five person's group get loans. If they repay on time, the next two get loans and finally the fifth one. When a member defaults, all five are barred from borrowing in the future. These institutions in china can claim repayment rates of over ninety percent (Signh, 1988).

2.6.2. Self help schemes

In Sri Lanka the Colombo women's thrift and credit cooperative society has the following features:

- ✓ Decentralized development in which the lower echelon (Ordinary members) is the heart of activities.
- ✓ Savings is promoted before loans are issued to members thus creating a lending base for the members themselves.
- ✓ A common bond between members is emphasized on the basis of living in the same area or being members of the same profession.
- ✓ Common ownership is done through the issuing of shares, which are sold to members.
- ✓ Equity is promoted by voting on the basis of membership and not number of shares (Albee *et.al.*,1996).

Associations run along similar lines exist in various countries. In Lesotho they are called cooperative credit unions (Steenkamp, 2000). In Nigeria some are called Okwu and

others Esusu clubs. These associations are known under different local names such as Chit funds in India; stockvels, gooi gooi and umgalelo in South Africa and pasanakus in Bolivia.

2.6.3 Moneylenders

Moneylenders, as the name suggests are people whose business is to lend money. The individuals concerned are usually not registered in most developing countries. More often they are viewed with scepticism. They have a bad reputation for usury in most countries, as among others they charge high interest rates, which is viewed as taking advantage of borrowers. The central banks specifically feel frustrated by this informal sector as it is perceived as flouting most of the financial control regulations and being the possible avenue through which black money, tax evaded income and wealth could be channelled.

However, as service providers these people are very essential to small borrowers, particularly those who do not enjoy favour with the formal financial institutions. They are accessible; they do not have cumbersome screening procedures and therefore give out quick service. They are only concerned with the individual's ability to pay, which they could quickly assess since in most instances they are staying in the same village or town with their clients.

Most of the countries have recently begun to regulate these individuals because of the very reasons mentioned above. In South Africa they are now registered under the Usury Act and they are commonly known as micro lenders. Despite the fact that they are registered, they still have the exploitative characteristics commonly associated with moneylenders in general.

2.6.4 The mashonisas

The mashionsas are the informal sectors lenders who operate completely outside of e formal sector. When there was there was no other alternative for borrowers, the mashonisas were their solution. They specialise in short term loans generally 30 days. Interest rates run in the range of 50 percent per month, though no additional interest is

charged if the borrower is late, effective reducing the cost of lending. (Strauss Commion,1996)

2. 7 FORMAL FINANCIAL SOURCES

Credit available for agriculture can be considered as falling broadly into three different categories based on the approximate period of repayment and the nature of the assets acquired. Farmers normally need short, medium, and long-term capital in their businesses at the same time, and no one type can be used to best effect without others. However, varying the use of one may change the need for the others.

2.7.1 Short-term capital

Short-term capital consists of the current liabilities of the business and it is far more under the farmer's control than long-term or personal capital. Short-term funds are needed to maintain liquidity through a normal year's trading to bridge the gap between, for example, sowing a crop and selling the harvest, buying stock and selling them fat and paying the tax.

This seasonal or short-term credit is required to cover seasonal peaks in working capital needed for growing crops, wages, purchase of feeders and other short-term assets that are completely used up during production. If it pays to borrow the money for these assets, the principal plus interest can be repaid out of income from seasonal sales.

Hence, loans associated with short- term assets are called self-liquidating loans because their original cost is repaid out of income. Many, but not all, short-term funds are renewable. Internal sources of short-term finance include retained earnings, delayed tax payments and depreciation provisions. External sources include loans and trade creditors.

There are two major security classifications of loans, which are secured and unsecured.

Secured loans

A. Short term and intermediate loans

- Loans secured by tangible personal property (stored crops,
- Livestock, machinery, equipment etc)
- Loans secured by intangible personal property (government bonds, stocks, life insurance policies etc).
- Warehouse receipts loans
- Conditional sales contracts

B. Long term loans

- Real estate mortgage loans
- Land contracts

Unsecured loans

Short-term loans may either be secured of unsecured. When secured, they usually are secured by movable property such as machinery and livestock under the provision of the uniform commercial code. Long-term loans generally are secured by a mortgage a real estate. When the term farm mortgage loans or debt is used it generally reefers to loans secured by farm real estate.

Purchase contracts, either conditional sales contracts or land contracts) are essentially a method of securing credit, although legally they significantly from loans. In the case of a loan ownership of the property passes to the borrower, whereas with purchase contracts, title to the property remains with the seller, to be delivered at some future date or upon the payments of a specified sum. There are lender classifications of credit which are frequently used because of the great variation in policies, those classifications are:

- **Short term and intermediate- term (non real estate) loans.**

Medium-term finance consists of funds tied up from one to about five years in medium term assets that are eventually used up in the production process. These assets are partly fixed capital items such as vehicles, tractors, implements, temporary buildings and breeding stock. Medium-term finance may also be needed for opening new arable land,

conserving it or for range improvements. Loans for medium-term are partly self-liquidating as they are paid out of net income over several years. They can be received from:

- ✓ Commercial banks
- ✓ Production credit association
- ✓ Other financing institutions
- ✓ Farmers' home administration
- ✓ Commodity Credit Corporation
- ✓ Machants and others

- **Long term (real estate) loans**

There is no generally accepted definition of how long "long-term" is. Normally, however, it means ten to thirty years and is used to buy long term assets such as land that are not used up during production. Properly managed land is as productive after production cycles as it was at the start. Therefore an investment in land is sound if net returns exceed the interest or opportunity cost of capital invested in it. Thus loans for land purchases are referred to as non self- liquidating. Besides buying farms, long-term finance is often used for initially equipping them, developing and improving land, fencing and water fencing.

They can be received from:

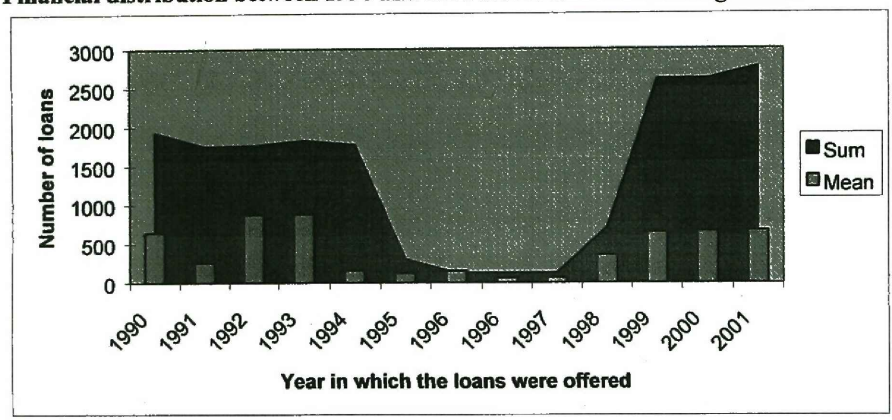
- Commercial banks
- Insurance
- Federal Land banks
- Individuals and others

2.8 FINANCIAL DISTRIBUTION FROM LANDBANK AND AGRIBANK

The figure below shows the allocation of loans from both Agribank and Landbank. Farmers receive a very good financial assistance from Agribank between 1990 and 1993. From 1994 to 1998 there was a decline in the supply of loans due to political dispensation. This was a very serious blow to farmers, as they did not manage to sustain themselves between those years. Farmer's production was extremely affected.

The findings of Strauss commission address problem by making constructive recommendations towards the financial assistance of farmers. The Land bank was mandated to assist farmers especially the developing black farmers. Landbank only offered these loans there was an increase in the number of loans offered from 1998, because the services of Agribank were terminated. Currently, the Land Bank is offering different products of the higher quality to meet the needs of the farmers in the province there is a very good financial assistance to farmers by Landbank and their different product made it easy for black farmers to get assistance from land bank.

Financial distribution between 1990 and 2001 from Landbank and Agribank



Difficulties faced by small farmers to finance purchases of seasonal inputs as outlined by Boune *et, al.*, 1984

- Small farmer's loans lead to very high administration and transaction costs for the financial institutions per unit lent (in searching, screening, monitoring and enforcement. Farmers also incur high transaction costs in accessing their loans (e.g. travelling expenses).
- These are exacerbated by the dispersion of rural population and poor communication infrastructures
- Agriculture is risky and insurance markets are usually non-existence(as they problems financial markets).

- Small farmers generally lack collateral (in SSA few smallholders have freeholds rights over land)
- Small farmers generally lack records and valuations of past income or future income estimates, or of assets
- Lending to agriculture in an area faces covariant risks from adverse weather or prices affecting large numbers of farmers in similar ways.
- The seasonal characteristic of agriculture leads to simultaneous patterns of lumpy demand and repayment by all farmers.
- The seasonal characteristics of agriculture lead too lumpy demands for finance at the start of the season, a period of several months without income (during which it may be difficult to make interest or principal payments) and then concentrated period after harvest when both interest and principal payments can be made.
- Financial intermediaries operating in rural areas may face a further difficulties in mobilising savings if agriculture is the dominant economic activity, as savers are likely to withdraw their savings at the of great demand for borrowers.
- The activities of the state and donor sponsor agricultural credit agencies in the past have led to a climate of 'strategic default' among farmers in many areas whereby farmers have no incentive to repay loans as a result of the past experience of getting away with loan default without any penalties of enforced loan recoveries and even reduced access to future credit opportunities.
- There are particular problems in financing inputs for subsistence crop production as by definition the financed inputs will not directly lead to an increased cash flow from which repayments can be made and although cross financing with other household activities may generate cash for repayments,
- This requires that borrowers can engage in activities generating sufficient cash income and match the timing of such income streams with the repayments.

2.9 LENDING AND BORROWING

Lending and borrowing are two sides of the same coin – bad lending is bad for both the borrower and the lender and a sound advance is good for both. Lenders are businesses selling the use of their funds. However, financing farming usually has a problem of

financing small farms with special risks and offers only a limited return to lenders. On the other hand, credit means having use of or possession of goods or services without immediate payment while a loan is money borrowed, at an agreed interest rate for an agreed period of time (Johnson, 1982). Borrowing is justified whenever the use to which the loan is put produces more than sufficient income to repay it with interest. This simply means ensuring that returns are likely to exceed the cost of the investment, so the loan shows a profit.

The main justification for a loan is that it enables farmers to buy things that will provide greater future returns than their costs. So farmers should decide, as accurately as possible, what future returns they expect from borrowed funds and what future costs are likely to be, because of the fear and distrust of borrowing felt by many people, unnecessary mystery surrounds the whole subject. A rand borrowed is a rand that must eventually be repaid with interest. Any extra return, after interest, is profit for the borrower.

Credit, as such, is neither good nor bad. It is the use made of it that determines its value. It is often blamed for all sorts of social ills when those ills are really caused by its misuse. In estimating a potential borrower's credit worthiness, lenders assess the risk involved on the three C's of credit – competence, collateral and character (Johnson, 1982).

2.9.1 Competence

Competence means repayment capacity that depends largely on the profitability of the use to which borrowed funds are put. An investment may yield a profitable long-term return but the borrower may be unable to repay when due if he has insufficient funds at the time. When assessed only on their returns, most farm investments are profitable. Most farmers can easily pay the interest on borrowed capital but they often find it hard to repay the principal. A clear proposal on how both the interest and principal would be repaid on a monthly or quarterly basis is therefore helpful.

2.9.2 Collateral

Sometimes called security, collateral is anything offered as a promise of loan repayment to be given to a lender in case of non-repayment. There is always a risk that a loan will not be repaid. Indeed, if a project fails or the loan is used unproductively, the borrower may be unable to repay. Hence a lender generally wants some security against total loss of his funds. Collateral can take many forms. A mortgage may be provided over a fixed property such as land, building or perennial crops. Marketable stock, shares and assurance policies are often pledged and stop orders on crops and produce also give security. Retained ownership of livestock and machinery bought on hire purchase is itself security for the credit. One of the major barriers to lending to poor farmers has been their inability to provide suitable collateral. Most farming is carried out on tribal land to which farmers have no title. In fact, much international experience indicates that mortgages on land are not a particularly useful or cost-effective way of ensuring against default.

2.9.3 Character

Prospective lenders need to know the borrower's technical training, past business record and reputed character. Even though this may be hard for newcomers to the industry, it is reasonable. Before granting credit to a new borrower, lenders may ask for bank or trade references; that is the name of firms and banks with which the borrower has dealt with before.

The applicant's attitude to the financial obligations of a contract can be assessed during negotiation. In practice, character is the most important consideration of lenders. Nobody of good character will over-commit himself/herself or knowingly accept duties that he/she probably cannot fulfill. He/She is likely to tell his creditors if anything affects his ability to repay so as not to harm credit standing.

2.9.4 Institutional Transformation

Institutional transformation is all about changing or creating organizations and coalitions to optimize service delivery. In smallholder agriculture organizations of concern include

farmer organizations, input delivery organizations, and financial service organizations. Optimizing service delivery or the linkages between organizations and farmers are constrained by, among other factors:

Trust: Trust cuts across workings of organizations as well as linkages between organizations and farmers. Delivery of water in irrigation schemes can be reduced by internal squabbles amongst scheme participants. Possibilities of high defaults have led to breakdown or non-formation of credit schemes. Delays in payments by produce buyers have discouraged farmers growing for the market. Possibilities of farmers' club members running away with project money have led to non-formulation of otherwise mutually beneficial ventures. Designing ways of eliminating such opportunistic behaviour will result in improved service delivery to the farmers.

