



## **The role of microcredit institutions of agriculture sector in Albania**

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### **Abstract**

The seasonal nature of agricultural production, the relatively high risk due to the volatility of production from one year to another, but also the prices of agricultural products, small and fragmented farms, the problems and difficulties in securing ownership of the collateral, low levels of technology used are some of the reasons that have generated a non-liberal policy of banks and other financial institutions related to agriculture lending. This has led to the shrinkage of the financial power of farmers that constitute more than half the employed population and that account for approximately 19 percent of National Product. Development of the agricultural sector, in terms of market economy requires a financial support for realization of investments. Increase of agriculture mechanization and the importance of the growing needs of the agro-industry and services in the rural areas sectors seek to provide a natural market to insure financing services for agricultural enterprises. In conditions, when the agriculture sector has always been considered as priority and the highest potential growth, it becomes necessary to explore other ways of financing farms and rural enterprises. Specialized rural financial institutions are more successful in attracting funds and fulfilling the credit needs of farmers. In this context, microcredit financial institutions represent perhaps one of the most efficient solutions that farmers can adopt to fund their activities. This paper examines the possibility that rural microfinance institutions can become a powerful instrument in the field of financing farmers and rural enterprises and aims to highlight the benefits that would create the agricultural sector.

**Key words:** Microcredit, financing services, savings, agriculture.

### **Introduction**

Agriculture is a very important sector of the Albanian economy not only because of its contribution to Gross Domestic Product (GDP), but more for the fact that half the population generates its income through this sector. In this context, the development of agriculture is very important for the future of the Albanian economy, but also for the welfare of rural population. In recent years, some efforts have been made to support the agricultural sector. This has occurred indirectly through investments in rural infrastructure, as well as directly through regulatory initiatives. Such is the law for the establishment of agricultural farms. According to INSTAT (Institute of Statistics), during 2010-2011, the GDP has increased on average by 6.1% while the agriculture sector by only 3.85%. The most efficient solution would be strengthening of this sector through significant private funding for raising medium and large farms<sup>4</sup>.

This can be achieved through the introduction of private financial instruments. Demand for agricultural loans by farm economies continues to rise. A successful farm requires not only abundant land but above all it requires a technological infrastructure of production, which is associated with a financial bill. This solution must be provided by the funding mechanisms of the market. Economies of Eastern European countries are facing various difficulties and problems concerning funding of services in the rural sector. Development of the agricultural sector in terms of market economy requires funding for realization of investments. As part of the Albanian financial sector, micro-finance institutions have contributed to farmers financing, rural enterprises and small businesses as well as in terms of economic growth in general for

the country. One of these institutions is the Albanian Savings and Credit Union Group. The purpose of this institution is to provide financial services for the rural areas, in order to promote productive activities, improve living standards and develop rural areas.

### **Materials and Methods**

The purpose of this paper was to analyze the operation of the rural financial system, the activities of microfinance institutions as effective tools in financing of rural enterprises.

These institutions represent an important financial instrument with a wide use in all world economies in financing farmers and to reduce the poverty in rural areas. These actually represent the main purpose behind this study, which is aimed at accomplishing several objectives.

- Increase of efficiency of rural financial institutions in the borrowing activities of economic actors in the rural areas.
- Introduction to economic actors that enable the delivery of rural financial services in the country.
- Identify the level of use of these practices and problems that have accompanied it.
- To evidence the potential of microfinance institutions as an alternative source of financing for rural enterprises.
- Providing recommendations and suggestions for improving lending policies for economic actors in the agricultural sector.

Sources of information for this paper consist primarily in the data accumulated through surveys with farmers, data collected

from interviews at various focus groups, to local and foreign experts as well as various statistical data published by official sources. Interviews include a broad range of stakeholders ranging from farmers to experts in the various sectors of agro-industry, representatives of rural communities etc.

In the Albanian market there are mainly two groups of microfinance financial institutions, namely commercial banks and non bank financial institutions. It is, however, worth pointing out, that from the beginning, the market was dominated by the second group, i. e. the microfinance financial institutions. We see this not only in the very limited number of commercial banks operating in this market, but as well in the low surplus of credit extended by the Albanian banking system. Thus, only Procredit Bank has lending policies oriented for the agricultural sector, as well as some other banks like Raiffaisen Bank or National Commercial Bank that are involved at negligible levels. The necessity of the operation of microcredit institutions arose as a consequence of reluctance of banks to grant microcredit to farmers in rural economies. Microcredit extended together by five non-bank financial institutions operating in this market, occupies a negligible percentage of the portfolio given to farm economy from across the financial system (banks and non-bank institutions) <sup>3</sup>. Expected developments make most optimistic the increase of the role of these financial institutions.

