

## Small Farmers in Mozambique Access Credit and Markets by Forming Associations with Assistance from CLUSA

*This case study was written by Douglas Pearce and Myka Reinsch, with research support from Joao Pedro Azevedo and Amitabh Brar. Fion de Vletter contributed key field research. The authors thank Johnny Colon for his valuable suggestions as a reviewer of this case, and Richard Rosenberg and Brigit Helms of CGAP for their helpful comments as CGAP reviewers.*

### Summary

The Cooperative League of the USA (CLUSA) launched its Rural Group Enterprise Development Program in Mozambique in the mid-1990s, when the country was still overcoming armed conflict and settling into a market economy. The program organized 26,000 impoverished, isolated farmers in the northern provinces into associations that could market crops to commodities traders. These efforts led to higher farm gate prices and an 85 percent (inflation-adjusted) reported increase in average annual farm revenues.

The CLUSA program assisted farmer associations to establish better relationships with the commodity traders and other agribusinesses. This enabled smallholder association members to access input credit and short-term crop advances from those agribusinesses, in return for the guaranteed purchase of their output. CLUSA also brokered a partnership with a local financial provider, GAPI, to offer solidarity group loans to the associations. As a result, associations supported by CLUSA established credit relationships that resulted initially in US \$300,000 in agribusiness company credits and nearly \$100,000 in loans from GAPI in 2003, with average repayment rates of close to 100 percent.

### Background

Mozambique is a largely rural country with a territory almost twice the size of the state of California in the United States, and a population half as numerous. After gaining independence from Portugal in 1975, Mozambique adopted a socialist economic system and plunged into 16 years of civil war, gradually emerging as a free-market democracy in the early 1990s. A decade later, 70 percent of the population still lives below the poverty line—most surviving on less than one dollar a day—and a third of the population suffers from chronic hunger. Although less than 20 percent of the country's arable land is cultivated, more than 75 percent of Mozambicans earn their livelihood in agriculture.

When CLUSA launched its program in Mozambique's northern province of Nampula in late 1995, limited credit and inadequate collaboration were among the factors that were constraining the

local agricultural sector. Many small farmers could not afford the small cash outlays (often US \$20–\$60) required to produce and commercialize their crops, and lenders were unable to efficiently supply such small loans. The government's attempts over two decades to provide rural finance at subsidized rates through the previously state-owned People's Development Bank persistently failed. And though microfinance operations began appearing in the 1990s, they remain concentrated in urban centers. Nampula Province was characterized in 1995 by poor transportation networks and communication infrastructure, isolated farmers mostly engaged in subsistence agriculture, almost no economic activity apart from several agribusiness concessions, and a post-conflict culture of relief dependency.

CLUSA is an American NGO run by the National Cooperative Business Association. Established in 1916 to create, support, and advocate on behalf of American cooperatives, CLUSA began

operating internationally after World War II. Its program in Mozambique, which ran from 1995 through 2004, aimed to improve the agricultural supply chain by focusing on small-holders' capacity to produce, market, and profitably sell high-quality agricultural products.

## Challenges and Responses

CLUSA overcame several challenges to organize farmers into self-managed associations and then assist those associations to connect with new buyers, access short-term agribusiness credit, and forge credit relationships with a local financial institution.

### Individual Farmers Linked to Buyers through Associations

CLUSA began its work in the country by bringing together existing farmer associations, as well as unaffiliated farmers, to create a network of more than 800 associations in the provinces of Nampula, Niassa, and Cabo Delgado. Each association consisted of about 30 smallholders; by year-end 2001, they collectively involved about 26,000 individuals. CLUSA trained the farmers to work together as intermediary bodies to identify likely crop surpluses, control quality, collect and weigh the harvest, arrange temporary storage, organize market days, coordinate the transportation of products to buyers, and pay farmers. Under the guidance of CLUSA, these associations also negotiated contracts with new buyers and agribusiness companies.

CLUSA also formed groups of associations, or "forums," to allow farmers to coordinate their agricultural marketing efforts on a broader scale, as well as to register with the government as legal rural enterprises. Simultaneously, CLUSA began to disseminate market information, such as regional and international price and trend data, via newsletters and community radio broadcasts.