Poor information flow between parties: Usually services are not delivered or are delivered to a sub-optimal extent due to poor understanding between farmers and potential service providers. Extension and research services may not have a good understanding on what technologies are really needed by farmers or how the technologies will work together with existing farmers method of doing tasks. Farmers may lack information on where their produce can fetch the best returns leading to them not taking advantage of such opportunities. Credit institutions may lack information on who are the best farmers so as to minimize possibility of default. To be safe, such organizations then just refuse credit.

Inefficient organizations: Organizations themselves may be poorly equipped to provide service efficiently through lack of leadership equipment and human capacity. To solve the above constraints there is need for institutional innovations/transformation.

This involves:

Changing the internal working of the organizations to limit the above constraints:

Making participatory approaches standard procedures in research and extension improves the information flow between farmers and service organizations and improves the flow and adoption of relevant technologies. Creating an irrigation management structure that ensures participation of all beneficiaries in designing regulations, fairness in water allocation and maintenance labour input and clear conflict resolution procedures, would ensure the productivity and sustainability of the scheme. All the above would need existence of capacity - leadership, physical resources and human - to achieve the internal change.

Coalition formation to improve linkages. Most of the constraints to improving linkages can be solved by forming linkages to exploit synergies that exist among organizations serving farmers. For instance, the poor information on good debtors held by credit organizations can be solved by the organization developing a coalition with extension agents who are in a close working relationship with farmers. Such a relationship will not only benefit the credit organization since extension would want farmers to get credit to buy cash inputs essential for success of most extension messages. Another innovation in the credit sphere is the group-lending scheme.

Farmers form themselves into a group or coalition for the purposes of accessing credit. Because every group member is liable for the default of one, members will tend to participate with people who are more likely not to default. This makes it more likely for credit organizations to favour such lending arrangements. Private input suppliers who give inputs on credit with the expectation of recovering loans from sale of farmer produce usually run the risk of farmers defaulting through selling to other buyers.

One way of discouraging such opportunistic behaviour is for the input suppliers and output buyers to form a coalition of associations that shares information on clients. If a farmer is unable get away from his obligation by switching traders, it will discourage

opportunistic behavior. The farmers' organizations can also perform the same task in sharing information on traders who do not pay in time or cheat on grading.

2.10 ROLE OF GOVERNMENT IN CREDIT ACCESSIBILITY

The state should provide leadership and coordination for widely based rural development and intervenes directly in key areas. State resources and skills will be needed for the imperatives identified by the RDP. The state's role in the financing of agriculture and rural development will go beyond the creation of a favourable context within which the private sector and other service providers can perform (Agricultural policy document, 1999).

The state must make available information, which will assist financial institutions and others to make rational business decisions in rural areas. In addition, the state must focus its attention on the developing farming sector. This does not imply neglect of large farmers, which may benefit from the creation of an environment, which helps the developing sector. Financial policies are needed that will create an environment in which enterprise, choice, the restructuring of agriculture and land allocation will flourish.

The state will guide financiers of agriculture, create a stable lending environment and enact legislation that will encourage new forms of rural financing to emerge. State guarantee schemes will be developed to provide finance to resource poor farmers (Agricultural policy document, 1999).

Agricultural subsidies should aim at improving access to resources. Criteria for beneficiaries qualifying for grants should be transparent and widely publicized. Financing should be structured in such a way that it does not fuel inflation. (Singh, 1988). Credit should be supplied at market-related interest rates, with limited differentials and recognizing those most in need of assistance. Public money should be channeled, via appropriately regulated and competitive intermediaries, to support acquisition and productive management of assets by the rural poor. Such people often lack collateral. The experience of a wide range of institutions locally and internationally indicates that very

good loan recovery is possible even where the beneficiary asset base is very small. Collateral for small farmers might best be provided by an assessment of the ability to repay, access to future loans and the borrowers' integrity (Agricultural policy document, 1999).

The most successful local intermediaries - and umbrella institutions - emphasize that borrowers must also be helped to be savers and provided with a range of financial services. Rural people need timely and fuss-free credit, delivered at speed, and with repayment guaranteed. Conventional collateral, which they often lack, should be replaced by a system structured for repayment and by efficient administration and recovery procedures. Peer support in borrower groups is important to secure benefits to, and repayments by, the rural poor. Incentive measures for both borrowers and lending agency staff should encourage the repayment of loans and the mobilization of savings.

Transaction costs in rural areas are high in the formal sector and relatively low in the informal sector. Linking the formal and informal sectors to improve access to data and information, to share facilities and resources, might enter into meaningful partnerships. Savings must be viewed as an integral part of rural finance policy. Savings create community ownership and control, generate data on possible credit clients and provide an alternative base for funds. These savings might be mobilized as deposits through appropriate and accessible instruments (Agricultural year book, 1999).

This should form part of a package of financial services, also including credit and transmission facilities. Care should be taken to ensure that where savings are primarily in ownership of cattle, that liquidating these assets does not eliminate the major source of working capital. A two-way exchange of information between borrowers and lenders should be encouraged so that potential customers might be made aware of the total range of available financial services, while entrepreneurs and business should be in a position to make rational business decisions rather then decisions based on fear and prejudice (Van Zyl, 1998).

2.11 FINANCIAL PLANNING

Establishment of goals has limited merit unless these goals are organized and coordinated in financial plans for the farm business. It has been said " when we fail to plan, we plan to fail" when we fail to plan, almost certainly some of our most valued goals go begging because available funds will have been spent on less important goals. Plans serve as guides in achieving goals in farming. A minimum of two basic financial plans should be made: a short-term plan or budget covering the period immediately ahead –year, quarter or whatever period is most pertinent and a long-time plan short time plan or budget covering the period immediately. Plans must be made to provide reliable guidance for decisions (Bradford *et al.*, 1993).

2.11.1 Financial management

The traditional practices in farm accounting have largely been informal, simplistic and in many cases different from accepted accounting principles. Historically, most farms are relatively small operations, organized as a sole proprietorship, partnership or family co-operations. The manager had to maintain accounts, along with other duties; business and personal assets were closely associated. In keeping records, farmers mostly relied heavily on cash accounts rather than accrual accounts (financial management in agriculture).

To effectively assess and monitor the financial position and progress of the farm business, four financial statements are needed, i.e. balance sheet, income statement, cash-flow budget and the total budget. The farmer should understand the need and the importance of preparing these statements. The farmers should also be in position to interpret these statements rather than preparing them.

Financial management in agriculture has become generally recognized as a high payoff area requiring additional strength and somewhat special skill. As Johnson (1982) has already defined it in the first chapter, financial management is a process of obtaining funds for the business and making the best use of them.

The tools of financial management are information flows, budgeting devices and contributing disciplines. Flows of information concerning the past, present and expected performance of a farm business and its operating environment are essential for the financial manager. This will generate a continuous flow of information concerning the farms profitability, liquidity and risk, reducing risk, meeting legal requirements and analyzing the farm business as well as to provide a basis for forward planning. This evidence for financial planning also helps to demonstrate credit worthiness and management capability to lenders and other parties to the farm manager depend on for financial support (Curtis, 1994).

There is a need for the manager to develop an orderly Budgeting device for assembling information and choosing among financial alternatives. The budgeting of seasonal cash flows is essential in the management of credit and debt. Monthly flows of cash in and cash out need to be anticipated as the manager arranges for a line of credit to finance the unit's operations within the year.

2.11.2 Procedures that ensures the effective financial management

To be effective, the financial manager must posses a great deal of general knowledge about the economic environment in which he operates and he needs very detailed information about his business. He must also have an organized procedure for recognizing and solving financial problems. The financial manager should keep up to date on economic environment in which he operates. He should be aware of prices of inputs and out put and he should try to determine their probable future trends. Synthetic substitutes for natural fibre and changes in import-export regulations are examples of factors that can have adverse or favourable financial effects on the individual farm business. He must be familiar with the legal rights and obligation of borrowers, lenders, tenants, landlords and owners of real and personal property (Hillman *et al,* 1983).

2.11.3 Financial control process

This process is very dynamic; it involves the passage of time and the use of the new information that is fed back to the decision-making unit for the process, analysis and

response. The control process provides an orderly framework for responding to an uncertain environment in which various signals caused by events trigger the need for control and response (Barry *et al*, 1979).

The following steps systematically express the financial control process as expressed by (Barry *et al*, 1979).

- The identification of goals or performance criteria. This includes mix goals their ordering and their weights in order of profits, risk liquidity.
- Developing measures for the goals. It involves selection of indexes, indicators to measure goals attainment.
- Determining norms to measure goals, this involves the degree to measure actual performance; some goals involve trade offs in the achievement level, for example, attaining higher expected profits usually means accepting higher risk.
- Setting tolerance limits on norms. Under risk and uncertainty, norms for the various goal measures will seldom be exactly as attained. Setting tolerance limits on deviations from norms allows for reasonable variations in the performance measure before corrective actions are needed.
- Developing information system periodic reports on the performance of the farm based on the financial accounting system, keep the decision maker informed of the firms progress and help to identify corrective actions when tolerance limits on norms are exceed.
- Identification and implementation of corrective actions.

2.12 LOAN REPAYMENT AND DEFAULT

Until recently, the study of loan default has emphasized exogenous factors and ad-hoc models that utilized climatic, economic and social concerns as explanatory variables. In this regard, the notion that default was a result unexpected floods, pests, poor marketing, land turner arrangements, transportation and extension problems have been exploited (Donald and Von Pischke, 1976). Harris, 1983 and Khalily *et, al.*, 1992 have recently added a political dimension. They argue that borrower unwillingness to repay is a result of trade-off between voters and politicians who promise debt forgiveness for a vote cast

in their favour. Others have suggested that loan default may result from dishonest borrowers who may be motivated to repay, only if it financially advantageous to them (Christen, 1984; Miller, *al.*, 1989).

Lack of access to a timely credible source of financial information has also impacted on the default problem in particular (Devaney, 1984), since there is no mechanism that will prior induce a tool revelation of an applicant's default probability and the maximum interests rates that the borrower is willing to pay. Banks must assess default risks based on independently observable borrower characteristics that are different from what the borrower claims. This has resulted in researchers modeling lender and borrower behavior by utilizing non-price information, including wealth variables, such as the value of land, equipment, livestock, collateral, collateral substitute and bank account.

In addition, demographic variables have also been utilized. Some of these are age, region, number of children, membership in organizations, gender, education, type of land tenure and religion. A final group of variable explaining default has been economic indicators, namely the type of borrower by economic activity, number of hired labour, technology, savings, risk measured by mean and variance in prices, yields, income, input pursued for replication and institutional memory.

After the first democratic elections, the Agribank went through a lot of changes and transformation. Many farmers had expectations of debt write-off, which resulted in the deteriorating position of the bank. The bank lost most of its top management through voluntary severance; and because of the moratorium on appointments, such posts could not be filled. As a result service delivery, and particularly debt recovery was hampered and this was evidenced by the lack of control within the bank (Annual Report, 1999/2000).

Farmers have some problems with borrowing. They usually want small sums for long period but lenders prefer to lend large sums for short period. Also, farming tends to have more risk, both biologically and economically, than most other industries, even though

farmers often have little suitable security. Many farmers often use loans for pleasure or consumption rather than productive investment, so they get no income from which to repay them. Because of such unproductive borrowing, some farmers become indebted and dependent on moneylenders.

According to Hills, *et al.*, (1987), the most heavily indebted farmers tend to come from the 40.5 – 121.5 ha working size group and from the 40 – 49-year-old working age group. They also tended to be full-time proprietors and to be tenants; but above all they all tended to be relatively recent entrants and, in terms of total borrowings, to be owner-occupiers. This is a reflection on the rising price of land and lack of availability of farms to rent, making it increasingly difficult to enter farming without borrowing heavily.

Farmers are sometimes unaware that stated interest rates often defer from the real cost of borrowing. They should check the true cost carefully before deciding anything. Differences between apparent and true finance charges are due to the different ways of calculating interest.

Loan default is a tragedy because failing to implement appropriate lending strategies and Credit policies often results in the demise of credit institutions. Default problems destroy lending capacity as the flow of repayment declines, transforming lenders into welfare agencies, instead of viable financial institutions it incorrectly penalizes credit worthy borrowers when the financial technology is sophisticated enough to separate high-risk applicant from low-risk borrowers. Loan default may also deny new applicants access to credit, as the bank's cash-flow management problem augment in direct proportion to increasing default problems. Loan default, especially in subsidized programs, may contribute to increasing income inequality as worthy borrowers captured the subsidies intended for small borrowers.

Finally, persistent default problems, resulting from lags lending criteria, a suspicion fraud or conflict of interest may undermine public interest in formal financial markets, causing savers to withdraw funds from financial institutions. No other concern in financial

markets has such a profound effect on the performance of lenders, yet effort to examine loan default problems in details have not been rigorously pursued in many rural credit programs. Loan default is often examined as moral hazard and adverse selection problems, resulting from the lack of accurate information about borrower information behavior. But while this is acceptable approach it is not complete, because it assumes that the lenders screening and rationing technology is efficient in separating credit worthy from non-credit worthy borrowers.

Adding a risk premium to the price of the loan to cover loan losses is another approach utilized to examine loan default problems (Gonzalez -Vega,1976). This risk premium results from the fact that at the time of the loan request, the lender is unable to clearly identify which borrower would repay and which borrower would defaults actual default losses are not known until scheduled repayment are due, but while this risk premium may have reduce loan default losses, it raised interest rates for all clients. Besides, it may very well have squeezed out the less risky borrowers whose investment may not have been able to carry the highly interest cost resulting in the adverse selection of high-risk applicant .

