# THE VALUE CHAIN FINANCING IN THE PHILIPPINES: A FARMERS' JOURNEY WITH RURAL FINANCE INSTITUTIONS (RFIs)

Country Presenters:

**DARWIN I. VALENCIANO**
**ONESIMO L. CUYCO**
National Livelihood Development Corporation

Regional Training Course on Value Chain Finance in Agriculture
July 15 - 19, 2013
Bangkok, Thailand

# CONTENTS

## INTRODUCTION

### A. The Philippines as an Agricultural Country

In spite of economic growth in other sectors, the Philippines remains an agricultural economy with around 40% of its land area devoted to agriculture. This translates to a 13.04% contribution to the country's gross domestic product/GDP (WorldBank Report, 2012). In the first quarter of 2013, the sector grew by 3.3% as all the subsectors— crops, fishery, poultry and livestock— posted respective increases reaching Php352.5 billion at current prices (Sec. Alcala, D.A. Website). The major crops being produced are rice, corn, coconut, and recently, the sector has just strengthened its campaign to venture into high value crops even for small landholders.

Around 33% of the country's labor force, who are mostly in the rural areas, rely on agriculture as a source of livelihood. These areas are scattered in major islands of Luzon, Visayas and Mindanao and are further dispersed into several island provinces and municipalities. The country is frequently visited by an average of 20 typhoons a year and floods during rainy seasons. The climate change has caused unpredictability of weather which brings worse disturbances in the provinces which were safe back then. These natural calamities, therefore, bolster a higher risk in agriculture posing a serious threat not just to individual farmers but to the entire economy as well.

On the government support to agriculture, there has been a more vibrant initiatives with involvement of various key government departments (e.g., Department of Agriculture, Department of Agrarian Reform and Department of Environment and Natural Resources) and state-owned corporations (e.g., Land Bank of the Philippines, National Livelihood Development Corporation, Philippine Crop Insurance Corporation, etc.) in providing assistance. From the financing standpoint, that trend is shown by the substantial increase in agricultural loan portfolio from Php41 billion in 1990 to Php231.8 billion in 2011 (ACPC, 2012).

### B. Objective of the Country Paper and Outline

The overall objective of this paper is to track the evolution of rural financing or agri-finance in the Philippines and the environment towards the application of the value chain finance. This shall focus on the Land bank of the Philippines (LBP) and the NLDC. Upon doing so, the documentation will further lead to the following sub-objectives:

1) Share the important considerations or innovations being made and the lessons learned;

2) Identify the capability building requirements of the value chain in agriculture (e.g., farmer level and at the RFI level);

3) Identify prospects for value chain finance amidst the growing demand for food.

## EXPERIENCES AND LESSONS LEARNED

### A. Development Efforts on Rural Finance and Value Chain Finance

The policy support for rural finance or financing in agriculture has been undaunted specifically with the Agri-Agra Law in 1970s requiring banks to have at least 25% of loan portfolio devoted to agriculture. This was reinforced by the issuance of Comprehensive Agricultural Loan Fund (CALF) in 1986, and the enactment of the Agriculture and Fisheries Modernization Act (AFMA) in 1997 (Llanto, PIDS, 1993). The *Bangko Sentral ng Pilipinas* and the Department of Agriculture have been devising favourable climate for investors in agricultural loans. Although the commercial banks were hesitant to cater with agri-finance considering the high risk of natural calamities, the presence of government corporations mandated to lend to farmers balanced the situation. The government initiated the creation of cooperatives and cooperative banks that served as conduits of funds to offer financial services in the rural areas. This rural financing approach characterized the Philippine rural finance landscape even up to the current period.

With the natural calamities becoming part of normal lives of farmers, the government likewise created the Philippine Crop Insurance Corporation in 1979 and further strengthened in 1995. Aside from protecting the farmers from financial losses, crop insurance was also considered as a confidence building instrument/financial security that can be offered as "surrogate" collateral to banks and other financial institutions to influence and encourage them to support government credit programs (PIDS, 2009). PCIC organizational structure was decentralized to the regional level to bring the program closer to the farmer-clients and immediately respond to local needs in times of calamities. In 2010, the PCIC insured 98,579 farmers with an aggregate of Php5.92 billion worth of crops/livestock (Yedra, ACPC, 2011).

While there are lapses that could not be fully addressed by the insurance to cover the production loan of farmers, another instrumentality of government-- the Agricultural Guarantee Fund Pool (AGFP) was established in 2008. Government corporations and financial institutions were instructed to contribute 5% of their 2007 surplus funds to form a guarantee fund to address the credit risk of rural financial institutions in order to further encourage them to lend to small farmers. The guarantee assures the reimbursement of 85% of the loan exposure of financial institutions from loan default caused by weather, pests, and other fortuitous events except those caused by fraud. As of 2011, 345 RFIs have been provided guarantee to cover to loans of 124,761 farmers costing Php4.9 billion (Yedra, ACPC, 2011).