By the end of the project's first phase in October 2001, i.e., after six years of CLUSA support, the associations' cumulative sales exceeded US \$3.6 million; more than 21,000 metric tons of agricultural products had been successfully marketed; and average annual sales by farm households participating in an association grew from \$40 in 1996 to \$70 in 2001 (adjusted for inflation).<sup>1</sup> Farm revenues continued to grow in subsequent years, reaching an average of \$74 in 2003.

In early 2004, an evaluation of CLUSA attempted to measure the effectiveness of the program with regard to USAID's investment. The

<sup>1</sup> CLUSA, Business Plan, 2002; Nadeau and Novoa, 2004, Evaluation.

analysis showed that for every USAID dollar spent during the 1996–1998 period, US \$0.46 was generated in participants' household income. During 2002–03, when USAID funding was about 20 percent lower, but the project benefited from the momentum of previous periods, this ratio jumped to \$1.28. The analysis suggested that net returns (measured in household income generated) became positive only in 2002.

### Agribusiness as a Source of Short-Term Credit

The predominant source of agricultural credit for small farmers in rural Mozambique is agribusiness and trading companies.<sup>2</sup> Such credit is vital in an environment where many farmers lack the resources to invest in inputs like seeds, fertilizer, and pesticide at the beginning of the season, or to pay for transportation of their harvest for sale several months later. Agribusiness credit is almost always provided under a contract: in exchange for the inputs or advance, the farmer agrees to sell his/her crop to the company (or individual trader), usually at a pre-arranged price. The company, in turn, promises to purchase the crop from the farmer.

One of the biggest risks to the buyer in contract farming is a practice called "side-selling," which occurs when a farmer diverts part or all of the harvested crop and sells it to another buyer at a higher price.<sup>3</sup> Due to the risk of side-selling, as well as the difficulty of enforcing contracts in Mozambique, companies typically provide input credit (as opposed to shorter-term credit for collection and other marketing costs) to farmers only on monopsonistic concessions, where the company is the only buyer for the crop in a given region.<sup>4</sup>

Leading agribusiness companies active in Mozambique are foreign-owned firms that purchase cotton, tobacco, and maize from small farmers.<sup>5</sup> These companies do not necessarily own the land on which the crops are produced, but usually benefit from government-allocated land "concessions" which grant them exclusive rights to buy the crops produced by farmers in a certain area.<sup>6</sup>

<sup>2</sup> Ruotsi, 2003, Agricultural Marketing.

<sup>3</sup> It should be noted that the inverse of side-selling is also a grave risk to farmers: agribusinesses in Mozambique have been known to decline purchase of contracted crops, leaving farmers with no buyer at the end of a growing season. The need for improved enforcement of contracts is thus as relevant for farmers as it is for agribusiness companies.

<sup>4</sup> Ruotsi, 2003, Agricultural Marketing.

<sup>5</sup> Most are owned by Asian, Dutch, or South African companies.

<sup>6</sup> Boughton et al., 2002, *Cotton Sector Policies*; Ruotsi, 2003, Agricultural Marketing.

To increase the crop production and revenues of eligible farmers, and thereby make them more attractive for receiving input credit, CLUSA established or revived existing associations on cotton concessions and organized them into larger “forums,” comprised of 5 to 15 associations. As with other associations, CLUSA trained them in organizational development, agricultural extension, crop management, and contracting (with an emphasis on the importance of adhering to contract terms and resisting offers for “side sales”). CLUSA also encouraged the forums to register with the government and assisted them in that process where possible. One year after its first interventions in support of contract farming, the number of farmer associations receiving cotton contracts from agribusinesses had increased fourfold, from 18 in 1997 to 79 in 1998. By 2000, a total of 362 farmers’ associations (including those cultivating crops other than cotton) held such contracts and had collectively received more than US \$300,000 in related agribusiness credit.

An example of CLUSA facilitating access to credit outside of concessions is the cooperation between CLUSA-supported farmers’ associations and the European agricultural trading company, V&M Grain Co. V&M provides short-term, interest-free crop advances to farmers’ associations at harvest time, in order to help secure its supply. These loans are made without collateral, but under a contract that specifies the amount, quality, price per kilo and total value of the crop to be delivered to V&M. The loan size is determined by crop value, with associations receiving 50 percent of the agreed value upfront, typically ranging from US \$2,500 to \$10,000 per association. The maximum loan term is 20 days. Associations often use these proceeds to arrange transport to V&M.

