Micro Agricultural Financial Institutions of South Africa (MAFISA)

1 Introduction

The Micro Agricultural Financial Institutions of South Africa (MAFISA) programme was launched as a pilot project in three provinces in 2004/05. Its goal was to provide small, short- and medium-term loans to small-scale farmers to expand production, particularly in communal land areas and on smallholdings with a variety of tenure systems.

MAFISA's approach was to channel funds appropriated to the Department of Agriculture, Forestry and Fisheries (DAFF) through the Land Bank to established financial intermediaries who would make loans of up to R500 000 to farmers. The programme's rules meant that the bulk of borrowed funds were to be used to pay suppliers of agricultural equipment and other inputs. MAFISA loan agreements stipulated that financial intermediaries generally would not pay the borrowed funds to the beneficiary, but would pay the suppliers of approved inputs and services directly.

A performance and expenditure review (PER) of the MAFISA programme was commissioned in October 2013 and completed in May 2014 by Cornerstone Economic Research (Pty) Ltd. Its objective was to evaluate MAFISA's success in reaching small, emerging farmers, and whether it helped them increase their scale of production and penetration of markets. Some of its key outputs and insights are summarised here; the full report is available at www.gtac.gov.za/programmes-and-services/public-expenditure-and-policy-analysis.

2 Institutional context

A key feature of the MAFISA model was that interest rates charged to borrowers were capped at 8% per year, with the Land Bank charging financial intermediaries only 1% for the use of these funds. Financial intermediaries selected to participate in the scheme were to be approved by DAFF. They were expected to use existing organisational infrastructure and processes to source and assess loan applications, make payment, and ensure repayment of the loans. Since they had to return the full capital amount extended by the Land Bank, they bore the full risk of default.

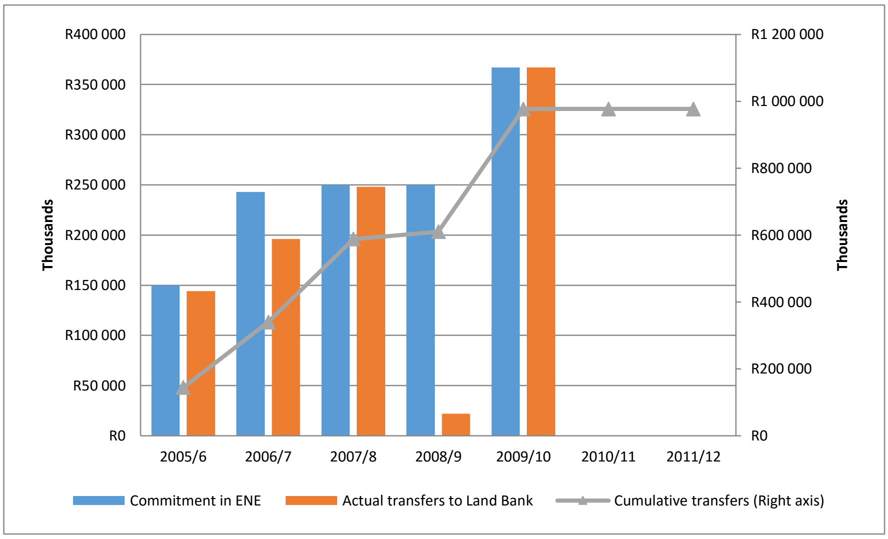
One of MAFISA's goals was to leverage the resources that provincial departments of agriculture used to provide extension services to farmers in the target market. Extension officers would assist farmers in applying for loans and also provide technical support to increase the likelihood of their success. The programme called for close working relationships and regular reporting between the provincial departments of agriculture and the financial intermediaries in the province.

The provisions governing bad debts had not been tested at the time of the PER, because most of the agreements with financial intermediaries had not reached their expiry date (at which point funds have to be repaid to the Land Bank). Only one intermediary – Kaap-Agri – had applied to the DAFF to have two loans written off against the MAFISA capital, but DAFF had not yet reached a decision on this. One of the findings of the PER was that bad debts would probably render the scheme commercially unviable for financial intermediaries, which would in turn be unlikely to repay the Land Bank.

3 Performance

Initially, it was envisaged that the DAFF would allocate R1 billion to the Land Bank between 2005/06 and 2012/13. When transfers were halted in October 2013, about R977 million had been transferred (see Figure 1). Of this amount, about R500 million had been committed to intermediaries, but not all of it had been on-lent to beneficiaries.

