Review of the Financial Environment for Agricultural Producers in Armenia

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Abstract

The lack of collateral prevents small-scale farm producers and processors from accessing commercial credit. This negatively affects farm productivity and product quality, limits the export potential of products, and prevents further development of the food supply chain. This paper reviews the financial environment for small-scale agricultural producers in Armenia. It reveals that only a limited number of institutions, mainly NGOs, were involved in lending for agricultural purposes. However, the loans often require collateral and are seldom accessible to small-scale producers. The paper provides suggestions and policy recommendations for improving the financial environment for agricultural producers in Armenia in order to support the development of food supply chains in the country.

Keywords: agricultural finance; supply chains

Abbreviations:

ACBA – Agricultural Cooperative Bank of Armenia
CARD – Center for Agribusiness and Rural Development
CMEA – Council of Mutual Economic Assistance
CRS – Catholic Relief Services
ECLOF – Ecomenical Church Loan Fund
FINCA – Foundation for International Community Assistance
GAF – German Armenian Fund
GDP – gross domestic product
HSBC – Hong Kong and Shanghai Corporation
IOM – International Organisation for Migration
MDF Kamurj – Microenterprise Development Fund Kamurj
MFI – microfinance institutions

SEF – Small Enterprise Fund
SME – small and medium enterprises
UMCOR – United Methodist Committee on Relief
USD – United States dollar
USDA MAP – United States Department of Agriculture's Marketing Assistance Project in Armenia
WCC – World Council of Churches

Introduction

Between the period of 1920 and 1991, Armenia was one of fifteen Soviet Union republics. During the Soviet era, about 45% of the GDP was produced by the industrial sector, and agriculture played only a minor role in the economy: 13% of GDP. Armenia was exporting its industrial output to the Soviet bloc countries, but with the collapse of the Soviet Union, the Council of Mutual Economic Assistance (CMEA) dissolved, Armenia lost its export markets, and the industry collapsed (Griffin, 2002).

In response to the situation, the government adopted a rapid reform strategy, whereby a number of reforms were implemented within a very short span of time. One of the first steps in its transformation from a centrally planned economy towards a market-led economy was the privatization of land, which started in February 1991, with the adoption of the Land Code and the Law on Peasant and Peasant Collective Household, and concluded in April 1993 (Spoor, 2005). As a result, almost 333,000 peasant farms were created in contrast to the 860 Soviet-type *kolkhoz/sovkhozes* (CFOA, 2003; Lerman and Mirzakhanian, 2001). Thus, private smallholder farms became the major agricultural producers in the country.

However, having acquired their land, farmers soon found themselves facing a serious problem in accessing capital resources. The breakdown of the centrally coordinated economic system also brought about a breakdown in the relationship between farms and their input suppliers and between farms and their output markets (Swinnen, 2005). For example, processors were unable to secure sufficient quantities of high-quality products from small individual farmers. Nor for that matter could small farmers, acting independently, meet the prescribed sanitary standards. With insufficient capital, they were unable to introduce new technologies, which in turn limited the export potential for Armenian products (Urutyan, 2006).

With so few financial institutions willing to support agricultural activities, limited resources, and little support from government, people were forced to look for alternative sources of financial support. Informal credit, such as borrowing from friends, relatives, and neighbors, became common practice

(Ministry of Agriculture of Armenia, 2002; Kernan et al., 2002). In 1996, informal credit provided more than 25% of the working capital required (Lerman, 1996). In addition, agribusinesses, which depend on farmers for their raw materials, provided the farmers from whom they purchased products with in-kind credit for seeds and fertilizers.

The paper is organized as follows: the next section provides the comprehensive review of the financial environment for agricultural producers in Armenia; section 3 describes the main sources of agricultural microfinance in the country, their products, and their terms of trade; and section 4 presents the main conclusions and gives possible policy recommendations.

