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Working Papers series

1. The Eastern Cape Smallholder Support Project: An assessment of the revolving fund

Richard Ewbank

FARM-AFRICA WORKING PAPERS

No. 1

Eastern Cape Smallholder Support Project:

Assessment of the revolving fund

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April 2004

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1. Background

FARM-Africa's Eastern Cape Smallholder Support Project was initiated in 1999 and completed its work in June 2004. The project worked with seven smallholder Farmer Associations situated in the central and eastern parts of the Province (former homeland areas). Of the seven, six had access to rainfed agricultural land and one to land in an irrigation scheme, which during the 1990s had ceased to operate.

The specific objective of the project was to optimise the community management of natural resources through a number of activities. These included the development of participatory land use plans and revolving credit funds to support and develop agricultural enterprises; capacity building of farmer associations in management and administration and association members in sustainable agriculture; and training of Government extension staff in participatory extension and agricultural business management so that these frontline advisory personnel would continue to support the development of farmer associations once the project had completed its work. Ten of these staff were formally assigned to the project and a further 90 included in the training programme to multiply the impact of the project to adjacent areas.

FARM-Africa initiated revolving funds in the Farmer Associations at the seven sites essentially as a means of providing material support in the form of investment credit to farmers in parallel to capacity building activities (including situation analysis and participatory land use planning). Ideally these funds would be established once the community had completed its land use plan, in order to ensure investment in the agricultural enterprises it identified. However for a number of reasons, revolving funds have been established before the completion of Participatory Land Use Plans (PLUPs).

- Establishing revolving funds after capacity building presupposes that communities are prepared to allocate their time to a substantial period of research and training without seeing any material return from their relationship with the project.
- Establishing revolving funds during training enables the revolving fund sub-committee (or 'umbrella' committee) and credit users to apply their training and capacity building immediately and thus strengthen the 'learning-by-doing' aspect of this work.
- Providing credit investment to Farmer Association members motivates them to engage in the capacity building aspects of the project and demonstrates to farmers that the project is serious about addressing their immediate livelihood priorities.
- Establishing revolving funds earlier in the project enables Farmer Associations to build up a credit track record during the project that can be used to attract further injections to the fund from other sources. This can also be facilitated by the project.

Revolving fund activity began in December 2000 with the issue of grants to Qamata (Section 2) and Mtshabe, with a further 11 grants issued up to December 2003. The revolving funds have attracted additional investment from both the Agricultural Research Council and Chris Hani Municipality, together contributing nearly R268,000, or 35 per cent of the capital provided.

Table 1. Grant support to the establishment of revolving funds (in South African Rand)

Farming Association	Grant size	Date received	Source
Isibane (Ngxabaxha)	70,000	14.11.02	FARM-Africa
Qamata (Section 2)	70,000	15.12.00	FARM-Africa
	5,000	22.10.01	FARM-Africa
	117,919	1.11.03	Chris Hani Municipality
Upper Chulunca	70,000	14.10.02	FARM-Africa
Mtshabe	35,000	1.12.00	FARM-Africa
	35,000	1.11.01	FARM-Africa
Ndonga	70,000	16.11.01	FARM-Africa
	5,000	14.12.03	FARM-Africa
	105,000	21.2.03	ARC
	45,000	6.3.03	ARC
Mquekezweni	70,000	1.11.02	FARM-Africa
Ntabankulu	70,000	1.11.02	FARM-Africa
Total	767,919		
From FARM-Africa	500,000		
% FARM-Africa	65.1%		

2. Revolving fund methodology

Rules to guide the operation of the revolving fund and its management by the umbrella committee are developed in a participatory way with the community. This is essential to promote the role of the umbrella committee in its management obligations and comprehensive understanding of their commitments once a credit user has taken a loan. The basic guidelines are as follows.

- Funds can only be lent to members of the Farmer Association
- A joining fee of R10 per member is required
- Each borrower must belong to a credit group of a minimum of five members
- Each credit group must have a constitution and membership list
- The group must fill in an application form, repayment schedule for the amount their members are borrowing and submit their bank book
- The group must submit a business plan approved by the relevant extension officer
- Business plans must be based on agricultural activities
- Interest will be paid on loans according to the rate set by the umbrella committee (e.g. 3 per cent per month)
- The maximum period for loan repayment is set by the umbrella committee (e.g. nine months)
- The length of the loan will depend on the enterprise to be undertaken, based on the number of months for the enterprise to reach maturity plus one month (e.g. for cabbages, four months to grow and sell the crop plus one month = five months)
- The loan is repayable in equal monthly installments
- An additional three per cent will be charged on the capital amount if a credit user fails to repay their monthly installments
- A group will not be eligible for a new loan until all its members have repaid existing loans
- It is the group's responsibility to ensure that all their members repay their loans
- The maximum loan is R500 per individual within the group
- The group members will submit all loan applications to the group head, who will then call in the extension officer to approve their consolidated business plan. This application is passed to the village committee for recommendation to the five member Farmer Association umbrella committee

- For repayment, each group collects monthly installments from its various members and pays these into their bank account. The deposit slip is submitted to the umbrella committee.
- Should a credit user become deceased, the family bears responsibility for the loan outstanding amount.

