



ADAPTIVE APPROACHES TO FACILITATING FINANCE IN MYANMAR'S AGRICULTURE SECTOR: A REVIEW

USAID VALUE CHAINS FOR RURAL DEVELOPMENT

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INTRODUCTION

In collaboration with local partners in Myanmar, USAID's Value Chains for Rural Development (VCRD) project is helping rural smallholder farmers and processors find affordable pre-season financing to successfully enter **higher-value domestic and international markets**. After five years of VCRD value chain development assistance for soy, ginger, coffee, sesame, and melons, better skilled, equipped, organized and market-oriented entrepreneurs are now producing higher-quality products, establishing direct and transparent relationships with buyers, penetrating new markets, and obtaining higher prices.

This review describes how VCRD has empowered banks, farmers, and agri-businesses to identify, evaluate and tap previously elusive – or simply unavailable – financing opportunities in Myanmar, including pre-season working capital loans, microfinance, credit for input purchases and equipment, and pre-procurement loans (trade financing) – **in many cases for the first time**. The long-term success and ability of smallholder farmers, processors, and other Small and Medium Enterprise (SME) owners to benefit from Myanmar's transition hinges on the flow of capital to some of those who need it most: the farmers and other food system stakeholders whose hard work contributes 30-40 percent of the country's overall Gross Domestic Product.

CONTEXT AND CONSTRAINTS

Using a market systems approach, VCRD facilitates access to improved, on-farm and post-harvest practices and technologies, processing facility upgrades, and higher-value markets. Lack of access to finance at reasonable rates has been a major barrier to the competitiveness and profitability of smallholder farmers and SMEs engaged in value-added activities, such as processing, packaging, distribution, and retail. Traditionally in Myanmar, smallholder farmers borrowed from family members or local moneylenders. Historically, access to formal credit has been constrained by problematic banking regulations, lack of banking experience, and inadequate credit risk management tools. Below are a few examples of these and other barriers:

Supply Side – Formal Sector

- Banking regulations in Myanmar specify the minimum interest rate banks must pay on deposits (deposit interest rate floor) and are allowed to charge on loans (lending interest rate cap). The narrow spread between the cost of capital and interest income makes it difficult for banks to identify financially viable loan products, particularly for high-risk borrowers like farmers who lack credit history and collateral.¹
- Myanmar banks have not been staffed with loan officers who understand the market potential of agricultural crops (other than perhaps food staples).

Supply Side – Informal Sector

- Traditional money lenders charge high interest rates. Agriculture input suppliers and buyers of agricultural products are generally reluctant or unable to provide credit to farmers.

Demand Side

- Myanmar was a mostly cash-oriented society for more than five decades under military rule. As recently as 2018, only about 15 percent of Burmese had a bank account.
- Myanmar people mistrust banks due in part to demonetizations of local currency in 1964, 1985, and 1987, which rendered Kyat notes worthless overnight without adequate compensation measures.
- Previous laws that prevented free assembly also prevented formation of farmers groups that could evolve into market-oriented, for-profit producer enterprises able to qualify for credit.
- Rural smallholders are often isolated and/or must travel long distances to reach bank branches or microfinance offices.

¹ Prior to 2019, interest rates were capped at 13 percent for both secured and unsecured loans. As of January 2019, this has been modified to allow banks to charge 16 percent on unsecured loans.

BACKGROUND

The VCRD project is part of the U.S. Government's global food security initiative, Feed the Future, and is implemented by Winrock International. The five-year initiative (2014-2019) aims to sustainably reduce poverty in Myanmar by improving the productivity and profitability of smallholder farmers and facilitating market linkages to improve the competitiveness and inclusiveness of selected value chains. VCRD works with diverse smallholder farming communities in the coffee, soy and ginger value chains in southern Shan, and in the melon and sesame value chains in the Central Dry Zone (CDZ). The project team selected value chains in consultation with USAID using a scoring and ranking system that considered: 1) potential profitability for smallholders; 2) market potential and commercialization; 3) potential for development of private sector alliances; 4) ease of entry; 5) potential for value-added; 6) potential inclusiveness (rural poor, women, youth); and 7) potential to scale.

