Advisory Note: Prioritising SDRs Drawdowns for supporting the Horticulture Export Revolving Fund in Zimbabwe

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Key Message

- Horticulture is one of the key subsectors of the agriculture sector in Zimbabwe, and is projected under the Horticulture Recovery and Growth Plan to contribute export earnings of US$300 million per year from current US$35 million by 2030. To attain and sustain such a growth, the country needs to address the major constraints impacting the horticulture value chains with the major one being the limited access to appropriately structured financing mechanism especially foreign currency for essential inputs.
- Zimbabwe as other IMF member countries globally, has received SDRs to the tune of USD961 million in special drawing rights and the Minister of Finance and Economic Development has already expressed interest in channeling part of this to establish revolving funds to support the productive sectors. For the Agriculture sector priority has been placed to support horticulture and irrigation development.
- Establishment of the Horticulture Export Revolving Fund for banks guaranteed by the SDRs will enable revival of the sector by facilitating importation of critical inputs along the value chain and improving production, productivity and competitiveness to enhance exports, value addition and gross value for the sector.
- Main recommendations for the Fund are as follows;
    - Should be disbursed by Banks independently with oversight by the Reserve Bank of Zimbabwe;
    - Ministry of Finance to provide a partial guarantee (with predefined risks sharing mechanism) using the SDRs to banks to catalyze the use of foreign currency balances sitting with banks and any lines of credit;
    - involve an inclusive multi-stakeholder coordinating committee to agree on the thresholds for risk sharing, define scope, tenure, parameters and eligibility with Banks independently vetting their own clients; and
    - Engage private sector players and relevant producer groups to operationalize the Horticulture Sector Plans Agreements using this funding mechanism.

1. Preamble

The Minister of Finance and Economic Development, Prof Mthuli Ncube on August 7th 2021 announced that part of the Zimbabwe's USD 961 million International Monetary Fund (IMF) Special Drawing Rights would be used to set up a Horticulture Export Revolving Fund Facility. The objective of the Facility would be to provide local banks with a partial cash guarantee facility to enable them to lend to the horticulture sector. The size of the facility will be matched to the amount of USD balances that local banks are sitting on or foreign bank with a credit line. The horticulture value chain players will access medium to long term funding for both capital and working capital. The Advisory Note provides options for the operations and set up of the facility. The note benefitted from literature review.

2. The Horticulture sector in Zimbabwe

Horticulture is one of the key subsectors of the agriculture sector in Zimbabwe, with substantial production potential across all agro-ecological regions. Until the late 1990's the sector contributed 3.5-4.5% of the National GDP and was a major foreign exchange earner for the country with diverse exports of horticultural products including tropical, citrus and deciduous fruits; various vegetables; tree nuts; avocados and cut flowers to European markets. Historically, the horticultural sector has generated significant amounts of foreign exchange, at one point being the second largest foreign exchange earner after tobacco in the agriculture sector. At the time the sector flourished due to the well-organized large scale commercial production and out grower scheme with small-scale farmers contributing at least 10 percent to exports.

The implementation of the FastTrack Land Reform disrupted the production of both local and export horticultural products and became fragmented. The collapse of contract farming and out-grower models made Zimbabwe to lose its ability to supply the export markets due to uncoordinated production (Figure 1). However, the horticultural sector once revitalised has a great potential to become one of the key drivers of Zimbabwean economy through export earnings.