Figure 1: Transfers to MAFISA, 2005/06 to 2011/12



About 4 200 MAFISA loans (of around R315 million) were made between 2005/06 and 2011/12, while intermediaries had yet to lend a further R190 million. These loans were made through nine intermediaries, two of which had dropped out of the scheme. MAFISA's geographical coverage was uneven, with inadequate services in the Northern Cape, the North West, the Free State and the Western Cape, where intermediaries had no offices for at least some portion of its operations. Note that the number of loans actually extended is only about one-sixth the number previously reported by the DAFF, a discrepancy that appears to be the result of poor data management. For example, loans to a single beneficiary that involved more than one payment were recorded as multiple loans.

The PER's main conclusion is that MAFISA's terms meant that the intermediaries carried too much risk and earned too little reward. They could not be profitable if default rates exceeded 5%, a figure that would be lower than expected for this market segment. In fact, the PER estimates that two of the current four intermediaries (which provided data) would make substantial losses on their MAFISA loans. The returns made by the other two (which refused to provide data) are expected to be modest.

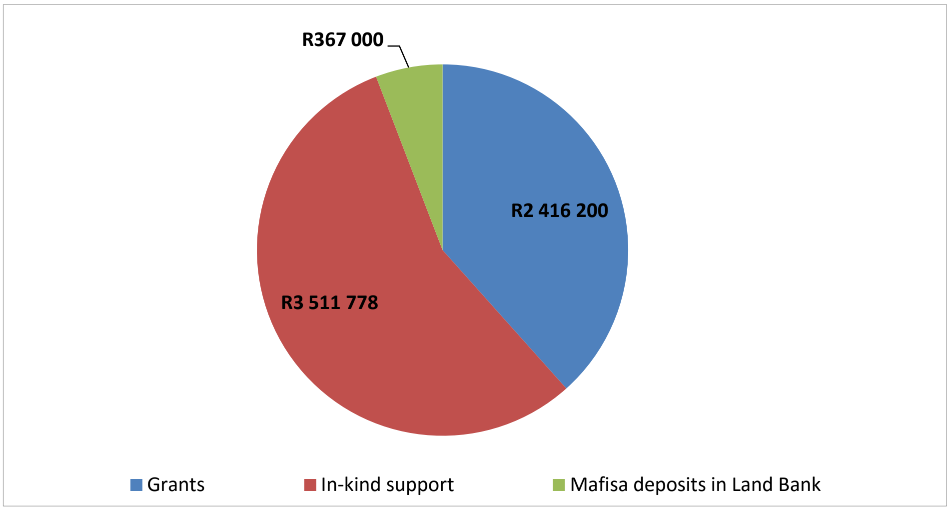
Table 2: Loans and expected returns by financial intermediary, 2010/11 to 2012/13

	Number of loans	Value of loans	Expected profit/loss	Expected profit/loss as % of loan value
National Emergent Red Meat Producers' Organisation (Nerpo)	915	R63 497 336	-R8 222 526	-13%
Kaap-Agri	29	R11 578 076	R210 446	2%
South African Sugar Association	180	R14 972 730	R1 824 387	12%
Eastern Cape Rural Development Agency (ECRDA)	1 438	R102 089 567	-R93 818 019	-92%
Total	**2 562**	**R192 137 709**	**-R100 005 712**	**-52%**

To a large extent, the significant expected losses reflect poor lending practices. For example, the Eastern Cape Rural Development Agency appears to have extended numerous unsecured loans to subsistence farmers. On the other hand, the intermediaries that were projected to make a profit had much lower default rates, owing to both better lending practices and risk management strategies that greatly reduced the range of activities they would fund. One example is the financial intermediary in KwaZulu-Natal, the South African Sugar Association. It used MAFISA loans to finance sugar production on communal or smallholder land by paying contractors for production, there and then purchasing the resulting sugar. This approach all but eliminated the risk of default, but the model, in effect, was that MAFISA funds were used to 'rent land'. The objective of empowering emerging farmers and growing their capacity to engage in the agricultural sector was not being achieved. The result of these practices was much less empowerment than the programme intended. This alone suggests that its structure should be reviewed, a conclusion that was reinforced by other findings.