During the project's first two years (2014-2015), VCRD emphasized working with smallholders, processors, and input suppliers to improve yields, quality, and sales of targeted commodities. The project team identified commodity characteristics (such as quality, size, color, and flavor); production characteristics (such as chemical residue free, volume, location, and season); and marketing characteristics (certification, traceability, packaging) that determine product quality and market value -- and then focused support on helping smallholders grow and sell higher quality produce. For the first production cycles of each value chain (from planting to harvesting and selling), interventions focused on promoting improved on farm and post-harvest practices and technologies (seeds and other inputs), using demonstration plots and intensive farmer training in partnership with community-based extensionists. This "direct delivery" approach to project interventions reflected the operating environment in Myanmar. The country had only recently (2011) opened after five decades of political and economic isolation, and lacked established farmers groups, service providers, and access to the information, inputs, technologies, and credit. Mid-way through the project, interventions shifted to building the capacities of local firms and Non-Governmental Organizations (NGOs) to provide services to smallholders and farmers groups on a sustainable basis. In parallel, the team promoted



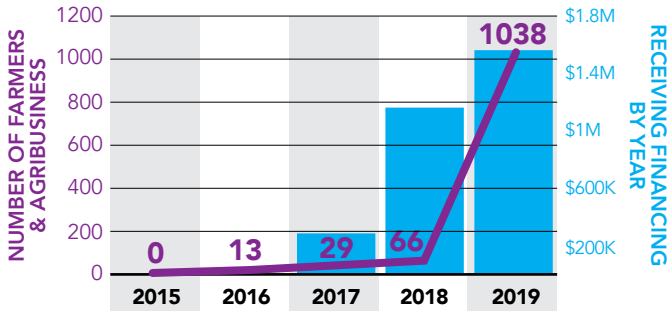
A major sesame buyer provided members of the Sesame Farmer Development Association (SFDA) with pre-season loans to help them produce GAP-quality sesame and earn quality premiums for the first time (August 2018).

a buyer-led approach to help producers and processors understand and align with buyers' preferences. It facilitated business-to-business (B2B) events to help link market actors and supported subsequent pilot activities to test new ways of doing business related to aggregation, quality control, and marketing. The project's most significant contributions to value chain development to date have been achieving proof of concept for new production and marketing models that can now be scaled to engage larger numbers of farmers, processors, and buyers.

UNLOCKING FINANCE: BRIDGING A SYSTEMIC GAP

VCRD did not set out explicitly to improve access to finance. However, as the project delved deeper into systemic problems thwarting value chain development, it became increasingly evident that smallholder farmers could not obtain the funds they needed to experiment with new production and sales models. Consider the case of smallholder coffee growers in the remote upland communities of Ywangan Township in southern Shan. By 2016, as a result of collaborating with VCRD and community extension providers, smallholders began to harvest and process high quality, specialty grade micro-lots of sundried Arabica green beans, attracting the interest of buyers from some of the most prestigious importers and roasters in the world. Some of those buyers were willing to pay two-to-four times the global price for commercial grade green beans (such as Blue Bottle of Oakland, CA; Atlas Coffee Importers of Seattle, WA; and Allegro Coffee of Boulder, CO). However, to meet buyers’ quality and volume targets, producers required pre-season working capital to finance the purchase of drying tables and coffee cherries. Similarly, the Kyet Thet Soybean Farmers Group needed working capital to finance production of quality seed, a critical input for improving soy yields and quality.

VCRD responded by including bank credit officers in value chain B2B events, to help them gain a better understanding of market opportunities from key value chain actors – buyers who shared knowledge of market demand for specific commodities and producers who shared information on production potential and financing requirements (refer to box). **Since 2015, VCRD has catalyzed an estimated \$2.94 million in affordable loans and credit that empowered more than 1,000 farmers and/or agribusinesses to diversify and expand production.** VCRD’s approach has been to link borrowers and lenders and empower them to



Saw Dino Ku, Executive Director of Ayeyarwady Farmers Development Bank (known as “A bank”) noted in a 2018 interview that agriculture lending is an extremely risky business in Myanmar due to potential crop failures and lack of crop insurance. Nonetheless, with VCRD support A bank has become a pioneer of value chain lending in Myanmar, due in part to its willingness to build relationships with farmers and learn about their market opportunities and financing needs.

“Most banks in Myanmar are not familiar with cash-flow based lending,” he said. “We only think about collateral. If you have collateral, we can lend, but it’s not like that in agriculture. We have to listen to the needs of the customer. We just lacked the knowledge, and most banks here do not have the skillset to do agriculture. It’s very challenging at the Board of Director level, they don’t understand the agriculture market so it’s really hard for us to convince the Credit Department to take these kinds of risks.” He added that A bank “thinks about the structure of financing, and we see three key categories: 1) access to markets; 2) access to knowledge and 3) access to finance. Most people in Myanmar think only about the financing, not about whether the customers have the knowledge and skills to deliver the product you bought.”

experiment with new forms of financing, moving from traditional sources of financing (described above) to better-resourced stakeholders/partners who have provided **collateralized or guaranteed bank loans; loans based on cash flow; and longer-term private equity investment.**

