Evaluation of the financial challenges faced by contract farmers in achieving transformation in the agricultural sector in South Africa

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Abstract

Access to finance is an essential factor in the agricultural value chain and enables participants to purchase essential inputs and infrastructure (e.g. machinery and land) necessary for the production process, grading, processing, packaging and distribution of their produce. Finance is also required where there are specific regulatory requirements (such as licencing and certification) to which a participant must adhere, and these may differ from commodity to commodity. With this in mind, it is clear that any farming enterprise that wishes to enter and participate in the agricultural sector will need access to finance to compete effectively. The study examines the financial needs and challenges faced by contract farmers in achieving transformation in the agricultural sector in South Africa. In line with the number of interviews conducted in other qualitative studies, a sample of eight contract farmers from Gauteng, North West, Mpumalanga, KwaZulu-Natal and Free State provinces of South Africa were chosen for the interviews. The study finds that purchase of land, farming infrastructure, farming equipment, working capital for agricultural inputs, and funds for environmental impact assessments are the prevalent financial needs of the sampled contract farmers. Most importantly, the study further documents evidence that business and financial understanding, lack of capital, insufficient collateral, the lending criteria and policies of financial institutions and rigid and non-inclusive products are the major challenges faced by black contract farmers in raising funds to meet their financial needs and their contractual obligations to their sponsors. The study recommends ways in which the farmers believe they could be part of the solution in financially assisting new and emerging farmers and creating a transformed agricultural sector in the country. Farmers believe that this requires a concerted effort by all the stakeholders to close the existing gaps in the current financial mechanisms used to finance farmers in South Africa. It is important that the critical stakeholders (government, development financial institutions and other financial institutions, farmers and their organisations, sponsors and agro-processors) work closely together so that more can be achieved in the least possible time period. The role of each of the above stakeholders is discussed in the recommendations chapter.

Dedication

This dissertation, in its entirety, is dedicated to two very special people in my life: my late mother Mrs Thelma Walase Skepe (Mamposh) and my late father Mr Thamsanqa Tamie Skepe (Tshawe). Their deep love for and unwavering support of me in all my undertakings, particularly my academic pursuits, was always a great encouragement. Thank you for giving up every little thing you had to ensure that I was able to study and for supporting me always.

Thank you for sharing your wisdom with me and for your unending prayers for me. Thank you for always believing in me and never doubting me. Thank you for teaching me that you can never allow anyone to define you and set standards for you. Thank you for instilling the culture of hard work and excellence in me. Thank you being my greatest fans and shoulders to lean on.

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List of Abbreviations and Acronyms

AGRA	Alliance for a Green Revolution in Africa
AgriBEE	Agricultural Broad-Based Black Economic Empowerment
Agri SA	Agri South Africa
APAP	Agricultural Policy Action Plan
ARC	Agricultural Research Council
CASP	Comprehensive Agricultural Support Programme
DAFF	Department of Agriculture, Forestry and Fisheries
DBSA	Development Bank of Southern Africa
DFI	Development Finance Institutions
DRDLR	Department of Rural Development and Land Reform
DTI	Department of Trade and Industry
EIA	Environment Impact Assessment
FAO	Food and Agriculture Organisation of the United Nations
GDP	Gross Domestic Product
Grain SA	Grain South Africa
IDC	Industrial Development Corporation
MAFISA	Micro-agricultural Financial Institutions of South Africa
NDP	National Development Plan
NEF	National Empowerment Fund
PLAS	Proactive Land Acquisition Strategy
SEFA	Small Enterprise Finance Agency
SMME	Small, Medium and Micro-sized Enterprises
Stats SA	Statistics South Africa

Chapter 1: Introduction

1.1 Introduction and background of the study

According to Statistics South Africa, the role played by the agricultural sector in the economy of South Africa is vital. Employment (Table 1) and opportunities for sustaining livelihoods are offered by this sector. Both "upstream" and "downstream" linkages to the broad economic sector can be identified and enhancements to foreign exchange reserves, the provision of raw materials and the market for goods and services are augmented by the agricultural sector. More than half – 52% – of employed people in the rural areas of South Africa's homelands work on farms (StatsSA, 2000).

Table 1: Employment in agriculture, hunting, forestry and fishing, and total employment

Number of workers (000)	Workers in agriculture, hunting, forestry and fishing	Skilled Agriculture (1)	Total Employment (2)
Sep. '12	661	67	13 645
Sep. '13	740	67	15 036
Sep. '14	686	86	15 117
Sep. '15	897	99	15 826
Sep. '16	881	72	15 833
Oct-Dec. 17	849	83	16 171

Source: Statistics SA – Quarterly Labour Force Survey 2018
(1) Skilled labour figures are included in the number of workers in agriculture, hunting, forestry and fishing.
(2) Total employment refers to employment in all sectors.

1.2 Contract farming

The Food and Agriculture Organisation of the United Nations (FAO) states that "contract farming is an arrangement whereby producers and buyers agree in advance on the terms and conditions for the production and marketing of farm products. The terms of the contract typically specify prices, quantities, quality characteristics and delivery dates, and may include other mutually agreed conditions such as production technologies and practices".

According to Eaton and Shepherd (2001), market provision, resource provision and management specifications influence contractual arrangements. The relationship between the grower and the buyer will be determined by these factors.

The aim of this research is to evaluate the financial funding challenges faced by black contract farmers in achieving transformation in the agricultural sector in South Africa. The research will look into what contract farming has achieved to date, what is currently being done and what is envisaged in the future to ensure that contract farming can better be utilised as a catalyst to transform the agricultural sector in South Africa. Further to this, the financial funding challenges faced by black farmers in a contract farming arrangement will be outlined.

1.3 Problem definition

Grain SA (2015) states that the contribution of the agricultural sector in the economy is currently less than 2.5% of the South African Gross Domestic Product (GDP). This is despite the fact that the sector uses more than 80% of the available land and around 60% of the available water. Greyling (2015) argues that South Africa is no exception since in the United States the agricultural sector currently represents around 1% of GDP. A world without agriculture looms as a reality and prompts questions about the contribution of this sector to the economy.

Despite this, the role of agriculture in South Africa remains an important factor notwithstanding its relatively small contribution to the GDP. Greyling (2012) suggests that the economic contribution of the sector can be analysed according to the following themes: the role of the sector as provider of food, earner of foreign exchange, employment source or provider, source of capital and buyer of goods or provider of inputs to the manufacturing sector.

It is clear that the agricultural sector is a key strategic sector of the economy and has huge potential to significantly contribute to South Africa's GDP and its economy in general. One of the ways to contribute is by the inclusion of those people who were previously excluded from the commercial agricultural sector.

To address this, the South African Government introduced the Broad-Black Economic Empowerment Act, No 53 of 2003. This has guided the development of the AgriBEE Charter. Its conception, as contained in the Strategic Plan for South African Agriculture (the Sector Plan), is linked to the vision of a united and prosperous agriculture sector designed to meet the challenges of constrained global competitiveness and low profitability, skewed participation,

low investor confidence, inadequate support and delivery systems and poor and unsustainable management of natural resources. The AgriBEE Charter is derived directly from the sector's core objective which is to ensure increased access and equitable participation in the sector.

1.4 Research questions

This study seeks to provide answers to the following questions:

- What are the financial needs of black contract farmers to meet their contractual obligations to their sponsors?
- What are the challenges faced by black contract farmers in raising funding?

1.5 Research objectives

The purpose of this research is an exploratory study to:

- Understand the financial needs of contract farmers in achieving transformation in the agricultural sector in South Africa in line with the AgriBEE Transformation Charter;
- Identify the major challenges faced by black contract farmers in raising funds to meet their contractual obligations to their supporters.

1.6 Research scope

This study only focuses on black farmers who are contracted to supply agricultural products to their sponsors in South Africa. Our definition of a black farmer is derived from the Broad-Based Black Economic Empowerment Act 53 of 2003**.** According to the Act, black people mean "African, Coloured or Indian persons who are natural persons and are citizens of the Republic of South Africa by birth or descent; or are citizens of the Republic of South Africa by naturalisation before the commencement date of the Constitution of the Republic of South Africa Act of 1993; or became citizens of the Republic of South Africa after the commencement date of the Constitution of the Republic of South Africa Act of 1993, but who, but for the Apartheid policy that had been in place prior to that date, would have been entitled to acquire citizenship by naturalisation prior to that date".

1.7 Justification of the study

The National Development Plan (NDP) reports that the overall employment target could be impacted if close to one million new jobs could be created by 2030. Contract farming is increasingly becoming a crucial part of successful agribusiness (Eaton & Shepherd, 2001). If used correctly, contract farming can be used as a catalyst for successfully achieving the NDP goals.

