

PAMCO's Position Paper on **Agribusiness Financing**

Background:

Agriculture contributes 26% to the GDP of Pakistan i.e. approximately \$30 Billion. Over 70% of Pakistan's population is directly or indirectly dependent on the agriculture sector. Effectively the same percentage resides and is physically present in the rural economy.

For Pakistan to have a balanced economic structure, it needs an efficient, growing and developed agriculture sector. All indicators for sustained social and economic development depend on agriculture sector's viability and vibrancy. Agriculture sector is needed by Pakistan for:

- Employment generation
- Poverty alleviation
- Growth in exports
- Reduction in inflation
- Growth in industrial production
- Reduction in rural to urban migration
- Better health & education
- Decrease in law and order problems
- Growth in service sector

These and many other critical issues of Pakistan's economy can be addressed with agricultural development.

It goes without saying that meaningful development of the agricultural sector requires exponential growth in investment. The banking sector must support this investment by providing annual credit to the extent of Rs.500 Billion i-e 25% of the total credit allocation per annum for a sustained growth of 6 to 7% for the foreseeable future.

Today, less than 5% of annual credit plan is focused on agriculture. The Rs.130 Billion targeted credit for 2005-06 is hardly adequate to make a good beginning. This target is mostly concentrated on short term production/ working capital farm credit. Medium term credit of 3 years and long term project loans are insignificant.

The banking system today is dominated by the private sector. Indeed, the foreign held financial institutions make up more than 60% of the total asset base of the system. This is against a system a decade ago when 85% of the banking sector was not only in public domain but also had specialized financial institutions catering to specific sectors e.g. Agriculture Development Bank of Pakistan for short term and long term needs of the agriculture / agri-business sector and Development Financial

Institutions for long term project financing . In addition the public sector commercial banks were also involved in all these activities.

The era of specialized financial institutions seems to be over and all functions and responsibilities have been entrusted to the commercial banking sector. In addition, the idea of directed credit has lost favor. As such, the only criteria for credit allocation in Pakistan are commercial consideration.

In this system however, an element of specialized credit does exist to favor certain segments of the economy e.g. exports, SMEs, and Micro credit. However, the role of Zarai Taraqiati Bank Limited (ZTBL) (formerly ADBP) has been systematically reduced and its share in the total targeted credit for agriculture sector is about 25%. In addition ZTBL's contribution in the quality of credit services is marginal at best. The export refinance scheme of State Bank of Pakistan is not as subsidized as before but it does have a significant impact as it brings additional funds from outside the traditional sources of funding for commercial banks i.e. deposits and borrowing.

The medium term financing source like leasing companies and Modarabas has also declined significantly due to their failure and amalgamation into bigger commercial banks. With the failure of DFI's long term project financing is also now concentrated with the commercial banks. The agriculture sector is the biggest loser of this change. Due to the complexity and specialized nature of agriculture financing, the commercial banks are either not equipped or not capable or not willing to expose themselves to a difficult credit area. Therefore, in the now market-oriented dispensation, various regulatory and state agencies have to play their role in attracting the interest of commercial banks towards agriculture for achieving the goals of sustained agriculture development.

In this regard PAMCO has a well considered position for Ministry of Finance, State Bank of Pakistan, small urban based private banks, deregulated large public sector, commercial banks and public-private organization like PAMCO. It also has its analysis regarding the success factors for multinational companies in agro-business as well as difficult environment faced by the Pakistani Agro-Industry

MNC vs Local Companies

MNC's can play a vital role in a developing the economy and for this reason their participation in a country's economy should be encouraged. However local companies find it difficult to compete with MNCs because MNCs have some inherent advantages:

Success Factors for MNCs

- Deep pockets – they can afford to develop their market over a period of time
- Experience of marketing their products all over the world
- Backup from world-class technical expertise
- Economies of scale- they operate on global basis
- Strong managerial / organizational systems
- Strong distribution networks
- Internationally recognized brands

Issues Facing Local Agro-Food Companies

- Lack of infrastructure
- Lack of financial strength
- Weak brands / marketing

- Weak managerial / organizational capabilities
- Inability to integrate the entire value chain
- Weak distribution network
- Unpredictable economic environment
- Competition from imports and/or MNCs
- Lack of institutional support e.g. poultry problem

In this scenario, PAMCO's recommendations are:

State Bank of Pakistan

- SBP should encourage smaller private banks to team up with large banks to penetrate rural areas.
- SBP should improve its capacity to collect and disseminate rural data [farm incomes, crop prices, yields, etc] so as to enable banks to develop innovative products.
- SBP's immediate target for agriculture sector credit should be 10% of Annual Credit Plan i.e. Rs. 200 billion in year 2006-07. This percentage should be increased to 25% over the next 5 years as a mandatory development. In order to achieve this goal State Bank of Pakistan:
 - a. Introduce agriculture refinance scheme with distinct share of short, medium and long term funding. Short term for production working capital, medium term for equipment / implements and development purposes and long term i.e. five years and more for project financing.
 - b. State Bank of Pakistan should include small urban based Private Sector Banks in the process through partnership with larger banks without the smaller banks losing the benefits of the scheme.
 - c. State Bank of Pakistan should mandate capacity building / human resource development and product development by the banks availing its refinance scheme through mandated investment program. SBP should build up their capacity and physical infrastructure focused on the agriculture sector in response to State Bank of Pakistan's mandated investment plan.
 - d. Bank should advertise and market their financial products and projects in the agri-food sector to attract the private sector investment on the national media.

Financial Institutions

- Banks should build up their capacity and physical infrastructure focused of the agriculture sector in response to SBP's mandated investment plans.
- Banks should advertise and market their financial products and projects in the agri-food sector to attract private sector investment on the national media.
- Banks should team up to capitalize on their strengths and cover their weaknesses for enhancing capacity to lend to the agriculture sector.

- Innovative products based upon cash-flow lending should be introduced along the lines of credit cards in the urban economy.

MINISTRY of FINANCE

- Taxation of agriculture should be transaction based.
- To encourage rural lending by the formal sector, a three tiered tax system should be introduced which will have higher tax for commercial lending, standard tax for corporate lending, and lower tax for agriculture and SME sector.
- Fiscal incentives like tax credit for investment in capacity building (as suggested to be mandated by SBP)
- Fiscal incentives to those banks which extend agro credit in excess of their mandatory targets.

Securities and Exchange Commission of Pakistan

- As a regulator of insurance industry in Pakistan, it should introduce mandatory insurance products for crop insurance against natural disasters and calamities in cooperation with lending agencies.
- SECP to support fiscal incentives for agriculture insurance products for insurance companies along the lines offered to financial institutions.

GOVERNMENT of PAKISTAN

- The Government of Pakistan should create an independent authority for certifying areas / crops / activities as disaster hit with categories to justify payment of insurance claims.
- The same authority should also facilitate the dissemination of crop data as well as conditions of maturity and sound health of crops for all stake holders without any prejudice or special interest.
- The Government of Pakistan should confine its role to investing in large infrastructural projects like water courses, dams and providing essential inputs like electricity, technical training and other support services of agriculture.

ROLE OF PAMCO

- Support and engage in marketing, investment, capacity building, cost sharing.
- To assist in the joint development of financial products which the banks wish to sell to the Agro-food sector
- Public sector should invest in water, dams, electricity, technical training, farm infrastructure improvement
- The definition of what constitutes Agri-food / agriculture should be a dynamic process between SBP/Banks and PAMCO-like companies
- The idea behind this seminar is to create awareness and capacity building of institutions in research and development