To facilitate this evolution, VCRD drew on the knowledge, experience and connections of its team and key, private sector partners to match farmers committed to producing higher-quality commodities to input suppliers looking to expand their customer base, and to processors and other buyers looking to expand and better manage their supply chains. For example, in 2017 the Kyet Thet Soy Farmers Group in southern Shan received a \$4,400 loan from Jaguco Myanmar Co., a private sector input supplier, and successfully aggregated and sold high-quality grain to a local tofu manufacturer. Based on the successful pilot, in 2018 Ayeyarwady Farmers Development Bank (“A bank”) provided a \$13,000 loan to expand production and value-added processing by purchasing soy from other farmers groups and drying it. This was one of the first loans by a national bank in Myanmar to smallholders engaged in a crop other than paddy.

The **importance of early relationship building** between value chain actors and potential financiers cannot be over-emphasized. Potential lenders needed time to interact with and observe the business perfor-

mance of potential borrowers -- at least for a season or harvest period -- to assess their ability to meet buyers' requirements and generate adequate revenue streams. Participants traded information and scoped opportunities at B2B and trade promotion events, field days and demonstrations, and post-harvest review meetings. In addition, VCRD helped farmers form **for-profit producer associations** that helped cultivate relationships with buyers, aggregate production, provide quality control (and in some cases traceability), negotiate better prices, reduce transaction costs (compared to those charged by traders), and apply for loans on behalf of members. These interventions laid the foundation for VCRD brokered loans to producers' associations that represent agricultural finance *market firsts* in Myanmar.

Below are some of the different, adaptive mechanisms VCRD utilized to help connect partners to capital or credit:

Model 1 – Supplier credit.

In 2018 Good Brothers Co., a family-owned input supplier, sold the Sesame Farmer Development Association (SFDA) 56 metric tons of high-quality compound fertilizers valued at about \$25,600 on interest-free credit to bridge the 5-month period from planting to harvest. SFDA's pre-season sales agreement with a major sesame exporter helped mitigate the credit risk.

Model 2 – Loan guarantees.

In 2017 VCRD helped facilitate Yoma Bank's first-ever guaranteed loan in the amount of \$143,210 issued to a large coffee processor and guaranteed by the Dutch social lender Rabobank Foundation. The coffee processor, whose members are coffee estate owners, agreed to on-lend to 13 organized coffee producing communities in Ywangan and a small coffee processor. Rabobank's agriculture loan guarantees in Myanmar have evolved in three significant ways: In 2018, the loan value

to this processor increased to \$645,000 and the loan guarantee dropped from 100 percent to 80 percent. The lower percentage represents a better lending practice from a market transformation perspective, because it ensures that the lender has an incentive to avoid a loan default. In 2019, Rabobank guaranteed the first non-collateralized loan issued directly to a community-based producers association, once the Ywangan coffee producing communities formed a for-profit producers association and successfully exported specialty coffee (refer to box).

Model 3 - Collateralized loans.

In the soybean sector, A bank made its first collateralized loan to farmers in 2017, providing \$13,000 to the Kyet Thet Soybean Farmers Group, a well-organized group focused on quality whose leaders guaranteed each other's financial commitments by providing proof of land ownership.

As news about these pilot loans spread, new investments in value-adding infrastructure based on cash flow projections, not collateral, also began to materialize. For example, in the sesame value chain, a Singaporean infrastructure developer, InfraCo Asia, linked to SFDA by VCRD, in 2018 decided to invest in a temporary aggregation/distribution warehouse run by the motivated new SFDA in Magway Township. A pair of private sector ginger processors, Green Eastern Agri and Heho Potato Co., invested separately in new ginger washing/packing facilities in southern Shan and began exploring export market leads facilitated by VCRD. Previously, investors were interested mostly in making downstream investments, supporting expansion of machinery, equipment, or buildings, for example, to help processors (most of whom can offer collateral) grow their businesses. Loans to these entities supported higher capacity, increased sales and standards, which helped increase demand for smallholder production. In general, lending to farmers was not a priority -- until now.

First non-collateralized working capital loan to a community-based producers association. In 2019 A bank provided pre-season working capital loans, guaranteed by Rabobank Foundation directly to Amayar Women's Coffee Producer Group and the newly registered Shwe Taung Thu Coffee Co., the association established by the Ywangan coffee producing communities. This was an important milestone for A bank. The project's prior attempts to broker a loan with A bank had been unsuccessful due to lack of confidence on the part of bank employees responsible for making lending decisions -- a consequence of lack of experience with agriculture lending and a loan application form that did not capture adequate information for assessing credit worthiness. A bank has since adapted Rabobank's loan guarantee application for their own use, paving the way for more robust future lending in agriculture and other sectors.