Agricultural Credit and Rural Financial Markets in Armenia

At the beginning of 1990s, during the first years of transition, the government of Armenia continued with the programs of directed agricultural credit. Banks were supplied with financial resources to support the operations of state-owned and newly privatized enterprises and farms. In a situation of high inflation and macroeconomic instability, this was necessary to secure the ongoing operation of the sector. However, these credits were not funded from the bank's operations but were subsidized agricultural credit programs. The inefficiency of such programs soon became obvious when in 1996/1997, the banks recorded substantial losses and had to write off a myriad of bad loans (Ministry of Agriculture of Armenia, 2002). Soon after, the government stopped these programs. At the same time, Armenian commercial banks declared that they had insufficient loan funds and insufficient experience to finance the agricultural sector, with some exceptions for downstream agribusiness activities. Overall, the total lending to the agricultural sector was very limited. In 2003, the total lending to agriculture amounted to only 2.5% of agricultural GDP (World Bank, 2005).

Only one bank, the Agricultural Cooperative Bank of Armenia (ACBA), has a notable share of its loan portfolio in agriculture. The bank has almost half of its loan portfolio in production agriculture and a portfolio at risk of less than 2% (World Bank, 2005). ACBA offers small loans to smallholders and small rural businesses. Spoor (2005, p.23) provides the following information: "In 2003, ACBA claimed to have 61% of the total commercial bank portfolio in agriculture. As the overall level of lending is very low, it is no surprise that in 2003 (ACBA, 2004, p.14) the agricultural loan portfolio was only USD 8.8 million."

ACBA has established branches in ten *marzes*, and its services cover 500 villages. It has a client base of about 28,000 (USAID, 2006). All agricultural loans are provided through about 700 village credit associations.

Each association is responsible for the repayment of all individual loans. Consequently, individuals wishing to borrow must first join the village credit association. Village leaders make a preliminary assessment of the credit worthiness of an applicant. The village leaders' approval, a business plan, and collateral equal to 100% of the loan are required for application to proceed. The interest rate for first-time borrowing is 20% per annum. After the first successful round, the interest rate may be reduced to 16%. The average loan term is usually 6 to 8 months, but recently, ACBA has made medium-term loans available for up to two years.

ACBA and USDA MAP also provide larger loans to agribusinesses. An ACBA leasing program provides loans for the purchase of large-scale capital equipment for up to seven years. The nominal per annum interest rate for this program is 18-20%. The USDA MAP Strategic Lending Program provides both short- and medium-term loans at an interest rate of 15% per annum, and the USDA-managed agro-leasing LLC leases agri-processing equipment for periods of 3 to 5 years at 8% interest per annum (Kernan et al., 2002).

A number of donor agencies have provided additional funds to the government of Armenia to support commercial banks in lending to agriculture. The loan funds are made available through subsidiary loan agreements between the Ministry of Finance and commercial banks. The Ministry of Finance selects eligible banks (Table 1) from those banks which meet the standards of the Central Bank of Armenia (Ministry of Agriculture of Armenia, 2002). The borrowers are private agri-processing enterprises and farmers. International credit projects are directed towards financing agricultural businesses and farming activities in marzes. These international loan funds offer lower interest rates than those normally charged by commercial banks. For example, the per annum interest rate of loans from HSBC, one of the largest banking and financial services organization in the world, ranges from 18% to 24% against 13% per annum for loans under an international program. However, credit is still collateral based, and accordingly, the current outreach is extremely limited since potential borrowers cannot offer the required collateral such as gold and/or residential property in the capital city of Yerevan.

Microfinance in Armenia

The microfinance sector is relatively new in Armenia. While the first microfinance program was implemented by Oxfam in 1995, by the end of the 1990s, an increasing number of donor organizations were providing microfinancing facilities in Armenia (Table 2).