Recent empirical evidence from Canada and United States, using wealth, demographic and economic indicators, show that the lack of liquidity and relatively high financial leverage have been the reasons why borrowers default on their loans. In a developing country setting with fragmented markets, it has been demonstrated that loan default is related to targeting in special credit programs (Aguilera *et al.*, 1990).

2.13 CAUSES OF DEFAULT

There are various causative factors to defaults:

2.13.1 Fungibility

First is the fungibility of borrowed funds as funds may be used for something other than for productive purposes. Secondly, they may occur due to failure caused by natural disasters. The third reason may be deliberate refusal or unwillingness to pay. The unwillingness of farmers to repay their loans is aggravated by the perceived general

unwillingness of governments through their credit institutions to take steps against those whose debts are overdue. They may rather resort to denying the debtor the new loan. This is a very weak sanction, especially for short-term loans.

There are however additional reasons why borrowers may default. Some loans may have been given on the basis of unrealistic expected outcomes while sometimes the loan may not be suited for the purpose for which it was issued, For example short term loans for medium term activities (World Bank, 1974).

Investments may fail due to improper technical advice, absence of supporting services or inadequate marketing. Failure to repay is common to large and small farmers alike. In several countries such as Bangladesh, Bolivia, Colombia, Costa Rica and Ethiopia there is evidence that indicates that larger farmers have poorer repayment records mainly because of their unwillingness to repay. This is because they use their political power to protect themselves against the penalties for delinquencies (World Bank, 1974).

2.13.2. Political interference

There are various reasons for political interference. The explanation by this model revolves around the governments desire to stay in power. Satisfying those who could be disruptive does this and this explains the biasness of services in favour of urban areas. In rural areas, this is done by patronizing the rural elite who in turn has influence on the masses with whom they have relationships in various ways such as tenancy, share cropping, informal loans, employee, etc. Granting subsidized loans to these elite is an effective way of ensuring continued support for the current government.

Additional resources from government in turn continue to strengthen patron – client relationships. Moratorium on loan repayments in Sri Lanka, India and Bangladesh are examples of governments buying votes (Finley *et,al.,*1994). Actions such as moratorium on loan repayment cultivate the culture of non-payment. There are examples of governments in the developing world who have made deliberate political attempts to influence or even coerce banks to lend to the small farmers and do so at very

concessionary terms. The Differential Interest Rate Scheme introduced by India forces both the state institutions and the commercial banks to lend at lower interest in rural areas (Finley *et,al.*,1994).

In Nigeria in 1977 the government ordered all commercial banks to open branches in rural areas within three years of the decree. These banks were even given specific rural towns or villages. Examples such as these have come to achieve nothing of the desired outcomes . Most of the authors argue that political interference has a negative influence in financial intermediation. It leads to poor targeting due to high demand of finance if credit is cheap, low repayment rates, and eventually collapses of credit institutions. This negatively affects the economy. However, having cited this, the prevalence of political interference cannot be wished away.

The literature review indicates two major trends, viz, that the financing of farmers is not an easy thing due to the complexity of their profiles and that there are common problems across countries pertaining to small farmer financing services. It should be appreciated also that banks are a business and they need to be sure that they would at least get their money back, hence they requirement of collateral as a minimum assurance. Access by small farmers to finance has been the objective of many governments. This however has been a very illusive goal, and wherever they tried to have a direct intervention, the efforts have not been sustainable. To investigate this issue in the context of small farmers in the North West Province in the districts of Ditsobotla and Molopo, the subsequent chapter will be directed at looking at the data collection approach.

2.14 LOAN REPAYMENT TERMS

The borrower usually sets repayments terms when the loan is obtained. From the standpoint of repayment capacity, the term of the loan and timing of the schedule of payments are of primary importance. There are numerous ways of repaying short-term loans depending on the policy of the lender and the needs of the borrowers. However most of intermediate and long-term loans are repaid according to one of three basic methods: the single payment plan, partial payment or fully amortized.

2.14.1 Single payment loans

The single payment or lump sum payment loan calls for payment of the entire loan on the expiration of the term. Historically, the traditional farm mortgage loan was a 5-year single payment loan. The borrower paid the interest each year, and every five years he extended, renewed or refinanced for a larger or small amount according to the losses or profits of the borrower during the preceding five years. With improvements made in credit service to agriculture, the five-year single payment was improved and partial payment loans were introduced. Partial payment loan with small fixed principal payment loan with small fixed principal payments or instalments each year during the repayment term of the loan. Principal payments made ach year are not large enough to completely repay the loan with the result that a fairly large amount, sometimes referred to as a balloon payment, is due at the end of the loan term.

2.14.2 Amortization loans

The amortization plan is a more extensive application of the partial payment plan. Amortization means killing by degrees, which may be interpreted as repaying the loans by series of instalments. Farm loans are customarily repaid in annual or semi-annual instalments while quarterly or monthly plans are more commonly used for consumer instalments loans. Currently each instalment is made of principal and interest. The interest portion is just enough to cover the interest to be paid on the outstanding balance of the loan.

2.14.3 Flexible or variable payment loans

Loans that call for payments of interest or principal or both, which are scheduled to fluctuate with crop yield s or income, are designated as variable or flexible payment loans. The development of flexible loans was stimulated by the difficulties that lending agencies experienced with fixed payment mortgages of all types in areas where annual income fluctuations have been exceedingly wide.

Very few, if any lenders are now offering a formal variable payment plan. Most lenders adjust or defer loan payments when net farm income drops severely due to weather

conditions, diseases, low prices and the like. However, basing all loans payments on some index of prices, yields or income has not been entirely successful. The chief obstacle in the development of variable payment mortgage loan has been in finding a satisfactory basis to which the variable may be adjusted. The suggestions thus far have cantered on four factors: prices of the farm products crop yields, rental shares, farm income.

The prices of the products plan provides for payments on principal or interest or both, varying with certain price index. The mortgage carries a definite term of years, interest rate, and schedule of principal payments of one percent each year. Annual payments are required only if the index of prices received by farmers for their products are around a certain normal level. This plan fails to work satisfactorily in areas where yields fluctuate. In such areas the plan may be worse than a fixed payment type because a drought may send the price index up and call for a higher payment than if the yield is up to normal.

The crop yields plan of adapting the payments to crop yields, although not entirely satisfactory, has more in its favour. Payments are scheduled as in the previous plan; with variations in the regular plan if the are large fluctuations in crop yields. If the yields are only used as the base, the plan does not work well for borrowers when yields are high and prices extremely low, or for lenders when yields are low and prices extremely high.

The rental shares plan is based on the crop yields. In essence, the borrower turns to the lender the share of the crop that he would give to a landlord as rent for the farm. The lenders sells this crop shares and applies the proceeds first on the interest and there remainder, if any on the principal. The borrower pays more than tenant because he agrees to pay the taxes, keep up the buildings and pay the fire and extended coverage insurances premiums.

The main advantage of this plan is that the borrower sets aside apportion of the crop at harvest to be applied directly to his mortgage obligation. If he wants to feed this portion of crop to his animals he must buy it from the lender. This plan adjusts for both yield and

price variations, if the yields or price is out on line, the lender makes the adjustment through the sale of the share that the borrower turns over.

The farm income provides for payments adjusted to the farmer's net income. In theory this plan is ideal in that the payments are in line with what the farmer can pay if crop yields or animal returns are low, the income is low and the payments reduced accordingly, but if the reverse situation occurs, income is high and the payments are increased (William *et al.*, 1993).

The loans are classified according to their use or purpose, with subclasses based upon specific uses of the funds. The purpose of classification has the advantage of facilitating analysis to determine the profitability of a specific loan if other records essential to such an analysis are kept. It also provides information on which loans are for operating credit and which ones are for investment purposes. Where items used up in the production process, their value enters the gross cash farm income flow, assuming operation are profitable, and are available to apply on repayments of the loan.

If funds are used to buy a tractor that lasts for 10 years, for example, the depreciation expense enters the cash income flow over the 10-year period and can be used to apply on the tractor. In contrast, where investments are not used up there is no depreciation and only the return on the investment enters the cash flow, with the result that principal payments on loans thus invested must be taken from the net income or savings. This limits the amount of debt a farm family can incur for investment purposes.

2.15 TRANSITIONAL ISSUES

2.15.1 Political obstacles to reforms

Many governments experienced strong political pressures to continue policies of lenient loan recuperation and rescheduling, and to maintain subsidized interest rates. In Colombia, Law 34 of 1993 refinanced loans to farmers affected by the crisis of 1992. This policy may discourage loan repayments in the future. Also in Colombia, Law 101 of 1993 capped interest rates and mandated subsidized credit to agriculture.

Mexico experienced widespread protests from farmers when the government curtailed the bloated Banrural credit program in the early 1990's. The issue of restructuration of bad debts for many farmers with commercial banks remains an open policy issue that currently limits the ability of agriculture to modernize and diversify in response to the new system of price incentives created by exchange rate depreciation and trade liberalization.

2.15.2 Property titling institutions

In many countries, the process of titling of property was streamlined in order to lower borrower transactions costs. Existing titling programs are being expanded beyond land to include other durable goods and equipment. Titling programs are fundamental for the penetration of commercial banks in agriculture and to give access to smallholders to these sources of finance using land and other assets as collateral.

2.15.3. New Market Compatible Policies

Collateral and Access to credit.

In general, the financial market reforms have had a strongly negative impact on the access of smallholders to credit. Many smallholders who could have borrowed from the development banks are unable to meet the more stringent collateral requirements of commercial banks. While titling programs will help, this will not solve the problem of many of the rural poor who have little collateral to pledge. The challenge thus remains to find market-based solutions to the problem of access to credit by smallholders who lack collateral assets. Many institutional innovations have been introduced in recent years to solve this problem, both by the public and private sectors.

There are a number of institutional solutions to the reconstruction of a rural financial system with the potential of giving access to smallholders, both those who were previously served by rural development banks, and those who were always marginalized from access to credit. In Mexico, Pronasol's Crédito a la Palabra Campesina is a public program that provides small loans with no interest charge to small-scale producers who have outstanding bad debts and consequently do not qualify for loans from Banrural or commercial banks.

No collateral was required for the loans, but borrowers lose their right to future loans if they default. The program suffers from low recuperation rates and is therefore far from self-sustainable. The Mexican government is currently adjusting the law on financial institutions to favor diffusion of credit unions, but this is still an incipient system in the rural areas.

In Guatemala, financial NGOs are following the model of Acción International to mediate the relationship between organized credit groups and commercial banks. Credit groups are self-formed and all members are jointly liable to repay the loan received by each member.

Since members have privileged access to information about the other members (which the commercial bank does not have) they can avoid adverse selection (incorporation in the group of risky members) and moral hazards (members refusing to pay when they can or placing false claims for mutual insurance by other group members) by group members. The NGO adds seven points service margin to the interest rate charged by the bank. Repayment rates have been exceptionally high, at least among merchants and micro entrepreneurs. Group lending is more problematic for smallholders due to the high co variation of risks, unless they engage in highly profitable activities and associate in groups with diversified activities. In Peru, many NGOs have entered the field of lending to organized groups, with an iron discipline for repayment since not only are groups jointly liable for repayment, but also the community is made liable for all groups. Due to the exceptionally high interest rates charged by commercial banks, loanable funds are

obtained through concessional loans from international development agencies or grants from international donors. While the system performs well in terms of repayment, its expansion is severely confined by access to loans from donor agencies. There are a number of unresolved issues regarding the reconstruction of financial services for agriculture following the collapse or the restructuring of rural development banks. One is the problem of graduation of households from schemes of access to credit.

Without collateral such as Pronasol or financial NGO loans to solidarity groups. If these households have accumulated enough assets under group lending, these assets can serve as collateral for individual loans from commercial banks. For many, this will not be sufficient. Credit records could be made available to commercial banks to facilitate individual access to credit on the basis of weak physical collateral compensated by strong reputation capital.

Most schemes have no explicit graduation strategy, often because it is not in the interest of the NGO to lose its best performing customers to commercial banks. Another issue is the role of decentralized commercial banks at the level of village branches versus financial NGOs. The latter may be seen as transitory institutions to be displaced by village branches once the formal system of financial intermediation has been reconstructed. In this case, financial NGOs would only continue to play a role with the more marginal and least organized potential borrowers. Village branches of commercial banks can access local information about borrowers by using village agents and giving them adequate incentive contracts to truthfully reveal this information.

A third issue is the potential reorganization of the rural development banks. In Mexico, Banrural, after having shed its non-performing customers, has continued to lend under strict performance criteria. These banks could absorb the lending technology developed by financial NGO and extend their clienteles to smallholders, potentially through subcontracting the services of financial NGOs. Innovative institutional solutions linking formal development and commercial banks, with the advantage of diversified loan

portfolios and access to broad financial markets, to local institutions and agents with informational advantages are still largely to be developed.

Many interesting experiments are in progress to achieve this goal and they are worth monitoring carefully. Indeed, one of the main policy implications of the theory of imperfect and asymmetrical information derived from the new institutional economics is the advantage of linking modem with local/traditional institutions to cumulate gains in risk reduction and market integration (afforded by the former) with gains in information (afforded by the latter) to reduce adverse selection and moral hazard problems in financial transactions. Credit as a poverty alleviation tool.

Credit access programs will only be effective for the credit "constrained" - those with access to productive investment opportunities who are unable to pursue these opportunities for lack of financial resources. Lack of access to credit does not imply an unmet credit need. Hence, it is often more efficient to provide assistance to marginal producers via targeted public assistance programs rather than via credit. NGOs can have an important role to play in assisting marginal producers formulate potentially profitable new projects. Once this has been done, the challenge remains for the lending institutions to recognize the entrepreneurial poor with no collateral to offer, in terms of their ability and willingness to repay, and to define a lending technology that is mutually advantageous.