Below are three illustrations that show how VCRD-brokered financing was used for value chain transactions related to sesame, coffee and soybean:

Figure 1: \$17,000 sesame value chain financing provided by a buyer, International Best Manufacturing (IBM), in conjunction with a pre-procurement deal with SFDA in Magway Township, CDZ



Steps: 1) Buyer (IBM, a local processor and exporter) commits to SFDA to purchase a specified quality (Grades A&B), variety (white sesame), and volume (up to 300 MTs) and makes a pre-payment for the first shipment. 2-3) SFDA manages a temporary collection center in Magway and uses the loan as a revolving fund to pay producers as they bring in sesame throughout the season. 4-5) SFDA delivers to IBM and receives immediate payment, including a 1 percent price premium for its role in GAP traceability, which it uses to help cover management costs. 6) SFDA repays the loan at the end of the season.

Figure 2: Coffee value chain financing (\$645,000) provided by Yoma Bank to a large coffee processor and guaranteed by Rabobank Foundation, with on-lending to smallholder communities



Steps: 1) Coffee importers/buyers “cup” coffee samples from community-based micro-lots and make verbal purchase commitments with quality and volume specifications. 2-3) Rabobank Foundation guarantees up to 80 percent of the value of a loan issued by Yoma Bank to a processor/exporter. 4) The processor disburses portions of the loan to local farmer association to enable them to buy cherries. 5) Association members and other farmers deliver ripe coffee cherries to the association for aggregation and processing. 6) Producers receive their “first payment” at this time based on local cherry prices. 7) The association oversees the drying process and delivers green beans to the large processor, who provides export services on a fee for service basis (as a supplementary business line). In addition, the large processor buys cherries from other communities, which it sorts, mills, dries or washes, and exports as its primary business line. 8) The processor ships the coffee to the buyer. 9) The buyer sends payment to the large processor or the local farmer association (depending on who owned and sold the beans). 10) The local farmer association provides a second payment to farmers that reflects the profit earned from value-added processing (after deducting for marketing costs). The processor also on-lent a portion of the loan to a local small processor (this small processor structured its transaction differently. This is omitted from the figure for simplicity).

Figure 3: A bank provides a \$13,000 revolving loan fund to Kyet Thet Soybean Producers Group in southern Shan



Steps: 1) A bank issues the producers group a \$13,000 loan in 2018, using members’ land holdings as collateral. 2-3) Kyet Thet bought larger volumes of high-quality, food-grade soybean grain from other local farmer groups, then aggregated and dried it according to buyers’ specifications. Kyet Thet also used the loan to produce high-quality soybean seed varieties. 4-5) Kyet Thet delivers on the order and receives payment immediately.

Encouragingly, by the end of 2018, Myanmar’s financial sector was beginning to develop new financial products, such as commodity transport insurance offered by a major domestic bank now being utilized by melon farmers in the CDZ. Crop insurance, credit insurance ratings and other products may be offered soon. Private sector partners are continuing to invest, with Nespresso, the Switzerland-based specialty coffee giant, now linked to Indigo Mountain Coffee Co. in Shan, and local coffee retailers and roasters forging direct-purchase relationships and in some cases, offering pre-season capital in return for a share of the most coveted Myanmar coffees. In addition, the Government of Myanmar’s Cooperative Department (under the Ministry of Agriculture, Livestock and Irrigation) in 2019 began issuing loans (totaling around \$19,000) to new seed businesses, including several soybean seed groups that formed as a result of VCRD’s work strengthening the soybean value chain. Finally, a vastly expanded array of microfinancing options have become available to farmers as a result of their now established credit-worthiness, as well as their ability to meet new quality benchmarks and enter new markets, especially in the melons, sesame and soybean value chains. The end result: after five years of VCRD collaboration with a wide range of partners in the agriculture sector, more knowledgeable and informed farmers and processors are cultivating, processing and selling more valuable products. In doing so, they have opened up new market channels to direct or high-end buyers and markets. Today, with several successful seasons behind them, farmers and other market actors in targeted value chains are successfully attracting a mix of financing and investment that was unavailable to two years ago.

“Agriculture lending is already a risky business. So we have to make sure we link the farmers with the right markets, so the risk is decreased. This is a new market – the supply chain, value chain market. We want to build a platform like a super highway... so that other banks and international banks will see the market. When other banks come in, Myanmar will move to the next level.”

SAW DINO KU, EXECUTIVE DIRECTOR, AYEYAWADDY FARMERS DEVELOPMENT BANK (“A bank”)

