OPINION PIECE:

The South African agricultural sector needs more innovative and inclusive financial instruments

by Thabi Nkosi and Wandile Sihlobo[i], Business Day, 02 May 2019

Agriculture has come under the spotlight in South Africa. Not only did the severe droughts experienced in 2015 to 2016 highlight the sector's importance to South Africa's economic growth and job creation ambitions, the recent policy proposal on land expropriation without compensation drew attention to the agricultural sector's importance in ensuring national food security, while also addressing inequality.

Over time the focus of the debate on agriculture has evolved from focussing mainly on the sustainability of production, to a discussion around farmer support, and more recently on land ownership. However, one factor -- access to finance -- remains a cardinal feature that has not been properly addressed. This is because the financial services sector plays a significant role in the growth of South Africa's agricultural sector.

The financial services sector's credit exposure to agriculture amounted to R158 billion in 2017, according to data from the Department of Agriculture, Forestry and Fisheries. The latest industry estimates put 2019 figures north of R160 billion. This figure has been on an increasing trend since 2000.

Aggregate agricultural debt, adjusted for inflation, has grown by an annual rate of 11% on average over the past 17 years, with the Land Bank, followed by commercial banks accounting for much of this growth. Evidently, the agricultural sector has somewhat proven to be lucrative for local financiers, particularly at a time when corporate lending has been stifled by weak manufacturing growth.

Interestingly, despite this boom in agricultural lending, emerging farmers and Small, Medium and Micro-sized Enterprises (SMMEs) in agro-processing have repeatedly lamented their inability to access credit and working capital. This is a challenge that has crippled many in their paths to commercialisation. Although the state has commenced several initiatives to bolster the provision of finance to these farmers and

SMMEs, primarily using the Land Bank as a conduit, many of these facilities remain underutilised primarily as projects fail to meet funding criteria.

This incongruency illustrates the need for alternative funding models and innovation in the agricultural funding space, a need that the numerous financiers in the sector have been slow to address over the years. The shortage of emerging farmer and SMME funding in the face of robust aggregate agricultural credit growth also highlights the agricultural sector's dichotomy and the scale of untapped potential in the market.

Against this backdrop, it is encouraging to take note of the emergence of Grobank, a new commercial bank, transitioned from the Bank of Athens, focussing primarily on the food value chain.

While most South African commercial banks have divisions offering agricultural finance, Grobank is the first commercial bank seeking to place all its eggs in the agricultural basket, so to speak. At a time when the big banks are reengineering their processes to modernise legacy systems and improve their digital offerings as numerous new-era entrants are hot on their heels, Grobank's entry into South Africa's banking landscape is certainly a bold one.

While some people have lauded the new bank for its daring ambitions for the agribusiness finance market, some have understandably raised concerns about the sustainability of the agricultural finance market, given the recent debates about land expropriation without compensation. Much has been written about the risks faced by South Africa's banking sector should wholesale land expropriation occur. From our reading of the governing party's policy documents, this situation is unlikely to materialise.

Many, including most credit ratings agencies, share this sentiment, and banks have to a large extent continued business as usual with positive results. Ernst and Young, in a report of South African banking performance notes that South African banks reported double-digit profit growth in 2018 and the highest returns on equity since the global financial crisis.

It is thus likely that if government continues to take a measured approach to land expropriation and the economy supports robust activity, new entrants into the banking landscape will be handsomely rewarded and increased competition will benefit agricultural clients.

On the agriculture front, the success of specialist banks such as Rabobank in Europe, South America and Australia provides a case for increased focus on the domestic agribusiness market. After all, agriculture continues to be viewed as one of the sectors that will drive growth, and job creation in South Africa. At the heart of all this, there should be financial innovation that is tailored for the agricultural sector.

New entrants in particular have the opportunity to step up to the task and plug the gap in unbanked segments of agriculture. This calls for innovative financing models that will leverage technological advancement, either through new digital platforms and satellite technology. The traditional financial institutions have been slow to respond to these segments because of the rigid screenings, collateral requirements, and other regulations. However, with digitization in this fourth industrial revolution, more can be done for the unbanked.

All over Africa, new agritech and fintech start-ups are mushrooming. Their business models are focused on improving the efficiencies of agricultural value chains, all boosting a case for more innovative and inclusive financial instruments for the sector. This, supported by technological advancement is the future of financing in the agricultural space, and the future looks bright for this critical sector.

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[i] **Nkosi** is an executive director, responsible for research, business development and investments at AFGRI Group Holdings. **Sihlobo** is chief economist of the Agricultural Business Chamber of SA.