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Impact of agricultural finance in rural areas – case study Kosovo

Jehona Shkodra[*], Liridona Shkodra

Univeristy of Prishtina, Faculty of Agriculture and Veterinary, Department of Agro-economy
**Corresponding author:* jehona.shkodra@uni-pr.edu

Abstract

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This paper aims to provide the overall state of rural finance in the Kosovo region, its status, the impact of credit lending, the role of banking institutions and governance in rural finance expenditures, and the improvement, barriers, and challenges throughout the years. The objective measure of access to rural finance is variable which help as to measure credit lending and the portfolio level of agriculture credit to find managing in financial institution performance. Therefore, the results show that the banks give more access than micro finance institutions at summation of large loans for agriculture, but at other side banks give less compared to micro financial institutions at summation of small loans for agriculture.

Keywords: rural finances; access to finance; credit lending; Kosovo

Introduction

According to recent data, the global population growth by 2050 is projected to increase dramatically. As a result of this, population growth will increase demand for food. Due to increased food demand, it will be impossible to meet these requirements without strengthening the private production sector.

The banking sector in developing countries gives less credit to the agricultural sector and its development. This is the case, although in the developing countries the distribution of agriculture in general GDP is quite large. The barrier for not lending to developing countries is not the lack of liquidity in the banking sector, but the lack of willingness to make the development of the agricultural sector. This fact makes investments in agriculture limited by both participating actors, both farmers and agricultural companies. These agricultural loans, which are available to developing countries, tend to be informal and of a short duration, which is directly related to long-term investments. These informal financial loans only partially cover the needs of farmers and small agricultural businesses, and usually of high interest (World Bank Group, 2015). Kosovo's agriculture share on overall GDP is 10.3% (Kosovo Green Report, 2016). Due to the importance of improving and developing rural economy, which affects the overall economy of a country, employment, and poverty reduction, expanding the rural finances is the main goal of the institutions and governments.

Micro finances and overall banking institutions in Kosovo are not specialized on agricultural loan lending. Therefore, the performance and the risk of these loans tend to be higher. The interest rates for agriculture loan are higher than the loans for other activities in the region, even though on the 2015 has been recorded a decrease of interest rate of 3.45% (Kosovo Green Report, 2016, p. 137).

Loans are considered as an important instrument for increasing agricultural production and revenue growth, through new technology to get inputs and increase productivity (Asiedu and Fosu, 2004; Shkodra et al., 2012). Challenges faced by financial institutions by providing financial products are threefold:

- Transaction costs for achieving remote rural populations;
- Higher perceptions of non-repayment of loans due to specific sector risks, such as output, market prices and risks;
- Lack of knowledge of financial institutions in order to

manage transaction costs, specific agricultural risks and how to market a financial customer's financial services (World Bank Group, 2015).

Also, government policies have often been ineffective and can, in fact, create obstacles to providing financial services to the agricultural sector. Policies such as concessional lending practices, interest rate coverage, and credit crunch programs could create barriers to private sector lending, creating problems for the government to provide agricultural loans (World Bank Group, 2015).

The paradigms of centralized and direct policies on agricultural credits are as follows:

- Agriculture is a major source of livelihood and the main driver of economic growth in developing countries, so the development of agricultural production is a public priority. Technology innovations and more data usage are essential to boost production;
- Farmers need more financial resources to adopt technological innovations;
- Most farmers are poor, therefore there is a lack in money resources that blocks the adoption of new and credit technologies that are needed to fill the void;
- Agricultural production is a risky business. Returns to agriculture are less than in other sectors of the economy, market interest rates reflect opportunities in other sectors: the cost of money market is too high for farmers to borrow for productive purposes;
- The government should intervene with subsidized credit (requiring no profit, high transaction costs depreciation, risk spreading on a national basis);
- Subsidies are justified if loans are intended for specific government objectives;
- Therefore, agricultural loans should be targeted to crops and technologies of interest to the elected government;
- Loan repayment capacity is shown by sustainable culture/model farm budgets;
- To provide subsidized loans for specific purposes, specialized government financial institutions should be established and funded with public funds;
- Specialization advises that savings collection and lending financial intermediation function are kept distinct;
- Since most rural borrowers are small (i.e. poor) farmers, low-cost loans are responsive to poverty alleviation, and subsidized credit also compensates farmers for high-tax agriculture (such as controlling grain prices, export taxes, artificial exchange rates (Smith, 2001).

The impact of interest rates on lending

Interest rates in Kosovo are indeed among the highest in the region. Agricultural producers, especially small ones, often have no access to banks. They borrow from IMF with interest rates ranging from 20% to over 30% per year. Agricultural processors have better conditions and pay interest rates between 10% and 30%, depending on their size, credit history, and other factors. However, they still complain about the high cost of borrowing (Financimi Bujqësor në Kosovë, 2014).