Wandile Sihlobo, the Chief Economist at Grain SA, contends that the farming population is ageing. AgriSA estimates that the average age of a farmer in South Africa is 62. In countries that lead in food production, such as the United States, the average age of a farmer is 55 (Bureau of Labour Statistics).

To achieve future food security, the agricultural commercial sector needs to be open to new entrants from the previously disadvantaged population groups in the country. Contract farming can be one of the tools used to open up new commercial farming opportunities for the previously disadvantaged population groups and to assist in the transformation of the agricultural sector.

The outcome of the research will help to advise relevant stakeholders on the funding challenges faced by black farmers when entering a contract farming arrangement. This will assist in closing the gaps in the current financial funding mechanisms used to finance contract farmers in South Africa.

1.8 Organisation of the study

Chapter 1 sets the context for the study, explains the purpose of the study, presents the research question and the objectives of the study, and indicates the scope of the study.

In Chapter 2, the researcher reviews literature on Contract Farming, Agricultural Sector Transformation, Agri-Black Economic Empowerment, and the Strategic Plan for South African Agriculture (the Sector Plan).

Chapter 3 discusses several issues on the research design including the research paradigm, the research method, data collection procedures, data analysis, and the issue of quality in qualitative research.

Chapter 4 presents the discussion and study findings from the interviews and the selected documents.

Chapter 5 presents the conclusions drawn from the study and the recommendations.

Chapter 2: Literature Review

2.1 Introduction

The previous chapter provided an introduction and background to the study. This chapter first describes the overview of the South African Agricultural Sector and the contribution that the agricultural sector has made to the country's GDP. Secondly, the chapter looks at the agricultural sector's contribution as a source of employment, provider of food, source of foreign currency, and source of inputs for the manufacturing sector. Thirdly, the chapter deals with the issues of financing agriculture in South Africa, considering the current funding landscape for agriculture and the funding challenges faced by emerging farmers. Lastly, the chapter studies contract farming, types of contract farming, contract objectives and provisions, and contract farming as a response to market imperfections.

2.2 Overview of agriculture in South Africa

The contribution of the agricultural sector in the economy is currently less than 2.5% of the South African GDP (Grain SA, 2015). This is despite the fact that the sector uses more than 80% of the available land and around 60% of the available water. Greyling (2015) argues that South Africa is no exception since in the United States the agricultural sector currently represents around 1% of GDP. A world without agriculture looms as a reality and prompts questions about the contribution of this sector to the economy.

The total gross value of agricultural production (total production during the production season valued at the average basic prices received by producers) for 2016 is estimated at R263 201 million, compared to R232 490 million the previous year – an increase of 13,2% (Grain SA, 2015, p. 12). The Department of Agriculture, Forestry and Fisheries (DAFF, 2017, p. 9) pointed out that, "the value of primary agricultural production in South Africa was R263,2 billion in 2016, while its contribution to the GDP was estimated at R72,2 billion in 2015".

Stats SA (2017, p. 8) reported that over time, other sectors of the economy of South Africa have grown faster than the agriculture, forestry, hunting and fishing sector. This has resulted in a drop in the share of the GDP that agriculture contributes from more than 6% in the 1970s to 2% in 2015.

Despite its relatively small share of the total GDP, the importance of primary agriculture in the economy of South Africa cannot be denied. As an employment provider, especially in rural areas, and a key earner of foreign exchange, agriculture has considerable significance. (DAFF, 2016, p. 15).

Agriculture plays a pivotal role with backwards and forwards linkages to other economic sectors. The manufacturing sector benefits from these links when fertilisers, chemicals and implements are acquired and raw materials – 70% of agricultural output as intermediate products – are supplied. Overall agriculture is "an important engine of growth for the rest of the economy" DAFF (2017, p. 13).

2.3 Financing agriculture

Financing is a major barrier to growth in Africa's agriculture sector, particularly when it comes to smallholder farms. Interest rates in several countries are extremely high, up to 47%. Farmers and businesses often lack collateral and banks struggle to price the risk of loans to smallholder farmers and small to medium-sized agribusinesses (AGRA, 2017). According to Akinwumi Adesina, President of the African Development Bank, "less than 3% of total bank lending in Africa goes to a sector that accounts for about 70% of all employment and over 40% of the GDP".

In most of the world outside Africa, agricultural development banks provide credit for small-scale commercial farmers. These banks are neither commercial banks catering for large-scale farmers nor micro-credit institutions assisting subsistence farmers but are positioned somewhere in between (AASR, 2018, p. 13).

Access to finance is an essential factor in the value chain which enables participants to purchase essential inputs and infrastructure (e.g. machinery and land) necessary for the production process, grading, processing, packaging and distribution of their produce. Finance is also required where there are specific regulatory requirements (such as licencing and certification) to which a participant must adhere, and these may differ from commodity to commodity. With this in mind, it is clear that any farming enterprise that wishes to enter and participate in the

agricultural sector will need access to finance to compete effectively (Mtombeni, Bove, & Thibane, 2019).

Challenges to both the farmers applying for credit and the agricultural financiers exist. Middelberg (2016) notes that the credit risk assessment criteria – financial history, management profile, cash repayment ability and collateral – used by commercial banks are very stringent for contract farmers. He believes that the cash repayment ability criteria should be the primary focus of the credit risk assessment and that the other criteria should merely support the main focus of the assessment. He further insists that both the farmers and the financiers have clear responsibilities in the transaction process: farmers must provide well-prepared credit applications and financiers must issue clear guidelines to ensure that the applications of the farmers are presented comprehensively enough to be successful.

"The sources of financing available to commercial farmers in South Africa include**:** agricultural companies (the previous agricultural co-operatives); commercial banks; the Land Bank; and other privately-owned institutions offering either agricultural finance or corporate farming initiatives" (Capital Harvest, 2016).

2.3.1 The current landscape for agricultural funding

Since 1994, South Africa's agricultural policy remains the mandate of DAFF. This department as well as the Department of Trade and Industry (DTI), the Department of Rural Development and Land Reform (DRDLR) and National Treasury have introduced various funding initiatives (DAFF, 2017, p. 12).

Over and above the Land Bank, the country has various other development finance institutions (DFIs) with clear mandates that are all targeted for economic transformation and job creation. They differ in terms of the weight of their financial resources and the nature and scale of the projects they finance. "DFIs that provide financing to entrepreneurs and farmers engaged in the agricultural sector include the Industrial Development Corporation (IDC), The Development Bank of Southern Africa (DBSA), the National Empowerment Fund (NEF), and the Small Enterprise Finance Agency (SEFA). There are also other provincial and regional DFIs in the country" (DAFF, 2018, p. 3).

While commercial banks (First National Bank, ABSA, Standard Bank and Nedbank) are the main funders for agricultural finance, there are also several non-governmental organisations, producer and other organisations and associations as well as private companies that have started funding initiatives in agriculture (Agri SA, 2016, p. 23). Table 2 shows the various categories of funding initiatives in South Africa based on the type of funding provided to farmers.

Table 2: Examples of loan financing and grant funding institutions

Type of Institution	Institution	Type of Finance	Target Recipient
Government	DAFF, the DTI Jobs Fund, a National Treasury initiative, the DRDLR	Soft-loan programmes such as MAFISA, grant funding such as the Comprehensive Agricultural Support Programme (CASP) and Agricultural Broad-Based Black Economic Empowerment (AgriBEE) Fund.	Emerging farmers
Development Finance Institutions	The Land Bank, IDC, SEFA, provincial DFIs such as Ithala Bank	Loan financing. It is notable that the Land Bank can play the role of administrator of some grant funding.	Emerging and commercial farmers
Commercial Banks	Absa FNB Nedbank Standard Bank	Loan financing. Masisizane Fund33. Limited grant financing through enterprise development programmes.	Commercial farmers
Private sector input suppliers and produce buyers		Grants and loans through enterprise and supplier development programmes e.g. Old Mutual, RCL Foods, Massmart, VKB Group and AFGRI.	Emerging farmers

2.3.2 Current funding challenges faced by emerging farmers

Emerging farmers face many funding challenges.

2.3.2.1 Lending models of development finance institutions

DFIs such as the Land Bank are criticised for adopting a purely profit-oriented approach and imposing strict criteria for successful loan approval. It is also claimed that the Land Bank is run akin to a commercial bank rather than a developmental bank (Mtombeni et al., 2019).

There has also been an acknowledgement from stakeholders that the current agricultural funding system is not working optimally, as it involves different DFIs such as the Land Bank and others which have different eligibility criteria for accessing funding and the funding amounts that are provided (Mtombeni et al., 2019).

2.3.2.2 Lifecycle and patient funding

Stakeholders have also raised an issue about the lack of lifecycle and patient funding. They have argued that while they obtain funding from DFIs and other programmes, this is ordinarily once-off funding. Therefore, this is argued to be a barrier in the sense that long-term investments are needed for some commodities before any returns are realised. Some instances will require constant capital investments, which emerging farmers will not have (Mtombeni et al., 2019).