2.16. Lender transactions cost and access to credit

The transaction costs borne by the farmer borrowers are decomposed into explicit and implicit costs. The explicit costs include administrative and transportation costs whereas the implicit costs refer to the opportunity cost of the time spent by a borrower on negotiating, acquiring and repaying the loan. Administrative costs comprise such expenses as application fees, legal service fees, and loan processing fees and cost of passport photograph. The study revealed that borrowing transaction costs averaged 21.7 percentage of the loan and 180.8 percent the nominal interest rate (Ahmad, 1982).

Variations in loan transaction costs at the farm level could be determined by a of factors such as the size of loan, the disbursement lag, borrowing experience, farm size and borrower's distance from the loan office. The borrower farmers are characterized by low scale of operation as evidenced buy the size of their farms and their loan requirements. These characteristics often define the preference of lenders in the granting of loans. If lenders are satisfied with the loan size and farm size of some borrowers and they have reasons to believe that such borrower are credit worthy, the negotiation, processing and delivery of loan will progress smoothly and quickly,

On the other hand non-preferred clients could be made to face numerous hurdles, which will affect borrowing transaction costs. The loan disbursement lag is apt to have effect of borrowing transaction costs in view of the fact that borrowers may be compelled to pay several visits to the loan office when the delays associated with loan negotiation and acquisition appear to be unbearable. Thus, it is expected that the loan disbursement lag will vary directly with the borrowing transaction costs. To date, the use of formal credit by most of farmers is still highly restricted. One of the critical constrains is the high cost of borrowing (Cuevas *et.al,* 1986). The studies have shown that the transaction cost of borrowing constitutes serious impediments to the acquisition of the credit and they have advocated cost-reducing policy innovations in agricultural lending (Adams *et. al.,* 1979).

Some of the problems have arisen as a result of policy intervention in the form of interest rate restrictions, selective credit policies and loan portfolio requirements in favor of the agricultural in many developing countries. Credit intermediaries have been found to circumvent such regulations through non-price mechanism, which often result in transaction costs. In some instances, borrowing transactions costs have been used as effective rationing device in rural credit markets (Cuevas *et.al,* 1986).

Lender transactions costs create an incentive for banks to minimize the number of loans they make, thereby discouraging them from making small loans. To encourage commercial banks to loan to smallholders, governments can provide fixed transaction cost subsidies to small rural loans. The World Bank has supported such an initiative in

Mexico. This type of subsidy is preferable to an interest rate subsidy as it encourages the bank to contract with smallholders and does not distort the capital intensity of projects. Ideally, transactions costs subsidies should be accompanied by technical assistance for the definition of projects and the management of loans, as is effectively done by FIRA in Mexico.

Transaction costs of administering loans do not vary according to the size of the loan. The banks apply the same procedure and processes to approve all loans and therefore find it not cost effective to deal with small loans. The fact of the matter is that small loans absorb a proportionally larger slice of the income the banks generate.

For example; after the approval of the loan the problem of monitoring the use and payment thereof becomes an additional cost. Monitoring is often not successful and defaulting adds even more costs because frequent visits to defaulters and the cost of collection. Default affects the cash flow, revenue and profitability of the bank. So if farmers do not pay back their loan, the ability of banks to further extend their service or continued existence is seriously affected (Finley *et,al.*, 1994).

The bank is faced with, the enforcement problem where farmers are unable to offer collateral, the courts are too weak to repossess any collateral which is offered, and the insurance against common adverse phenomena such as drought is unaffordable to developing farmers (Ibid). Commercial credit institutions therefore need specific inducements to lend to small farmers. There is a need for government regulation and supervision of commercial banks, credit unions, and credit cooperative to enhance consumer confidence in these institutions, particularly if they are to mobilize rural savings. There is also a need to provide technical assistance and training to new RFI's, especially small-scale credit unions and credit cooperatives. Definition of a regulatory framework to codify the initiatives of financial NGOs as well as the provision of financial services by RFIs are still also largely to be defined and require urgent policy attention.

The removal of caps on deposit interest rate and deregulation of the commercial bank sector should encourage savings mobilization, which is crucial for the long-term sustainability. Privatization of the social security system, as was done in Chile, is an effective way of mobilizing savings for the private sector. Other countries in Latin America such as Bolivia are emulating the Chilean example, and many other countries are pondering shifting their welfare system from a pay-as-you-go to a capitalization scheme. In Mexico, commercial banks are opening windows on both sides of the U.S. border to assist in the transfer of remittances and channel deposits toward potential investors in the emitting communities, thus helping use remittances for local employment creation, and the eventual reduction of future migration flows (FAO, 1997).

2.17 FACTORS CONTRIBUTING TO POOR ACCESS TO FINANCING

2.17.1 Poor communication

The availability of elements sighted by Singh (Ut supra) are lacking in the rural financial services institutions. The element of accessibility particularly to small and developing farmers is lacking in a variety of forms. They range from poor communication network, roads or lack of buildings for office accommodation for financial institutions in rural areas to actual resentment of financial institutions' staff to live in rural areas. These banks branches location appear not to be planned with farmer's needs in mind.

2.17.2 Collateral

Most farmers do not have access to credit institutions because of a lack of required collateral. Land, in communal areas is not acceptable security because the customary tenure system makes it inalienable. Land tenure is problematic to banks in two ways. An agricultural banker is concerned with land service because land, as a basic factor in production, is both the purpose for and means of repayment of the loan. Firstly, the banker must therefore be sure about the borrower's access to the land in question. Secondly, there are considerable problems for the banks in using land as collateral specifically the difficulty of foreclosing on a land mortgage in a situation where a buyer for the land may not be found.

2.17. 3 Perceptions

On the other hand the relationship between banks and small farmers is influenced by misperceptions from both parties and therefore leads to negative attitudes towards each other. Bankers perceive developing and small farmers to be bad credit risks while these farmers in turn perceive banks as alien institutions, which exist to serve the needs of their social superiors. The realities concerning access to banks are legal or conventional requirements for the extension of credit, including the need to offer physical collateral, which the small farmers seldom possess, and formalities of documentation, which these farmers find difficult to satisfy.

2.18 LENDING POLICIES IN DEVELOPING COUNTRIES

2.18.1 Industrial expansion and import substitution

The first policy approaches that is growth through industrial expansion and import substitution. These approaches in essence favoured industry over agriculture (Johnson,1980).. This is contrary to policy approaches in developed countries such as the U.S.A and England whose initial development base was agriculture and later transformed to industrial development such as wool spinning (Eicher, 1990).

2.18.2 Biasness towards urban development

The second policy approach that disfavoured agriculture was the pattern of government expenditure. Governments in developing countries tend to bias their funding towards industries and automatically to urban areas that leads to the lagging behind of rural development. On the opposite, the rural economy formed the backbone of development in Developed countries prior to industrial revolution. The added element to this issue was the effort of keeping food prices down for cities. The reasons for such decisions are political in nature. The intended approach is meant to please urban dwellers because their dissatisfaction can trigger unrest as they are more sophisticated and are able to quickly mobilize as they live in closer settlements. They are able to form powerful pressure

groups. In cases were resources were allocated by governments to agriculture, it mainly helped larger farmers not small disadvantaged farmers (Johnson,1980).

2.18.3 Interest rate subsidies

According to Adams, (1984), there are arguments for and against interest rate subsidies. The first argument is the usury. The usury argument is based on moral grounds supported by the Bible, the Talmud and the Koran where the charging of interest to a brother is condemned. Protagonists of this argument simply suggest that it is immoral to charge interest to anyone you loan money. However, the real economic fact is that money is a commodity and has a price in the form of interest. Failure to charge interest is tantamount to giving a commodity without charging any price for it. The second argument is also that high-income countries charge low interest and therefore the same must apply in low-income countries. What this argument reflects is the fact that the economies of developed countries are stronger and more stable than developing countries. The reduction of interest rates in the latter economies may worsen the state of the economy by accelerating inflation. This is because the cheaper the price of the commodity, in this case money, the more demand for it.

The third notion is that lenders get cheap money. For example an Agricultural Bank may get loanable funds from the government, from cheap rediscount windows at the central banks and funds from foreign donors. The argument is that these benefits should be passed on to the farmer or borrower. This argument ignores the fact that the bank has its own administration costs besides the fact that in many cases those funds have to be paid back.

The fourth argument advanced against higher interest rates is that the deregulating of interest rates on savings instruments would force institutions to pay higher rates to obtain loanable funds and would force many into insolvency. However, it should be realized that agricultural lending is costly because of geographic dispersion, collateral problems, the small size of loans and the risks inherent in farming. Therefore the higher interest rates banks are allowed to charge strengthen their viability. In general, the lower interest rates

do not necessarily benefit the poor. This is clearly illustrated by the Iron Law of Interest Rate Restriction proposed by Gonzalez Vega (1976) which states that the lower the real rate of interest the more heavily concentrated will the loans be in the hands of relatively few people. Also, paying lower interest rates would force intermediaries to even pay lower interest rates to savings deposits.

The fifth common argument is that lower interest rates are necessary to encourage farmers to make productive investments. Problems with this argument is that it assumes that farmers are irrational when it comes to allocation of resources and that it is necessary to 'bribe' them to do something that is profitable. The fact of the matter is that farmers allocate their own funds rationally and they will do likewise with borrowed funds. The second problem with this argument is that it assumes that cheap loans are inexpensive. This is untrue as there are costs for paperwork, travel costs, time taken to negotiate and pay the loan and other related administration costs. It is also surprising that the very same farmers or borrower borrow funds from informal institutions with even higher rates and are able to pay them.

Sixthly, others argue that cheap agricultural credit is a way of transferring income to rural areas. It is assumed that there are three ways that loans can affect income distribution and these are returns gained by using additional resources purchased with loans, transfer via negative real rates of interest, and through loan default. The truth is that distribution is far from equal. Small borrowers get small benefits, large borrowers get large benefits and non-borrowers get no benefits at all.

An interest rate that would cover the cost of capital would include the opportunity cost of capital, the costs of administering the provision of credit and the cost of risk and defaults (World Bank, 1974). If subsidies are offered it would be advisable to subsidize particular inputs or technology or administration costs rather than the cost of credit to borrowers (Adams, *et al,* 1984).

2.19 AGRICULTURAL FINANCIAL INSTITUTIONS IN SOUTH AFRICA

Commercial banks supply a range of products that meet a range of farmers needs. They provide financial support in terms of short, medium and long-term credit. The interest rate varies according to the creditworthiness of the applicant (Van Zyl *et al*, 1999). This latter aspect entails the fact that the less creditworthy one is the higher interest rate one pay. Obviously most of the small farmers find themselves having to pay higher interest due to their shortfall on creditworthiness.

Discussion

The foregoing discussions about various ways of financing distinguish between formal and informal credit institutions. In informal savings and credit schemes, a lender, who may be a borrower's friend, a landlord, a moneylender or a mutual assistance association, bears the full risk of default. Formal institutions by contrast, act as intermediaries between those from whom they give loans, and savers. They are designed for credit and savings e.g. commercial banks (Devereaux, *et al,* 1990).

According to Aguillera (1990) there are four yard sticks for successful rural financial institutions i.e. viability, self-sufficiency, accessibility and efficiency. Viable institutions should be able to meet their administrative costs without periodic cash injections in the form of grants from donors or government. Their profitability is determined by lending rate, borrowing rate, loan turnover and transaction costs all conditions being equal e.g. if among others, there are no defaults. Self-sufficiency in credit institutions is accumulating resources by guarding against defaults, mobilization of savings and guarding against decapitalization by inflation. It would be self-defeating if viability and self-sufficiency were achieved by confining lending's to big farmers. Accessibility to rural farmers is an important criterion by which to judge a credit programme. Shifting the emphasis from collateral to profitability of investment activities supported by credit can go a long way in increasing the access of the small farmers to credit. Effective intermediation implies reduction in transaction costs by making direct contact between surplus and deficit units, management of resources and the reduction of risks.

2.20 LAND BANK

The Land Bank was established in 1912 to assist in implementing government agricultural policy aimed at promoting white commercial farming. Over the years, it has gained a reputation as a sound conservatively managed financial institution with solid professional and technical standards in the specialized field of agricultural banking. While its policies were not explicitly racist, the bank avoided lending money to black farmers.

It did not support black farming, either in freehold areas or in the Bantustans, defining it as the role of the Department of Agriculture. Black farmers and women, of whom the majorities were disenfranchised, oppressed and poor, were almost entirely neglected. Later, the Development Bank of Southern Africa (DBSA) was created to cater to the needs of middle class farmers in the Bantustans (Land Bank Prospectus, 1998). Land bank has establish all over South Africa, in the North West Province were the study will be conducted it have branches in Lichtenburg , Vryburg , Rustenburg and Potchefstroom.

To meet its new mandate the Land Bank had to develop a completely new range of products. At the bottom of the range is a micro-finance product, called Step-Up which is designed in such a way that people build up from the very low base of a R250 loan that can be repaid over six months. Formal loans to farmers are graded on a scale that begins with Bronze and proceeds up to the Land Bank Staircase of products through Silver, Gold, Gold Premium and finally, Platinum loans.

The product range consist of:

- Low risk long and medium term loans to experienced farmers with adequate traditional forms of security. These loans provide long terms mortgage bonds to buy land and medium term assets such as livestock and equipment and to pay for fixed improvements.
- Low risk short-term seasonal production retail credit is also available at a higher rate than is usually charged by our wholesale on lenders (Land Bank Prospectus, 1998).