Kosovo's banking system continues to maintain a high level of stability, characterized by strong capitalization, acceptable credit portfolio quality, and satisfactory liquidity position. The capital adequacy ratio at the end of 2012 stood at 14.2%, representing a satisfactory level of capitalization and exceeding the minimum 12% required by the CBK[1]. The share of non-performing loans in relation to total loans has been increased each year from 2008 with 3.3% to 2013 with 8.7%, so the NPL in 2014 started decreasing trend (8.3%) whereas in 2015 NPL reached 6.2% (Shkodra and Ismajli, 2018). The level of non-performing loans coverage with provisions for credit loss stood at 112.4%, representing a satisfactory level of coverage. Among Southeast European (SEE) countries, Kosovo continues to be among the countries with the highest growth rate of credit and the highest quality of the loan portfolios (Financimi Bujqësor në Kosovë, 2014, p. 23).

The credit rate during 2014 for agricultural loans is 13.2%, compared to the current year 2015 with the average credit rate of 9.3, down by 30%. And as a result of this interest rate drop, a number of credits for these two years have increased by 14%. In 2014, agricultural loans were reported with a total of 43.3 mil. Euros, while in 2015 the amount was 49.6 mil. Euros (Fig. 1).

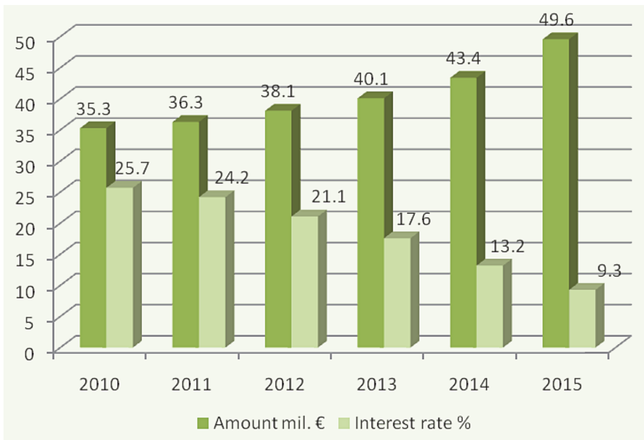

Fig. 1. The agricultural loan rate and the amount in mil. Euro

Source: Ministry of Agriculture, Forestry and Rural Development – Department of Economic Analysis and Agricultural Statistics

[1] CBK – Central Bank of Kosovo

The interest rate cut on agricultural loans has increased in lending. As a result, there has been better performance on borrowers and lenders.

Rural Finance

The role of finance is important to grow the firms including farms which is argued by many researchers and experts (Malhotra at al., 2007; Deakins at al., 2008; Teima et al., 2010; Shkodra, 2010; Shkodra, 2014; Fowowe, 2017).

Today's rural financial services are focused on a variety of services, including not only agricultural lending, but also loans for non-agricultural production farms, loans made to non-rural firms, rural savings deposit services, and other financial services, such as insurance (Smith, 2001).

Despite of the demand for subsistence of their activities through loans, and because of the low level of insurance system in agriculture, the farmers on the regions of Kosovo have performed a low access on the loans. The loan term varies from 12 months to 50 months. In 2006, interest rates vary between 8% and 48%, depending on the amount of the loan and the term of return, and in 2014 and 2015 it is seen their stabilization from 9% to 26.5%. Agricultural producers continue to be disappointed with interest rates, which do not stimulate the development of this sector (Kosovo Green Report, 2016, p. 140).

A very important aspect which in the short term cannot be financially assessed for its effects is the application of the grace period. "The grace period or period of postponement of the payment varies from 3 to 12 months actually, although in some publications it is 18 months, depending on the cases where the grace period is flexible" (Kosovo Green Report, 2016). The farmers in Kosovo as the society in general have scarcity of knowledge on the banking system and the effects of applying these systems in the households' budget.

Agricultural finances should focus on four important areas:

1. Segregating small farmers and identifying their financial needs. Small farmers are heterogeneous and have different requirements. It is very important to preliminarily identify or group the sub-segments of this group of farmers and then evaluate their needs and requirements. Once the requirements and needs for these sub-segments are known then designing the products and solving their problems is easier. Also, it should be borne in mind that small farmers need not only for agricultural loans, which cover the costs of agricultural activities but also need for other loans covering household expenses, insurance, payment system and savings (World Bank Group, 2015).

2. Finding ways to avoid the risk of agricultural finance by addressing permanent, individual and systemic risks. The individual risk is mainly related to risk assessments, information and systems to assist this risk. While in systematic risk, health insurance, risk catastrophe program, hedge price during value chain exchanges may have a positive impact on problem-solving (World Bank Group, 2015).

3. Identification of relevant institutions and distribution channels that will reduce the cost of service to agricultural customers. A number of institutions can provide agricultural funding, depending on the type of clients it serves. Commercial banks can offer solutions through value chains and for well-organized groups and small farmers. New technologies and advances in mobility of bank problem solving and the integration of farmers into an organized value chain can promote solutions and encourage the reduction of service cost in rural areas (World Bank Group, 2015).

4. They address the issues of creating the environment and specific government policies that limit the flow of financial services to small farmers. Government policies may limit lending but may also limit private sector crowds (World Bank Group, 2015).