2.3.2.3 Subsidised interest rates

According to stakeholders, the interest rates currently charged by DFIs such as the Land Bank are an obstacle and limitation for small businesses, as it increases running costs and overheads which impacts the financial sustainability of potential entrants into the market. For example, the fundamental problem for emerging farmers is that they borrow from DFIs to have capital and are expected to repay their loans on market-related interest rates, which sometimes results in them defaulting on their loans (Mtombeni et al., 2019).

2.3.2.4 Timeframes in the assessment of funding applications

Lengthy timeframes for the assessment of funding applications and the granting of funding are regarded as a significant challenge for small, medium and micro-sized enterprises (SMMEs). Emerging farmers often require funding urgently and feel that the processes and turn-around times to access funding are long and too much information is requested from them.

Stakeholders have also critiqued the timeframes for the disbursement of funds by the DFIs, as the cycles in which funding is disbursed do not meet the needs of farmers. For example, a farmer will need funding to plant in February but will only receive funding in August (Mtombeni et al., 2019).

2.3.2.5 The role of intermediaries

Stakeholders have further raised an issue regarding the role of intermediaries used by the Land Bank in influencing the funding made available to emerging farmers. The concerns raised relate to the fact that these intermediaries are more established players (e.g. mostly commercial farmers) competing with the emerging farmers. The allegation is that these intermediaries pursue their interests and may not necessarily be keen to provide adequate assistance to emerging farmers as they can potentially be their future competitors (Mtombeni et al., 2019).

2.3.2.6 Views of funding challenges from the Land Bank

The Land Bank seems to confirm much of what the stakeholders have raised, stating that new entrants into agriculture are at the mercy of access to finance. The financial constraints also affect producers and entrepreneurs whose failure to acquire the necessary inputs leads to limited production. Table 3 sums up the views of the Land Bank.

Table 3: Views from the Land Bank

Activity	Constraint	Description
Pre-investment/ Origination phase	Inability to access suitable land for farming activities at an affordable cost and with secure tenure	Constraints associated with available land: Private land: • cost often prohibitive Government land through land reform programmes: • long process • beneficiary selection process not transparent • allocated land portions not necessarily suitable/adequate for farming intentions • cannot offer land as collateral Communal/tribal land: • allocated land portions not necessarily suitable/adequate for farming intentions • insecure tenure arrangements • cannot offer land as collateral
Structuring/Due diligence	Inadequate business plans due to a lack of financial and technical farming knowledge, and no or limited track record	• Prepared by consultants with little interest in the actual intentions of smallholder farmers • Prepared by farmers themselves with little knowledge of the content required by financial institutions

Activity	Constraint	Description
		• Unrealistic assumptions regarding both costs and income in the business plan • Misalignment in terms of the productive capacity of land to support domestic consumption versus commercial production requirements.
Financing	Lack of own equity to invest in venture	• Results in unacceptably high gearing ratios that equate to reckless lending and set up the venture for failure. • Agriculture cannot sustain high debt ratios due to the external risks related to climate and commodity prices, which must be factored into the operation.
	Lack of collateral	• Sustainable DFIs and the Land Bank Act requires collateral and government and communal land cannot be offered as collateral. • Alternative sources of collateral such as equipment and livestock may be accepted but increase the cost of financing due to the limited value thereof.
	Unaffordable cost of finance/interest rates	The Land Bank raises money in the capital markets due to its funding model. Thus, it must lend at a rate that allows repayment of the funding and covers its operational costs to maintain financial sustainability. These interest rates cannot necessarily be carried by enterprises in the start-up phase and strain cash flows while the climate and business risks to the enterprise are high.
Post finance support	Inadequate technical, managerial and/or operational experience	The level of expertise of the farmers differs based on experience. Many smallholder farmers have solid technical skills, but few business skills. New-generation farmers who join the sector from a professional services background often have solid business skills, but few practical farming skills. However, commercialisation of smallholder farmers requires both technical skills to meet higher standards from formal suppliers as well as business skills to manage the larger enterprise and formalise accounting, health and safety, labour and other practices.

Activity	Constraint	Description
	Lack of access to formal markets	Value-chain financing where farmers are included in strong value-chains offer several advantages including technical support and confirmed buyers of produce. Farmers are inevitably price-takers in the market, but lack of access to better-structured markets often results in waste and financial losses to smaller farmers. An alternative challenge is where smallholder farmers have strong access to informal markets but cannot use the arrangements to obtain finance.
	Limited access to risk management tools such as insurance	Smallholder farmers cannot afford the premiums associated with crop insurance. South Africa is the only market globally where farmers carry the full cost of crop insurance premiums. As the risk increases to the insurer, both from climatic events and limited re-insurance capacity, premiums will continue to increase.
	Limited access to implements and equipment	Certain implements and equipment such as tractors and harvesters require businesses to operate at a certain scale for the business to be able to carry the high capital costs. Smallholder farmers generally do not have the necessary scale and must, therefore, contract equipment. This creates dependencies for the farmer including availability at key times and the quality of the equipment. All of these may have a detrimental effect on the business.
Monitoring	Limited access to technology that improves risk management and productivity	The Fourth Industrial Revolution is providing many technological solutions that allow smallholder farmers to improve productivity through better monitoring of crop health and application of inputs. However, the costs associated with these technologies are high, and smallholder farmers are often not aware of the possibilities due to lack of exposure. Such solutions will also increase the risk to the bank and therefore increase the credit risk of the client if available and accessible.
	Limited ability to respond to regulatory compliance matters	Smallholder farmers are often unaware of regulatory compliance matters such as environmental and labour legislation. Projects are delayed due to the unavailability

Activity	Constraint	Description
		of environmental impact assessments, water licences and other certificates and permissions. In some cases, farmers cannot afford the cost of compliance resulting in viable business plans being abandoned or profitability reduced as portions of projects cannot be implemented.

Source: The Land Bank's compilation dated 12 February 2019

2.4 Contract farming

The Food and Agricultural Organisation of the United Nations (FAO, 2011) defines contract farming as an arrangement whereby producers and buyers agree in advance on the terms and conditions for the production and marketing of farm products. This arrangement specifies prices, quantities, quality characteristics and delivery dates, and also includes other mutually agreed conditions such as production technologies and practices.

Eaton and Shepherd (2001) confirm that contract farming is thus a partnership and long-term commitment between agribusiness and farmers. They maintain that managers and farmers need to work together to honour their contractual arrangements and to safeguard their investments. They note the importance of the reciprocal nature of the relationship between these contract farmers and the contractual farming companies in countries such as South Africa where much of agricultural engagement is small-scale. The grower and the buyer must consider market provision, resource provision and management specifications to ensure that the contractual arrangement functions optimally.

Contract farming must be practised as a commercial venture and not be merely an intervention promoted by aid donors, governments and non-governmental organisations. "Projects that are primarily motivated by political and social concerns rather than economic and technical realities will inevitably fail" (Eaton & Shepherd, 2001).

2.4.1 Contract farming framework

A sound business decision and commercial focus is paramount for a profitable outcome to a contract farmer's venture. The joint interests of contract farmers and agribusiness is presented in Figure 1 that shows a pictorial representation of a theoretical contract farming framework revealing the phases involved in the undertaking (Eaton & Shepherd, 2001).

Successful decision making regarding the start of a contract farming endeavour depends on a number of pre-conditions such as the existence of a market for the produce, the availability of land and resources, and physical, social and cultural factors. Government support – including ensuring political stability and installing appropriate regulatory systems and legislation – is an unequivocal requirement. (Eaton & Shepherd, 2001).

It is important that a contract farming structure – dependant on the crop involved, available resources from the buyer, farmer needs and the local environment – is established during the determination of the contract farming project. The contract farming agreement, including the provisions and specifications, is finalised during the project component phase (Eaton & Shepherd, 2001).

Two other important aspects of the framework include the production performance phase and the feedback phase. These phases are concerned with the quantity and quality of the farmer's output, price adjustments, contract amendments, innovations and adaptations. The interaction of the farmer and the agribusiness during these phases will have an impact on the sustainability of the project and the viability of introducing new contract farming projects (Eaton & Shepherd, 2001).