Albanian agriculture currently faces many problems, while most of them have been inherited from the past. Some of these problems that make financing of the agricultural sector by financial institutions even less attractive have to do with conflict or lack of right to land ownership (this problem also derived from the absence of uncertainty in the relevant legislation for agricultural land):

- the small size of farms,
- undeveloped market of land transactions,
- low levels of cooperation in all its forms among farmers,
- the need for an increase in the productivity use and competitiveness of the sector,
- modernization of production technologies,
- the need to further improve the conditions of reproduction, quality and product safety,
- capacity building of sector actors including manufacturers, processors, traders, institutional capacity building support and policy makers,
- harmonization of legislation and development policies with those of the EU.

The data show that Albania has about 350 thousand agricultural farms with employment rates of over 50% of the workforce. Agriculture contributes almost 1/5 of the GDP, while there is a noticeable stable increase of agricultural production by about 3% during the last years. Lack of financing is one of the main problems that hinder the development of agriculture. Furthermore, the agriculture sector in Albania has received less crediting than it has in other European countries. The private banking sector should work for the supply of capital for the agricultural sector. This is not simply because the agricultural sector should be developed for social reasons, but because of the rich lands of our country are a possibility, which so far has not been capitalized. In this case, there will be benefit not only for the agricultural sector and the rural residents, but also for the banks <sup>5</sup>.

Currently, commercial banks provide loans in large amounts, but which require collateral, which, as mentioned above, farmers do not have. There are also institutional instruments for lending to small microfinance, in amounts from 10 to 50 thousand US dollars. However, many times it lacks secondary way of funding to provide loans without collateral in the amounts that range from 100 to 300 thousand US dollars. Unfortunately financing agricultural activities and rural areas are still far from the preferences of banks for lending. Indicators of lending to the agriculture sector during the last decade are low. There are two reasons that have directly led to this indicator:

**First:** Commercial banks prefer not to credit agricultural business and above all agricultural farms, because they consider them as the economy or as small businesses by giving thus more lending opportunities to medium and large businesses. The number of commercial banks interested in financing small businesses including agriculture is even more limited.

**Second:** Commercial banks consider lending to agricultural farms as a very high risk even there are opposing opinions which claim that the repayment of credit to agriculture is even more sure than in many other sectors of the economy. In the conditions and influences of global financial crisis the phenomenon of stopping lending to the agriculture sector becomes even more pronounced. There are several main causes of lack of credit from commercial farming economies among which we can mention:

- Lack of institutional capacity of commercial banks due to high cost that have small loans.
- Banks do not see farms as ongoing and sustainable activities and therefore they not prefer to grant them credit.
- A considerable part of the farmers do not have the proper education, as well as the required qualifications by the banking institutions to apply for loans.
- Another problem is related to the possibility of receiving credit in rural areas, as mentioned above, there are only two banks that provide lending opportunities for the agricultural sector and they were Raiffaisen Bank and Procredit Bank.

## Results and Discussion

The need for cooperation in the financial field, introduction of legal and financial performance of basic services for Albanian farmers, are some of the main factors that have made possible the establishment and operation of a number already credit and saving associations (CSA) in the rural sector. So far, two of the projects focused on this area for development have played an important role: Rural Financing Fund, supported by funds of the World Bank and Foundation Development Movement of Credit and Savings Associations, supported by the League of Credit Unions Irish Based on long experience of credit cooperatives in the world (society, union or mutual fund), as well as in legal and regulatory basis in our country, these institutions or “small village bank”, called them savings and credit associations (CSA). CSA was conceived as a financial body for small peasant producers. Villagers have their own financial institution; they are responsible for all decisions, in line with their needs and their common interests. Through mobilization of savings, CSA can constantly increase its loan resources and gain economic dimensions. CSA was conceived

so as a higher form of cooperation.

In our terms these “micro banks” should initially perform limited operations such as:

- (1) The collection of membership quotes.
- (2) The collection of member’s contributions.
- (3) Accumulation of deposits only from members of CSA.
- (4) Credits only CSA members.