### B. Renewed interest of MFIs to cover Agri-financing through microfinance approach or Agri-micro

While the rural financing was traditionally concentrated on the production stage and had been penetrated by the traders or middlemen with exorbitant charges, a growing interest among the microfinance institutions is now shaping in the Philippines. From among the small farmers being served by the National Livelihood Development Corporation (NDLC), there are two modalities of the MFIs entering the agricultural financing. One is for the small farmers to integrate non-farm or off-farm activities as alternative sources of income that would finance the farmers' needs while waiting for the harvest and eventual marketing of their produce. Two is the entry of the MFIs in providing small and programmed credit in the post production stage of the value chain. The former adopts the principle of staggered repayments using the off-farm income, while the latter espouses the staggered release of loan but with a lump-sum payment upon harvest or at the end of the term.

C. Private Sector Initiatives in supporting food security and food supply chain from farm production to marketing

Aware of the possibilities of food insecurity all over the world, and in line with the ASEAN Integrated Food Security Framework (AIFS) the government provided the private sector an avenue to partnership programs. Note that ASEAN policymakers are well-aware of the indirect role of food prices in provoking revolts in Tunisia and other Arab countries leading to the fall of governments in North Africa (Unpublished Article, Nanyang Technological University, 2011). Thus, the business sector has now been increasingly involved with campaign for pro-environment, sustainable agriculture and food security. Specifically, the food related companies have integrated in their corporate social responsibility (CSR) projects and advocacies that would promote expansion in the farming communities and provide ready market to further boost agricultural production.

D. Presence of Value Chain Finance in some MFIs as championed by NLDC's advocacy

In pursuing these renewed enthusiasm among the government, the MFIs and the business sector, the NLDC co-organized a pilot implementation of a project called, "Bridging Small Farmers to the Jollibee Supply Chain". This was an initiative with the Catholic Relief Services (CRS) who has been advocating for the clustering of small farmers so they could have a leverage in bargaining with institutional markets. That goal was made possible with the Jollibee Group Foundation (JGF) which drummed up support from the business sector and initiated partnership building at the grassroots level. (Note: Jollibee Foods Corp., the mother organization, is the largest food company in the Philippines believed to have outweighed a multinational firm in terms of market penetration and income in the Philippines) NLDC enlisted around 10 MFIs which have been very open in redesigning their financing packages just to accommodate the small farmers. To date, some of them have already successfully linked with Jollibee Foods or other companies, and are now in the process of sustaining their operations.

E. Government Financing Institutions highlighting Access of rural poor to Value Chain Finance in Agriculture

With the policy framework and advocacies for small farmers or the rural poor, the government has mandated specialized financing institutions for the agricultural sector. This paper shall concentrate on the two major financing providers, namely, the Land Bank of the Philippines and the National Livelihood Development Corporation.

<u>The Land Bank of the Philippines (LANDBANK)</u>

To promote agricultural productivity and financing, the Department of Agriculture and the Department of Finance jointly launched the LANDBANK Food Supply Chain Program. The program extends financial assistance to the key players in the food system such as the agricultural producers, consolidators, processors and other market players. It also aims to provide capacity building support to strengthen farmers' organizations to enable them to meet market requirements in terms of quantity and quality.

The LANDBANK Food Supply Chain Program as a scheme covers activities for financing from input and production to processing, marketing and others.

There are three main components under the food supply program:

1. Financial assistance to support the requirements for production, and securing working capital for the acquisition of fixed assets. The assistance is not limited to the processors or firms but it also reaches the producers by way of conduit lending through cooperatives, rural banks, etc.

2. Market linkages among cooperative producers and anchor firms. Under this framework, the chain of producers and anchor firms on one side working with the market and consumer side. At the centre of this paradigm, anchor firms aid in the collection of loans so that lending is extended to farmers and fisherfolks.

3. Technical assistance to cooperatives to ensure meeting market requirement for volume and product quality.

The program will supply the following assistance:

1. Agricultural production and production support facilities loans for crops, livestock fisheries
2. Loans for commodity processing and manufacturing to be used as working capital for acquisition of transport facilities and processing equipment or construction of processing and development plant, cold storage facilities and warehouses
3. Loans for marketing and trading operations to be used as working capital for construction of warehouse or storages.
4. Capacity building programs for farmers organizations in the areas of organizational strength, development, product packaging and marketing
5. Technical assistance for improving productivity and product quality

In terms of opportunities, the FSCP of LANDBANK was able to improve financial assistance and SFF reach to small farmers and fisherfolks through coops and other conduits. There is also greater collaboration and synergy between the partner government agencies and the private sector.