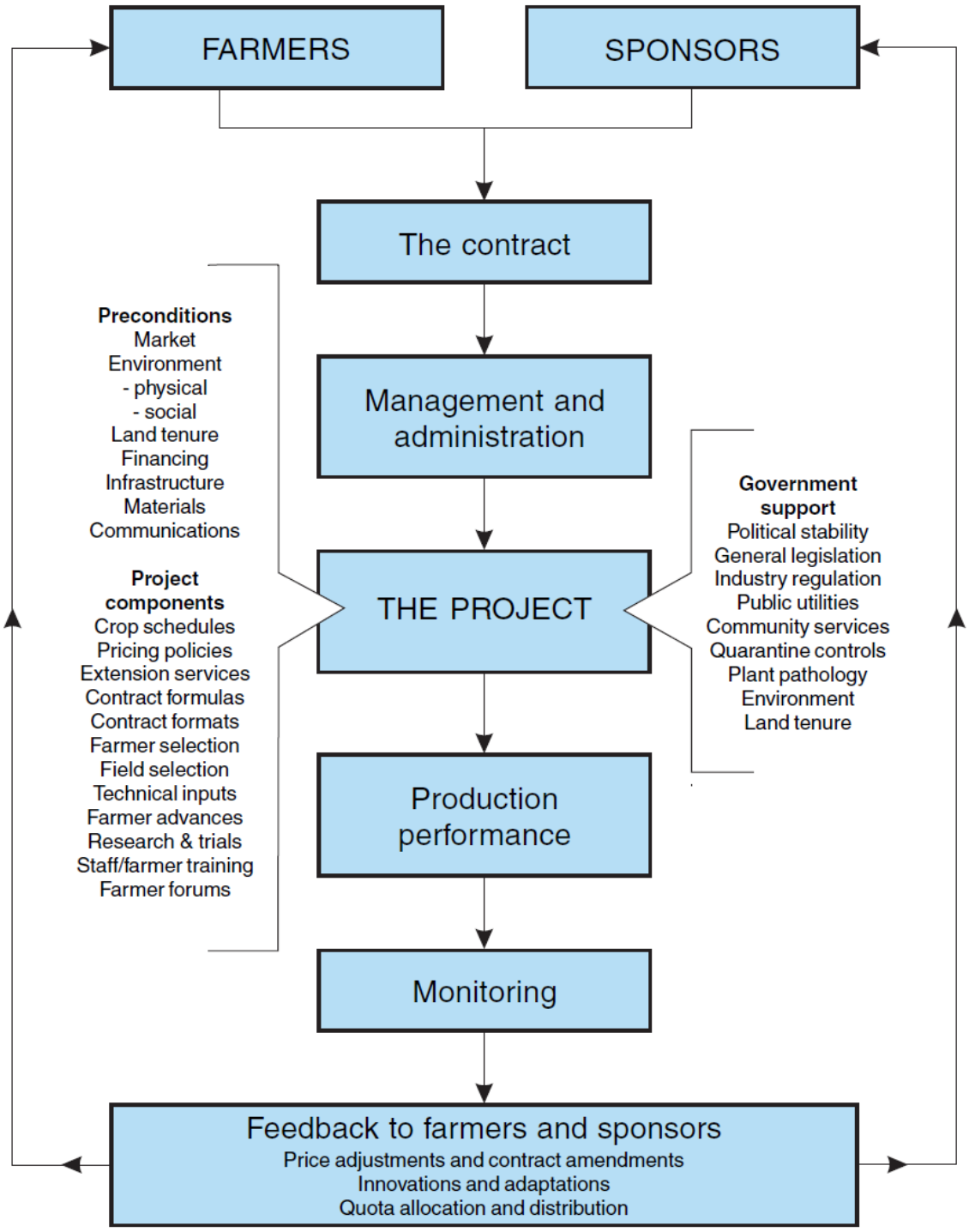

Figure 1: Contract farming framework

Source: Eaton and Shepherd (2001)

Key and Runsten (1999, pp. 381-382) pointed out that "contract farming can thus be seen as a response to flaws in the markets for agricultural credit, insurance, quality information, raw products, and factors of production. It can also be viewed on the part of sponsors as an

institutional response to address transaction costs that are associated with searching, selecting, bargaining, and transferring produce from farmers to the buyers".

2.4.2 Types of contract farming

There are a number of structures/models in which contract farming can take place. This is highly dependent on the nature of the farming produce, experience of the farmer and the resources the sponsors are willing to avail to the farmer. Eaton and Shepherd (2001) theorise that "contract farming arrangements fall into one of five models: the centralised model, the nucleus estate model, the multipartite model, the informal model and the intermediary model".

2.4.2.1 The Centralised Model

In this model, the sponsor only contracts the growing of the crop or farm animals. Upon harvesting time, the sponsor purchases the produce from the farmers and they do their own processing and packaging and directly market the product to the end consumers.

This is a common model in Africa where big multinational corporations contract a number of famers to grow tobacco and cotton. The sponsors purchase the produce directly from contracted farmers and they do their own processing and packaging (Eaton & Shepherd, 2001).

2.4.2.2 The Nucleus Estate Model

In this model, the sponsor of the project owns the land (estate) and manages the plantation on their own land which is normally close to a processing and packaging plant. The estate is often large enough to cater for sufficient production in order to ensure that the processing and packaging plant is kept running at all times (Business Innovation Facility, 2012).

2.4.2.3 The Multipartite Model

The Multipartite Model usually involves more than two parties to the contract farming agreement. Multipartite contract farming may involve a number of organisations, some responsible for providing the necessary credit, some for skills training, some for the production, processing and marketing of the produce. Eaton and Shepherd (2001) note that in Mexico,

Kenya, and West Africa, among other countries, governments have actively invested in contract farming through joint ventures with the private sector.

2.4.2.4 The Informal Model

The Informal Model applies to individual business people or small companies who normally have an agreement with the farmers on a seasonal basis. This model works well for crops that need a minimal amount of process such as fresh vegetables and tropical fruits. "Material inputs are often restricted to the provision of seeds and basic fertilisers, with technical advice limited to grading and quality control matters" (Eaton & Shepherd, 2001).

2.4.2.5 The Intermediary Model

The Intermediary Model involves subcontracting of crops to intermediaries. The farmers sell their produce to individuals or farmer committees and these go-betweens sell the produce on to large companies – a system known as *plasma* in Thailand (Eaton & Shepherd, 2001). The risks to both the sponsor and the farmer when using this model are increased and usually have an adverse financial impact. Eaton and Shepherd (2001) maintain that "subcontracting disconnects the direct link between the sponsor and farmer".

2.5 Contract objectives and provisions

Bijman (2008, p. 7) and Wolf, Hueth and Ligon (2001, p. 364) are at one about an agricultural contract having different functions whether stated or implied. Wolf et al. (2001) identify three functions: the contract as a coordination tool, a means to offer incentives and impose penalties, and a record of financial risk allocation. Contracts ultimately involve all the players, their interactions and the financial gain (or loss) as the bottom line.

2.6 Contract farming as a response to market imperfections

Key and Runsten (1999, p. 383) state that "contract farming is a transitional institutional pact that permits firms to participate in, and exercise some form of control over, the agricultural production process without having to own or directly operate the farms".

Agricultural enterprises choose contract farming for different reasons, and these reasons manifest in the type of contract they undertake. Bardhan (1989, p. 23) pointed out that "from an institutional economics viewpoint, contract-farming institutions are formed as a response to neglected markets in an environment of invasive risks, deficient markets and information irregularity. This school of thought believed that there are significant additional costs arising from imperfect markets and information unevenness in agricultural transactions, and not merely the costs from agricultural production alone".

Bardhan (1989, pp. 23-24) maintain that "imperfections that exist in the market for agricultural credit, insurance, factors of production, raw farm produce, information and transaction costs may affect the structure of the contract farming sponsors and the characteristics of contract farmers in an agricultural contract".

In a study done by Key and Runsten (1999, pp. 383-392) on the Mexican frozen vegetable industry, "contract farming was seen as a response to the following four identified market imperfections:

1) Credit
2) Insurance
3) Information
4) Factors of production."

These identified market imperfections are discussed in the following sub-sections.

2.6.1 Credit

Adams and Nehman (1979, pp. 169-171) declare that "the relation between the sponsor firm and the smallholder farmers can reduce transaction costs between lender and the borrower. This may signify a large part of the total cost of the loan. The credit finance portion of the whole contract can be executed at the same time as the farming contract and does not require any visits to the bank. In this regard, transportation costs are reduced for the farmer; likewise, administrative costs and time are lessened for the sponsor as the lender. The need for collateral as a prerequisite for lending is greatly reduced due to the fact that a contract exists between the sponsor and the farmers. This also implies that the farmer (borrower) can circumvent notary and other fees needed for the perfection of collateral title".

2.6.2 Insurance

Rosenzweig and Wolpin (1993, p. 226) pointed out that, "in developing countries, and especially among smallholder farmers, formal institutional mechanisms such as crop insurance and commodity future markets, which are conventional approaches for smoothing fluctuating consumption patterns in agriculture, either cost too much or are unavailable". Likewise, Key and Runsten (1999, p. 385) observe that "where informal approaches of coping with risk are available for smallholder farmers, they are too expensive and ineffective".

