

## “ The bankers are interested in the low-hanging fruits ”

Even after 50 years of permanent shortcomings in rural financing, governments and banks are still bent on old-school thinking, the Secretary General of the Asia-Pacific Rural and Agricultural Credit Association maintains. A discussion on risk aversity, green financing and the need for alternative collaterals.

### Mr Das, generally speaking, global crises aside, are farmers in Asia and Africa facing the same challenges?

Theoretically, the overall challenges seem to be same. However, in terms of agricultural production and productivity, farmers in South and Southeast Asia are a little ahead. Asia is the largest producer of rice, feeding rice to the world, and also leads in the production of some vegetables and fruits. Factors this depends on include the comparatively better availability of agricultural inputs and of natural resources like water. The same applies to technical innovations.

### Any other specificities?

Eighty per cent of the world's smallholders are within South and Southeast Asia, and the average land holding is lower here than in sub-Saharan Africa. And the latest Long-Term Climate Risk Index – or CRI – developed by the NGO Germanwatch in 2021 demonstrates that the farmers in Asia are more vulnerable to climate change. On the other hand, politically, Asia is more stable. In Africa, there are countries that have to struggle with civil war and other issues that also have impacted agriculture, albeit indirectly.

### So what about the commonalities?

In both continents, agricultural policies are driven by political issues. And both suffer from insufficient public investment. The governments do support agriculture, but predominantly in terms of subsidies; long-term investment in infrastructure is lacking. Moreover, in both continents, the value chains at national level are insufficiently developed. While within the ASEAN Community, a well-functioning value chain of agricultural commodities has been developed, similar activities are often absent in Africa where the sub-regional agencies are not so strong. Other commonalities include ecological risks such as the increasing degradation of soils and ecological capital, as well as aspects like ineffective population policies and a disorderly rural exodus.

### Is there any commitment in Asian countries similar to the CAADP 10 per cent pledge?

Not exactly. But related to finance, there is a mandatory share of the gross credit going

to agriculture, for example of 12 per cent in India or 4 per cent in Bangladesh. However, instead of financing smallholders, you can also indirectly give the sector money, for example via investments to support agricultural development in general, such as rural electricity or irrigation projects. Regarding smallholders, all the bankers are interested in the low-hanging fruits. That's a very big issue here in Southeast and South Asia. The money goes to short-term agricultural products, commodities, and not so much to the investment side. But finance and investment are two very different things.

### What is APRACA's strategy to address these numerous challenges?

There is no one-size-fits-all strategy at operational level. Asia is very big, spanning countries as different as China or Korea, India or Bangladesh, Iran or the Pacific Islands. The issues and challenges of our member institutions are unique to each of these regions, and our engagements vary accordingly. Based on the feedback we get every quarter from members, we organise our specific programmes. Within our local-sub-regional-regional approach, we have five pillars of interventions: a policy and dissemination platform, capacity and institution building activities, project implementation services, advisory services and policy research, and knowledge management services. Gender and sustainability are cross-cutting issues.

### And what are the main contents?

In the current biennium, there are four priorities: Green and Climate Finance for Sustainability, Value Chain Strengthening and Finance Agri-SMEs, Risk Proofing in Agriculture and SME Finance, and Digital Financial Service to Agriculture and SMEs.

### Let's talk about the first priority. How do you support smallholders regarding "green and climate financing"?

For several years now we have been collaborating with CGIAR to identifying the financial instruments aimed at incentivising smallholder farmers and other direct food system actors to improve their socio-economic sustainability while protecting and restoring nature and promoting resilience to climate change in the Global South. Currently, we are working with



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the SEI, the Stockholm Environment Institute, on developing or upgrading of financial instruments to support inclusive green finance in ten countries in the Asia-Pacific region.

### How does "green finance" differ from "climate finance"?

Green finance is considered as a potential vehicle to accomplish the global agenda on sustainable transformation in order to transition to a new economic and financial era. This is one of the greatest opportunities in decades for investors and financial institutions to switch from vanilla ventures to sustainability-focused green asset products.

### Can you specify this for the agri-food sector?

There is no universal definition here. We say that green finance to the agriculture and food sector is an approach to effectively use all types of financial services – credit, savings, insurance, guarantees, etc. – directed to the agri-food sector with the overall objective to achieve greater resource efficiency in agriculture and envi-

ronmental sustainability with a climate-smart approach, and to enhance the quality and safety of agri-food produce. In our opinion, resource efficiency plays an important role, for water, soil and the other natural resources are scarce. So finance going into changing the cropping system, for instance, will be considered green finance. Yielding economic, social and environmental benefits to all actors in the agri-food sector, green finance targets a triple bottom-line.