Table 2. Interest rates set by each of the seven Farmer Associations

Farming Association	% Monthly rate
Isibane (Ngxabaxha)	5
Qamata (Section 2)	3
Upper Chulunca	10
Mtshabe	3
Ndonga	10
Mqhekezweni	15
Ntabankulu	5
Average	**7.3**

It is important to stress that these are set by the umbrella committees themselves (not FARM-Africa).

3. Performance

A total of 407 credit users in seven Farmer Associations have joined the revolving funds managed by their respective umbrella committees. By 31st March 2004, credit recovery for all sites averaged 80 per cent based on results for the 2002/3 season. Of the seven sites, two – Ngxabaxha and Qamata – had particularly low recovery rates, at 22 and 53 per cent respectively. The default rate in Qamata would be considerably lower had they not received an injection of capital for the 2003/4 season from Chris Hani Municipality, which increased the size of their revolving fund and therefore decreased the default from 2002/3 as a proportion of the fund size. It remains to be seen if credit recovery for 2003/4 loans will improve on 2002/3 to maintain this recovery level.

The other five sites have all achieved recovery rates of about 90 per cent or more so far. Of these sites, there are two – Mquekezweni and Ntabankulu – which are basically in their first main season of credit operation and it is therefore too early to conclude as to whether they will maintain this recovery rate. Of the other three, their credit recovery performance can be ranked with Ndonga the best performer, followed closely by Mtshabe with Upper Chulunca in third place.

4. Revolving fund movement summary

Table 3. Summary of revolving fund movement (all figures in South African Rand)

Farmer Association	No. of clients	Bank balance 30.4.04	Outstanding loans from 2002/3	Loans issued for 2003/4 season	Average loan size for 2003/4	Payments received for 2002/3 loans	% Recovery rates
Isibane (Ngxabaxha)	43	3,286.21	60,626.54	14,084.97	327.56	3,239.21	22.27
Qamata (Section 2)	76	11,826.81	112,026.42	117,919.36	1,551.57	9,502.19	53.66
Upper Chulunca	51	53,022.61	26,642.09	22,803.15	447.12	38,927.00	89.74
Mtshabe	87	97,505.36	9,352.03	29,774.22	342.23	21,905.99	93.16
Ndonga	70	167,381.90	7,831.45	42,033.50	600.48	27,350.00	96.40
Mquekezweni	18	86,100.00	0.00	45,193.05	2,510.73	23,509.96	100.00
Ntabankulu	62	32,781.82	987.35	59,187.63	954.64	33,897.69	98.94
TOTAL	**407**	**451,904.71**	**217,465.88**	**330,995.88**	**813.26**	**158,332.04**	**79.87**

Table 4. Distribution of loan portfolio

Of loan portfolio	
% in the bank	52.7%
% out as loans	47.3%
% default	20.1%
Of loans	
% default	39.7%
% for current season	60.3%

5. Reasons for sub-optimal credit performance

The two most significant reasons for sub-optimal performance are as follows.

- **The policy of other stakeholders, especially the Department of Agriculture and the Municipalities.** Whilst the operational support of both of these institutions in the implementation of the FARM-Africa project and the revolving funds has been invaluable to the successes achieved, both of these institutions have a policy of providing ad-hoc or planned grants and subsidised credit to farmers in the Eastern Cape. The Department of Agriculture is currently implementing large maize promotion projects which provide subsidised credit of 75 per cent (i.e. farmers only repay 25 per cent of the loan). Municipalities provide inputs such as tractors and agricultural inputs to Farmer Associations and no repayment is expected. Even grants to revolving funds (for example, at Qamata) are viewed by farmers as 'government therefore grant' funding, eroding the ability of umbrella committees to enforce repayment.
- **Weak umbrella committees.** In the two sites - Ngxabaxha and Qamata – where particularly low recovery rates have been registered, the motivation of the umbrella committee in enforcing credit recovery has been judged by project staff as particularly weak, especially at the level of Chairperson.

Secondary reasons are discussed below.