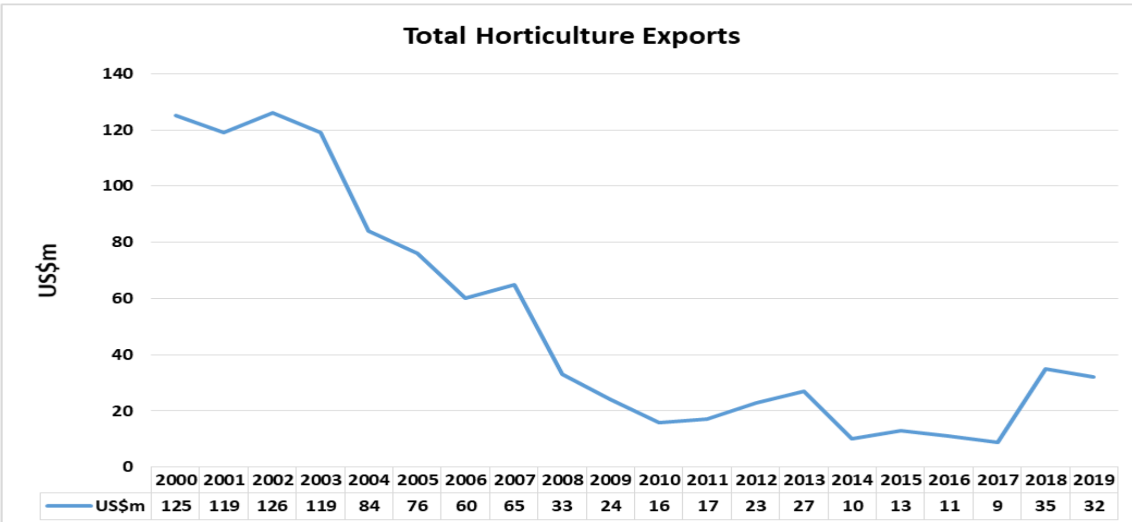


Figure 1: Value of Horticultural Exports in Zimbabwe
Source: RBZ Report (2020) "The State of the Horticulture Sector in Zimbabwe"

Current challenges affecting growth of the horticulture sector include lack of foreign currency to import critical imported inputs, limited capacity for horticulture seed production, poor internal cold chain management, high transport costs for taking produce to overseas markets, failure to meet the required export volumes on time and disjointed marketing and export clearing arrangements among others. Whilst investment in horticultural enterprises is capital intensive, funding towards the sector have been sluggish owing to liquidity challenges in the economy, high interest rates and shorter grace period. Provision of affordable and accessible financial services is essential for the development of the horticultural industry. These challenges are centered on the lack of access to a reliable and efficient access to finance and financial packages which have been identified as a critical requirement for the success of the revival of the domestic and export horticulture sectors.

The Horticulture Recovery and Growth Plan seeks to grow area under horticulture from 36,606 ha to 55,348 ha by 2025. The real gross value production is expected to increase from US$3.3 billion to US$3.9 billion whilst export earnings are expected to increase from US$35 million per year to US$300 million by 2030. The Government of Zimbabwe has attempted to bridge the funding gap through subsidized loans through the quasi-fiscal operations by the Reserve Bank of Zimbabwe (RBZ) support towards the agricultural sector, loan guarantee programs, meant to support medium- and long-term investment in agriculture through ensuring large shares agricultural loans advanced, whilst the farmer and private sector guarantees the other share and input schemes benefitting some horticultural crops such as Macadamia nuts, sugar beans among others. However, the demand for horticultural funding still outstrips supply/available funding streams. Hence, the establishment of the Revolving Fund is a welcome development and will help deal with financing gap that has been constraining the growth and development of the sub-sector.

Figure 2: Challenges emanating from lack of appropriate finance

3. Establishment of Zimbabwe's Horticulture Export Revolving Fund

The development of the horticulture sector value chains requires the availability of financial resources to support working capital requirements to fund day to day operations and reliable medium to long-term financing for capital infrastructure investments such as cold chains, pack houses, feeder roads among others. The Horticulture Export Revolving Fund (HERF) announced in the 2020 National Budget if carefully operationalized will help resuscitate the sector by providing the most needed financing to diverse horticulture value chain players particularly those that are geared towards export production.

Against this background, the Center for Agriculture and Food Policy has put together this advisory note to contribute to the ongoing discussion regarding the establishment of the Horticulture Export Revolving Fund as announced in the 2020 national budget. The advisory note seeks to provide some recommendations on the modalities for the establishment, governance and operationalization of the Fund. The recommendations presented herein mainly draw from lessons learnt from implementing revolving funds for the agricultural sector in Africa and other credit guarantee schemes in Zimbabwe.

3.1 Lessons learnt from similar initiatives in Africa

Nigeria and Tunisia are two countries which have been implementing credit guarantee schemes/funds to prop up their agricultural sectors.