### What does that mean in terms of the financial architecture?

In traditional agricultural finance, we basically depend on the government bank and financial system, e.g. the development banks, but green finance centres around unlocking private capital. That will be like a new window for agricultural finance and make a big difference.

### And how can you get this green finance going?

To promote the flow of finance to green growth in the agricultural sector in a sustainable manner, public support mechanisms are required, such as macro-level enabling policies and project-level support. And accelerators – or escalators – are needed for generating new ideas and eventual investment demand for green initiatives. We have defined four of these escalators: innovation incubators, networks and associations, research and advisory services, and international cooperation.

### What could obstruct implementation?

Traditional agricultural finance is already extremely challenging for our member institutions because of the embedded risks, the non-availability of instruments, lack of policy support etc. But this is only one hurdle. If you are a banker, you think about banking rather than agriculture, cropping systems and how to make things greener, sustainable, resource efficient ... none of this concerns you.

### So we would need to have agricultural experts in the banks?

Agricultural experts are important for the financial institutions. However, the bankers do not see the importance of the escalators in improving the delivery of green finance. Our experiences and understanding show that there is a high potential of increased green finance if the banks can work with all four escalators. But there is also a lack of tailored financial products. Let's take India, the biggest market for agricultural finance for the banking sector. The bankers there mostly rely on financing the Kisan (Farmer) Credit Card, given for three or five years, which can also be used for claiming



Conventional financing approaches and instruments are often not suitable for small rural entrepreneurs. Blended finance has proven to be very effective.

Photo: Jörg Böhling

insurance from the government. With that, as a banker, you are trying to keep yourself in a risk-free zone. This low-hanging fruit does not allow bankers to go up and see the better fruits in the treetops which can potentially improve the household assets of smallholder farmers. Over the last 20 years, South Asian farmers have not improved their household assets, and no concrete steps have been taken in that direction. One reason might be that agricultural finance is mostly subsidised and does not follow the market criteria. The bankers embark on agricultural finance because it is a government requirement, but they still don't see this as a business.

Another important issue is what we call "alternative collateral instruments" to mitigate agriculture-related risks. Most of the bankers in Asia, Africa and Latin America are only keen to finance if you have a hard collateral – like some land or fixed deposits. They think that these are marketable collaterals, but they are not. If you have taken land off a farmer who cannot pay, you can't sell the land because of the social issues it raises. Nobody will buy it from you. Therefore, we are trying to teach our bankers to accept alternative collaterals.

### What could these be?

These might be good regulation, good infrastructure or cash-based financing. When you know that your farmer is selling his produce to a trader who has a bank account, then the banks are aware of the transactions which will help them consider a cash-based financ-

ing mechanism. Let's take the example of McDonald's. They pay the farmers after 60 days, which clearly helps the banks to calculate the financial requirements for each cycle of activities as the return is guaranteed.

### What about barriers on the demand side?

One is the slow pace of adaptation. It took one generation to understand the impacts of climate change. Moreover, although having some strategies, most of the countries lack good agricultural practices as a regulation. Non-diversified household income is a third barrier. If farmers have no alternative income stream, we will not take any collateral from them. The low level of awareness about green finance products and instruments is another aspect, as is the low literacy level in many developing countries.

### Looking back at more than 40 years of experience in rural finance now, which changes have brought about the greatest success?

One of the major breakthroughs is group financing. In South Asia for example, 60 per cent of smallholders have less than two acres of land. These farmers are not commercially viable, resulting in most of them leaving agriculture and migrating to a city site for a petty job, while farmland is converted for non-farming purposes. When farmer producer groups come together and pool their land, they make it a viable proposition, even for the bankers. If they do this in the shape of a private limit-

ed company or registered company, however, most of the farmers need help – either from the government or the private sector. What we see is that the private sector is more active here, working with contract farming for example, which is a win-win.

The second breakthrough is related to the instruments. We all know that the common instruments in agriculture have not worked for various reasons. One interesting new instrument is blended finance, which means employing development finance to mobilise additional finance, which, in order to reach the smallholder farmers, needs to be slightly adapted. For example, in Vietnam, the women farmer groups are getting finance from the Agribank Vietnam, who are financing in bulk through a blended instrument with the support of the government. The women group pass it on to their own members. This has been very successful. Of course, such an approach has to be scaled up and contextualised for the respective country context.