- **The agricultural trading environment in South Africa is based on open markets operating at world market prices.** South Africa is a member of the Cairns Group and as such, advocates a policy of free and non-subsidised global trade in agricultural products (in contrast to the protectionist policies of the EU and United States). In addition, approximately 85 per cent of South Africa's farmland is under commercial operation with well-established marketing capacity. Smallholder farmers entering the agricultural market are faced with a highly competitive situation and in some cases, e.g. poultry, imports at prices lower than local costs of production. This is a particularly tough environment for smallholders to operate microfinance-supported agricultural enterprises.

- **Extension agents lack operating costs and agri-business assessment skills needed to fulfil their regulatory functions.** FARM-Africa has addressed this problem by having ten extension staff assigned to the project to receive formal and in-service training and mentoring and has run a full one-year agribusiness training course for 90 extension staff. But the commitment of the Department of Agriculture and Municipalities to improve their effectiveness to implement sustainable (as opposed to hand-out) support for smallholder agriculture is still in doubt.

- **FARM-Africa has endeavoured to integrate lessons learnt from other microfinance operations in Africa and South Asia,** yet there are still some areas where changes could improve recovery and sustainability of revolving fund management. Loans for high risk, low return agricultural enterprises should be avoided, e.g. rainfed maize in areas of less than 600mm rainfall per annum.

- **Business plan formats should be reviewed critically** to determine whether projected income streams are realistic and will cover loan repayments plus income expectations.

- **Umbrella committee records should be summarised** to demonstrate whether credit recovery and interest rates are covering inflation, operating costs, default rates and required growth rate of the fund (i.e. a profit and loss account for the revolving fund).

- **Umbrella committees need to establish a five-year business plan for their revolving fund** including anticipated fund growth and the interest rates needed to achieve this (this was attempted by the project in some sites).

- **Interest rates are in some cases high by microfinance standards.** Umbrella committees should calculate rates based on default, inflation and operating costs. Once these and planned fund growth rates are catered for, there could be room for reducing the interest rates in favour of increasing the profitability of the enterprises for which loans are taken. This could in turn exert downward pressure on default rates, but on the other hand cheap credit attracts freeloaders so this issue should be approached carefully.

- **Loans for non-agricultural rural businesses should be included** and loans issued based on a critical and competitive assessment of business plans and the likely returns and profits to the credit user. One association – Mtshabe – did issue loans for non-agricultural rural enterprises and these performed well with high recovery rates, but were unfortunately discontinued by the umbrella committee after advice from the project.

- **All Chairs of umbrella committees are men** and men dominate these committees, although 57 per cent of credit users are women.

- **The project has investigated legal ways of enabling umbrella committees to enforce repayment.** The conclusion was that the courts would ask defaulters how much they could pay and then enforce this level, which would not realistically address the problem.

- **High bank charges are levied on the current accounts operated by the groups** and the umbrella committees. Farmer Associations, extension staff and the Provincial Department of Agriculture need to open a dialogue with commercial banks to address this issue and explore other areas of cooperation and support.

6. Impact of enterprises supported by credit

a) Irrigated summer maize

In Qamata Section 2, farmers' performance with credit-supported agricultural enterprises was assessed using gross margin analysis and incorporating the interest paid on loans. The figures for maize production follow below.

Table 5. Figures for maize production

Lay dam	No. of farmers	Area cultivated (ha)	Average area/ farmer	Profit/ha (Rand)	Increase over 2001/2[1]
4	5	1.87	0.37	2,260	47%
5	4	2.16	0.54	2,846	43%
6	12	6.48	0.54	2,770	51%
7	7	3.29	0.47	2,406	184%
TOTAL	**28 (13 men, 15 women)**	**13.8**	**0.49**	**2,626**	**81%**

Over the whole sample, the average return on the investment was R1,287 to each farmer after repaying credit with interest. The average yield was 7.76 MT/hectare. The research findings are qualified in a number of aspects.

- Fertiliser accounts for the bulk of costs and soil tests may show the possibility of reducing amounts of some fertiliser or using cheaper mixes
- Mechanical costs could be reduced by the adoption of minimum tillage techniques (although this would also reduce yields)
- Some sales of green maize were not recorded, which if included would increase profitability
- Some casual labour costs were not included, which if included would decrease profitability
- 16 per cent of the maize harvested was used for home consumption and therefore profitability includes a small proportion of household costs foregone as home-grown maize replaced purchased maize

[1] Increase in gross income

- A price of R80 per bag of maize is used but it is likely that the price could fluctuate above and below this, thus affecting profitability either positively or negatively.

b) Poultry

A poultry group of five members in Ngxabaxha purchased a total of 900 chicks to be reared as broilers.