According to Key and Runsten (1999, pp. 385-386), "agribusiness sponsor firms are usually in a position to insure farmers against price fluctuations and harvest variability. They have the capacity to spread their production sources geographically in order to hedge against risks of poor harvests in certain areas because of harsh weather or pests". In addition, "these sponsors have access to reasonably priced financial resources, which they can apply to smooth variability in profits. The sponsors' involvement in the agricultural production process affords them an opportunity to offer insurance with low transaction cost and to deal with some of the moral hazard problems that stems from crop insurance" (Walker & Jodha, 1986, p. 59).

2.6.3 Information

Eaton and Shepherd (2001) believe that "a well-organised agricultural production process requires that farmers have access to information about the best possible farming techniques, for example, how and when to use chemicals such as pesticides and fertilisers and when to weed, water and practice crop rotation".

It also demands that "the farmers have information about the requirements of the sponsoring firms, such as: the date by which the supply of the produce is required; the agricultural processes that will meet the sponsor's standards; the chemicals they are allowed to use; and the specific characteristics the sponsors desire in the crops. When this information is missing, it may slow down activities on the part of the farmers and the consequence for the sponsor could be a costly or poor-quality produce supply" (Key & Runsten, 1999, p. 386).

2.6.4 Work effort and labour supervision

Key and Runsten (1999, pp. 386-387) assert that "without proper supervision, it is unfeasible to ascertain the level of effort a labourer puts into his tasks. This is because of the lack of clarity in establishment of labour output. Extra supervision is needed when the quality of work to be delivered is of utmost importance". They further argue that "more supervision would be required when the effort on the part of the labourers is low as poor effort can cause harm to the crops or the farm machinery used".

2.7 Conclusion

Contract farming is crucial in the South African Agricultural Sector as it has a huge potential to integrate non-commercial farmers or small commercial farmers with sponsors, financiers, investors and buyers into a commercial agricultural value chain.

In the South African context, contract farming can be used as a way of integrating the previously disadvantaged black farmers in the commercial agricultural sector. Contract farming can be used as a response to market imperfections (credit, insurance, information, and factors of production). For these farmers to gain access to more developed markets, there would need to be funding to improve their farming operations to create scale to service both local and international markets.

Chapter 3: Research Methodology

3.1 Introduction

The preceding chapter reviewed literature relevant to this study. This chapter provides an overview of the study's research methodology which was used to collect the data for this study. It further provides information on the research approach and design, population and sampling, and how the data was collected and analysed. Lastly, this chapter looks at the research quality and the ethical implications of the study.

3.2 Research approach and design

The aim of the research is to evaluate the financial funding challenges faced by contract farmers in achieving transformation in the agricultural sector in South Africa. The researcher employed a qualitative research approach because of the nature of the research problem. The researcher needed to explore the experiences of the contract farmers and other relevant stakeholders in the South African Agricultural Sector.

Qualitative research does not involve findings produced by any means of quantification (Strauss & Corbin, 1990, p. 17). By employing a methodological approach, qualitative research can be organised and streamline the issues related to data collection. The researcher conducted the research in its natural setting using personal interviews as the data collection technique because by doing so an empathetic interaction can be ensured (Patton, 1990, p. 55).

A qualitative research method enabled the contract farmers to give their true perspective on the research problem. The qualitative method also enabled the researcher to describe and provide meaning to people's experiences through analysing words. "Qualitative research provides us with the ability to ascertain if correlation exists among variables, without necessarily giving too much consideration on how people under study delineate the variables" (Strauss & Corbin, 1990, p. 17).

3.2.1 The research design: multiple case study

The researcher selected the multiple case study design. This allows for data collection from multiple sources – the farmers in the study. Hartley (1994, pp. 208-209) defines a case study as: "a detailed investigation, often with data collected over a period of time, of one or more organisations, or groups within organisations, with a view to providing an analysis of the context and processes involved in the phenomenon under study".

3.2.2 Population and sampling

The target population was the black farmers who are involved in contract farming. The researcher employed the use of purposeful sampling. "Purposeful sampling attempts to discover information-rich cases which can be studied in depth" (Patton, 1990, p. 171). There are a number of different strategies for purposeful sampling.

One of these strategies is maximum variation sampling. This type is sampling is naturalistic (Lincoln & Guba, 1985, p. 14) and can identify participant deviations (Hoepfl, 1997, p. 19). Guba (1985, p. 161) pointed out that greater variation is evident in small samples because there may be unique experiences among the respondents. This apparent shortcoming need not be disconcerting because the commonalities that do result from the responses prove to be of particular interest (Patton, 1990, p. 172).

Despite the great benefits offered by purposeful sampling, the researcher was always mindful of the three common errors that could occur in qualitative research: distortions caused by inadequate sample size, changes over time and insufficiency of data (Patton, 1990, p. 172). A sample of eight contract farmers from Gauteng, North West, Mpumalanga, KwaZulu-Natal and the Free State provinces of South Africa were chosen for the interviews. This is in line with the number of interviews conducted in other qualitative studies. Guest, Bunce, and Johnson (2006) suggest that the number of interviews can range between 6 and 12 participants for a qualitative study. Interviewees were selected based on their number of years in contract farming, age and gender.

The researcher had few guiding principles on when to stop sampling and decided to adopt the following criteria: exhaustion of resources, surfacing of regularities, limitation to the

boundaries of the research goal (Guba, 1978, p. 24). In the decision to stop sampling, the researcher also considered the relevance of the information provided by the farmers to reflect the research objectives.

3.2.3 Data collection

Bodgan and Biklen (1982, p. 140) and Marshall and Rossman (1989, p. 22) agree that personal interviews are favoured in qualitative research. These interviews allow the interviewer to engage with the interviewees to discuss their experiences comprehensively. The researcher chose to use personal interviews as a primary source of data collection. This allowed the researcher to be the key instrument for collecting the data from the sample of farmers chosen for the study. The researcher carried out the interviews guided by semi-structured questions (Appendix 2), which permitted the researcher to address the context and background of contract farming, its advantages, its challenges and what could be done to address the financial funding challenges faced by contract farmers.

An interview “schedule” or guide was utilised by the researcher. Creswell (1994, p. 74) endorses the interview guide because an appropriate level of consistency can be maintained. The researcher utilised the interview guide to ensure that the time granted by the farmers for the study was effectively used during the interview and assisted the researcher to focus on the research objectives. Lofland and Lofland (1984, p. 15) claim that an advantage of the interview guide is its flexibility. In the course of an interview, questions can be adjusted to explore the evidence that comes to light more closely.

3.2.4 Data analysis

Bogdan and Biklen (1982, p. 145) define qualitative data analysis as "working with data, organising it, breaking it into manageable units, synthesising it, searching for patterns, discovering what is important and what is to be learnt, and deciding what you will tell others".

The researcher applied what Patton (1990) calls an inductive analysis of data. This means that the researcher fully notes the important themes that come out of the collected data. This required that the researcher apply some creativity and demanded that the researcher arrange

the data into similar and meaningful categories. Thus, a holistic view of the different categories could be created, and the interpretation of the data could be articulated to others.

The researcher started the data analysis by classifying the themes emanating from the raw data from the interviews. Similar facts and observations were grouped together. This assisted the researcher to create a guiding framework which the researcher used as a foundation to start data analysis. Strauss and Corbin (1990) referred to this as open coding. The researcher updated and re-arranged the different categories as he continued with the data analysis.

3.3 Research quality

Lincoln and Guba (1985) view the issue of trustworthiness of the research as an interaction between the researcher and the audience. The researcher has to convince the audience that the research findings are worthy of attention. They further suggest that judging the trustworthiness of qualitative research requires the consideration of credibility, transferability, dependability, and confirmability.

3.3.1 Credibility

The credibility of qualitative research lies with the extent of the data collected and the researcher's ability to analyse it (Patton, 1990, p. 23). Credibility for Gray (2004, p. 34) resorts with ensuring that raw data is available for scrutiny by other parties including the interviewees who are required to confirm that the data is valid. The researcher confirmed with the research participants that the research findings were indeed consistent with their responses from the data collected during their interviews.

3.3.2 Transferability

In similar situations, the study goals and findings should be transferable Eisner (1991, p. 19). The researcher addressed transferability by clearly articulating the context of the study. This helped to provide clear information to the readers of the paper so that they could apply the research findings to their own fields of interest.

3.3.3 Dependability

Dependability requires the reassurance of the research assessors who have examined and evaluated the research process and findings that the research outcome is authentic and consistent (Lincoln & Guba, 1985). Research questions posed to the research participants have been shared and notes from the interviews will be made available to the research assessors.

