ACCESS TO FINANCE ASSESSMENT FOR THE AGRICULTURE SECTOR

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DISCLAIMER

ACCESS TO FINANCE ASSESSMENT FOR THE AGRICULTURE SECTOR

AN ANALYSIS OF FINANCIAL INSTRUMENTS AND FUNDING SCHEMES TO SUPPORT KOSOVO'S AGRICULTURE SECTOR

Business Climate Legal and Institutional Reform (BizCLIR) Project.
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EXECUTIVE SUMMARY

The purpose of this assessment is to make recommendations for improving the availability of credit to the agriculture sector in Kosovo. This study proposes financial instruments and agriculture development initiatives that could increase access to credit for smallholder farmers and agribusinesses in Kosovo. The analysis focuses in particular on options for diversifying and increasing agricultural finance by utilizing public sector support of the Ministry of Agriculture and Rural Development (MAFRD) and USAID, specifically in the context of the GOK's commitment to agricultural development as an important contributor to economic growth and EU integration.

The agriculture sector in Kosovo is considered to be seriously underperforming relative to its potential, and agriculturalists and economists agree that lack of financing is one of the main constraints to development and innovation in the sector. Although agriculture is considered the mainstay of livelihood in rural Kosovo and contributes as much as 15%-to-20% to the country's GDP, it only receives 4% of bank financing. Advances in agriculture have significant potential to reduce Kosovo's heavy reliance on food imports, increase regional and international exports, and generate new jobs. This assessment recommends financial tools, policy reform initiatives, and opportunities for technical assistance that would address the low level of financial support that the currently sector receives.

"Agriculture" as defined by financial institutions and adopted as a working definition for this report is limited to production (typically referred to as farming) and processing activities that are close to the production end of the agricultural value chain. This includes the purchase of products directly from farmers to process and package for wholesale or retail markets (e.g. pickling peppers and cucumbers, freezing raspberries, frying potatoes, processing milk, etc.).

Input for this study was obtained through interviews with senior level managers and credit officers closest to these issues at commercial banks, microfinance institutions (MFIs), and leasing companies; producers in need of financing at farm organizations and agriculture processing facilities; officers at the CBK and MAFRD; and development partners, primarily USAID. Their collective opinions established the basis for identifying the key reasons why financing to agriculture is limited and formed this report's recommendations for improving the current finance environment for agriculture.

Agricultural borrowers in Kosovo often criticize financial institutions for offering too little credit to the sector while also demanding high interest rates and/or excessive collateral requirements where they do lend. Lenders, on the other hand, cited a lack of demand from borrowers themselves for financial products as well as the significant risks associated with agriculture in Kosovo that continue to make it an unattractive sector for lending. Lenders also cite different risks for various constituencies of agricultural borrowers, with a major distinction being made between obstacles to lending to commercial farmers versus smallholders. Recognizing these differences, the study attempts to identify and prioritize financial tools that are most appropriate for each agricultural population.

From the perspective of the banking community, the main reason why agriculture is not receiving larger amounts of bank financing is because of low profitability in the sector, particularly at the farm level. Due to the costs and challenges associated with reaching farmers in Kosovo, traditional commercial banks generally target agro processors and firms involved in the production of agricultural products. Lending remains disproportionately low, however, even among this population of borrowers who are better suited for traditional financing from commercial banks. A second leading reason why banks are not lending more to agriculture is the risk related to the value and collectability of loan collateral. Poor contract enforcement in particular increases uncertainties and loss exposure, banks in Kosovo have responded with higher interest rates on agricultural loans. According to almost all of the bankers interviewed, lack of confidence in the courts to enforce lenders' contractual rights with regard to collateral is the leading cause of high interest rates on agricultural loans. The inefficient legal system especially impacts the value of the moveable assets that agricultural borrowers would often prefer to pledge because they quickly depreciate in value. If the courts were efficient and claims could be processed quickly, especially for moveable assets, it would substantially improve the borrower-bank relationship. To summarize, low profitability is the leading reason few agriculture borrowers qualify for loans, while collateral uncertainty is the leading cause of high interest rates, which in turn discourage many borrowers from applying for loans. Both of these interrelated issues keep the perception of risk associated with agricultural lending high. Both must be addressed before banks will substantively increase lending to agriculture. High priority was given to these issues in the recommendations that follow.

MFIs are the main providers of credit to smallholder farmers. Adopting a micro-lending approach with on-the-ground community representatives, they base lending decisions on a less formal approach than banks, relying heavily on borrowers' community reputation and third party guarantees. Due to small loan size and high cost of delivery, most smallholder farmers are not ideal candidates for commercial banks, so MFIs will continue to dominate this sector in the future. From the perspective of MFIs, access to affordable sources of funding is the main challenge. Unlike banks, MFIs are non-depository institutions, and they obtain funding either from donors or through lines of credit from development banks. Donor funds, while important, cannot meet the financial needs of the entire industry sector. Development credit lines available to larger MFIs come at a high cost of about 10%. While MFI's are successfully lobbying to obtain CBK licensing as deposit-taking institutions, another recommendation to consider, based on the predominant method that has been used in the US to fund agriculture for the past 75 years, is raising capital through government bond sales.