V&M has provided such credit to around 30 farmers’ associations, which do not have to be legally registered with the government in order to participate.<sup>7</sup> The company reports low credit losses of around 2 percent, and about 10 percent of crop value lost in side sales, and is generally satisfied with the arrangement and the associations’ performance. But V&M cites side-selling as the main obstacle to expanding the provision of crop advances and finds that the yields per association are still too low to make contracting with them truly efficient. The farmers’ associations, for their part, remain uncomfortable with being locked into a buyer and price—commodity prices often rise in the

weeks after harvest – and would also like to see wider availability of credits at the beginning of the season.<sup>8</sup>

### **Forging partnerships between Farmer Associations and Financial Institutions**

In 1999, CLUSA turned its attention toward finding more flexible credit alternatives for small farmers. CLUSA identified a financial institution, Gabinete de Consultoria e Apoio à Pequena Indústria, S.A.R.L. (GAPI—Unit for Consultancy and Assistance to Small Industries), as a potential partner. GAPI became one of Mozambique’s first regulated, non-bank financial institutions in 1990. Based in Maputo, it provides loans, venture capital, and technical assistance to small- and medium-sized enterprises, cooperatives, and individuals throughout Mozambique. As of early 2003, it had a total loan portfolio of US \$8 million, consisting of 304 loans (including loans to associations) averaging \$26,000 in value.

Providing credit to farmer associations fit within GAPI’s mission and existing portfolio, but the organization lacked the resources to administer small loans or undertake the significant training and capacity building required. CLUSA therefore assumed the task of training farmer associations and organizing them into larger forums. It then facilitated solidarity group loan agreements between the forums and GAPI, with the associations collectively guaranteeing one another’s repayment.

With the help of CLUSA, the associations created an umbrella union of forums and a credit committee structure at the union and forum levels. These bodies are responsible for soliciting and evaluating business plans from the associations, liaising with GAPI to apply for group loans, receiving loan proceeds from GAPI, and distributing smaller credits to associations based on their plans, monitoring use of loan proceeds, collecting interest payments, and ensuring full principal repayment to GAPI at the end of the term. By March 2002, forum loan applications valued at US \$168,000 had been approved under the CLUSA-GAPI agreement.

The GAPI loans are intended for the commercialization of lower-input cash crops (maize, cashews, and beans) during two growing seasons each year. They carry terms of three to four months and monthly interest rates (3 percent in 2002, 2 percent in 2003) charged on a declining balance.<sup>9</sup> Whereas monthly interest payments are required,

<sup>7</sup> V&M does not have a concession, but does benefit from a similar monopsonistic arrangement involving exclusive control over a network of warehouses. Participating farmers may be located on or off concessions, (CLUSA).

<sup>8</sup> CGAP Consultant report, 2003 and IFAD, 2004.

<sup>9</sup> Commercial banks in Mozambique charge annual interest rates of 35–42 percent in an environment where inflation rates are around 10 percent. See De Vletter, 2003, Review of Three Approaches.

principal is paid according to each forum's agreed schedule. Forums are not obligated to draw down the full loan amount from GAPI, even after the contract has been signed.

Although promising, the CLUSA-GAPI lending arrangement faces several hurdles. First, forums must be legally registered with the government in order to qualify for GAPI loans, a requirement that currently excludes 60 percent of their number.<sup>10</sup> CLUSA was assisting the forums with this onerous process, which in 2003 cost about US \$350 and took between six months and two years. Second, side-selling also continues to pose problems, despite the fact that forums engaging in side-selling become ineligible for future GAPI loans.<sup>11</sup> Third, loan monitoring by the forum credit committees needs to be greatly improved. An evaluation by CLUSA in early 2004 revealed that many forums had poor repayment records, engaged in little or no discussion of loans at credit committee meetings, and had experienced some mismanagement, as well as one theft.

### Donors and Partners

The Rural Group Enterprise Program in Mozambique has received support from an array of international and local organizations, including US\$8 million in grants from the U.S. Agency for International Development (USAID) between September 1995 and September 2004. It has also received over US \$3 million from other donors, including CARE-European Union, Oxfam-Great Britain, and the government of Mozambique. A public-private partnership exists between CLUSA and the government's Directorate for Rural Extension, which links CLUSA-supported farmers with government-promoted technologies to improve agricultural output.

The primary source of funds for CLUSA-GAPI loans has been an EU food security grant. GAPI itself was established in 1984 by the German Friedrich Ebert Foundation and has subsequently received financial support from the German development bank KfW, Agence Française de Développement (AFD), the Danish International Development Agency (DANIDA), and the formerly state-owned People's Development Bank of Mozambique.