The lending techniques vary among the participating institutions, from individual to group guarantee. At least three microfinance providers, including

Table 1. Loan products of banks under international agricultural development programs

Bank	Product	Minimum size (USD)	Maximum size (USD)	Term	Interest (%)	Target population
Converse Bank	Agricultural Reform Support Program (legal entities)	10,000	50,000	< 5 yrs.	12	Agriculture and food industry (USD only)
Converse Bank	Agricultural Reform Support Program (farmers)	500	2,000	< 18 mo.	12	Agriculture (USD only)
Ardshininvest Bank	Agricultural Reform Support Program	-	2,000	1.5 yrs.	18	Only to farmers in the regions
HSBC Bank	USDA Marketing Assistance Project	10,000	250,000	< 3 yrs.	13% fixed rate of the outstanding loan amount	SMEs (food and agricultural). Selection is made by USDA MAP
Anelik Bank	USDA Marketing Assistance Project	5,000	50,000	< 3 years	13% fixed rate of the outstanding loan amount	SMEs and farmers. USD only. Terms of repayment to be settled by the contract

Source: Micro Enterprise Development Initiative (2003)

Table 2. Microfinance providers in Armenia

Provider	Organization Status	Year Launched	Sector
AREGAK	Established by foreign NGO	1997	Trade, agribusiness
MDF Kamurj	Established by foreign NGO	2000	Trade
FINCA	Established by foreign NGO	2000	Trade
SEF (started by World Vision)	Commercial for profit company	1998	Trade, agribusiness
Horizon (formerly Oxfam)	Established by foreign NGO	1995	Trade, agribusiness
GAF	Bilateral donor agreement program	1999	Trade, manufacturing
ACBA	Cooperative bank	1998	Agribusiness
IOM	Established by foreign NGO	1997	Trade
ECLOF	Established by foreign NGO	1998	Agribusiness, trade
WCC	Established by foreign NGO	1997	Agribusiness
Aniv Foundation	Local NGO with no foreign affiliation	2000	Agribusiness

Source: Alpha Plus Consulting (2001)

AREGAK Universal Credit Organization, Microenterprise Development Fund Kamurj (MDF Kamurj), and Center for Agribusiness and Rural Development (CARD), practice group guarantee lending. MDF Kamurj, started by Save the Children and Catholic Relief Services (CRS), was established in 1998 as a nonbank financial institution to provide accessible long-term financial and nonfinancial services to low-income families to improve their well-being. AREGAK, funded by United Methodist Committee on Relief (UMCOR), was established in 1998 as a nonbank financial institution to support economic empowerment and to improve living standards for low-income families, as well as small- and medium-sized entrepreneurs. USDA MAP Credit Clubs and its successor, CARD, have been in operation since 1998. These credit clubs are established around USDA MAP–supported agribusinesses and farmer production and marketing cooperatives. These institutions reach lower-income borrowers, thus, playing a significant role in rural development.

Generally, the market is segmented with different programs serving different market segments (USAID, 2006). For example, the services of ACBA are appropriate for commercial farmers and small- to medium-sized agribusinesses which are able to provide sufficient collateral. The interest rates for these clients range from 16% to 20% per annum.

Low-income borrowers who are not able to meet collateral requirements form another market segment. These borrowers usually pay interest rates of 28–39% per annum. These loans are provided under group guarantees and are collateral free. AREGAK and MDF Kamurj advance loans under these circumstances.

The USDA MAP Credit Clubs and CARD serve small-scale precommercial farmers who are linked directly with processors that are the part of the USDA MAP program. Funds are advanced based on joint liability criteria. The nominal interest rate for CARD is 10% per annum.

Aniv Foundation specializes on individual agricultural credit for small- to medium-sized enterprises with no access to commercial credit. The nominal interest rate for funds advanced under Aniv lending is 12% per annum (Table 3).

Different programs have different terms and requirements in relation to business plans and collateral. Aniv borrowers, for example, must submit a business plan and provide collateral. The collateral requirements are high and amount to 200% of the loan (Table 4).

Loans are provided from 1 to 3 years duration. The USDA MAP program provides short-term loans with the term of 1 year or less. All borrowers need to be members of village credit clubs. The lending is made to the group, usually 15 to 20 people under a joint liability. In addition, a business plan for each member is required. The nominal interest rate for loans advanced through a credit club loan is 10% per annum. According to USAID (2006), the members do not make formal interest payments but receive only 85% of the required loan amount. The remaining 15% is divided as follows:

- 4% is paid to an individual capital fund which remains on the account of the borrowers but is used by the credit club as part of its loan pool
- 5% is paid to a joint capital reserve fund which remains the property of the credit club and is part of the loan pool
- 2% is paid into the joint risk reserve fund that is not part of the loan pool
- 3% is paid to CARD to cover servicing the credit club loans, including training

