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Rural and Agricultural Finance: Glossary: A Review

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Abstract

Agriculture provides livelihoods to many people in developing and emerging economies—especially those living in rural areas. Yet access to agricultural finance is often a hurdle. Lack of access to finance stops many farmers from adopting new technology and improving their efficiency. With demand for food expected to increase by 60 percent by 2050, and the agricultural system already under pressure to satisfy current demand, the only way to increase food production is to invest in sustainable technologies and climate-smart agriculture. These kinds of investments would enable farmers to produce more food with less of an environmental impact. Wise investments could also help keep food prices lower and promote economic health in rural areas. Yet financing the agricultural sector presents many challenges for financial institutions. Reaching remote rural areas can be expensive. Weather risks, crop concentration, and price volatility increase the credit risk for lenders, reducing their appetite to finance the sector. Risk-assessment technologies often lack precision for evaluating investment opportunities in rural areas. Financing the agricultural sector requires integral risk-management strategies and close collaboration with tech providers and agribusinesses.

Key words: Agriculture, management, environmental, Finance etc**.**

Introduction

Agriculture plays a significant role in the Indian economy and provides employment and livelihood to a large section of the Indian population. Approximately 44% (as per ILO estimate of 2018) of the working population is employed in agriculture and allied sector1. However, the contribution of agriculture to GDP has been declining from 52% in the 1950s to 30% in the 1990s and further below 20% from 2010 onwards as per data from Ministry of Statistics and Programme Implementation (MoSPI). In 2018-19, the share of Agriculture & Allied Gross Value Added (GVA) in overall GVA was 16% (Ministry of Agriculture and Farmers' Welfare (MoA&FW) Annual Report 2018-19).

Allied activities contribute approximately 40% to agricultural output, whereas only 6-7% of agricultural credit flows towards allied activities. One important characteristic of Indian agriculture is that it is mainly small holders' farming with an average landholding size of 1.08 hectares. The small and marginal farmers account for 86 per cent of all holdings and 47 percent of the operated area. They contribute more than 50% of the total agricultural and allied output. In smallholder farming, it remains a challenge to raise agricultural productivity and farmers' incomes. It requires appropriate solutions starting with easy access to modern inputs and then selling the produce in most remunerative markets. Institutional credit at reasonable cost all along the value chain is one such catalytic instrument that can facilitate the process by converting many subsistence farmers into vibrant commercial farmers. They can then diversify their agricultural operations in growing high value crops like fruits and vegetables, and engage in allied activities, like dairy, poultry, fishery, honey, beekeeping, etc. Allied has huge potential, which can be capitalised by improving credit flow towards it and by encouraging farmers to move towards allied activities.

Type of Agricultural Finance

Agricultural Finance – Financing of agriculture-related activities, from production to market. Not all agricultural finance is rural, and not all rural finance is agricultural. Yet financial service providers offering rural, micro- or agricultural finance often have overlapping objectives and opportunities.

Agricultural Subsidy – A governmental subsidy paid to farmers and agribusinesses to stabilize food prices, ensure plentiful food production, guarantee farmers' basic incomes, and strengthen the overall agricultural sector of the national economy. Proponents of agriculture subsidies claim the country's food supply is too critical to the nation's well-being to be governed by uncontrolled market forces. They also contend that to keep a steady food supply, farmers' incomes must be somewhat stable or many farms would go out of business during difficult economic times. Critics argue that subsidies are exceedingly expensive and do not achieve the desired market stability.

Contract Farming – An agreement between farmers and processing and/or marketing firms for the production and supply of agricultural products at a specified time in the future, frequently at predetermined prices. Repayment of the input credit is deducted when the farmer sells the produce.

Covariant Risk – Covariant risk arises when many farms/households in one area are adversely affected by a single phenomenon such as a natural disaster, epidemic, unexpected change in world prices, macroeconomic crisis or civil conflict. This is distinct from individual risks, which randomly affect individual households.

Index-based Insurance – A special form of insurance that can be used to compensate for losses related to extremes in weather that often plague agricultural enterprises and increase the level of risk involved in agricultural endeavors. Unlike traditional insurance, which is most useful in compensating for losses from idiosyncratic events, such as house fires or car wrecks, index-based insurance works best where there is correlated risk, i.e., risk of an event that causes consistent damage or losses across a geographical area or sector, such as drought, flooding or price volatility. More recently, some insurers are also piloting innovative index-based livestock insurance products.

Lease – Contract for use of an asset for a set term in exchange for fixed regular payments between two parties. Leasing is a method of financing the acquisition or use of a fixed asset, predicated on the concept that the value of the asset is in its business use rather than through ownership.

Rural Finance – Provision of financial services to a heterogeneous rural farm and non-farm population at all income levels. It includes a variety of formal, informal and semiformal institutional arrangements and diverse types of products and services including loans, deposits, insurance and remittances. Rural finance includes both agricultural finance and rural microfinance and is a sub-sector of the larger financial sector.

Secured Lending – Pledging of an asset as collateral by a borrower to a lender until a loan is paid back. If the borrower defaults, then the lender has the right to seize the collateral and sell it to pay off the loan.

Trade Credit – Short-term or seasonal loans between buyers and sellers of inputs or products. It is typically provided in commodity value chains. Relationships between buyers and sellers are often more temporary and more price-driven than out grower schemes.

Value Chain – Series of transactions necessary to bring a product from inputs to the final market, involving a process of adding value at every stage.

Value Chain Finance – Credit or other financial services flowing through actors along value chains. Value chain finance can improve the overall effectiveness and efficiency of the value chain by identifying relationships among players along the value chain, mitigating constraints, and exploring how formal financial institutions can participate to provide services. If designed well, value chain finance interventions can increase the competitiveness of a range of agricultural and agribusiness enterprises, including small producers.

Warehouse Receipt Financing (inventory credit) – The use of securely stored goods as loan collateral. A document is issued by a warehouse listing the goods or commodities deposited in the warehouse. The depositor can then use that receipt as a pledge to secure a loan from a bank or other lender. The lender places a lien on the commodity, so that it cannot be sold without the proceeds first being used to repay the outstanding loan.

Agricultural Loans in India

Agriculture is the backbone of Indian economy and it definitely comes as no surprise to see financial institutions offer monetary aid to farmers all across the country. Agricultural loans are available for different kinds of farming-related activities.

Types of Agricultural Loans in India

One can avail a loan for the following activities related to agriculture:

- Running day to day operations
- Buying farm machinery such as tractors, harvesters, et cetera
- Purchasing land
- Storage purposes
- Product marketing loans
- Expansion

Moreover, these financial aids can be offered in form of grants and subsidies too, which are usually meant to protect the farmer in an event of crop damage or loss of crops.

Agricultural loans in India are not only offered to farmers working towards the cultivation of food crops, but they are available to anyone who is engaged in other agriculture-related sectors like horticulture, aquaculture, animal husbandry, silk farming, apiculture and floriculture.

Conclusion

Indian agriculture faced a formidable challenge to grow more food. Today, we are a food surplus country and a net exporter of many agriculture and allied products. This requires the government policies related to agriculture to be shifted from that of managing food scarcity to managing food surplus. Today, agriculture in India faces an even more demanding challenge: to grow agri-produce sustainably, inclusively and responsibly. This can be achieved when all the stakeholders align their policies and actions towards the SDGs. As far as financing of agriculture is concerned, going forward, banks will have to integrate 'sustainability' into their business strategy and decision-making processes in order to support environmentally responsible and sustainable projects in the agriculture sector. For this, banks will have to undertake innovative agricultural financing models so that environment friendly and sustainable projects can be supported.

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