The Bronze loans are aimed at farmers who have little or no collateral and are intended primarily to buy seed or equipment. The maximum of a Bronze loan is R50 000. The next step on the Staircase is Silver, which goes up to R250 000. At this level the farmer must have some form of collateral. At the very top of the scale, Platinum goes to clients where there is very little risk to the bank. In the nature of things, interest rates are lower at the upper end of the scale (Land bank prospectors, 1998).

Step Up

To address the widespread need for micro finance the Land bank introduced the **'Step-up'** scheme targets the rural poor (Steenkamp, 2000). This enables rural people with no security to borrow an initial amount of R250. The scheme will provide these small loans without the need for collateral or checking by field visits from a loan officer (Dolny, 1998). A time pay- back record will be the only criterion. Borrowers who meet this criterion will qualify for bigger loans. Failure to repay means disqualification from the scheme l. By December 1999, more than 35000 people had taken out **'Step-up'** loans with the repayment running at 82%(Steenkamp, 2000).

Total loans granted by land bank in 1998(land bank annual report, 1998)

Loan granted	Gold		Silver and bronze	
Amount	Number	Amount	Number	Amount
Long-term	4163	R1 803,1m	27	R3.4m
Medium-term	5049	R 717, 7m	3040	R102.4m
Short-term	2631	R 8772.6m	3132	R23.6m
Total	11843	R1193.4	6199	R28.44m

In 1998, 25 thousands farmers were having bond with land bank and these compose of farmers of whom larger percentage constitute black farmers. This bond makes it possible to purchase land. The bond alone worth R5 million at the end there was about 13000 accounts for medium term loans taken up to purchase livestock and other farm equipments. In 1998 the land bank retail network granted 3000 loans. In the first six months of 1999 the branches approved and disbursed monies on 9800 loan applications.

Six thousands of this loans applications were farmers from historically black disadvantaged community. Loans granted to establish commercial clients rose from 3000 in 1998 to 3800 in 1999. More micro loans were made available to rural entrepreneurs on the to establish a financial track record.

Land bank in the case of insolvencies: Due to harsh natural selection farmers find it difficult to meet their financial obligations. Insolvency is declared and the bank dispossesses the farmers the assets to recover as much as possible of the outstanding balance. In very few cases the value of the bid made or the farm is considered to be low on such occasions the Landbank take the property to its book with the intension to bid better price in the future.

Insurance for mortgage clients: The land bank is running a subsidiary insurance company. This company is providing life insurance for mortgage clients and takes care for their outstanding balance on the loan in the event of death of the customer.

Risk management in Land bank: The risk assumed by the bank arises from extending loans and issuing variety of debt instruments in the capital and money markets. Credit risk arises were there is a possibility that the loan will not be paid on time and in full. The risks associated with the bank treasury operations include liquidity and interest risk.

According to Pinstrup- Anderson (1982) modern agricultural technology may reduce production risks. He said, the risk factors contribute to variations in yields and production and, as a result, may cause considerable variation in the income of farmers. The higher the risk the higher the interest rate. This lead to poor farmer's hesitation to borrow under such conditions. Irrigation reduces the risk associated with variations in rainfall, (Pinstrup-Anderson, 1982).

The point to be made here is that the risk issue is more important in developing areas, particularly among small black farmers for whom a crop failure may imply severe consequences. New technology may increase production risk, or rather make it more

difficult for the farmer to accept the consequences of such risk, because the use of some new technology requires additional capital. If such capital is borrowed, possibly with the farm as the security for the loan, the effects of a bad harvest are likely to be worse than where traditional technology is used. Unless special arrangements are made, loans must be repaid irrespective of the amount-harvested.

According to Upton. (1996), risk has an important influence on the costs and volume of credit. The borrower must undertake to repay instalments and interest on the loan annually regardless of the state of the harvest. He further said in good years he (borrower) should produce a surplus over and above the cost of servicing the loan, but in bad years, even if he makes a loss, he still has the loan service charges to meet. However, he said the lender is also facing a risk that the borrower will default and the loan will not be repaid. Before making a loan he may require some reassurance that the borrower is creditworthy.

This can be provided in two main ways:

(i) Personal knowledge of his operations, or

(ii) Collateral security, meaning some possession of the borrower, which the lender can keep if the loan is not repaid.

The provision of credit will facilitate and accelerate the necessary investment and hence the adoption of the technology, provision of credit alone may have little impact on agricultural production, (Upton, 1996).

Many farmers lack knowledge and experience of formal application procedures for loans. They are discouraged by the need to complete application forms and other documents, which naturally introduce delays (Coetzee, 1999). According to Barry et al, 1983, self-liquidating loan can be used in farming activities. This type of loan is made for purpose that generates sufficient income to repay the loan within the maturity period. Two conditions are required for self-liquidating loan:

First, the asset or project being financed must generate more cash returns over its life than the size of the loan. Second, the maturity of the note and schedule of repayments must be such that the payments can be met from cash generated by the investments. Thus, loan to finance the purchase of fertilizer in the spring of the year should be scheduled for repayments with funds arising from the sale of the products grown with that fertilizer.

Financial reserves should be available to meet unanticipated (or random) fluctuations in cash flows caused by variable prices, yield, expenses and so on and by severe hazards such as fire, hail, drought or floods (Swart, 1989). Included are the magnitudes and sources of risk involved, the manager's risk attitude, the uses of various responses to risk such as commercial insurance, the characteristics of various sources of liquidity and the extent of fixed cash demands on the farm.

Risk management is another factor to consider in dealing with risk. Risk management involves performing the management planning function in a manner that will reduce uncertainty. Thus it applies to insurable business risks and involves a total approach to insuring against these risks (Upton, 1996). One example of a program of risk reduction would be to have sprinkler systems installed in the farm to curtail any damage that might be experienced during fire or drought (Kelly, 1996).

The fundamentals of diversification are important in risk analysis. Gains in business planning and risk efficiency can occur by following the principles of diversification (Hopkin *et al,* 1983). Why does risk decline from combining two seemingly comparable investments. This relationship can be developed using a portfolio model approach. According to Barry *et. al.*, the word "portfolio" refers to a mix, or combination of assets, enterprises or investments. It is most commonly used to describe holdings of financial assets such as stocks and bonds. The portfolio model indicates how different combinations of investments may reduce an investor's risk more than having only a single investment.

The principles employed by Landbank in managing credit and market

related risk include:

- Loan policy guidelines formulated by loan product and customer segments
- Port folio management and analysis to limit risk concentrations and build flexibility and liquidity.
- Line management accountability at the level of the organisation
- Loan approval rules that establish tiers of the loan approval authority as well as checks and balances.

Identification of problem loans for the attention of senior management

All loans applications are evaluated base on the following:

- Capacity, defined as the ability to repay obligations when due
- Colleteral presenting the assets availability to service the loan
- Character base on the subjective estimate of the clients likelihood of
- Honouring their obligation
- Conditions based on the evaluation of macro economic trends and
- Regulations affecting ability
- Capital, essentially the client's liquidity and solvency

Several measures are use to manage the risk inherent in lending to resource-poor farmers. Such measures include:

- Character base lending
- Acceptance of collateral substitute
- A gradual increase in the size of repeat loans, based on the repayment record
- Interest rate rebates for timely payments, to reduce the cost of borrowing.

2.21 AGRIBANK (FORMER AGRIBANK)

Because of the Land Policies during the apartheid era, the North West Agricultural Bank (generally known as Agribank) was established in 1981 by the former Bophuthatswana homeland. Its purpose was to promote agricultural, pastoral and agro-economic development of the homeland. The bank rendered financial assistance in and in connection with farming and agricultural operations and activities. It provided agricultural credit in the form of loans and advances to individual farmers and institutions engaged in farming.

Agribank's main business is short –term loans. During 1990/91, nearly 90% of the loans approved were for short-term advances for crop inputs – seed, fertiliser, insecticides and herbicides, equipment maintenance and repairs, fuel, labour and other expenses During the same period, medium-term loans accounted for about 9% of the total loans approved (Annual Report, 1991).

North West Agricultural Bank is poised to lose over R100 million in unpaid loans by local farmers (Nakedi, 2000). The public hearing on the auditor general' s report heard earlier in the year 2000, reveals that most of the farmers deliberately stopped repaying their loans out of sheer reluctance while some were being pushed by adverse farming conditions including drought and storms.

Gyus Van der Merwe and Malick Mather from Agribank told the hearing in the year 2000 that it was difficult to force the farmers to pay their dues through attaching their assets. Among other things the Auditor General indicated concern about the accounting system and administration at Agribank.

Other concern raised by the Auditor General included, the non- recovery of advances and loans, inadequacy of security when loans were granted, depreciation of assets value, lack of proper records to verify provision of leave pay, unstated short term borrowing, irregularity in bank and cash balances, unavailability of proper records of clients deposit, non compliance with the generally accepted accounting practices, unavailability of supporting documents for loans, expenditure, cash and receipts and fixed deposits,

inadequate internal control and discovery of fraud and corruption by officials (Nakedi , 2000).

Repayment may occur due to low production, possible increase in interest rate, inflation, increase in operating inputs e.g. fertilizer, feeder cattle etc., death as well as unemployment. According to Akinsanmi 1975, before credit facilities can be granted to a farmer, the lender must have detailed information about the borrower. For example he would like to know whether the borrower is a reliable citizen who can be trusted to use the money for the intended purpose.

The lender expect to see the plan for the proposed project, in order to asses its feasibility and the ability of the farmer to execute its successfully (Akinsanmi, 1975). He further said that credit agents must normally visit the farmer from time to time, advising him on how to make efficient use of the supplies and equipment with the loan." Agribank began operations with an administrative staff of nine and five field officers (Annual Report, 1982). The bank has its head office at Mmabatho and its present spread of branches enables it to cater and serve 12 of the districts within the North West Province, these being; Ganyesa, Ditsobotla, Madikwe, Odi, Vryburg and Heuningvlei (*Annual Report, 1998/ 1999*).

Village Bank projects was launch in July the 17 1998. The launch was a signal that the project has a green light to be implemented throughout rural communities of South Africa (*Nufarmer, 1998 vol 3. No 2*). Between 1995 and 1998 it has centres in three communities namely: Motswedi, Lotlhakane and kraaipan. They were granted an exemption to the Bank Act by the Minster of finance on 17 February 1998 and later registered with the office of the registrar of Cooperatives as cooperatives (*Nufarmer, 1998 vol 3. No 2*).

The Village Banks are officially known as Financial Services Cooperatives (FSCs) because they are not 'banks' according to the definition of the Bank Act. The FSCs are community based financial intermediaries whose objectives are to provide banking

services to the rural and remote areas. They support community structures by creating a window that will link the rural community to the formal financial sector.

Multi purpose business Loan by Ithala was available in 1998 with finance ranges from relatively small amounts to the financing of large amounts for larger small farming. Repayments structured up to 20 years, depending on the life expectancy of the assets offered as security (Nufarmer, 1998). A positive evaluation of a viability study or business plan is prerequisite. Disadvantaged small farmers were advice to consult the Ithala Business Loans Analyst for assistance with the preparation for a business plan (Nufarmer, 1998).

Agribank provides agricultural credit in the form of loans and advances to individual farmers and institutions engaged in farming (Annual Report, 1992). In the first nine years of its existence accumulated loan applications considered by Agribank totalled R655 million, of which 63 percent was granted and 49 percent utilised (Annual Report, 1992). R368 million was for short- term advances for crop inputs-seed, fertilisers, insecticides and herbicides, equipment, maintenance and repairs, fuel, labour and other expenses.

Medium- term loans accounted for about nine percent of the total and amounted to R41,6 million. These loans are for tractors and implements and for the purchase of livestock, mainly for improvement of existing herds. The bank also provides long- term loans for the purchase of land and for improvements. The total approved for this purpose during the first nine years was a little more than R41, 1 million (Annual Report, 1992).

The total utilisation per annum rose steadily from about R1, 8 million in 1981/82 to nearly R50 million in 1986/87 and peaked just under R63 million in 1989/90 (Annual Report, 1990). During 1990/91, 15 percent interest rate per annum was maintained on short- term loans. The rate on medium- term loans was 15,5 percent for mechanisation packages and 14,5% for livestock, while long- term loans bore an interest rate of 10 percent (Annual Report, 1990).

Mather and Van der Merwe said accounting and control are in place at Agribank, but they only lacked segregation of duties due to the shortage of staff. They said the majority of supervisors and middle management were in more than one task, which in turn made segregation of duties very difficult. The Auditor General, 2000 said the financial statement for the year revealed that R62 811 374 increased the provision for bad debts relating to secure advances and loans. Responding to the concern, Malick and Van der Merwe said the bad debt provision of R62 million was provided due to the outstanding monies. They said all loans were validated by signing all necessary loan application documents including looking into security and all other things.

They said in cases of non-repayment they resorted to legal ways, which were normally expensive and sensitive. The security base of Agribank attaches assets such as land. Most farming is carried out on tribal land to which the farmer has no title (Molekwa, 1991). Short- term or seasonal advances are secured through a lien on the crop, Medium-term loans by a hypothec of movable property and long- term loans by first mortgage on immovable property et. al. Repayments of loans due in the past financial year amounted to 84% and of the R322-million in loans approved in the past nine years only a little over one percent has been written off.