From Financial products & services related to credit would mention Microcredit

- Maximal amount: 5800 Euro
- Duration: up to 5 years
- Interest: (with descending balance) 16% in year
- Loan SME [In Leks (Albanian currency) & Euro]
- Maximal amount: 6 Million Leks (30,000 Euro)
- Duration: up to 5 years (3 year for the loan in Euro)
- Interest: 16% in year
- Credit in euro
- Overdraft

Banking associations and financial cooperatives in general have had much success in all countries of the world, where members are free to undertake private economic activities<sup>2</sup>.

Members of these associations cannot save large sums, but membership of a large number of people, makes possible the collection of savings and loan start-up. Specialized credit institutions in the field of financial services in the rural sector have different arrangements. One of these institutions is Group Union – CSA.

Group Union - CSA is an institution that has its beginnings in 1992, when the first project began for the alleviation of the rural poverty, financed by World Bank and the government of Albania.

Union is a voluntary union of savings and loans, which enables a level of cohesion and solidarity in the activity in national level. The beginning of savings and credit associations activity, although it constituted an important step in the development of rural finance, has faced many troubles of legal and regulatory character. The main activity of CSAs, relationships with third parties, the status of members and the establishment of the regulatory agency responsible for licensing, supervision and regulation of them is in accordance with Law 8782, dated 3.5.2001 “on savings-Credit “. Regulatory function performed by the Bank of Albania.

CSA was conceived as a financial organization for farmers and rural enterprises and works based on three basic principles of self creation, self responsibility and self administration.

Group Union CSA is lying in hundreds of villages in the country, in 16 districts of Albania and has a membership over 26,000 thousand people and during the second 6 months of the year 2011, the group has disbursed 3505 loans with a total of 1.2 billion. While in the first 6 months of 2012, according to data from CSA had an increase in the credit lending by bringing in about 3600 the number of disbursed loans to a monetary value of nearly 1.3 billion. Real support to farmers in the service comes in two basic aspects in lending and deposits for them.

- Farmers and rural residents found their main support for microcredit as the further development of their activities. Credit savings are the exclusive providers of financial services in rural areas
- The union of CSA operates in the most intensified segment of the agricultural sector (field and coastal plains area) being

managed as a financial institution in growth, which is based on savings and credit societies involved in this institution

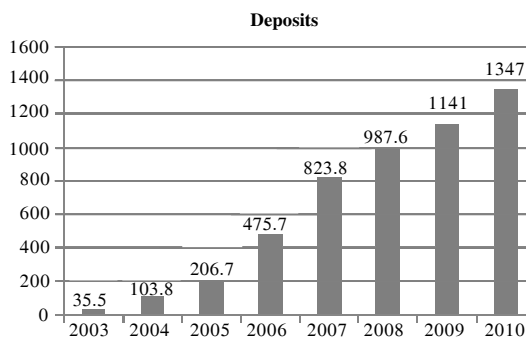


Figure 1. Deposits in million Leks according to year.

Source: Bank of Albania<sup>1</sup>

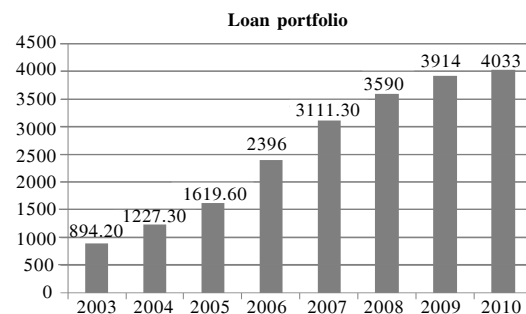


Figure 2. Loan portfolio in million Leks according to year.

Source: Bank of Albania<sup>1</sup>

Figs 1 and 2 show some important indicators of CSAs in Albania.