Table 3. Selected indicators of financial institutions providing credit to the Armenian agriculture and agribusiness sector

Financial Institution	No. of Staff	No. of Borrowers	Average Loan Balance (USD)	Gross Portfolio (USD'000)	No. of Borrowers per Staff	Cost per Borrower (USD)	Nominal Interest Rate (%)
AREGAK	123	17614	326	5747	143	140	28–39
MDF Kamurj	76	6536	317	2075	86	97	28–39
SEF	34	1686	667	1142	50	278	28–39
Aniv	19	174	7036	1224	9	787	12
Agricultural Cooperative Bank (ACBA)	223	28292	1193	33762	127	131	16–20
CARD Credit Clubs	3	969	1709	1656	323	51	10

Source: USAID (2006)

Table 4. Loan products of selected nonbank financial institutions

NBFI	Product	Minimum size (USD)	Maximum size (USD)	Term in Years	Note
ECLOF	Group guaranteed agricultural loans	500	Depends on business plan	< 1	At least 3 farmers needed in the group
Aniv	Technical assistance and loans to rural enterprises	2,000	15,000	< 3	Collateral should be 200% of the loan; immovable and/or movable property
AREGAK	Agricultural loans to women groups	100	Depends on performance	< 1	After every successful phase the loan is increased by 40%; collateral free
MDF Kamurj	Group guaranteed agricultural loans	900	1,700	< 1	Minimum 10 farmers in the group from the same village; interest is paid monthly; Loans are provided in AMDs
Izniryan-Eurasia Universal Credit Organisation	Agricultural loans to legal entities only	10,000	125,000	< 4	Collateral should be 150%–200% of the loan; immovable and/or movable property

Source: Urutyan and Aleksandryan (2005)
Note: The Armenian dram (AMD) is the monetary unit of Armenia; as of January 2008, 1 USD = 350 AMD.

Thus, the program is a unique form of commercialized grant. The credit clubs are registered as legal organizations with the Ministry of Finance and are subject to regular audits.

Not-for-profit microfinance institutions (MFI) have a much stronger position in the market than others. They serve over 82% of the known borrowers. The consolidated outstanding portfolio of the three largest MFIs account for 72% of the total portfolio for the seven main MFI: AREGAK, FINCA Armenia, MDF Kamurj, SEF-ARM International, Aniv Fund, ECLOF–ARM, and Horizon Fund (Dalyan and Graham, 2006).

Compared to commercial banks, between 2001 and 2003, the loan portfolio for the MFI grew by 52% compared to the commercial banks' loan portfolio which grew by just 13%. However, MFIs invest 50.5% of their total portfolio in trade.

There is a high degree of concentration with one MFI (AREGAK) holding between 40% and 45% of the market share (World Bank, 2005; USAID, 2006). According to the World Bank (2005), "MFI's clients seek loans to serve one or a combination of the following needs: (i) working capital to sustain crop cultivation and animal breeding cycles; (ii) small investments and/or operating capital for retail business operations and small trading concerns; and (iii) supplementary liquidity to smooth family consumption needs" (p.23).

Conclusions and Recommendations

The lack of collateral limits the ability of farm producers as well as small-scale processors to access commercial credit. This negatively affects product quality, limits the export potential of Armenian products, and prevents the development of whole food supply chain. In Armenia, only a limited number of institutions, mainly nongovernment organizations (NGOs), are involved in agricultural lending. The loans are often collateral based with high interest rates. Thus, the current outreach to farm producers is very limited.

The government should intervene to create an appropriate environment for the development of agricultural finance in Armenia. The introduction of new financial products with alternative collateral requirements may improve the situation. The training of staff in banks to more accurately assess the risks may increase the willingness of such institutions to enter the market.

The introduction of longer-term credit than that currently offered will support the development of the agricultural sector in general and the development of supply chains in particular. Finally, supporting the formation and the development of agricultural producers' cooperatives may improve farmers' ability to access capital and/or to lease facilities. This will improve both productivity and product quality.

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