Drought contingency fund with an initial amount of R250 000 was established (Watson, 1991). This provided an extension of time for repayment of debts, advances for subsistence aid and loans for the purchase of new production requisites. In 1983/84 the board granted extension for payment in 387 cases, totalling just over one million to 492 cases. Grants and subsidies were received to assist the cattle industry and for farmers who had no crop in the previous season. After 1994, the North West Agricultural Bank had to go through a lot of changes and transformation. Many farmers had expectations of debt write off, which resulted in the deteriorating position of the Bank (Gaoraelwe, 1998/99). The agricultural Bank Act is to provide financial services to and on behalf of the provincial government to individuals, Co-operatives, Partnerships, Closed corporations, Parastatel bodies' etc. directly or indirectly involved with Agriculture,

Agri- business, Rural enterprises and related activities/ business and to provide for incidental matters (Bank Act, 1996).

Operation activities within the Agribank

In terms of out reach, Agribank initially operated within the borders of the former Bophuthatswana through six branches and six agencies. Farmers financial support services were provided by the bank's agricultural inspectors to monitor the high risk profile of clients who were still need to be educated on the basic principles of loan financing, however this had resulted into high transaction costs for the bank.

The security base differs from that of Landbank in the difficulty of attaching assets such as land , because most of farming is carried out on tribal land to which the farmer has no title. The bank therefore relies on attaching the crop on the land and movable assets. As security this was backed by compulsory life insurance until it was phased out in July 1992 and reintroduced in July 1996.Agribank was not providing finance to farmers and co-operatives only, but to agricultural related industries for the processing of agricultural products, creating ready local markets. It was a fact that Agricor turned to rural development and neglected agricultural extension in the process. It force Agribank to appoint field officers. Although this reflect negatively to the bank, when considering to the initial costs, it was beneficial to the farmers because the received necessary assistance in their production hence they were having good production.

Statistics Number of loans and amount approved by classes from Agribank

DESCRIPTION	NUMBER OF LOANS	AMOUNT APPROAVED

	94 & Prior	95/96	96/97	97/98	94& Prior	95/96	96/97	97/98
Land & buildings	13	2	3	1	553 953	112 101	590 101	80 000
Livestock	1 120	124	505	81	21971578	3261873	11757631	1 896 771
Tractors	713	32	110	23	35559 33	1779 88	6 124 130	1 439 317
Implements	557	45	51	21	6 498 571	1139 47	1 037 858	372 118
Drought relief	3	1	1	1	112 890	22 000	44 620	20 000
Redemption	12	-	5	2	355 867	-	206 041	206 041
Crop intake	24	2	1	-	111348 807	9225 000	1 500 000	-
dev finance	2	-	354	16	550 660	-	13245 175	553 911
Lime	25	-	-	1	631 319	-	-	79 150
Production	5 902	855	1 079	748	283589 101	38122 16	56855 240	41223 202
Micro loans	209	184	106	4	680 744	553 006	369 956	17 000
Major repairs	500	32	55	17	4 349 637	523 915	690 630	269 260
Business	97	34	26	6	24301 982	1286 955	2 052 216	7 521 939
Trading stock	11	2	6	2	8 803 578	1895 000	5 087 990	7 502 400
Total	**9 208**	**1 313**	**2 302**	**923**	**499308 520**	**57921 601**	**99561 703**	**61073 713**

2.22 HOW FARMERS GET ACCESS TO LOANS

According to Act 14 of 1981 no loan or advance shall be granted or made by the Board except –

a) Upon a written application which shall be in a form prescribed by the Board and shall indicate the purpose for which the loan or advance is required and which, in the case of an application by a company, co- operative, corporation or other body of directors or controlling body of such company,

b) Upon a resolution of a properly constituted meeting of the Board wherein shall be Stated –

i. The amount of the loan or advance
ii. The security required
iii. The rate of interest payable in respect of the loan or advance, and where applicable, the premium on debt insurance to be paid.
iv. The period of repayment of the loan or advance.

c) In the case of a farmer, and if so directed by a magistrate or other competent person or authority designated by the Board, as to the character, ability and general suitability of the applicant.

The current debtors book in excess of R200 million and in order to sustain development financing in the province, Agribank had to look at alternatives means of debt collecting. The Bank will however continue to finance those clients with a good repayments record and those supported by the government (Annual Report, 1998/99). During the past three years R181 million was loaned out to 387 clients. Agribank assist different kind of applicants, e.g. land, livestock, equipment, production cost, SMME's crop intake and trading stock. During 1998/99 76 women clients received R2, 96 million from Agribank (Annual Report, 1998/99).

The business of the bank is to provide financial services to facilitate service linkages with role players such as Commercial banks, the Land bank, Cooperatives and the Agricultural Credit Board in order to provide accessibility to the rural communities e.g. Village Bank concept (White paper on Agriculture, 1996).

2.23 OFFENCES AND PENALTIES APPLICABLE IN RESPECT OF APPLICANTS TO ANYONE WHO:

a) Obtains financial assistance from the bank in terms of the Act through fraud or false representations knowingly made by him;

b) After having obtained financial assistance from the bank in terns of the Act, without the written consent of the bank, wilfully destroys, damages, consumes or disposes of-

   1) Any property, thing or right given by him as security to the bank for such financial assistance;
   2) Anything deemed to be pledged to the bank upon payment of any loan or advance or any part thereof to an applicant in respect of the purchase of livestock or any other movable property or both

c) Wilfully applies any loan or advance granted or made to him by the bank for any purpose other than that for which it was granted or made

d) Wilfully fails to disclose to the bank any material information in his possession or makes any statement or representation knowing it to be false, when required in terms of or by virtue of the Act to make any statement or to disclose any facts or information.

Such person shall be guilty of an offence and liable on conviction to a fine not exceeding four hundred rand or to imprisonment for a period not exceeding twelve months or both such fine (Act 14 of 1981). In the final days of apartheid the new Land bank acted as agent for the state's R3,2 billion drought relief programme. The programme saved many farmers who were direct or indirect through cooperatives clients of the bank from bankruptcy (Land bank prospectus, 1998). This reduced the potential bad debt portfolio and helped to maintain land by which the democratic post apartheid government launched its market based land reform programme. The Land bank's new mandate is to pay special attention to the needs of emerging black farmers, of people receiving land under the land reform programme and of Agric- business that is, the business of making products and equipments used by farmers (Farmer's Weekly, 1997). For this purpose, the bank had to design a new set of financial products that new clients could use successfully (farmer's Weekly, 1997). The bank contributes to economic growth, help to eradicate poverty and create a vibrant rural economy. It must meet the needs of people who have no access to finance- to target the poor who do not normally get loans (Landbank 1998, *Vol No 1*).

Political change has brought South Africa a democratically elected government, committed to redressing the injustices of apartheid through sustainable development that benefits all (Land bank money matter, 1988). As part of its investigations the government set up the commission of Enquiry into the provision of the rural financial services. The commission, commonly known as the Strauss Commission, supported the need for a new land bank (Landbank prospectus, 1998). The commission's recommendations provide the mandate for transforming the bank.

Dr Dolny said although the bank 's priority is developing black farmers, commercial farmers would remain by far the most important clients of the Land bank. According to Dolny, 1998 the bank charge its clients lower interest rates than the commercial banks do and it can also support farmers through difficult periods such as droughts.

In a range of recommendations specifically aimed at the land bank the Strauss Commission proposed that it:

- Consolidate its existing client bases;
- Take special measures to service previously disadvantaged people, especially those in deep rural areas and land reform beneficiaries;
- Undergo transformation with particular attention to its human resources and structural organisation to ensure a capacity to address the needs of new clients;
- Reconsider its branch network, with an extended group of retail financial agencies serving the deep rural areas, and
- Develop new lending criteria not dependent on unencumbered freehold.

The Commission also recommended that government support the bank's development role with enabling legislation and grant finance (Bank Prospectus, 1998). To meet its new mandate, the bank has had to design a new set of financial products that new clients can use successfully (Land Money Matter, 1998). The products consist of a gold, silver and bronze range which were made available in March 1998.

2.24 FARM RECORDS

Records of the farm must be kept and used as an integral part of the business and tax management. On commercial farm, farm records are practically a necessity for income tax purposes and if properly designed will contribute materially to financial management. Farm records should provide the following information as outlined by Coffenman in 1991.

- A complete annual inventory of assets and liabilities in sufficient detail and with adequate description to make them understandable. The number and description of livestock; items of machinery; method of depreciation; name, addresses and explanation of account receivable and payable will be helpful.
- A complete listing and description of income and expenses items during the year. Preferably by enterprise. This part of the record should also show production, purchase, births, debt payments, funds borrowed and the like, to permit bringing the inventory up-to-date.
- A summery of cash flows and an analysis of each enterprise in the farm business for use in management decision and for tax purposes.

CHAPTER 3

3.0 Methodology

3.1 Study Area

Since the number of small farmers who use loans for their production are few and scattered in terms of geographic origins, the study was conducted in Molopo, Rusternburg, Lichtenburg, Zeerust, Ganyesa and Kuruman of the North West Province to get a sample of hundred and sixty farmers.

3.2 Sampling technique

Hundred and sixty respondents were randomly selected from the areas around the North West province (the areas indicated above).

3.3 Data collection instrument

One questionnaire was developed to collect the data. The questionnaire consisted of open and close-ended questions. Borrowers (farmers) were interviewed. The first sections of the farmers questionnaire address questions relating to demographic characteristics of the farmers, for example, age and education. The second part contains questions, relating to farming activities, resources, loan acquisition utilization and repayment.

3.4 Method of data analysis

The statistical Package for Social Sciences (SPSS) 9.0 for windows 1998 was used to analyze the data. Descriptive statistics including means, medians, frequency and standard deviations were calculated for the respective variables. Correlation analysis was used to determine the relationship between variables. The use of regression models to establish the relationship between depended variables and independent variables. The dependent variable was the amount of loan defaulted by farmers and the independent variables are listed in the model below.

Models to be used:

$$Y_i = a + b_1x_1 + b_2x_2 + b_3x_3 + b_4x_4 + b_5x_5 + b_6x_6 \ldots\ldots\ldots + e_i$$

Where

- Y_i Default rate
- **a** represents the intercept
- b_i represent regression coefficients
- x_i represent explanatory variables
- e_i represent the error term

X_1 = Age of the respondents
X_2 = No. of years at school
X_3 = No of children studying
X_4 = Total monthly income
X_5 = Number of loans granted
X_6 = Number of cattle kept
X_7 =Lack of financial management skill (possess Fin management skills =0 do not = 1)
X_8= Lack of record keeping (Keep farm records = 0 Do not = 1)
X_9= Lack of technical support(Receive technical support = 0 Do not = 1)
X_{10}= Fungibility (Did not practice fungibility = 0 Practiced fungilibity = 1)
X_{11}= Transaction cost for farmers
X_{12}= Insufficient loans (Sufficient = 0 Incomplete =1)
X_{13}= Time release of loan (Time released = 1 No = 0)

CHAPTER FOUR

4.0 RESULTS AND DISCUSSION

4.1 INTRODUCTION

In this chapter geographical characteristic of the farmers, demographic factors, agricultural production, technical and financial assistance were discussed. Descriptive analysis, quantitative analyses were used to explain the above-mentioned factors on the default rate of the farmers.

4.2 DEMOGRAPHY

With reference to the subsequent, Table 4.1, the results indicate that most of the farmers are in the old age category. The average age of the respondents is 58.54 with the highest and lowest age being 77 and 30 years respectively. This scenario poses a challenge to the stakeholders in agriculture specifically the succession plan to these elderly people when they leave agriculture due to retirement. It also has direct effect on the repayment rate or farmers default rate and their efficiency in farming because of their inabilities to manage funds and to be productive as the following Table 4.1 also highlight low educational level (average years in school is three, which is equivalent to standard one). Literacy and numeracy are the prerequisite to modern farming.

Most of the respondents receive pension grants, R500 per month on average. The household average monthly income is R832.12 with the lowest and highest been R200 and R5000 respectively. The results show that the respondents incur more expenditure than their total monthly income. The households monthly average expenditure is R1403.46 with the lowest expenditure being R200.00 and the highest being R1621.20. Table 1 reflects the average number of household members to be five with the largest households having twelve members. Out-of 160 respondents interviewed only 123 households have at least two members who are employed and who can supplement the respondent's expenditure by at least R644.71 on average.

Table 4.1: Demographics analysis of the respondents

Variables	*Sample size*	*Mean*
Age of the respondents	160	**58.54**
Standard passed	160	**3.91**
Monthly income	160	**831**
Monthly expenditure in Rands	160	**1403.46**
Number of household members	160	**6**
Household members employed	160	**2**
Average contribution to the family by Working household members in Rands	160	**644**
Keep farm records	160	**135**
Conduct market analysis before production	160	**48**

The analysis clearly indicates that out of hundred and sixty respondents, hundred and thirty-five (69%) cannot keep record for their production due to high illiteracy level. It is believed that the higher the educational level, the higher the chances that the farmers may keep farm records. This is inline with the finding of William *et. al.*, (1993) that stress literacy and numeracy as a prerequisite for modern agriculture. Some of the respondents with standard ten did not keep records this can be attributed to low technical assistance either from the extension officers or the bank officials. From all respondents who indicated that they keep records it was found that none of them keep formal records, they either keep their records in the middle of production or after harvesting time when they are preparing for the market. Farmers should have a complete annual inventory of assets and liabilities, a complete listing and description of income and expenses, a summery of cash-flow analysis of each enterprise.

Availability of market for one's produce is very important as it dictates what the farmer's profit as well as his/her ability to continue production in subsequent seasons. It is therefore important for farmers to have knowledge of the supply and demand of their produce. This can help them to improve their cash flow within the production year and their repayment ability can be improved. The results show that only 30% of the sampled farmers conducted market survey before engaging in production, which invariably could

help them to produce the right crop at the right time. The results show that most (70%) of farmers are producing blindly and only few (30%) know the demand status of their products.