From the demand side of agricultural financing, this study accounts for the distinct borrowing patterns and needs of agro processors and smallholder farmers. Agriculture processors use very limited amounts of bank financing. Even those that are creditworthy and able to obtain bank credit limit the amount of bank financing used to as little as possible, citing the high cost of credit in Kosovo. None of the processors interviewed used long-term investment credit. Processors unanimously cited high interest rates and loan terms unsuitable for the agriculture sector as the main reasons for this. These processing-oriented borrowers demand low-cost investment credit of 3-to-4 years and short term seasonal inventory/trade financing, which they report is currently not available.

From farmers' perspective, the main reason for not utilizing credit in their operations is that it is seldom available at a cost they can afford. Interest rates of 20%-to-30% are not uncommon on small farm loans. Low farm profitability and limited availability of basic financial records make smallholders in Kosovo an unattractive population for traditional commercial bank financing. There is a small, but growing trend for processors to provide inputs, such as seed, or credit directly to farmers that supply them. The maturation of this business relationship between suppliers and processors provides an opportunity to work through the processor to administer group credit lines from banks and expand access to finance for smallholder farmers.

RECOMMENDATIONS

SUMMARY OF RECOMMENDATIONS TO INCREASE CREDIT FLOW TO AGRICULTURE

Considering the various constraints of producers, processors and lenders, the following recommendations are suggested to increase the flow of credit to agriculture:

Loan Risk/Interest Reduction. Another DCA Loan Guarantee program could quickly increase the amount of credit extended to agriculture because it reduces loan loss exposure, thus minimizing bankers' concerns about enforcement of collateral rights. After the successful results of the prior DCA program implemented in 2006/07 through Raiffeisen bank, the loss-share ratio of a potential new DCA program could be reduced to 40%, thereby supporting a larger loan portfolio. A question remains as to the extent that guarantee funds would be subscribed by the banking community, given the fact that Raiffeisen probably cannot access additional DCA coverage due to program restrictions on multiple usages. Based on the favorable opinions about the program, the remaining banks such as ProCredit, Banka Economike, and TEB could utilize an additional $5-to-$10 million in DCA guarantee coverage, supporting new agriculture lending of $12-to-$25 million (at a 40% loss-share), which would be a substantial increase of financing (estimated at 13%-to-28%) for Kosovo's small agriculture sector[1]. To achieve the greatest development impact, guaranteed lending should be specifically targeted for agriculture investments in equipment and facilities. Several examples are: i) to establish greenhouses to extend the vegetable season, ii) to install irrigation and seedlings for high-value crops like raspberries, blackberries and saffron, iii) to processors for equipment, packaging and storage to sell to both domestic and export markets, and, iv) for cold storage facilities at collection points and other improvements in the cold chain, including refrigerated trucks. Also, a reduced loan interest rate, more aligned with the reduced risk exposure, should be negotiated in return for the loss protection banks receive. A more detailed summary of the successes of the previous DCA program and input from stakeholders on the prospects for a potential follow up guarantee program is available in the following section.

Farm Loan Funds Availability. MFIs will continue to be the main provider of micro-loans for small farmers because these borrowers represent a market segment that is not compatible with commercial bank practices. The main issue MFIs face is accessing affordable sources of funds. Larger MFI's have lines of credit from development banks, but the cost of funds (around 10%) makes it impossible to provide affordable rates to farmers. If financing for farmers is a top priority for the GoK, it could issue agriculture development bonds, thus raising capital that could be used as a source of low cost funds for qualifying MFIs to on-lend to farmers. In March 2010 the GoK announced approval of draft law which would allow the CBK to issue treasury bonds in support of economic initiatives. As this function of the CBK becomes more formalized, an initial goal for new bonds could be to support funding for MFIs engaged in lending to agriculture with a specific aim to increased access to finance for smallholder farmers. One approach may be modeled after the Farm Credit System in the US where Farm Credit System bonds provide a main source of inexpensive funds for agriculture lending. These bonds carry very low rates because of implied backing of the government.