The National Livelihood Development Corporation (NLDC)

The experiences of NLDC in rural finance emerged since its creation in 1980s. Given the resources it prudently managed as it helps the rural poor in the past three decades, it was able to offer a variety of programs and services that directly benefit the marginalized sectors which were practically not welcome in the formal banking industry.

It continuously partners with the conduit institutions such as cooperatives, rural banks and non-government organizations which have the competence and expertise in retailing the funds at the community level. Under the current setup, the main recipients are the agrarian reform beneficiaries and their households, who, aside from being tillers of the land, have small enterprises that augment the household income from farming. This means that financing in the rural areas need not necessarily be concentrated on farming activities.

In 2008, the move to further focus assistance to farming communities had come to fruition. NLDC partnered with the Catholic Relief Services and the Jollibee Group Foundation to pilot the implementation of the "Bridging Small Farmers to the Jollibee Supply Chain"\ (FEP, 2009-2012). Each organization put up a counterpart contribution of development resources. The approach was not that simple although the positive effects have been wide ranging.

Within the initial years of pilot implementation, the project was able to:

- Organize some 350 farmers into agro-enterprise clusters, thus consolidating product supply and pooling logistics such as warehousing and transportation;
- Assist farmers to engage in value-adding activities, thus enhancing their compliance to quality requirements. The wives of the farmers, for example, had find a value adding job by peeling the white onions which addressed the demand of the corporate market;
- Increase the knowledge of farmers about farming practices, thus improving their productivity, reducing their cost and increasing their competitiveness. This was expected to result in higher incomes; and
- ➢ MFIs under the project were able to develop their own financing product that is geared towards addressing the loan requirement of the farmers in the value chain.

The project rested on the assumption that a business relationship between modern agri-food companies like JFC and small farmers is mutually beneficial. A well-organized small farmers with the number and geographical spread could provide JFC with a stable, diversified source of supply while meeting the required quality standards. JFC, with 1,600 stores nationwide representing various brands, can provide a stable and long-term market for the farmers' produce.

While the project followed this business model, NLDC, JGF, and CRS were aware of the unique challenges. JFC is a highly integrated company that procures from suppliers that are able to organize their activities from farm production to post-harvest, processing and marketing following the concept of supply chain management.

On the other hand, small farmers were typically unorganized, tilling fragmented farm areas and are used to producing small amounts of low value crops with uneven quality. Their market has traditionally been limited to the wet market – or the trader or the trader's agent from whom they would ask for cash advances or input supplies for farm production or household needs. In effect, they would have sold their crops before these are even harvested. Then, their market horizon would not usually include institutional buyers such as JFC.

The partners looked at the following criteria for selecting the project sites:

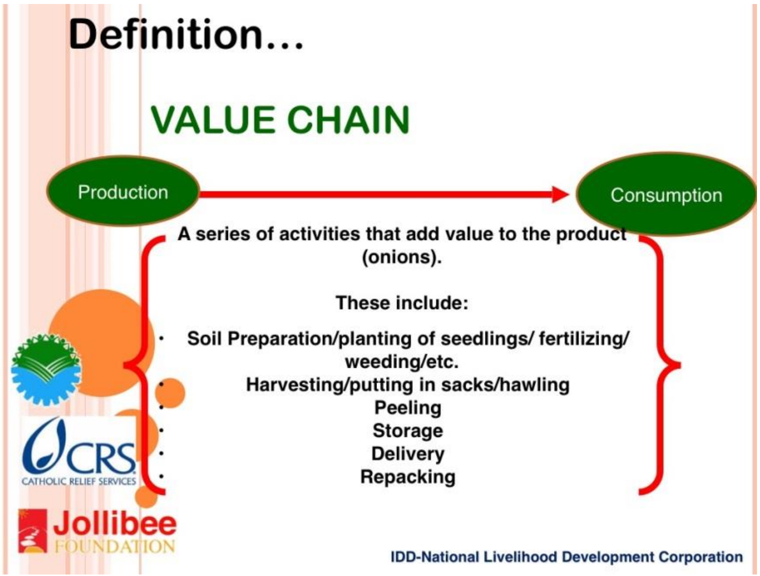
- Presence of a local entity which either be a municipal government unit, a non-government organization (NGO), or people's organization (PO) that JGF, CRS, and NLDC were acquainted with based on earlier interactions.
- An Agrarian Reform Community (ARC) where credit is available from an affiliated MFI of NLDC.
- A product grown in the area that JFC would need in considerable volume so the farmers' production would be market opportunity driven.