It was discovered that only 40% of the respondents have their own land (Table 4.2). Out of these 40%, thirty respondents practice animal production, twenty-two respondents practice crop production and only twelve respondents indicated that they practice both productions. Under hired land, 13.13 % tenureship was discovered in the study area, of these two farmers practice animal production, sixteen respondents practice animal production and only three respondents practice both productions. State land is mainly used for crop production as indicated in Table 4.2 that 18.12% respondents are using state land. Almost twenty nine percent of the respondents are using communal land for their production, of which twenty-seven respondents are involved in livestock production. Only one respondent indicate that he is using State land for crop production only and eighteen respondents shows that they are using state land for both productions.

Table 4. 2. Type of tenure system **No. 160**

Tenure systems	Type of production and number of respondents				Total percentage
Type of tenure	Animal	Crop	Both	Total	Percentage
Own land	30	22	12	64	40%
Hired land	2	16	3	21	13.13%
State land	0	29	0	29	18.12%
Communal land	27	1	18	46	28.75%

4.1.3 FINANCIAL TRANSACTIONS COSTS

The former Agribank had enough branches around the villages as indicated in the previous chapter. After the closure of the Agribank the farmers were left with no option but to make new loans with Land bank to sustain their production. Unfortunately Landbank had only four branches in the province (Rustenburg, Lichtenburg, Vryburg, Potchefstroom). All three branches i.e. Rustenburg, Lichtenburg, Vryburg are mostly

serving small farmers from deep rural areas of the province and its very hard for these farmers to reach the bank.

Although the Landbank tried to create ways to reach those farmers by visiting them in their different tribal offices, it was still not enough for them. That is why farmers are still having high transaction costs. This problem is aggravated by lack of infrastructure in rural areas. Commercial farmers are having less problems with the distance of their branches because most of them are mobile and have good infrastructure like telephones, good roads, electricity etc. most of the thing are so convenient for them.

There are different types of loans offered by the different banks for farmer's assistance. Number of loans taken by farmers varies from one to three. Most of them were offered medium term loans (98%). From the category of medium term loans 65% of the respondents have only one loan offered to them and 33% of the respondents have two loans offered to them. Number of loans offered to a farmers has a direct impact on loan repayment because they are required to settle installments with different banks at different times, and when taking into consideration the commitment that the emerging farmers are confined within, it is difficult for them to manage their cash-flow and thus causes farmers to default (World Bank, 1994).

Table 4. 3 Number of loans and loan type **NO. 160**

TYPE OF LOAN OFFERED TO YOU			
NO. OF LOANS	SHORT-TERM	MEDIUM-TERM	LONG-TERM
1.00	26%	65%	7%
2.00	4%	33%	17%
3.00	6%	0	0

The result shows that out-of 160 respondents who received loans 96 % of them defaulted irrespective of the number of loans they received. Only four percent of the respondents never defaulted in their repayments. Most of the respondents (36.88 %) defaulted because

of poor production, 23.13% defaulted because of drought and 7.3% percent of respondents default because they did not have profit in their production. Late disbursement of funds by financial institutions appears to be the second important reason, which caused the default of farmers in the study area. One can conclude that the number of loans taken by farmers has no bearing to default. Above stated factors are also highlighted by Donald *et. al.*, 1976 as the factors of concern when coming to farmers default.

Table 4.4 Reasons for loan default **No .160**

Reasons for defaulted	Number of Farmers	% of sampled farmers
Poor production	59	36.88
Drought	37	23.13
No profit	12	7.3
Lack of market	3	1.88
Transaction	11	6.88
Late disbursement of funds	38	23.75

4.1.4 PROBLEMS RELATING TO LATE DISBURSEMENT OF LOANS

The question was to find whether there was late approval of loans within the both banks. Majority of respondents from the Land bank agreed that there is a delay in the disbursement of loans. This is because most of the clients do not submit the required documents in time e.g. quotations of their required inputs and from the bank the problem of the time between the filling of convincing section of the agreement form and these prolong the time for disbursement.

The bank also delay on the payments of inputs required therefore it causes service providers to have negative attitude towards the request of farmers for production inputs. The respondents from the Agribank confirmed that their services were good in terms of the loans. This was effective because the bank was having more branches around and there were farmer's cooperatives, which were having a very good link with the former Agribank.

4.1.5 FUNCTIONAL ANALYSIS

A modified Cobb Douglas function was fitted to the data and the regression estimates of the relationship between dependent variable and predictors was determined. Eleven predictors were used and nine predictors had statistical significant impact on the amount of loan repaid by the farmers. Significant predictors are: number of years at school (P= 001), total monthly expenditure, number of loans, possession of financial management skills, technical support received by farmers, fungility, have incomplete loan, and loan offered in time (P= 000). These variables are supported by the value of F-statistics, which is 38.61 that, shows significant relationship between the dependend variable and the predictors. The value of R^2 is 0.954 and adjusted R^2 is 0.886. This means that the predictor's account for 88.6% change in the default rate of the respondents and 11.4% is accounted for by other unknown factors, which are not included in the model. Durban-Watson value is 1.9, which indicates that there is no auto-correlation between the variables.

4.1.5.1 MODEL SUMMARY

Table 4. 6 Result of modified Cobb Douglas functional analysis (N=160)

Variables	*Un-standardized Coefficients and standard deviation of parenthesis*	*Standard coefficients*	*T-test*	*Significance level*
Constant	.130 (2644)		2.033	*Constant*
Age	.002 (10.5927)	-.042	-.542	.591
Number of years at school	.004 (4.1913)	-.216	3.091	.004
Children studying	.024 (1.2388)	-.084	-.752	.456
Total monthly expenditure	000 (1917.46	.337	5.054	000
Number of loans granted	.033 (0.6934)	.525	6.114	000
Number of animals	.001 (22.26)	.010	.092	.927
Lack of financial management skills	.040 (0.5043)	.475	6.266	000
Lack of record keeping	.057 (0.5492)	.549	6.253	.001
Technical support	.051 (0.4423)	.610	7.119	000
Fungibility	.066 (0.3172	.612	7.744	000
Transaction costs	0.057 (0.265)	.592	086	.005
Incomplete loans granted	.047 (4960)	.653	7.338	000
Timing of loan disbursement	.049 (4521	-.205	-2.465	.018

Dependent variable : Default rate

* Significant at 95 % * * Significant at 99 % * * * Significant at 99.9 %

R^2 =0.954 Adjusted R^2 = 0.886 N=160

Durban Watson = 1.918 Df = 53

4.1.5.2 DISCUSSION OF REGRESSION RESULT

The number of years at school shows a significant impact on default rate of the respondents. These suggest that one unit increase in number of years at school will decrease the default rate of respondents by 21.6 % when other factors are held constant. These simply suggest that if literacy level of farmers can be improved, their management can also improve and they might be able to repay their loans.

The results indicate that a unit increases in the farmers total monthly expenditure will results in 33,7% increase in the loan default rate when other factors are held constant. This suggests that when farmers are faced with more monthly expenditures, they use loan funds to cover their financial obligations.

The results from regression analysis highlighted that a unit increase in respondents in ability to keep record will increase the respondent's default rate by 54.90%. This suggests that if farmers can be assisted with good record keeping system in their production, their management might improve and these can also improve their repayment ability. This is inline with the literature by Coffenman *et al.*,(1991) which states that on commercial farming, farm records are practically necessary for income tax purposes and if properly designed will contribute materially on financial management of the farm.

A unit increase in the number of loans received by a respondent will result in 52.5% increase in default rate with other factors held constant. This implies that when farmers are given more loans they default, as they are unable to repay multiple premiums as stated in their loan contracts. The major problem might be low production from their enterprises and some of the loan funds are not used in the manner that they will generate income e.g. loans that are used to meet household needs. This might also suggest that loans are divided to cater for production and household needs, which the loan is not meant for (fungibility).

A unit increase in the lack of financial management skills of the farmers will increase default rate of respondents by 47.5% other factors held constant. The current situation shows that farmers lack financial management skills and their production is very low. Therefore, to assist them from defaulting, one should consider financial management skills as the priority in their production. This is inline with the findings by Curtis(1994) which shows that understanding of financial management will generate a continuous flow of information concerning the farm profitability, liquidity and reducing default risk and provision of a basis for forward planning.

Lack of technical assistance from either the banks officials or extension officers causes the default rate to increase by 61%. This suggests that the farmers might have not received proper assistance from relevant stakeholders. A unit increase in fungibility will cause respondents default rate to increase by 61.2% with other factors held constant. It is confirmed in the literature by World Bank,(1994) that loans are sometimes given for unrealistic expected outcomes and some times are used for the purpose not applied for by farmers.

The results show that a unit increases in transaction costs will increase farmer's default rate by 59.2% with other factors held constant. This suggests that the transaction costs incurred by the respondents are very high which can be attributed to the distance coupled with frequent traveling of farmers to the bank to inquire about their applications and also poor communication between financial institutions and the respondents. The study done by Adams *et. al.*, (1979) shows that the transaction cost of borrowing constitutes serious impediment to the acquisition of the credit and they have advocated to cost-reducing policy innovation in agriculture lending. Most of respondents are been given insufficient loans as highlighted by the results due to different reasons provided by financial institutions. The regression result shows that a unit increase in granting of incomplete loans will cause the default rate to increase by 65.30%. This is the highest significant level shown by the regression results and it suggest that farmers need to be assisted with the adjustment of business plan if the loans required has been reduced.

CHAPTER 5

5.1 FINDINGS FROM THE STUDY

- Age was found as a major challenging factor in the Agriculture sector for both government and financial institutions.
- Lack of financial management skills coupled with low education level which led to poor record keeping had a negative impact on the management of production loan funds and that causes poor repayment by farmers.
- Inadequate contacts of agricultural technical advertisers to farmers had influence low production of farmers thus causing them to default.
- Lack of field staff members causes lack of follow up after the disbursement of funds to evaluate the progress of farmers in the production.
- Frequent crop failures in the study area have been adversely affecting the repayment schedule of the cultivators, Since most of the cultivated areas are under unirrigated dry land the income from crop yields are not sufficient enough to repay the loan and to maintain the families.
- Agricultural financial institutions (Land bank branches) are far away from their clients and these causes high transactions costs on both farmers and the bank.
- Late disbursement of loan funds by the bank causes a delay in farmer's production thus hampering the quality of their products, which led to low profit.

5.2 CONCLUSION

5.2.1 Introduction

The main objective of this study was to investigate reasons underlining small farmers default on the bank loans repayments in the specified areas around the North West province. Factors such as transaction costs, timing of loan disbursement, monitoring of loan usage by bank officials, the effect of natural disasters to the repayment of farmers were of outmost concern. There were nine subjective and eleven hypotheses for this study. The response from farmers and bank officials were analyzed and recommendations were made to address the current default rate problems of farmers in the province.

The study reveals that most small farmers in the province are having high default rate with the former Agribank but some of them are still receiving loans from Landbank, which is currently the main financial supplier for farmers in the province. Farmers around the province are having similar problems for their default; these problems were highlighted during the discussion held at different regions during data collection.

Currently farmers are required to settle their debt with the government and the unfortunate part of it is that those farmers are in their old age and they are having no income except their pensions and it will be difficult for them to repay. Some are still in farming but they cannot repay because they are not making profit due to many diversed factors. In the interest of poverty alleviation, self-sustainability of farmers and improvement of agriculture in the province, farmers default rate should be addressed both technically and financially by the stakeholders (government and financial suppliers).

5.2.2 Recommendations

From the first objective factors such as high transaction costs, timing of loan disbursement, lack of monitoring on the usage of loans by the bank officials, natural disasters had a great negative impact on the repayment rate of farmers in the study area. It was therefore concluded that farmers defaulted because of the above mention factors.

- Age was found as a major challenging factor in the Agriculture sector for both government and financial institutions. It is therefore recommended that the government and the financial institutions should encourage youth participation in farming. There is also a need to encourage youth to join agricultural projects by giving them necessary training and financial support especially young agric graduates.

- Lack of monitoring of loan funds causes farmers to default. Farmers in the study area have very low education level, coupled with lack of farm management skills, high family responsibilities and low income from pensions. Since the Land bank have no field officers to assist farmers it is recommended that there bank should

have field officers to assist farmers in their production, especially with marketing, financial management and farm management skills.

- The Landbank should update their clients regularly on the development of their application so that their transaction costs can be minimized. The reason behind this is because farmers are using their pensions and other minimum income for traveling and making enquiries on the progress made on their applications.

- Incomplete loans were discovered as a major problem for the farmers as shown in the regression analysis that it contribute to 65.30% increase in default rate. Therefore it is recommended that if incomplete loan is given to a farmer he /she must be assisted with financial adjustment so that the funds allocated can be equal to production plan.

- It is also recommended that government policies for disasters funds be restructured to cater for the developing farmers because they are also affected by these disasters.

- It is also recommended that Landbank branches should be increased or the service should be extended to reach farmers in the far side of the province to minimize the farmer's transaction costs and to improve farming of developing farmers around the province.

- Frequent crop failures in the study area have been adversely affecting the repayment schedule of the cultivators, since most of the cultivated areas are under unirrigated dry land the income from crop yields are not sufficient enough to repay the loan and to maintain the families. It is therefore recommended that a better cropping systems suitable to the area should be encouraged by agricultural department through their technical services to increase the crop yields which will ensure good repayment rate.