Model specification

Access to finance is the objective in this study. In order to find that we identify some specifications such as:

Access to finance (AF)

Financial institutions (FI):

Commercial banking (CB)

Micro financial institutions (MFI)

Summation of loans (SL):

Small – to 10.000 € sum of loans;

Medium – 10.001 € – 50.000 € sum of loans;

Large – up 50.001 € sum of loans.

Interest rate (IR):

Small – to 5%;

Medium – 5.1% – 10%;

Large – 10.1% – 20%;

Extra large – over 20%.

Farm scales which take loans (FS):

Small – to 10 employers;

Medium – 11 to 20 employers;

Large – over 20 employers.

We include financial institutions (banks and micro financial institutions), summation of loans (small, medium and large), interest rate (small, medium, large and extra large), and farm scale which take loans (small, medium and large) and loans portfolio (LP).

The following models are:

$$AF = \alpha_0 + \alpha_1 CB + \alpha_2 SL_i + \alpha_3 IR_i + \alpha_4 FS_i + \alpha_5 LP_i + \varepsilon_i$$
$$AF = \beta_0 + \beta_1 MFI_i + \beta_2 SL_i + \beta_3 IR_i + \beta_4 FS_i + \beta_5 LP_i + \varepsilon_i$$

Results and Discussion

Firstly we examine some general information for financial institutions in Kosovo which are presented at Table 1. There are ten banks that operate in Kosovo and there are sixteen micro financial institutions. Total sum of assets in banks which operate in Kosovo is 3.64 billion Euros whereas micro financial institutions have just 142.2 million Euros, although by number they are more. The same situation is the amount of credits when banks have issued 2.23 billion Euros loan and micro financial institutions have issued 108.9 million Euros loan. The average loan interests have great difference especially in recent year when loan interest at banks have decrease at 7.2%, percentage which is very high but is good comparing with previous years. But it is worrisome the fact for micro financial institutions when average loan interest is very high at 21.3%.

The results of examining access to financial institutions constraint analysis by summation of loans are presented at Table 2. It shows the results for access to financial institutions including banks and micro financial institutions affected by summation of loans. The results show negative coefficient which means that access to financial institutions is affected by summation of loans. The significant negative coefficient at summation of large loans indicates that banks institutions give more access than micro finance institutions at large sum of loans.

Table 3 shows the significant negative coefficient on small farmers who took loans. They have highest access to financial institutions compared to medium and large farms. This fact can be due to high norms of interest, because according to Shkodra (2016) farmers with more experience have created a greater equity and are oriented to the investment with its own means.

Table 4 shows the access to financial institution measured by interest rate, grace period, collateral, and loans portfolio. From the result we can conclude that the financial institutions which give more loans will be able to grow faster. This is the strong arguments to conclude that the management of financial institutions in Kosovo is for commendation.

Table 2
Access to financial institutions – analysis by summation of loans

Depending variable: Access to FI	
Independent variable:	
Summation of small loans	-0.009
Summation of medium loans	-0.005
Summation of large loans	-0.002***
Adj. R^2	0.0302
Obs.	26

Source: Personal calculation
* Significance at 10% levels; ** Significance at 5% levels; *** Significance at the 1% levels

Table 3
Access to financial institutions – analysis by farm size which takes loans

Depending variable: Access to FI	
Independent variable:	
Small farm which take loans	-0.021***
Medium farm which take loans	-0.037
Large farm which take loans	-0.045
Adj. R^2	0.025
Obs.	26

Source: Personal calculation
* Significance at 10% levels; ** Significance at 5% levels; *** Significance at the 1% levels

Table 4
Access to financial institutions – analysis by important variables for loans

Depending variable: Access to FI	
Independent variable:	
Interest rate	0.056***
Grace period	0.012*
Collateral	0.042**
Loans portfolio	0.059***
Adj. R^2	0.061
Obs.	26

Source: Personal calculation
* Significance at 10% levels; ** Significance at 5% levels; *** Significance at the 1% levels

Table 1
Summary of financial institutions in Kosovo

	No. FI	Sum of assets	Sum of credits	Loan interest
Banks	10	3.64 billion Euros	2.23 billion Euros	7.2%
Micro financial institutions	16	142.2 million Euros	108.9 million Euros	21.3%

Source: CBK, 2017

Conclusions

In this paper we found some important results which can help as to conclude for access and managing in financial institutions in rural zone in Kosovo. Firstly for access in financial institutions we found significant negative coefficient which tell as that banks give more access than micro finance institutions at summation of large loans in rural zone but on the other hand banks give less compared to micro financial institutions at summation of small loans at rural zone. When analyzing farm size which takes loans we can conclude that those small farmers who took loans have highest access to financial institutions comparing to medium and large farms. That can be due to very high interest rate so the medium and large farms decide to make self investment. At second part we can analysis the rural finance managements where we can find two sides of medal. On the one side the highest interest rate, highest value of collateral and highest value of loans portfolio are very strong arms to contribute to profitability of financial institutions which argument good management, but on the other side this indicator creates difficulties in the growth and development on farms, excluding farms which are able to obtain large amount of loans and make returns in short periods of time.

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