Nigeria: Since 1978, Nigeria has been implementing an Agricultural Credit Guarantee Scheme Fund to enable farmers exploit the untapped potentials of Nigeria's agricultural sector, reduce inflation, lower the cost of agricultural production, generate surplus for export, increase Nigeria's foreign earnings as well as diversify its revenue base. In particular, the guarantee Fund was created for the purpose of providing guarantees for loans extended for agricultural purposes and targeted crops such as coffee, tea, cocoa, rubber, oil-palm and cereals, and animal production. The Scheme has a prescribed fund of N50.0billion (US$121.5 million). The Federal Government holds 60% and the Central Bank of Nigeria, 40% of the shares. The Fund assume a maximum liability exposure of 75% of the loan amount whilst banks assumed 25 % of the outstanding loans. The risk sharing mechanism is intended to ensure that banks do not engage in reckless lending that can result in loan defaults.

Critical success factors of the credit Guarantee Scheme in Nigeria include the following:

1. Provided guarantees to loans granted by financial institutions for agriculture purposes rather than direct Fund transfers to banks for on-lending;
2. Clearly defined risk sharing mechanism coverage of 75% of principal loan;
3. Independent and standalone state -owned institution that manage the day-to-day operations of the Fund but reported to the central bank;
4. Open to all registered financial institutions in Nigeria; and
5. Clearly defined selection criteria, fund targeted only agriculture producers.

Tunisia: The Tunisian Government established the National Guarantee Fund (NGF) in 2000 to support small and medium-sized farmers and fishermen in accessing short-, medium- and long-term loans from local banks. The NGF provided banks with guarantees against the risks of non-payment by refinancing outstanding payments, and reimbursement of eligible credits/inputs advanced by local banks by paying interest on unpaid amounts. The NGF assumed between 50% and 90% of unrecoverable loans. The guarantee Fund was structured into two entities namely, the Fund for Promoting Exports and Access Fund for Foreign Markets. The Fund had selected activities that were acceptable for funding such as promotional materials, market research; participation in trade fairs abroad and internal development of an export department within any company. On the other hand, the Access Fund for Foreign Markets was also complemented by services provided by the Fund for Promoting Exports which provided subsidies of up to 70 per cent, on approved loans for funds intended to finance the cost of export marketing by exporting companies. The Fund also had a pre-determined and standard selection criterion for eligible inputs and as well as a risk sharing mechanism which provided a framework for efficient and transparent management of the Fund as well as a framework for risk sharing between the Fund and its implementing partners. This Fund helped the country build the export portfolio and crowd in many stakeholders to participate in the export market.

Critical success factors of the NGF in Tunisia include the following:

1. The Fund is funded by a levy of 1% of the amount of each loan provided by the Microcredit Association;
2. Provided guarantees to loans granted by the Tunisian Solidarity Bank and members of the Microcredit Association for credit extended for export activities (Export Credit Guarantees);
3. Cleary defined risk sharing mechanism coverage of 90% of debts;
4. Refinanced outstanding payments; and
5. Clearly defined selection criteria. Fund targeted small and medium sized farmers and fishermen in accessing short-, medium- and long-term loans.

3.2 Experiences in Zimbabwe

In Zimbabwe some guarantee Funds have been operationalized by both government and development partners in collaboration with private sector; examples of such Funds include the Command Agriculture programs, government guaranteed bank lending and private run Funds such as the Zimbabwe Agriculture Development Trust Fund. Government initiated and subsidized schemes have been identified as not being effective, characterised by low loan recovery rates at 50% or less. To strengthen the repayment and targeting of beneficiaries, the program was transformed into the CBZ Agro Yield scheme, with the private sector being responsible for the day-to-day administration of the Fund. Lessons from this programme points to substantial contribution to production increases by crowding in Banks and private sector. However, a moral hazard accompanied by poor credit assessment was created as a result of government running fully the scheme over the years also increasing the burden on the fiscus.

The Agriculture Development Trust Fund provided a credit facility that is market-driven, and is administered through selected local financial institutions. The financial institutions on-lend to Zimbabwean agricultural value chain actors or agribusiness entities who have commercial linkages with smallholder farmers. The funding is also accessed directly by smallholder farmers from some financial institutions such as those which do micro-lending. The partnership with Commercial Banks and Micro Finance Institutions (MFIs) allowed the Fund to have vigorous credit assessment framework that was effective in reducing default rates and also having them market the fund reduced incidence of moral hazard were beneficiaries perceive donor funds extended to them as a gift that should not be repaid.