The viability of the partnership project is strengthened because of the presence of a financing system that adopted to the situation. Although at first, the mechanics for a value chain finance was not that established yet, the NLDC-accredited MFI was able to devise an appropriate financing package as it went on. Through the Alalay sa Kaunlaran (ASKI), the small farmers were able to access credit without relying too much on the traders or middlemen. The traditional production loan was transformed to other equally important activities in the chain such as the warehousing and delivery of the produce. In this case, ASKI entered into an financing agreement with the farmers considering the market assurance already established under the project. Support to market linkages therefore, functions like a risk mitigating measure that worries the funders a lot aside from the misfortunes brought about by natural calamities.

> Best Rural Financing Practices and Innovations

Looking at the financing program for the above-mentioned project, the MFI was able to identify key areas for financing, namely, buying fund for the consolidated produce, warehousing, and transportation service during the delivery to the JFC.

To illustrate the value chain in the NLDC Project:



Value chain is the series of activities from pre-production (e.g., soil analysis, input buying, etc.) up to the delivery and marketing of the produce to the end-consumer. Typically, the access of rural poor or the farmers are coursed through the traders or the middlemen who owns the capital/money like the most superior among the factors of production. But this has been addressed using the newly developed financing package that is purposively for specific activities in the value chain. ASKI as partner conduit of NLDC designed the financing according to the requirement of the small farmers. The production loan was made on a staggered basis aware of the needs for funds using the farming timetable. In this case, the risk of fund diversion has been mitigated. And because of the succeeding requirements, ASKI was able to devise additional financing products such as the buying fund which is crucial for the farmers to obtain prior to the encashment of the value of produce. Note that the delivery of the produce is also done on a staggered basis and actual payment by the corporate markets could come only after deliveries were made. This setup expanded the opportunities or loan portfolio of the funder.

In a recent consultations made by NLDC, of the 132 accredited MFIs, barely 10% has a variety of financial packages that could cover the chain in agriculture. This situation points that the opportunities for rural finance institutions or agri-financing remain wide. This also points to another reality that small farmers are still handicapped as to the provision of credit for their farming needs.

> Lessons Learned

These experiences brought out the main lesson that rural or agri-financing can be viable provided the market for agricultural produce is assured. This assurance is a risk-mitigation measure that counters the voluminous risks specifically those brought about by natural disasters and infestations. This also proves the continued presence of “traders or middlemen” who act as the financing agents. Simply put, the rural financing structure still needs to be aligned with the specific requirements of the small farmers at a particular time and thus, it is best describe under the value chain approach. It can also be said that the corporate markets could be opened if the farmers would know how to be competitive in terms of their prices, quality and consistency of deliveries.

## ISSUES AND CONCERNS

### Rural Finance Program and Service Delivery

- Financing institutions need to know what are the risks and how these can be addressed. There is a need to know how the loans will be paid given the risks. In financing value chain, a financial institution needs to have a good handle and understanding of the issues related to the different blocks in the chain, and able to come up with mitigating measures to address risks.
- Financing packages remain tilted towards production loan and thus, the farmers are left out as to the succeeding funding especially during times of deliveries. This led to the persistence of the “traders or middlemen” who are actually serving like loan sharks. RFIs have to make a diversified portfolio to mitigate risks so that whatever it takes to run an operation can be recovered. A need to provide simple, affordable, and accessible innovative financial products is called for.

Rural Finance Implementation

- As discussed, rural financial institutions must be encouraged to go full blast in providing funds in the agricultural sector. Although the implementation has been in an upward trend as shown by the government financing institutions' increasing loan portfolio, the private sector, banks, or cooperatives have to increase their portfolio and scale up as well.
- There is also a need to put into place financial inclusion policies not as corporate social responsibility but as a viable business activity.
- Government has to provide more support in terms of technology and infrastructure

Monitoring and Evaluation

- There is no serious monitoring system to track the impact of existing initiatives to the lives of the small farmers.
- Government data is mostly limited to state-owned financing corporations making it hard for farmers to access funds from private entities or that information may already be lacking.

Staffing and Human Resource Development

- The players in the value chain financing need to upgrade their capacities ranging from product development, approaches in dealing with small farmers, strategies in mitigating the risk, and the application of new technology not just in business advisory function but in monitoring of farmers and the development in the financial aspect both at the farmer and institution levels.