3.3.4 Confirmability

As stated by Shenton (2004, p. 6), "the researchers must ensure they are in a good position to demonstrate that the research findings were derived from the data collected not their own predispositions". The researcher ensured that all the personal notes taken during the interviews with the farmers were kept in a safe place and could be made available for scrutiny.

3.4 Ethical implications of the research

The researcher has abided by the ethical standards and expectations of the University of Cape Town and has signed an ethical clearance with the university. Welmann et al. (2005) explain that principles underlying "research ethics" are universal and concern issues such as honesty and respect for the rights of individuals. The researcher observed the highest ethical conduct throughout this research by respecting the rights and privacy of the respondents, their right to confidentiality and obtained their informed consent. The researcher is not a contract farmer and has no interest in the problem statement other than gaining scientific insight from those involved in contract farming and therefore has no motive to manipulate any of the research findings.

Chapter 4: Research Findings

4.1 Introduction

The foregoing chapter discussed the research methodology employed in this study. This chapter discusses key findings which emerged from the collected data from the interviews held with eight black contract farmers across five provinces of South Africa. The sample was inclusive of both male and female black contract farmers, young and old. It is also important to note that the interviewee sample included both crop and animal farmers. All except one of the farmers that the researcher interviewed have been practising contract farming for more than five years. They have all been contracted to the same sponsors from the first day of their contract farming practices.

4.2 Profile of respondents

The profile of the sampled contract farmers covered for the study is presented in Table 4. While all the participants have indicated that they have open-ended "evergreen" contracts with their respective sponsors, the contracts do, however, have exit clauses for both parties. The farmers indicated that, as long as they produce good agricultural produce that meets the agreed standards with their sponsor, the contract is open-ended.

There are a number of interventions offered by the sponsors to assist contract farmers. These include training of the farmer and his/her employees, ongoing mentoring provided by the sponsor on issues related to human resources and financial management, and regular monitoring of crops and animals to ensure good acceptable yields.

In other instances, sponsors also provide inputs and credit lines for the farmers to acquire feed and fertilisers. Sponsors also provide soft low interest rate loans to their suppliers as Pick n Pay and Woolworths do. Suzanne Ackerman-Berman, transformation director at Pick n Pay, says that big business plays a major role in helping small businesses, and in their case, small suppliers. She believes that entrepreneurs often needed a boost, be it financial or through mentorship expertise, to expand and grow their businesses. In the case of one of the farmers who participated in this research, the boost needed was financial. She proceeded to explain that this farmer knew his business well but needed financial support to expand his business to build

a sustainable future. Pick n Pay's commitment to fulfil orders meant that the farmer could secure the funding he needed to grow from the retailer.

Table 4: Overview of the respondents

Interviewee	Province	Sex	Sponsor	Agricultural produce	Sponsor's support	Duration of the contract
1	Gauteng/Northern Cape	Male	Tiger Brands	Pork	Training of staff, ongoing mentoring	Evergreen contract
2	Gauteng	Male	Joburg Fresh Market	Fresh vegetables	Training of staff, ongoing mentoring	Evergreen contract
3	Gauteng	Male	Woolworth	Fresh vegetables	Soft loans, training of staff, ongoing monitoring	Evergreen contract
4	Gauteng/Limpopo	Female	Pick n Pay	Meat produce	Soft loans, training of staff, ongoing monitoring	Evergreen contract
5	KwaZulu-Natal	Male	Shoprite	Fresh vegetables	Training of staff, ongoing mentoring	Evergreen contract
6	North West	Female	Food Lovers	Fresh Vegetables	Training of staff, transporting of vegetables	Evergreen contract
7	North West	Male	Sangiro Chickens	Poultry	Training of staff, ongoing mentoring, input credit line	Evergreen contract
8	North West	Male	Pick n Pay	Mushrooms	Soft loans, training of staff, and ongoing mentoring	Evergreen contract

4.3 Financial needs of contract farmers

All the contract farmers who were interviewed share the same sentiment as described by Mtombeni et al. (2019). They felt that access to finance is an essential factor in the value chain and enables participants to purchase essential inputs and infrastructure (e.g. machinery and land) necessary for the production process, grading, processing, packaging and distribution of their produce. Finance is also required where there are specific regulatory requirements (such as licencing and certification) to which a participant must adhere. These requirements may differ from commodity to commodity.

With this in mind, it is clear that any farming enterprise that wishes to enter and participate in the agricultural sector will need access to finance to compete effectively. The major financial requirements of the farmers were for land purchase, farming infrastructure and equipment, working capital and regulatory requirements.

4.3.1 Purchase of land

Famers have identified the purchase of land as a major financial requirement. They have indicated that the DRDLR's strategy to acquire land pro-actively, the Proactive Land Acquisition Strategy (PLAS), is not working. Some farmers have indicated that they have been on the waiting list of the PLAS programme for more than five years and have opted to buy their own farms.

Sponsors need to be assured of land availability and land tenure security before the start of any contract farming venture. "In the majority of projects, sponsors contract directly with farmers who either own land or have customary land rights within a communal landowning system" (FAO, 2015). Interviewee No. 1 acknowledges that land ownership improves a farmer's potential to acquire financing when he makes the following comment:

> "It is always better to have your own land, as this can be used as security when trying to acquire funding from financial institutions. The farm prices are very expensive for a new or a young farmer who has not built wealth as financial institutions require a 20% to 50% deposit for the purchase of a farm. This makes

acquiring a farm a major barrier for aspiring farmers and those who wish to expand their agricultural production."

4.3.2 Farming infrastructure

Good infrastructure serves as an assurance to the sponsors that inputs can be delivered to the farms and farm produce can also be easily transported to the desired location. This is particularly important for perishable produce that needs to be processed as soon as possible after harvest.

> "Good infrastructure is a major competitive advantage in farming, it serves as a major contributor to the quality of your produce as well" (Interviewee No. 7).

4.3.3 Farming equipment

Contract farming can be intensive. A farmer needs reliable farming equipment to be able to scale their farming operations. This is even more vital for those farmers who are involved in the exporting of fresh produce and in the agro-processing sphere. Farmers indicated that it is important to have their own equipment in the contract farming arrangement to ensure that they are able to meet the sponsors' timelines. Interviewee No. 4 claimed:

> "If you want to scale your farming operations in the most efficient way, you need good farming equipment, and this could also save you on labour and the costs associated with labour. Modern farming is mechanised, and farmers need to embrace this and get themselves ready for the possibilities that the Fourth Industrial Revolution will present to modern farming."

4.3.4 Working capital for agricultural inputs

Farmers pointed out that in most contract farming arrangements the sponsors are the ones who source the input materials and it is their duty to ensure that these inputs get to the farms. The sponsors need to be assured of the availability of inputs and need to be confident of their logistics management systems to get the inputs to the farms as some inputs may be sourced locally and others from overseas suppliers. Failure to access and deliver inputs could cause

serious disruptions to the production process and could result in severe financial losses for both the sponsors and the farmers. It is, therefore, important that the farmers have good working capital to pay for these inputs in cases where the sponsors do not provide credit lines for the agricultural inputs and fertiliser.

> "Farmers need to have access to cheaper working capital facilities such as a bank overdraft facility. This alleviates cash flow pressures for those unexpected expenses associated with acquiring agricultural inputs" (Interviewee No. 5).

4.3.5 Funds for regulatory required Environmental Impact Assessment Studies

Finance is also required where there are specific regulatory requirements (such as licencing and certification) to which the farmers must adhere. Without adherence to these requirements, the farmers cannot start their operations and compete effectively. Interviewee No. 1 indicated that a possible way to get around this was by using the local universities to assist with Environmental Impact Assessment studies (EIAs). This will give university students practical experience at the same time. This is not always possible though; farmers need to pay upfront for these.

4.4 Financial challenges

Access to finance is an essential factor in the value chain which enables participants to purchase essential inputs and infrastructure (e.g. machinery and land) necessary for the production process, grading, processing, packaging and distribution of their produce. Credit risk has to be managed by agricultural financiers, so every application is evaluated after consideration of the farmer's financial history, management profile, cash repayment ability and collateral (Middlelberg, 2016).

4.4.1 Business and financial understanding

The farmers pointed out that the first thing that they are expected to do before they go out into the financial market to source funding is to draw up a business plan. They are expected to have a proper understanding of cash flow projections and the risk associated with their farming operations.

> "This can be mammoth for farmers who do not have commercial backgrounds" (Interviewee No. 2).

Often farmers would need to source the services of professional people to help them draft and develop a bankable business plan. There is substantial cost associated with this exercise. Interviewee No. 1 states:

> "Having a good business plan does assist in giving the potential funders a commercial picture of what you are trying to do; however, it does not guarantee funding though as the financiers might want the farmer's own contribution and collateral."