The third important area is the evolution of networks. Some 40 years ago, APRACA was the only networking institution in the region regarding finance. But today, there are many of them, for example the microfinance networks all countries now have. These networks play a very important role, and we are currently trying to bring them into a common group which is a “network of the networks”. The fourth success factor is good agricultural finance research, which is now coming up. The Rural Finance & Investment Learning Centre, RFILC for short, is performing great work in disseminating such knowledge as well as in corresponding management.

### **Despite these breakthroughs, only a small share of climate finance has so far directly reached the smallholder farmers. How can this be changed?**

To bring green funding to the local level, social responsibility among all stakeholders is just as important as environmental stewardship. The smallholder producers must enjoy economic gains. But this is also true for both upstream and downstream value chain actors. There is

still a big gap in financing the small- and medium-sized enterprises who process the commodities the banks are financing. Countries of the Global South often lack infrastructure, storage facilities and market infrastructure. But if you want to do green finance from the start to the finish, you need this infrastructure.

### **Must banks generally rethink their practice?**

Yes, but above all, so do the governments. Even after 50 years of continued engagement with the financial sector, the national governments have been unable to mainstream agricultural finance within the commercial banking system. We lack policy commitments to long-term investments needed for greening the agri-food sector – this refers to the infrastructure mentioned before, but also to soil health, smart forestry, ecosystem services, circular agri-based industries, etc. The volume of agricultural finance is increasing annually, which is a good indicator of its growth. But in most countries, this growth is still state-sponsored and not considered commercial growth. Here, there has to be a process of rethinking among politicians – away from subsidies and towards fiscal incentives.

### **And at instrumental level?**

There are numerous promising instruments and good practices, including, for example investment funds and bonds or the already mentioned blended finance and value chain finance. Technology-enabled innovations such as digital finance support, blockchain or app-based lending platforms are already being applied. Innovative risk proofing techniques are also available, such as partial guarantees. It is encouraging that more and more FinTechs are coming up, which aren't banks as such but are getting financial support from the big banks. One example is India's NABARD – the National Bank for Agriculture and Rural Development. NABARD finances the FinTechs, which in turn finance the bulk of farmers. In this manner, NABARD can control the terms and conditions for the FinTechs, and when one takes a loan from a bank at a lower interest rate, it has its cost already embedded and can also provide a loan at a lower interest rate than

the market. This raises market competition, and the more market competition, the more government subsidies will decrease, making it easier for smallholders to take a loan.

### **So we need fresh thinking?**

Absolutely. We still see some old-school thinking about risk-proofing techniques. There are three major instruments here in agriculture: insurance, collateral and guarantee. I don't consider these useful anymore. I propose that risk management be mostly cash-based finance. But for that, you need some support from the government in terms of identifying the value chain actors. China, for example, has started mapping all actors in the top 15 commodities. We propose that the Indian Government do this too. This will help understand what the issues and challenges are, and where finance and commodities go.

### **What are you currently concentrating on?**

Taxonomy is a big issue. We started thinking about using the European Union's green finance taxonomy. But does it make sense to use a system based on the European agricultural finance and crop system, which differs completely from that in Asia? Here, a lot of international banks are getting much money from donors doing greenwashing, which we don't like. So I started talking about how to develop our own nomenclature. But it's difficult to reach an agreement in the region – countries like China, for example, have their own taxonomy. This is one of the items we seek to address in our IKI – The International Climate Initiative – project. So for our next June meeting, we have kept one full day for our Central Bankers to discuss green finance taxonomy or green taxonomy.

### **Has COP 27 helped bring the topic of green finance forward?**

It will be helpful if they talk more about adaptation. Around 70 per cent of green financing across the globe goes to mitigation, which is important, but we also need funds for adaptation with special reference to agricultural activities. Most of the Development Financial Institutions are interested in mitigation finance, because it is a hard, tangible structure, unlike adaptation, which requires social engineering and patience. It will be great if the COP 27 declaration can support the national governments in finding a good mix between adaptation and mitigation – that will be a big help in financing small-scale agriculture.

#### **APRACA**

The Asia-Pacific Rural and Agricultural Credit Association (APRACA) was founded in 1974 with the support of the UN Food and Agricultural Organization (FAO). A current 87 institutions in 24 countries in the Asia-Pacific Region are among its member institutions, with the region being divided into five sub-regions: South Asia, Southeast Asia, East Asia, Central Asia and the South Pacific Islands. Currently, the APRACA board is headed by India and co-headed by China.