During 2011 Union CSA has managed to consolidate its position in the market, as compared with competitors, and in its relationship with customers. CSA Union achievements testify for the growing and sustainability of Union CSA, where his base stays principles financial cooperatives philosophy as mutual trust, solidarity and transparency. Union CSA in 2010 is concentrated and focused in these directions:

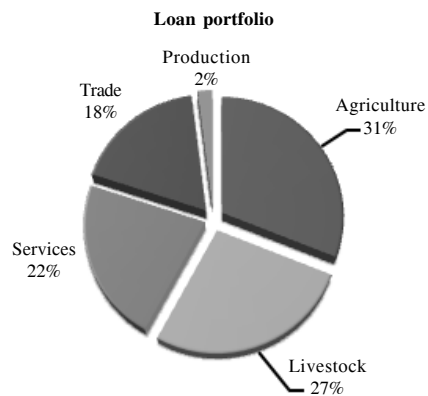
- CSA Union has achieved to consolidate more its structures in many regions and its position in the financial services market.
- CSA Union has aimed and has achieved to operate and expand its activities in new areas.
- CSA Union has improved and diversified products offered to members.
- Maintenance and improvement of services quality has been the focus of activity of CSA Union.

Referring to the Bank Albania, Savings and Credit Associations are included as members of two unions: Albanian Union of Saving and Credit (AUSC) and Jehona Union.

In December 2010, total assets for the Group Union-CSA reached 5902 million Albanian Lek and SCAs network with a total asset value for 4539 million Albanian Lek, so with a growth of 13.7% compared to 2009 (source: Albanian Union of Saving and Credit). Much of the activity of the Unions and the network of CSAs is oriented towards lending (Figs 3 and 4).

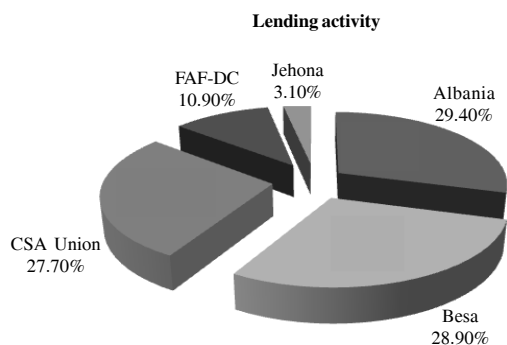
Unions loan portfolio and network of CSAs are respectively 0.5% and 0.9% of total banking system credit (source: Bank of Albania)

During 2011, the Group Union - CSA will continue to compete strongly in the market, maintaining its position as the leading institution of financial services in rural areas. By way of concluding



**Figure 3.** Data for lending activity according to sector in the end of 2011.

Source: Bank of Albania <sup>1</sup>



**Figure 4.** Data for lending activity according microfinance institutions in the end of 2011(Credit Portfolio, outstanding).

Source: Bank of Albania <sup>1</sup>

we can say that creation and development of new CSA is a necessity and an opportunity for development and delivery of financial services in the rural sector. This occurs for some reasons:

- Lack of specialized financial institutions in the rural sector and the growing demands and needs of the farmers for funding.
- Lack of financial services in the rural sector and particularly the withdrawal of free monetary resources and use in this sector.
- The existence of a necessary legal basis to support this process.
- Involvement of various projects in their activity supported by foreign donors.

Important direction of CSA and their union is also the increase of attractiveness of savings deposits from farmers. This will bring increased sources of funds for loans and will make CSA more independent from donor's funds and will a premium to reduce the cost of borrowing.

### Conclusions

- Diversification of loan portfolio according to customer activity and the respective regions provides a low risk loan portfolio as well as leads to consistency and consolidation in the future of these institutions.
- Establishment of Cooperative Banks, we think it will be a premium for rapid development of rural financial market as well as a consolidated rural financial institution referred to global experience.
- Regarding the credit default risk, we can say that it is lower in

agriculture when compared with other sectors such as in construction, although banking institutions think differently. Farmer's culture is such that it does not allow the debt for a long time in the institutions. This is proved by the micro credit schemes that have a return of 95-98% of the loans taken.

- We can recommend two scenarios to solve the problem of financing farms. One would be the creation or recreation of the National Agrarian Bank, which will be focused entirely on agricultural projects. This bank, in any case should not be restricted only by public funds. Even it is established by the state, public funds should make up only 20%. The rest should support by private funds, formatting hypothetically Agrarian Bank as a partnership between the public and private, but with noticeable dominance of private.

- A second scenario to guarantee credit to farmers would be the increase of financial investment funds concentrated in the agricultural sector. Even this solution requires the action of private operators. These funds are similar microfinance forms, but offer much greater lending and guarantee their capital by borrowing the major companies which have previously subscribed supply contracts.

- We recommend that there should be a secondary funding way to provide loans without collateral for farms of a size about 30 to 40 hectares, in order to facilitate their activities in accordance with market requirements related to agricultural products.

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