Interviewee No. 4 voiced this opinion:

> "It is not enough for the funders to rely on the business plan. They must also come out to the farms and see what the farmers are talking about in their business plans. This will give the farmers a golden opportunity to answer the financier's questions and concerns. This can also help employees of the funders, particularly the deal making and credit assessment staff, to gain technical "on the ground" exposure and expertise that will help them to do their work better."

4.4.2 Lack of capital

Often a farmer is required to have an own contribution of between 20% to 40% of the required loan amount for the purchase of a farm. This is between R600 000 to R1.2 million as an own contribution for the purchase of a farm worth R3 million. This becomes a major barrier for most aspiring farmers more especially young people who want to get into farming. Some of the older farmers have taken their pension pay-outs and used them as the owner's contribution to the farming enterprise.

Investment in infrastructure and technology involves a substantial capital outlay but is the only way that farmers can compete in developed markets both locally and abroad (Eaton & Shepherd, 2001). Access to credit is regarded as one of the key elements in increasing

agricultural productivity. In addition, the farmers pointed out that they require finance for running their day-to-day farming operations. Interviewee No. 3 asserted the following:

> "The need for capital or farmer's own contribution towards the agricultural enterprise is a significant barrier for farmers to access finance from formal means and will remain a hindrance for emerging farmers to enter the commercial agricultural sector. It greatly undermines the transformation efforts to include previously disadvantaged people in the sector."

The financial institutions often want to see unencumbered cash in the bank account as an acceptable form of capital. They do not consider that a farmer could for example have a herd of 100 cows and use that as capital.

> "Financial institutions need to change their paradigm in thinking about what forms of acceptable capital are required by farmers when raising funds" (Interviewee No. 5).

4.4.3 Insufficient collateral

The farmers all agreed that lack of or insufficient collateral is a major barrier to developing and creating a transformed agriculture sector in South Africa, particularly when it comes to emerging farmers and new entrants to the sector. Farmers often lack collateral and banks struggle to price the risk of loans to smallholder farmers and small to medium-sized agribusinesses. Interviewee No. 4 stated:

> "Communal land granted by traditional authorities cannot be used as collateral even though the traditional leaders can confirm that the land has been permanently granted to the farmer. Alternative sources of collateral such as equipment and livestock may be accepted but increase the cost of financing due to the limited value thereof."

The farmers do concede though that having a contract with a sponsor helps significantly to reduce the need for collateral demanded by the financial institutions.

4.4.4 Lending criteria and policies of financial institutions

The farmers indicated that financial institutions have rigid and outdated lending credit assessment criteria that are centred around the traditional credit evaluation method of assessing financial history, management profile, cash repayment ability and collateral. The farmers believe that their credit application should centre on their cash repayment ability only because the other three criteria merely provide support to achieve the required cash repayment ability.

The farmers also heavily criticised DFIs such as the Land Bank for adopting a purely profit-oriented approach and imposing strict criteria for successful loan approval. This is supported by responses from Interviewees No. 3 and Interviewee No. 5.

> "The Land Bank is run akin to a commercial bank rather than a developmental bank and is not clear on its development mandate. The Land Bank's main focus is on big commercial farmers" (Interviewee No. 3).

> "The Land Bank's willingness to help achieve transformation in the agricultural sector is highly questionable. There are no visible practical measures taken by the bank to advance transformation" (Interviewee No. 5).

There is a wide acknowledgement from the farmers that the current agricultural funding system, including those of different DFIs such as the Land Bank and others which have different eligibility criteria for accessing funding and the funding amounts that are provided, is not working optimally. The farmers believe that the financial institutions have not sufficiently responded to the changing needs of the farmers and to the type of profile that is now entering the commercial agricultural sphere.

4.4.5 Rigid and non-inclusive bank products

Over and above what the farmers called "rigid and outdated credit assessment criteria", the farmers feel that there are no innovative financial products on the market to better serve contract farmers and emerging farmers in general. Farmers believe more can be done to develop new financial products that have a much higher risk tolerance for the farmers while

being highly commercial at the same time. Farmers indicated that they are aware that financial institutions are required to manage their risk, but they feel that there are innovative ways of doing so.

4.5 What needs to be done to help black farmers raise funding

The need to assist black farmers to raise funding is undeniable. The interviewees shared their ideas about what can be done to provide this assistance.

4.5.1 Government guarantees and the co-funding model

Interviewee No. 2 offered the following opinion regarding government guarantees:

> "The South African Government needs to use its buying power to develop the country's agricultural sector. The government through municipal fresh produce markets needs to procure more agricultural products from black contract farmers for hospitals, prisons, schools and other government departments."

If this procurement is done, the government can offer guarantees for the contracted farmers to use as risk mitigation when raising funds in the financial markets. The government will be creating self-sustainable black farmers who do not need or rely on government grants and funding.

The government guarantees will help farmers overcome the collateral requirements of financial institutions. The reduced risk offered by government guarantees will also positively impact the pricing charged by financial institutions helping farmers to get better interest rates.

Farmers agree with Sihlobo (2019) who promotes the co-funding model. Subsidised loans for farm improvements could be provided. After the farmers have paid for the improvements out of their pockets, provided proof of expenditure and submitted to on-site verification inspections, they will claim the refunds from government and utilise these to offset against outstanding credit amounts.

4.5.2 Cash flow funding

The financial institutions should seriously consider the farmers' credit applications based on their ability to repay funding extended to them. Financial history, management profile and collateral should just provide a certain level of comfort for the financial institutions. Interviewee No. 6 pointed out the following:

> "Cash flow funding is successfully being used in trade finance funding structures, where reliance is heavily put on the business' cash flow from the organisation the business is supplying. There is absolutely no need that the same principles cannot be applied in contract farming."

4.5.3 Funding linked to mentorship

One of the innovative financing solutions that the farmers proposed is mentorship-linked funding. Farmers believe that new entrants to the sector could be funded on condition that an experienced commercial farmer is assigned to them to mentor them with both technical farming knowledge and with commercial skills. For example, as a funding grant condition, a new farmer could be expected to spend six months being mentored by an experienced successful commercial farmer before the funding gets disbursed after the mentor confirms that the incumbent is ready to start their farming operation.

4.5.4 Increase access to information

Farmers believe more could be done to improve access to information about different types of funding structures offered by the Land Bank and other financial institutions. Farmers also mentioned that information about government grant funding is not easily accessible.

4.5.5 Innovative funding models of banks

Godwin Isuekebhor (2014) insists that the traditional funding models of banks are not going to be viable in the Africa context. The creation of innovative financing plans is imperative for agricultural transformation in Africa.

The farmers indicated that urgent alternative and innovative financing in agriculture that caters for the changing demands of the agricultural sector in South Africa is needed. Farmers indicated that there is a need for public-private partnership arrangements such as those in the big infrastructure projects in the country. This will lead to sustainable transformation, development and productivity in the agricultural sector.

4.5.6 Development finance institutions need to come onboard

The farmers believe that well-trained staff who really understand the agricultural sector are needed at the Land Bank. This will help improve efficiencies at this DFI. Farmers feel that the skills of some of the Land Bank dealmakers are shocking. They really do not understand farming and that is why they cannot always help the farmers. They feel commercial banks actually have a better understanding of the agricultural sector than the Land Bank.

Interviewee No. 6 indicated that the farmers demand that the Land Bank comes onboard and fully understands their developmental mandate. They believe the Land Bank could do a better job of mobilising funds from international agricultural funders and donors and use these funds to offer soft loans and grant funding to black farmers.

Interview No. 5 believes the Land Bank can do more to help mitigate the risk associated with agricultural lending. The Land Bank can take an equity stake on the back of a loan and this will significantly decrease the collateral required from farmers and significantly reduce the risk associated with the transaction.

4.5.7 Better capacitation of the Department of Agriculture and the Agricultural Research Council

The farmers believe that the government needs to better capacitate and capitalise the Agricultural Research Council (ARC). They believe that the ARC has a critical role to play in developing black farmers through their research and training. This will assist in building stronger human capital and directly address the issue of the required skills needed to assess agricultural credit applications. Farmers can prove that they have received the required training and research information offered by ARC. Interviewee No. 5 stated the following:

> "The Department of Agriculture can contract experienced farmers as mentors to the new and emerging farmers."

This will ensure that there is a constant knowledge sharing between the experienced commercial farmers and the emerging farmers.

Interviewee No.6 believes that the department can also do this at a reasonable cost by using some of the successful beneficiaries of the government's land redistribution programme and grants as mentors to the new farmers at no cost to the government. The government would only need to cover transport costs, and this is an insignificant cost. The farmers believe that this will alleviate the lack of technical skills in the department.

