Editorial

Ten years ago, 500 farmers in Warangal, a district in south India, committed suicide by drinking pesticide. They had taken out loans to plant cotton, and when their crops were attacked by bollworm, they borrowed more to buy pesticides. Their efforts to stop the insects failed; at harvest they had nothing to sell and nothing with which to repay the input suppliers; suicide was at least a way out that would secure government compensation for their families.

This was not an isolated incident; farmer suicides have occurred in this region for years, and were one spur to the call for interest-rate ceilings among MFIs in Andhra Pradesh in 2006. Further back, again in India, many researchers have studied the relationships between landlords, farmers and input traders and shown that input credit is often provided at high rates or is linked to forced sales at uncompetitive prices (Harriss-White, 1994).

The theme of this edition of EDM is value chain financing. The purpose of recounting the story of Warangal's cotton farmers is to remind us that although linking farmers to global value chains may appear to be a good thing, bringing technical advice, higher yields, assured prices and raised incomes, the downside is that it may expose poor farmers to higher levels of debt and risk than subsistence farming.

In his opening article Calvin Miller gives 13 lessons about value chain financing. As world food prices rise and traditional banks and microfinance remain reluctant to loan to agriculture, clearly value chain finance is worth exploring. He points out that value chain financing can reduce the risks involved for the lender and for the farmer: for example when finance is combined with the correct, high-grade inputs, technical advice and assured markets then there is less chance of crops failing and of farmers defaulting, as happened in Warangal. Nevertheless, dealing with one person for inputs, credit and crop sales can also lead to confusion regarding charges and the potential for exploitation.

Johnson and Meyer explore further the risks faced by participants in a value chain, and suggest that different types of governance in the chain lend themselves to financing to different degrees. Where farmers have plenty of potential buyers for their produce, such as in the Ugandan maize spot market, buyers are unlikely to risk financing farmers at the beginning of the season for fear of them side selling and defaulting on their loan. However, in the case of the sugarcane market, in an area where there was only one mill buying the farmers' produce, the risk of side selling was smaller and the mill was prepared to provide loans for the farmers' inputs.

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doi: 10.3362/1755-1986.2008.023, ISSN: 1755-1978 (print) 1755-1986 (online)

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Although in such a 'directed' value chain the risks are lower for the buyer, they might be higher for the farmer who has no-one else to go to if the mill breaks the contract and pays a lower price for the sugarcane, perhaps claiming that it is of low quality. The financing might work – but the deal might not be fair.

The claim of sub-standard produce was made in the case of the potato value chain described by Braja Mishra in his article from India. In this case the farmers were able to sell their potatoes elsewhere and it was BASIX, the financing partner, which lost out. The contract was broken, and there were no plans to repeat the experiment in value chain financing the following year. The potato farmers' association, that might have been expected to negotiate matters of quality and price, was not confident enough to do so, and Mishra points out that BASIX had underestimated the time it takes for a farmers' organization to learn these roles.

Brian Milder's article describes the role of external financing agencies in providing trade finance to associations or brokers who need to pay farmers immediately for their produce but will only themselves be paid months later. The financial institutions are mainly 'social investors' from developed countries, but they are making efforts to introduce local commercial banks to what is proving to be a reliable sector with good repayment rates.

In the case of trade loans to bee-keeping enterprises, as described by Ashok Kumar, the commercial banks are introduced from the beginning, by an 'external agent' whose role is not to provide finance but to facilitate the contract.

All of these cases point to the need for farmers' leaders or facilitators to educate farmers about product quality, delivery timing and cultivation techniques while at the same time making sure that their buyers honour their commitments to price and payment timing. Building up the trust of both parties is essential to successful value chain finance, but requires time and exceptional leadership skills. Without leaders who can represent the interests of marginal farmers, being part of a value chain is likely to mean accepting whatever poor terms and prices are offered, and may mean a way deeper into debt rather than out of poverty.

Clare Tawney, Editor

References

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