### Lessons Learned

CLUSA and its numerous donor partners, including CARE and Oxfam, collaborated in northern Mozambique for almost a decade to develop active farmers' associations and connect them with commodity markets and sources of agricultural credit. Lessons from this experience include:

- Farmer associations can make small farmers more attractive borrowers from agribusinesses or financial institutions
- The development of strong, self-managed producer organizations requires a substantial investment of money, time, and expertise. The first six years of CLUSA's work in Mozambique were heavily focused on creating a viable network of farmers' associations and forums.
- While a narrow cost-benefit ratio of initial increases in access to credit (over US \$400,000 in loans received by farmer associations over two years compared to \$2.5 million in funding to CLUSA<sup>12</sup>) is unfavorable, the positive results of the CLUSA project include such long-term benefits as improved access to credit and markets for small farmers, enhanced skill levels, and improved incomes.
- Narrow and often non-transparent credit products, such as agribusiness credit, play an important role in agriculture in developing countries, particularly in the absence of rural financial institutions willing to offer services to small farmers.
- Financial institutions lack the client, market, and production knowledge of agribusinesses, but a broker such as CLUSA can compensate for those deficiencies and facilitate appropriate lending to small farmers.
- Rigorous and ongoing training in credit management and monitoring may be necessary to ensure that farmer associations can effectively manage group loans. Structures may need to be put in place to ensure that such training continues after an international implementer such as CLUSA departs.

<sup>10</sup> Nadeau and Novoa, 2004, Evaluation.

<sup>11</sup> CLUSA attempts to reduce side-selling by raising farmers' awareness about the issue and by threatening to exclude offending associations from future contracts.

<sup>12</sup> CLUSA, 2004, NCBA/CLUSA web site. This figure includes USAID and non-government funding over the same period.

- The broker role played by CLUSA will need to be covered by fees (e.g., from agribusinesses or the farmers) or a percentage of sales, in order to ensure the sustainability of links between small farmer associations and financial institutions and agribusiness companies.

## Conclusion

Between 1996 and 2003, more than 700 farmer associations and 100 forums were established in northern Mozambique under the auspices of the CLUSA program, connecting farmers with commodity buyers and agricultural credit. A greater number of northern Mozambican farmers contracted with agribusiness companies during this period than ever before, contributing to a growth in sales and an increase in their average annual revenues. Moreover, 28 forums—representing approximately 10,000 farmers—benefited from appropriate, flexible credit products provided by GAPI in 2003.

Although the total increase in credit extended to farmer associations (US \$400,000) was not very

large over the nine-year program, it should be noted that as of 2003, the GAPI solidarity loans had only been in existence for two years. Less quantifiable results of the CLUSA program included structural, long-term changes in farmers' access to finance, markets, and negotiating position, as well as enhanced agricultural skills, market knowledge, organizational development, literacy, and community lobbying power.

CLUSA has taken deliberate measures to build sustainability into the forums and associations at many levels, grooming at least one trainer ("animator") in each association to gradually assume the facilitative role that CLUSA trainers play. Thousands of association and forum members have also received training to serve as marketing managers, fiscal committee and institutional board members, and forum managers. CLUSA also worked with CARE International to establish a local NGO, called OLIPA-ODES, to support the associations and forums in western Nampula province upon conclusion of the CLUSA program.

<sup>13</sup> CLUSA, 2004. NCBA/CLUSA web site.

## Bibliography

Boughton, D., D. Tschirley, H. de Marrule, A. Osório, and B. Zulu. *Cotton Sector Policies and Performance in Sub-Saharan Africa: Lessons Behind the Number in Mozambique and Zambia*. Lansing, Mich.: Michigan State University, 2002.

CLUSA (Cooperative League of the United States of America). *Business Plan: Producer Own Trading Company*. Rural Enterprise Development Program. Nampula, Mozambique: CLUSA, 2002.

———. *CLUSA Mozambique Quarterly and Annual Reports* (October 2001–June 2003). Washington, DC: CLUSA, 2001, 2002, 2003.

———. NCBA/CLUSA web site, [www.ncba.coop/clusa.cfm](http://www.ncba.coop/clusa.cfm). Accessed January–March 2004.

De Vletter, F. "A Review of Three Approaches to Agricultural Microfinance in Northern Mozambique." Report prepared for CGAP, Washington, DC, February 2003.