The Livelihood Food Security Project (LFSP) Rural Finance component designed to enhance access to finance to LFSP programme beneficiaries so that they would invest in productivity enhancing technologies to increase productivity, increase household incomes, invest in income generating activities and reduce poverty. LFSP entered into partnership with the USAID Development Credit Authority (DCA) set up a guarantee facility-a risk sharing mechanism- to address high-perceived risks by participating commercial banks and lack of collateral by targeted smallholder farmers and related value chain players. The guarantee facility shared risk and provides an incentive for commercial banks to expand their lending to rural areas in target districts, including smallholder farmers and related value chain actors. USD1, 500,000 was invested with USAID DCA to secure USD10 million covers under the guarantee facility in September 2015 to provide partial cover for Steward and CABS banks. As at end of 2020 guarantee utilisation was USD7, 151,902 and zero claims were made on the facility pointing to the prudence of the management of the credit facility.

The RBZ through its subsidiary the Export Credit Guarantee Corporation of Zimbabwe (ECGC) has export credit guarantee facility that offers products that include export payment insurance policies, domestic payment insurance policies, Micro, Small, medium Enterprises (MSME) and financial guarantees as well as short-term insurance. The company seeks to provide specialized skills to Zimbabwean exporters so that they may be able to assess and analyse cross border risks in efforts to sustain and expand export markets. ECGC seeks to protect exporters and enhance their capacity to compete in the international markets and enable them to break into new markets, introduce new products and take up new buyers. However, ECGC facilities seems to favour large scale corporations and leaves out most small business who require small amounts including horticulture exporters and also have a strong bias towards insurance rather than credit provision.

4. Recommendations for Zimbabwe's Horticulture Export Revolving Fund

4.1 The Credit Guarantee Revolving Fund

4.1.1 Establishment of Fund

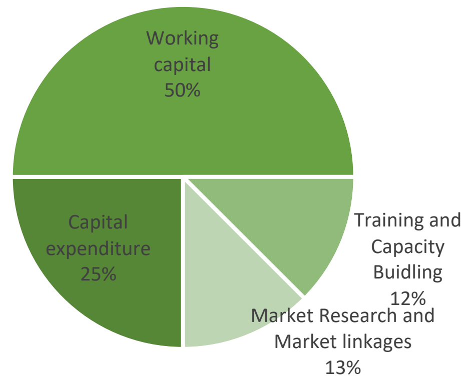
What should the Fund cover?

The objective of the Fund is to support horticulture exporters with foreign currency requirements geared towards export production as a result not all inputs and costs borne by horticulture farmers will be eligible for financing under the Horticulture Export Revolving Fund. It is, therefore, recommended that the Fund support, but not limited to the following expenditure line items:

i. Capital and working capital requirements;
ii. Inputs such as seeds, fertilizer, chemicals, irrigation equipment's, greenhouses renovations, automated harvest machines and other working capital needs;
iii. Market research activities aimed at creation of export market for horticultural produce and linking the farmers to the export market; investing in value addition of horticultural produce for example drying of vegetable, canning of fruits and vegetable; and
iv. Financing of Global GAP certification.

It is also further recommended that eligible inputs or expenditure items to be funded by the export revolving fund, 50% should be directed towards working capital needs as most farming activities are seasonal hence there is a mismatch between farming operations and revenue flows as such the fund will bridge the gap. On the other hand, it also proposed that 25% of the fund be allocated towards capital equipment given that capital expenditure is long term in nature the export revolving fund depends on repeated cycle of loans and repayments, for the sustainability of the Fund it is prudent that funding should be provided for short to medium term needs hence the cap on long term capital funding.

Figure 3: Proposed fund allocation by type of expenditure



4.1.1 Governance and management structure

Taking a leaf from lessons from the global best practices, Zimbabwe should establish a Guarantee Fund that is independently managed and disbursed by commercial banks and other lending institutions with oversight provided oversight provided by the RBZ and guarantee by the Ministry of Finance and Economic Development.