In practice, MAFISA loans are only a small proportion of the resources devoted to assisting emerging farmers (see Figure 3). In 2009/10, when allocations to MAFISA peaked at R367 million, they still comprised less than 6% of all spending on emerging farmers. Because much of the other support is in the form of grants (for which neither repayment of capital nor interest is required), demand for MAFISA loans is low. Intermediaries find it hard to secure repayment from beneficiaries who believe it unfair to have to repay loans when beneficiaries of other programmes do not have to repay their grants. Much more policy coordination is needed to avoid such situations.

Figure 3: Value of farmer support, 2009/10 (R'000)



When MAFISA was first designed, commercial interest rates were about 11%, a figure that rose to nearly 16% in 2008. At the time, fixing the interest rate on MAFISA loans at 8% made loans through this programme attractive to borrowers and a relatively 'easy sell' for intermediaries. By 2012, however, commercial interest rates had fallen to around 9%, making MAFISA less attractive for both borrowers and intermediaries, who found that it was competing with their other offerings.

Although MAFISA loans were supposed to be complemented by in-kind support from provincial departments of agriculture, in practice extension support was limited.

4 Costing model

The PER developed a costing model to test how alternative specifications of policy variables would affect the viability of the MAFISA scheme. The model enables users to test the cost implications of different modes of extension support by the province and/or the financial intermediaries. Users can model different structures and risk profiles of the loan books to test whether it would be financially viable for intermediaries to offer MAFISA loans. Variables include the number of beneficiaries applying for loans per province or financial intermediary, the amount of support beneficiaries need when applying for funds, and the level of aftercare provided.

The most significant finding from the model is that MAFISA is only viable at default rates below 5%. This leaves virtually no margin for error for financial intermediaries, and prudent intermediaries must either set strict access conditions to minimise the risk or remove the farmer from the process completely by requiring that all payments go to contractors that farm the land. Financial intermediaries that adopted a less stringent approach to lending stand to incur significant losses. If, however, the intention of MAFISA is to reach marginal or emerging smallholder farmers, the way write-offs are handled needs to be reviewed. A risk-sharing model suggests that if MAFISA is to play an empowerment role, the DAFF would need to accept at least some losses on these loans.

5 Suspicious transactions

The PER found that some of the key accounts through which funds flowed could not be properly reconciled. Significant amounts appeared to have been spent in ways that were either inappropriate or not properly authorised.

The funds paid into the two MAFISA accounts managed by the Land Bank cannot be reconciled with the amount allocated to DAFF for MAFISA through the budget. Land Bank figures show that nearly R420 million more was transferred out of the two MAFISA accounts than had been transferred into them through the budget. In addition, of the funds transferred from the MAFISA accounts, only about R610 million went to financial intermediaries approved for providing MAFISA loans. The DAFF appeared to have transferred the remainder to entities that were not authorised to manage MAFISA loans. Such expenditures do not comply with the Public Finance Management Act (PFMA).

Some of the more unusual transactions include:

- The transfer of R337 million to the Agricultural Research Council, seemingly for a ‘tractor mechanisation programme’; such a programme should be managed by the provincial departments of agriculture and not the council, and should not be funded through MAFISA.
- The transfer to Peulwana Financial Services of R227 million, although they were only authorised to receive R20 million in MAFISA capital; they do not appear to be particularly well-suited to making large volumes of loans.
- The use of MAFISA funds to purchase a liquidated company (Makhathini Cotton), a transaction that may amount to ‘fruitless and wasteful’ expenditure in terms of the PFMA.

The patterns of spending identified here suggests the DAFF may have treated the MAFISA funds inappropriately, allocating them to projects without due regard for the intended use of the funds determined by Parliament through the budget process. Alternatively, the DAFF may have channelled departmental funds into the MAFISA accounts and then transferred them to other entities in order to avoid normal oversight processes.

In line with the provisions of the PFMA, these expenditures need to be investigated and, where appropriate, steps taken to recover the funds. This may include recovering them from the official(s) who authorised these expenditures, as well as laying charges of financial misconduct against them.

6 Postscript

In October 2013, the National Treasury instructed the Land Bank to return unutilised MAFISA funds to the National Revenue Fund. It is unclear whether and to what extent this has created a gap in the agricultural microfinance market, as there is a range of government grants and other loan products available to small-scale farmers. There is no reason why a remodelled MAFISA could not be relaunched. Alternatively, a similar product may be expanded, such as the Wholesale Finance Facility offered by the Land Bank.