De Vletter, F. "The Evolution of Microfinance in a Successful Post-Conflict Transition: The Case Study of Mozambique." Geneva: International Labor Organization, September 1999.

Muholove, Adolfo Adriano. "GAPI, SARL's Experience in the Promotion of Small and Medium Enterprises in Mozambique: A Case Study on the Provision of Agricultural and Rural Credit in Nampula Province." Maputo, Mozambique: GAPI, S.A.R.L., 2002.

Nadeau, E.G., and M. Novoa. "Evaluation of CLUSA's Rural Group Enterprise Development Program in Mozambique." Draft paper, March 2004.

National Cooperative Business Association web site, [www.ncba.org](http://www.ncba.org). Accessed February–March 2004.

Pearce, Douglas. "Buyer and Supplier Credit to Farmers: Do Donors Have a Role to Play? Rural Finance Innovation Case Study." Paper presented at "Paving the Way Forward for Rural Finance. An International Conference on Best Practices," WOCCU/USAID Rural Finance Conference, Washington DC, June 2003.

Phillips, R., and A. Serrano. "Developing Self-Managed Outgrower Capacity in Zambia and Mozambique." Case Study. Washington DC: CLUSA, March 1999.

Ruotsi, Jorma. "Agricultural Marketing Companies as Sources of Smallholder Credit in Eastern and Southern Africa: Experiences, Insights and Potential Donor Role." Rome: International Fund for Agricultural Development, 2003.

## Agricultural Microfinance Case Studies

### FINANCIAL INDICATORS DEFINITIONS TABLE

**Outstanding gross portfolio**—the outstanding principal balance of all of the MFI's outstanding loans including current, delinquent, and restructured loans, but not loans that have been written off.

**Number of active borrowers**—the number of individuals who currently have an outstanding loan balance with the MFI or are responsible for repaying any portion of the gross loan portfolio.

**Average loan balance per borrower**—the outstanding gross portfolio divided by the number of active borrowers.

**Average loan balance as percent of GNI per capita**—average loan balance per borrower divided by the country's World Bank-published gross national income per capita.

**Total savings deposits**—the total value of funds placed in an account with the MFI that is payable on demand to the depositor. This item includes any current, checking, or savings accounts that are payable on demand. It also includes time deposits, which have a fixed maturity date.

**Number of savings accounts**—the total number of deposit accounts at the MFI, as a proxy for the number of depositing individuals that the MFI is liable to repay. This number applies only to deposits that are held by the MFI, not to those deposits held in other institutions by the MFI's clients. The number is based on individuals rather than the number of groups. It is possible that a single deposit account may represent multiple depositors.

**Average deposit balance**—total savings deposits divided by number of savings accounts, as a proxy for average client savings.

**Portfolio at risk (PAR > 30 days)**—the value of all loans outstanding that have one or more installments of principal past due more than 30 days. This item includes the entire unpaid principal balance, including both the past due and future installments, but not accrued interest. It also does not include loans that have been restructured or rescheduled.

Return on assets (ROA)	$\frac{\text{Net operating income plus taxes}}{\text{Average assets}}$	Measures how well the MFI uses its total assets to generate returns
Return on equity (ROE)	$\frac{\text{Net operating income less taxes}}{\text{Average equity}}$	Calculates the rate of return on the average equity for the period
Operational self-sufficiency	$\frac{\text{Operating revenue}}{\text{Financial expense plus Loan loss provision expense plus Operating expense}}$	Measures how well an MFI can cover its costs through operating revenues. In addition to operating expenses, it is recommended that financial expense and loan loss provision expenses be included in this calculation as they are a normal (and significant) cost of operating
Financial self-sufficiency	$\frac{\text{Adjusted operating revenue}}{\text{Financial expense plus Loan loss provision expense plus Adjusted operating expense}}$	Measures how well an MFI can cover its costs taking into account a number of adjustments to operating revenues and expenses. The purpose of most of these adjustments is to model how well the MFI could cover its costs if its operations were unsubsidized and it were funding its expansion with commercial-cost liabilities.
Operating expense ratio	$\frac{\text{Operating expense}}{\text{Average gross loan portfolio}}$	Includes all administrative and personnel expense, and is the most commonly used efficiency indicator
Loan officer productivity	$\frac{\text{Number of active borrowers}}{\text{Number of loan officers}}$	Measures the average caseload of each loan officer