The coordination mechanism to ensure that the scope of the fund is clearly defined will involve a multi sector coordination committee composed of following proposed institutions and members:

i. Reserve Bank of Zimbabwe;
ii. Ministry of Finance and Economic Development;
iii. Ministry of Lands, Agriculture, Fisheries, Water and Rural Development;
iv. Agricultural Marketing Authority;
v. ZIMTRADE;
vi. Zimbabwe Investment Development Authority;
vii. Horticulture Exporters Association;
viii. Farmers Unions and,
ix. Bankers Association of Zimbabwe.

The coordination committee will be co-chaired by the Ministry of Lands, Agriculture, Fisheries, Water and Rural Development and the Horticulture Development Council and will not interfere with day-to-day operations of the banks and their clients.

4.1.2 Risk sharing Mechanism

In principle, the Government guarantee should reduce losses incurred by lending institutions on any issued loans to the horticulture value chain as part of the credit risk is transferred to Government. If the risk sharing mechanism is not properly designed, the scheme is likely going to face the same fate of many government-initiated funding schemes that face high default rates. Therefore, the Fund should agree on a risk sharing formula between the Fund and financial institutions to ensure that lending institutions adhere to strict lending rules and risk assessment measures. The rationale behind sharing the risks/guarantee is to incentivize both the loan recipient to repay the loan and the banks to monitor the use of finances. In instances were guarantee funds have been created exclusively by the Government this creates a moral hazard in which farmers will perceive the coverage of their loan defaults and this may discourage compliance to meet their debt obligation

4.1.3 Interest rate

Interest should be LIBOR plus a margin agreed between the Fund manager and the implementing banks. The margin should be enough to cover bank costs and a return for their participation to be economically viable. A very high interest rate would likely drive off safer borrowers from the lending pool leading to a riskier portfolio of loans with high default rate. Such a scenario would destroy the revolving fund hence, a lower interest rate would increase the likelihood of the Fund to revolve as defaults will be minimized. This would require the Government to guarantee a higher percentage of the loans issued by the Fund.

4.1.4 Duration of loans

The Fund is financed by an initial injection of bank balances stimulated by guarantee facility modalities for the durations should be refined and agreed by the coordination committee in consultation with banks to ensure viability for all. However, as the fund operations grow and banks have more confidence in the revolving Fund based on loan recovery rates and government provided guarantee, the loan grace period can be reviewed in consultation with the multi-sectoral committee and the Fund manager.

4.1.5 Beneficiary selection

The objective of the HERF Fund is to support horticulture exporters production geared towards export. It is against this objective that the beneficiaries of the Fund should meet the minimum selection criteria to ensure the Fund revolves and also borrowers should repay back the loans at agreed times. The quality of borrowers will depend on the selection criteria. The criteria should also crowd in smallholder farmers to facilitate commercialization of the sector. Figure 5 summarises the proposed selection criteria for borrowers of the Horticulture Export Revolving Fund.

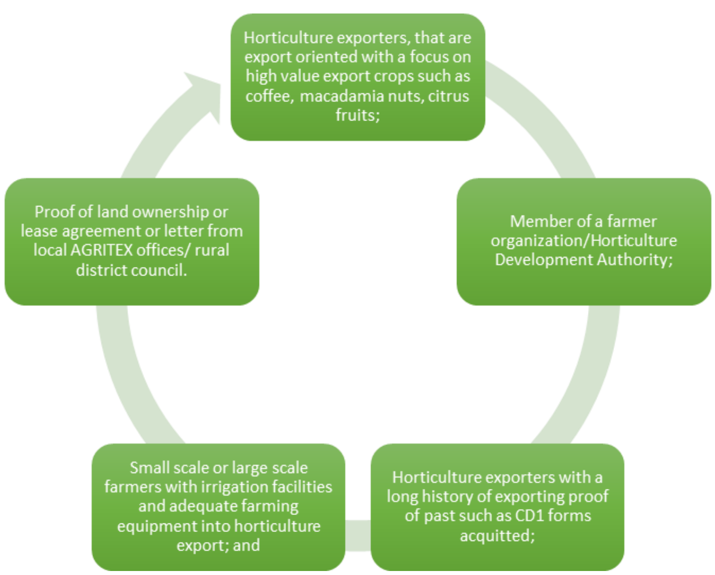


Figure 5: Beneficiary selection criteria

HERF should benefit both small scale and large-scale commercial farmer's hence increasing Government's foreign currency earnings among others. This is in addition to a broader social impact, which can best be measured by the participation of communal smallholder and resettled farmers resulting in the creation of additional direct and indirect jobs

4.2 Performance Monitoring of the HERF

There should be a periodic review of the Horticulture Export Revolving fund performance by the multi sector coordinating committee to review and assess the amount paid out, number of beneficiaries and non-performing loans, periodic visits to beneficiaries of the Fund to assess how the funds have been deployed. Regular monitoring of the performance of the Fund will facilitate refinement of the implementation of the Fund. It is also important to assess the impact of the Fund on the sector, economy and livelihoods.