Table 6. Performance of poultry group

Name	No. birds	% Mortality	No. sold	Sale price	Profit
V. Nakani	200	11	178	35	2,610
N. Ngcunguza	100	4	96	15	-266
M. Bukwana	200	15.5	169	15	-111
N. Mxabo	200	17.5	165	15	592
M. Diko	200	15.5	169	15	688
AVERAGE	**200**	**12.7**	**155.4**	**-**	**703**

Despite three members making a profit on an investment of only three months duration, two made a loss.

- The sale price of eight week old broilers was considerably better than six week olds, thus generating an improved profitability (see V. Nakani)
- Keeping feed costs under control is the key factor in maintaining lower costs
- The group went ahead before receiving training from the project (members say that results have improved since this was completed, especially in correct use of feed)
- Despite this, the average profit was still R703 per member, or R3.90 per chick purchased.

7. Conclusions

The Eastern Cape Smallholder Support Project has implemented a revolving fund strategy that has taken the essential elements of successful microfinance operation in other parts of Africa and attempted to apply it to the smallholder agricultural economy. Even in an enabling environment, this would have proved a difficult task, but the project has not encountered an enabling environment. However despite this, three out of seven sites have performed well and only two could be described as microfinance failures (although in many other ways, Qamata is an exceptional success related to other irrigation schemes in the Eastern Cape). Given the relatively high interest rates, of these three, two are covering inflation, default and operating costs and one is on or near it.

Table 7. Interest rate and margin

Farmer Association	Inflation + default	Interest (per month over 9 months, declining balance)	Margin to cover operating costs + growth
Ndonga	10.6%	50%	39.4%
Mtshabe	13.8%	15%	1.2%
Upper Chulunca	17.0%	50%	33.0%

The available data indicates the profitability of agricultural enterprises supported by the revolving funds but more information is needed on the diverse crop and livestock enterprises undertaken (especially in non-irrigated areas) and how these compare with other income generating opportunities. Also encouraging is the increase in income (averaging 81 per cent from 2001/2 to 2002/3 for Qamata) obtained, showing the way farmers are improving their ability to implement profitable irrigated crop production and livestock enterprises. Based on the data in section 6, a farmer with 0.5 ha of irrigated maize and a poultry unit could achieve an additional annual income of R5,438 or US$2.23 per day.

Whilst the public sector continues to undermine sustainable provision of smallholder credit with handouts and subsidised credit, the future for NGOs such as FARM-Africa and farmer associations promoting micro finance models that have demonstrated considerable success and poverty-alleviation capacity in other parts of Africa is bleak. If the Eastern Cape adopts a comprehensive policy covering all departments, NGOs and Micro Finance Institutions, drawing from lessons learnt in South Africa and elsewhere, and the market principles that South Africa espouses for agriculture internationally, then prospects could improve. This would have to overcome the tendency to go for ‘quick-fix’ solutions to stimulate ‘massive’ food production in favour of a measured and long-term approach to capacity building, genuine farmer empowerment and the ability to learn from failures and build on successes. This change in policy, if it occurs, needs to be **widely publicised** to promote a change in practice and attitude on the part of all stakeholders.

In the meantime, all project revolving funds should be formally graduated to full umbrella committee control with the local extension officers taking over the support and regulatory role that the project has undertaken hitherto. Revolving fund rules with all associations should be amended to ensure that the representation on the umbrella committee reflects the gender balance in the groups and women have genuine authority in the umbrella committee. Members in the two poorly performing Farmer Associations should be encouraged to reform their committees as well as review and restructure their management. This should be discussed with both the Municipality and the Department of Agriculture for their support in implementation.

Rules should also be relaxed to include non-agricultural enterprises being eligible for loans. Given the seasonal nature of the revolving fund operation, a relatively higher proportion of the credit fund sits in the bank than is usual with most microfinance operations. Typically 20 per cent at most of a credit fund should be in the bank at any one time, but the project revolving funds have already reached nearly 53 per cent (April) and this will increase with further repayments made as the year progresses. The faster credit revolves, the more profitable a credit fund is – the seasonal nature of the credit provided slows the revolving fund, thus reducing returns. This reinforces the reasons for diversifying the types of loan given, but also highlights the importance of umbrella committees switching funds temporarily to interest-bearing deposit accounts to offset bank charges.

This summary[2] only examines the operation of the revolving funds and, in part, the profitability of enterprises supported. The remaining part of the equation is to examine how farmers assess the value of their involvement with the project in terms of the capacity building they have received and the benefits that they assess as important to their livelihoods (improved skills, knowledge of agriculture and agricultural enterprises and their status in the community, amongst others).

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[2] Information sources – (a) Financial monitoring data (EC SSP); (b) Growing Practices & Yield Records 2002/3 (EC SSP); (c) Discussions with EC SSP staff and PAC members. See project evaluation for farmer assessment.

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