Knowledge Sharing

- Operationalization of a legislated credit bureau to enrich the data that lenders use to make better credit decisions. Data should not be limited to those provided by financial institutions. There are other members in the value chain that are rich in data. Credit information allows financiers to understand the risks involved in value chain financing. This will lead to better understanding of value chains and value chain financing mechanisms.
- There must also be mechanisms for value chain stakeholder information sharing and collaboration at the local level so that discussions are focused around specific commodities and value chains. Microfinance councils at the local levels may be used to handle this.

## CAPABILITY BUILDING REQUIREMENTS

### Current Capacities

RFIs have mastered credit management in its strictest sense looking at the risk-mitigating elements such as capacity to pay, collateral and capital of the borrowers. The focus was how to recover the loan funds thus showing excellence in loan collection strategies and restructuring. It could also be observed that the existing setup does not complete the value chain in designing the financing packages for the farmers. And if this is not given emphasis, the farmers are left clueless as to how they proceed with the whole chain and eventually how they approach the end-market.

## Areas for Further Development

Considering the existing capacities, the following areas need further development:

- Service providers need to help in institution building of key players to include value chain, approaches in value chain financing, innovative risk-mitigating measures such as insurance, guarantees and market-linkaging.
- Small farmers or their groups have to be oriented with entrepreneurship, technical production emphasizing on quality standards, market negotiation, costing and pricing, and financial management, among others.

## CONCLUSIONS AND FUTURE DIRECTIONS

The Philippines is undoubtedly an agricultural country. The development of rural financing and the shaping of value chain finance must be farmer-centered. RFIs have to design financial product according to the needs and requirements of the farmers and not merely to satisfy targets usually set under a banking industry setup.

As discussed, the overall loan portfolio devoted to agriculture is indeed increasing and government support is steadfast. But it remains a fact that out of the overall portfolio, the agriculture sector still does not get its appropriate share compared with the industry sector. This condition has to be addressed in a manner that has already been started similar to what the NLDC and LANDBANK have initiated. Under a market-oriented farming approach, it has been established that more and more RFIs and even MFIs would be motivated to venture into agri-financing or the more specific value chain financing.

The initial works have been done. To establish a more sustained effort, the following directions have to be set:

- The government must foster a macroeconomic environment that makes value chain financing feasible and viable. A need to enable policy and regulatory agencies to come up with measures for inclusive finance as well as guidelines for mainstreaming informal financial services (PinoyMe & MCPI, 2012).

- Improve value chains through institutional capacity and capacity-building of rural finance players including the MFIs. This improvement shall impact on the kind of financing products going to be offered to the target farmers. The scenario of varied financing services where the farmers can choose from must be prevalent.

- Small farmers have to be re-oriented that farming is a business and not just a traditional job passed on by their forebears. They have to know the processes of scientific farming from the production to marketing, engaging the RFIs or MFIs as partners to guide them in the farm planning, market negotiation, etc.

- Government support must remain in the areas of technology, infrastructure, insurance and guarantees--- all considered to be risk-mitigating measures on the part of the RFIs.

- Private corporate markets need to be encouraged to accommodate the produce of small farmers under a competitive arrangement. Assurance on quality and consistency of supply has to be established by the farmers in order to fix this farm-to-market institutional arrangement.

The entry and journey of farmers to the value chain approach is never too late. The innovations and lessons learned have to be taken into consideration in order to craft the best rural financing support to the farmers. Gone are the days when farming is a hard job, when bigger income goes to the traders than to the farmers, when the farmers are left out in the whole chain of economic activities. As an agricultural country, the Philippines must not lose its focus to agriculture as the viable business where 40% of its populace depend much in terms of income and know-how.

***

## REFERENCES


Farmers Entrepreneurship Program (FEP) Series of Reports, National Livelihood Development Corporation, Catholic Relief Services and Jollibee Group Foundation, 2009-2012.

Llanto, Gilbert M. "Agricultural Credit and Banking in the Philippines: Efficiency and Access Issues", Philippine Institute for Development Studies (PIDS), June 1993.

Philippine Data Profile, World Bank Report, 2012.

Published Article of Secretary Proceso Alcala, Department of Agriculture Website, May 14, 2013.

Reyes and Domingo, "Crop Insurance: Security for Farmers and Agricultural Stakeholders in the Face of Seasonal Climate Variability", Philippine Institute for Development Studies (PIDS), 2009.

Value Chain Financing for Agriculture and Rural Microenterprises, A conference organized by the PinoyMe and Microfinance Council of the Philippines, August 2012.

Yedra, Ramon, "Managing Risk in Agriculture" presented during the 4th Microfinance Best Practices Forum in Cebu City, Agricultural Credit Policy Council, 2011.