The implementing banks are expected to coordinate the collection and submission of CD1 forms by beneficiary export firms for monitoring and evaluation. The multi sector coordinating committee will review CD1 forms returns by beneficiary to assess changes in the export volumes and values. Achievements or problems would be reported in the project quarterly/annual progress reports and should be timely addressed by the project management and the Bank.

The following is recommended to be done:

i. Periodic review of the fund performance by the multi sector coordinating committee to review amount paid out, number of beneficiaries and non-performing loans.
ii. Periodic visits to beneficiaries of fund to assess how the funds have been deployed.
iii. Periodic review of CD1 forms by beneficiary export firms for programme monitoring and evaluation.
iv. Review of beneficiaries CD1 forms returns to assess changes in the export volumes and values.

The following indicators should be collected on a regular basis:

v. Volumes and value of exports by value chain and destination;
vi. Conduct market intelligence and export promotion studies for specific market segments and value chains;
vii. Number of new horticulture investment projects started;
viii. Number of new jobs created; and
ix. Number of smallholder farmers engaging in horticulture exports by gender.

5. Other complementary areas requiring attention

In order to ensure that the Zimbabwe's horticultural sector sustainable transformation, the provision of funds through the HERF should be complimented by other interventions including the following:

- Irrigation and infrastructure development- The Fund can also assist in rehabilitation of small holder irrigation schemes in Zimbabwe. This will help the small holder farmers improve productivity of horticultural produce.
- Improve the status of feeder roads from major producing areas.
- Capacity strengthens of value chain players especially horticulture producing farmers horticulture to produce and be able to comply with h international regulations and standards.
- Strengthening of value addition capabilities of horticultural produce players.
- Post-Harvest management is a key area requiring attention in-terms of shortage in logistics and handling facilities and services.
- Lack of capacity building in quality management issues to further improve the sorting, packing, cooling, etc. in line with requirements of the chosen end market also requires attention.

6. Proposed steps to establish the fund

In establishing and operationalisation of the Horticulture Export Revolving Fund the following steps are being proposed.

Step 1: Identify critical stakeholders;

Step 2: Invite and establish an inclusive multi-sectoral committee to manage the setting up and Operationalisation of the Fund;

Step 3: Develop minimum criteria for selecting potential beneficiaries and qualifying inputs; allocation mechanism;

Step 4: Establish a standard risk sharing mechanism and claim settlement protocols;

Step 5: Develop Key Performance Indicators for the Fund Manager; and performance appraisal framework;

Step 6: Identify potential partner financial institutions with USD balances and foreign lines of credit;

Step 7: Sign agreements and contracts on how the funds will be managed, accounted for and the effective date for operations of the fund. Agreement also covers, risk sharing mechanism, implementing agents' fees and Claim settlement process;

Step 8: Training and capacity development of loan officers and credit department heads on the specific eligibility criteria for borrowers and qualifying inputs under HERF; and

Step 9: Begin process of accepting and processing of loan applications for funds and disbursement of funds to beneficiaries.

7. Conclusion

The Horticulture Recovery and Growth Plan seeks to grow area under horticulture to 55,348 ha and production to 7.7 million hectares respectively by 2025 and increase export earnings to US$300 million by 2030. However, the provision of affordable and accessible financial services is essential for the development of the horticultural industry as a result the establishment of the Revolving Fund is a welcome development that will help deal with the financing gap constraining the growth and development of the sub-sector. To be successful the Fund should have the following critical elements; operate independently, an inclusive multi stakeholder coordinating committee, predefined risk sharing agreement with implementing financial institutions and clearly defined eligibility criteria for borrowers and qualifying inputs. It is there recommended that these minimum critical elements be put in place for the success of the Horticulture Export Revolving Fund.

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