4.5.8 Credit guarantee of sponsors

Sponsors need to offer a credit guarantee to their contract farmers. This guarantee could be used to raise funding and could be offered with the Jobs Fund guarantee. If the farmer defaults, the sponsor could call up the guarantee from the Jobs Fund.

4.6 Government support

The farmers fully support the opinion of Eaton and Shepherd (2001) that governments have a critical role to play in fostering successful contract farming ventures. Government has to, first of all, provide an investor-friendly environment with an easy to understand legal framework and legal systems which are important in developing contract farming agreements and in resolving any disputes that may arise. Governments can also play an intermediary role in linking sponsors and farmers.

The most encouraging thing was that all eight farmers interviewed for this study admitted that government has provided non-financial assistance to them in some or other form. Some farmers have received tractors, greenhouses for crop production and the construction of pack houses from the government. The farmers admit though that the assistance from government came long after they had started their farming operations; it was not right at the beginning when most of them needed the assistance.

Interviewee No. 3 stated:

> "Government's assistance to emerging black farmers is critical to drive agricultural transformation in the country. Government should work closely with farmers to understand their needs and to improve its implementation capacity."

4.7 Conclusion

It is critical that the relevant stakeholders should make a clear collaborative effort to deal with the funding challenges faced by black contract farmers and emerging farmers in general. It is clear that the current funding structures and models have not sufficiently responded to the challenges faced by black contract farmers when raising funding. A concerted effort is required by all the stakeholders in the agricultural sector.

Government needs to play a critical role in creating an investor-friendly environment and to play a significant role in farmer capacity building through training and other non-financial support to farmers. Private sector funders and the DFIs need to come up with innovative products and solutions to respond to the needs of contract farmers. Sponsors need to play their part in making it easier for farmers to raise funding and to decrease their transaction costs through sponsor support and credit guarantees.

Chapter 5: Conclusion and Recommendations of the Study

5.1 Introduction

The purpose of the study was to evaluate the financial funding challenges faced by contract farmers in achieving transformation in the agricultural sector in South Africa. The results of this study enable aspiring contract farmers to develop a clear understanding of the challenges faced by contract farmers in raising funding for their farming enterprises. The results also enable credit funders in the agricultural sector in South Africa to understand how they can develop and create innovative financial products to respond to the financial needs of contract farmers in the country. The study clearly indicates that without addressing the financial barrier challenge in the agricultural sector for farmers, the South African Government will fail to embrace the previously disadvantaged groups and transformation in the sector will be impossible. The penultimate chapter focused on the research findings of this study. This final chapter will discuss the conclusion and recommendations of the study.

5.2 Summary and conclusion

The purpose of this study is an exploratory study to understand what the funding challenges are faced by black farmers in achieving transformation in line with the AgriBEE Transformation Charter in the agricultural sector in South Africa. Thus, the importance of this study was to provide all South African agriculture stakeholders a greater understanding of the challenges faced by black contract farmers and what the farmers themselves think could be done to assist them by both financial institutions and the government to raise funds for their farming enterprises and to meet their contractual obligations to their sponsors.

This study is important for closing the gaps that exist between the current financing solutions offered by financial institutions (including DFIs) and the needs of the farmers. It looks at ways in which the farmers believe they could be part of the solution in financially assisting the new and emerging farmers and creating a transformed agricultural sector in the country.

The study concludes that the four credit risk assessment criteria (financial history, management profile, cash repayment ability and collateral) that financiers, especially commercial banks usually apply when evaluating a farmer's credit application, are in a way restrictive to

advancing transformation in the agricultural sector. The four credit risk assessment criteria used by financial institutions (including DFIs) are not responsive to the financial funding challenges faced by the farmers and can indeed act as a barrier for farmers to enter the commercial agricultural market and, therefore, are a barrier to transforming the agricultural sector. These make it difficult for the farmers to acquire land and farming equipment, to develop agricultural infrastructure, to raise working capital for agricultural inputs and running costs, and lastly to fund EIA reporting and regulatory requirements.

The study pointed out that the farmers believe that business and financial understanding, lack of capital, insufficient collateral, the lending criteria and policies of financial institutions, and rigid and non-inclusive bank products act as both the biggest challenges in raising funds for their farming enterprises and as a big barrier for new entrants who want to enter the agricultural sector. This undermines the required transformation in the agricultural sector as stipulated by the AgriBEE Charter.

The study findings propose that more can be done by the government through its buying power and its municipal fresh produce markets to procure more from black farmers for hospitals, prisons, schools and other government departments. In this way, the municipal fresh produce markets can issue guarantees in favour of the farmers for utilisation when raising funding.

Innovative credit assessment criteria can be used to assist farmers to raise funding, for example, pure cash flow funding assessment and funding linked to mentorship. Farmers strongly believe that the Land Bank should come onboard by improving the skill levels of their deal-making team, improving efficiencies to fast track the application process, and by carrying out its development mandate of mobilising funds and building innovative less costly products for the emerging farmers and not only for commercial farmers.

The study reveals that there is an urgent need to better capacitate the staff of the Department of Agriculture and the ARC to play a meaningful role in developing black farmers through their research and training. The Department of Agriculture can contract experienced commercial farmers to mentor new and emerging farmers. Farmers believe that this will alleviate the lack of technical skills in the department.

The most encouraging finding was that all the farmers interviewed for this study have admitted receiving some form of government support in one or other form. Farmers believe that government should work closely with them to better understand their needs and to improve its implementation capacity. All the farmers interviewed stressed the importance of training and mentorship for success in the agricultural sector.

5.3 Recommendations of the study

Contract farming can be one of the tools used to open up new commercial farming opportunities for the previously disadvantaged population groups and can assist in the transformation of the agricultural sector. The following recommendations are based on what the study identified to be the financial challenges faced by farmers:

- Business and financial understanding – funding must be linked to mentorship both on financial skills and technical farming skills.

- Insufficient collateral – government and sponsors should provide guarantees that farmers can use to raise the necessary funding from both DFIs and other financial institutions.

- Lack of capital – cash flow funding should be implemented by both DFIs and other financial institutions. The farmers' credit applications should centre around their cash repayment ability.

- Lending criteria and policies of financial institutions – the financial sector urgently needs to come up with alternative and innovative financing models for the financing of the agricultural sector, particularly for the new entrants to the sector.

- Rigid and non-inclusive bank products – the banking sector needs to develop innovative financial products that are able to better respond to the needs of the farmers.

This, however, requires a concerted effort by all stakeholders to close the existing gaps in the current financial mechanisms used to finance farmers in South Africa. It is important that the

critical stakeholders (government, development financial institutions and other financial institutions, farmers and their organisations, sponsors and agro-processors) work closely together so that more can be achieved in the least possible time period.

5.4 Suggestions for further study

Research findings have shown that business and financial understanding, lack of capital, insufficient collateral, the lending criteria and policies of financial institutions, and rigid and non-inclusive bank products are the biggest financial funding challenges faced by black contract farmers.

This study proposes that an examination should be conducted on the role that a DFI such as the Land Bank could play in mobilising international grant funding to assist black contract farmers and black emerging farmers in general to access funding for their agricultural enterprises. The economic impact of such an intervention could have an enduring impact on promoting transformation in the commercial agricultural sector.

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Appendices

Appendix 1: Letter of introduction

26th May 2019.

Attn: To whom it may concern

INTRODUCTORY LETTER: SIPHELO SKEPE (SKPSIP002)

This letter serves to confirm that the above-mentioned student Mr Siphelo Skepe is a registered second year Master of Commerce in Development Finance student at the **Development Finance Centre (DEFIC)**, Graduate School of Business, University of Cape Town and working towards the completion of his minor dissertation by the end of 2019.

The title of his dissertation is **"Evaluation of the financial funding challenges faced by contract farmers in achieving transformation in the Agricultural Sector in South Africa".** He is required obtain primary data in the form of interviews with members of your organization towards the development of the minor dissertation. Kindly accord him all the necessary support towards this objective. The dissertation is part of the requirements for the completion the degree.

For any further information, please do not hesitate to contact the research co-ordinator at the development finance centre, Candice Marais at candice.marais@gsb.uct.ac.za/ +27 21 406 1437.

Kind Regards,

Signature Removed

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Appendix 2: Questions for the study

1) What agricultural product do you produce?

2) How long have you been practising contract farming?

3) Who is your sponsor?

4) What type of contract farming arrangement do you have with your sponsor? How is the price determined for your produce?

5) What is the duration of the contract with the sponsor?

6) What are the financial requirements/needs that you need to meet your contractual obligations to the sponsor?

7) What financial challenges have you faced in raising the financial funding?

8) What do you think needs to be done to assist black contract farmers?

9) Any financial support provided by the sponsor?

10) Any government/donor financial assistance?

11) What other support is provided by the sponsor?

12) How does the sponsor monitor product quality and yields?