- Farmers tend to prioritize to repay private loans that are used for both productive and consumption purposes and this has been adversely affecting the repayment to the bank. It therefore recommended that farmers applications should be processed in time as stated in the business plans to avoid a delay in the start of the production period.

- While identifying the beneficiaries under government sponsored schemes, a freehand should be given to the bank staff to carefully verify the confides, credit worthiness and the repayment capabilities of the borrower, which will ensure a better repayment performance by the borrower.

- In case of crop loans overestimating of incomes to enforce recovery of loans should be avoided by making realistic assessment of the actual production, which reduce the burden of the loan to the borrower besides preventing diversion of the excess amounts to other unproductive purposes.

- Land bank should introduce consumption loan facilities to needy people to discourage resort to private loans from non-formal financial institutions, which are cornering a major part of their earnings towards repayment of exorbitant interest rates. This result in multiple loans which have a great impact on the repayment of their production loans.

- Record keeping was found as a major problem in the study area, therefore it is recommended that agricultural economist from both the bank and department of agriculture should provide training to farmers on farm management skills on a regular basis.

In case of crop loans overestimating of incomes to enforce recovery of loans should be avoided by making realistic assessment of the actual production, which reduce the burden of the loan to the borrower besides preventing diversion of the excess amounts to other unproductive purposes.

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FARMERS DEFAULT ON BANK LOANS REPAYMENT
QUESTIONAIRE FOR FARMERS

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NB: Please write the number of your answer in the box, if the box is provided.

Personal details

1. Location .....

2. Relationship of respondent to household head

1. Self
2. Spouse
3. Son
4. Daughter
5. Other (specify)

3. Age of the respondents .....

4. Gender of household head

1.Male
2. Female

5. Marital status

1. Married
2. Single
3. Divorced
4. Widowed

6. Number of years of schooling of the respondent .....

7. Post matric qualification of respondent .....

8. Occupation of the respondent.....

9. Monthly household income .....

10. Number of household members .....

11. How many children are studying .....

12.How much do you spend on their fees per year .....

13.How much do you spend on their transport fees per

month.... ...

14. How much do you spend on their provision per month .....

15. Amount of money spent on food per month .....

16. Amount of money spent on other household goods per month.....

17. Total monthly household expenditure (food, furniture, clothes etc. .....

18. Number of employed household members.....

19. Amount of money contributed by the employed household

members .....

20. Do you keep records for the farm operations?

1. Yes...
0. No ☐

21. If yes, when do you start to keep records?

1.Before production
2. In the middle of production ☐
3. After production

22. Do you do market survey to analyze/check demand and supply of the product you produce before production ?

1.Yes...
0. No ☐

23. Do you do production planning before the production start?

1. Yes...
0. No....

24. Who helps you to do planning?

1. Ext Officer
2. Bank Officer
3. Relative
4. Self

25. Is your planning in most cases inline with your implementation?

1. Yes
0. No

26. Which banks do you receive loans from?

1. Agribank
2. Landbank
3. FNB
4. ABSA
5. Standard bank

27. When was your first loan granted?.....

28. How many loans have been granted to you?
.....

29. Type of loan offered to you.

1. Short term
2. Medium term
3 Long terms

29. How much money was received and how much was repaid in

Year	amount received	amount repaid
1990	----------	----------
1991	----------	----------
1992	----------	----------
1993	----------	----------
1994	----------	----------
1995	----------	----------
1996	----------	----------
1997	----------	----------
1998	----------	----------
1999	----------	----------
2000	----------	----------

30. Total amount of money granted to you?

---

31. Total amount repaid ----------

32. What were your reasons for not paying?

.....
.....
.....
.....

33. Have you ever been granted an incomplete loan?

1.Yes
0.No ☐

34. Which bank. .....

35. When .....

36. How much was given ?.....

37. What was the amount applied for?.....

38. What was the purpose of the loan ?.....

.....

39. What were the reasons given?.....

.....

.....

.....

.....

40. How did you use this incomplete loan ?.....

.....

.....

.....

41. Have you ever been declined a loan

1. Yes
0. No ☐

42. Which bank .....

43. When did you apply for the loan .....

44. What was the amount applied for?.....

45. What were the reasons given?.....

46. Have you ever been unable to repay a loan

1.Yes
0. No ☐

47. What were your reasons .....

.....

.....

Agricultural activities

48. Land tenure system use in the land you occupy

1. Own land
2. Hired land
3. State land
4. Communal

49. Type of production

1.Animal
2. Crop
3. Both
4. Poultry
5. Piggery

50. Type of farm assets you have

---

51. Do the banks offer you the required loan on time?

1.Yes
0. No

52. Do you have any off farm income generating activities?

1.Yes
0. No

53. Amount spend on:

0. Diesel (used in production season).....
1. Service and maintenance.....
2. Fertilizer.....
3. Insecticides.....
4. Seeds.....

Crop production

54. Person in charge

1. Self
2. Spouse
3. Son
4. Daughter
5.Other

55. Amount of land cultivated

Year	Maize	Sunflower	Sorghum	Groundnuts
1998				
1999				
2000				
2001				

55. Amount of crop harvested

Year	Maize	Sunflower	Sorghum	Groundnuts
1998				
1999				
2000				
2001				

56. Revenue received from crop production.....

57. Type of labour used in production

1) Household
2) Temporary hired
3) Permanent hired

58. Activities done by hired labour

1. Weeding
2.harvesting
3.Irrigation
4.Planting

[ ]

Animal production

59. Person in charge (manager)

1. Self
2. Spouse
3. Son
4. Daughter
5 Other

[ ]

60. Type of Production

1. Cattle
2. Sheep
3. Goats
4. Poultry
5. Pigs
6 mixed (specify)----------

[ ]

61. Number of animals or birds in the specified enterprise

.....

62. Type of labour used in production

1. Household
2. Temporary hired
3. Permanent hired

[ ]

63. Amount spent on labour in these years

1. 1998.....
2. 1999.....
3. 2000.....

63. Production revenue from sales

1. 1998.....
2. 1999.....
3. 2000.....

64.What are the problems encountered when you apply for the loan

.....

65.What are the problems encountered in using the loan funds

.....

66. What should be done to enable farmers to qualify for loans?

.....

67.When would you not be prepared to repay a loan?

.....

68. How do you manage risk for your production?

1. Future contract
2. Insurance
3. No protection

69. How many bank credits do you have currently? .....

70. Through you production process have you manage to repay your bank loans on time.

1. Yes
2. No

71. When was it been paid?.....

72. How do rate your self in preparing the following financial statements?

	No knowledge	**Little Knowledge**	**Good**	**Very good**
1. Balance sheet	----------	----------	-------	-------
2. Income statement	----------	----------	-------	-------
3. Cash flow budget	----------	----------	-------	-------
4. Total budget	----------	----------	-------	-------

73. Do you understand the purpose of this financial statement?

1. Yes
0. No ☐

74. Can you interpret the above-mentioned financial statements?

1. Yes
0. No ☐

75. How are the transaction costs on your side before you receive a loan?

1. High ☐
0. Low

76. Do you provide security before you can get a loan?

1. Yes ☐
0. No

78. Do you have access to market?

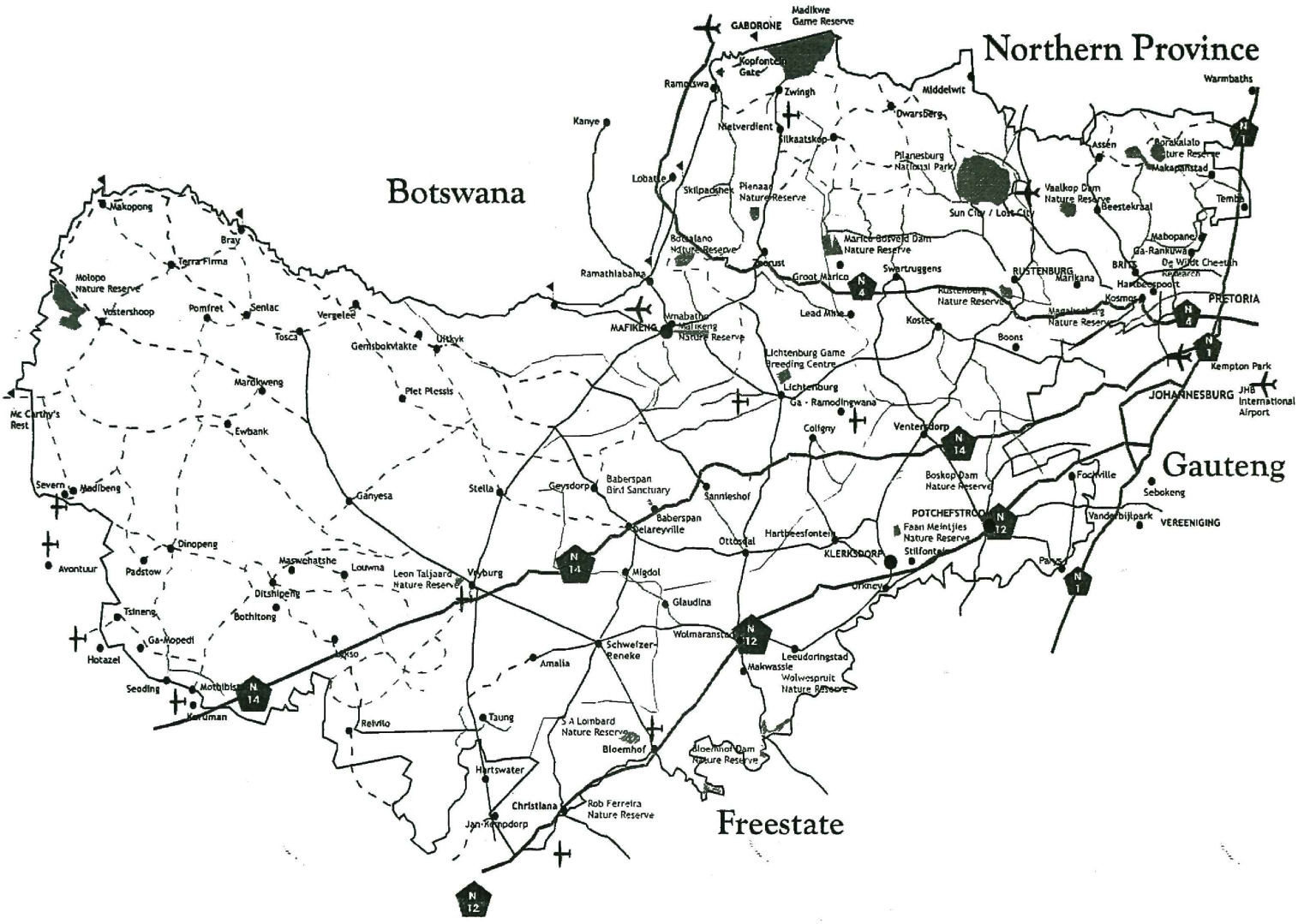
1. Yes
0. No ☐

79. Do you get support from financial institutions after the loan has been issued?

1. Yes ☐
0. No

80. Have you ever use your loan for other purposes than agriculture

1. Yes
0. No ☐


Northern Province
Botswana
Gauteng
Freestate
GABORONE
Madikwe Game Reserve
Kopfontein Gate
Ramotswa
Zwingh
Middelwit
Warmbaths
Kanye
Nietverdient
Dwarsberg
Silkaatskop
Pilanesburg National Park
Assen
Barakalalo Nature Reserve
Makapanstad
Lobatse
Skilpadshek
Pienaar Nature Reserve
Vaalkop Dam Nature Reserve
Sun City / Lost City
Temba
Beestekraal
Mabopane
Ga-Rankuwa
De Wildt Cheetah Research
Molopo Nature Reserve
Bray
Terra Firma
Nakopong
Ramathlabama
Botsalano Nature Reserve
Marico-bosveld Dam Nature Reserve
Groot Marico
Swartruggens
RUSTENBURG
Marikana
BRITS
Hartbeespoort
Kosmos
PRETORIA
Rustenburg Nature Reserve
Magaliesberg Nature Reserve
Vostershoop
Pomfret
Sentac
Vergelee
Tosca
Gemsbokvlakte
Uitkyk
MAFIKENG
Mmabatho
Mafikeng Nature Reserve
Lead Mine
Koster
Boons
Kempton Park
JOHANNESBURG
JHB International Airport
Lichtenburg Game Breeding Centre
Lichtenburg
Ga - Ramodingwana
Coligny
Ventersdorp
Mc Carthy's Rest
Marikweng
Piet Retief
Ewbank
Severn
Madibeng
Ganyesa
Stella
Geysdorp
Baberspan Bird Sanctuary
Sannieshof
Baberspan Delareyville
Ottosdal
Hartbeesfontein
POTCHEFSTROOM
Faan Meintjies Nature Reserve
Stilfontein
KLERKSDORP
Orkney
Parys
Fochville
Sebokeng
Vanderbijlpark
VEREENIGING
Boskop Dam Nature Reserve
Dinopeng
Avontuur
Padstow
Maswchatshe
Louwna
Leon Taljaard Nature Reserve
Vryburg
Migdol
Glaudina
Ditshipeng
Bothitong
Tsineng
Ga-Mopedi
Hotazel
Kuruman
Mothibistad
Seoding
Taung
Reivilo
Amalia
Schweizer-Reneke
Wolmaransstad
Leeudoringstad
Makwassie
Wolwespruit Nature Reserve
S A Lombard Nature Reserve
Bloemhof
Bloemhof Dam Nature Reserve
Hartswater
Christiana
Jan Kempdorp
Rob Ferreira Nature Reserve
N1
N4
N12
N14