Affordable Investment Credit. MAFRD could subsidize, or buy down, interest rates on credit lines to agriculture processors for the purpose of on-lending to the farmers that supply them. Loans could be

[1] Bank loans totaled 1.4 billion euro as of June 2010, while MFI/NBFI loans total about 100 million. Rough estimates are that 4% of bank loans and 10% of MFI/NBFI loans finance agriculture, so loans outstanding to the agriculture sector are currently about 65 million euro.

used to finance seasonal inputs or for capital investments in greenhouses, irrigation systems, seedlings, equipment, and cold storage facilities. Based on interview responses, long-term (e.g. 4 year) investment loans would need to carry an interest rate of around 5% per annum to be considered affordable for farmers. Direct interest rate buy down by governments or donors is generally discouraged because of its market distortions, but, if interest rates in Kosovo are abnormally high because of the broken court system or bank collusion, making credit unaffordable for agriculture, then it may be a justifiable action. This is one way that the MAFRD could directly assist farmers and encourage investments in new technology and facilities. A key element of any buy down initiative would be to target farmers with a guaranteed market for their products through an agriculture processor. This increases the chances that the investment will be successful and sustainable. In this type of credit arrangement, participating farmers typically cross guarantee the credit line and assign rights to the processor to withhold payments from crop sales in order to repay the credit line[2].

Technical Assistance for Group Credit. USAID, through its agriculture support programs, can provide technical assistance to banks and agribusiness to structure group loans through agriculture processors, lead firms, and vendors. Group credit using sales assignments has proven to be an effective financing tool that works when products move through identified marketing channels, such as a dairy processor, or when supplies are obtained through a leading vendor, such as fertilizer distributors. In addition, a group credit program should include ongoing technical assistance to farmers throughout the season to increase the likelihood of successful crop production in order to repay the loans. Vendor credit on-lending has been used successfully in Kosovo in the past. In 2003, the American Bank of Kosovo (a USAID project bank), working in cooperation with IFDC (a USAID project) provided approximately $800,000 in credit to a qualifying group of local fertilizer dealers to purchase train shipments of fertilizer from Macedonia, then providing fertilizer on credit to farmers in Kosovo, with repayment at harvest time.

Pledge Registry Improvements. The pledge registry, administered by the Ministry of Trade and Industry, gets mixed reviews from the financial community. If lenders accept moveable assets as collateral, they need to be able to rely on a system that allows them perfect their lien on those assets in order to establish claim rights in the event of foreclosure. Usually, the practice for securing moveable assets is a “first-in-time, first-in-line” approach, so the first lender to file a lien at the pledge registry would be the first in line to claim repossession rights in the event of foreclosure. Without a functioning pledge registry, moveable assets can be pledged to multiple lenders without any lender being able to establish a priority claim. In Kosovo, two steps should be taken to address this issue: first, the pledge registry needs to be updated to make it more efficient with on-line registration capabilities; and, second, training is needed to ensure that lenders understand the process for perfecting liens[3].

Building Connections. MAFRD should organize regular coordination/planning meetings to bring together banks, agriculture leaders, government counterparts, and USAID. In interviews lenders and borrowers alike pointed to a significant gap in information available on available agricultural financing, lack of knowledge about ways to make agribusiness more attractive to finance providers, and a perceived lack of clear government leadership and explanation of ongoing initiatives to support agriculture. Several stakeholders suggested that MAFRD take an active role in filling these gaps. USAID could provide assistance to the Ministry by helping to organize the conferences and

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[2] TEB bank’s Direct Debit Business program is specifically structured for this type of relationship, where a lead company (such as an agriculture processor) that deals with a network of smaller businesses (or farmers), with the loan made to the lead company based on the credit needs of the entire network.
[3] This recommendation assumes that the courts also recognize the rights created by the pledge registry and adjudicate appropriately.

develop presentations on the business model for agriculture opportunities in need of financing, such as greenhouse production and berry farming. Annex D contains an illustrative agenda for an agriculture development conference. These conferences could be broadened to include international buyers and businessmen interested in potential investments in the agriculture sector[4].

SUMMARY OF RECOMMENDATIONS TO IMPROVE PROFITABILITY OF AGRICULTURE AND DECREASE PERCEIVED RISK

Banks in Kosovo cite low profitability in the agriculture sector as the main reason for limited financing to both smallholder farmers and larger agribusinesses. Credit officers interviewed at commercial banks indicated a number of sector-specific risks keeping the sector from reaching potentially higher levels of profitability that would make it more attractive for traditional bank financing. Despite consistently high repayment rates of agricultural borrowers reported by several banks and MFIs, perceived risk in the sector continues to drive lenders' decisions. One agricultural lending officer, in charge of credit at the bank considered to be the leader in agricultural lending in Kosovo, noted, "agro loans are statistically no more risky than non-agro loans." The same officer, however, also reported that the sector makes up only 10% of the bank's entire lending portfolio. The following recommendations address initiatives cited by lenders as notable risk factors for extending finance and by borrowers as significant obstacles to improved profitability. Interviewees suggested that MAFRD, USAID, and the GoK undertake several of these initiatives to lower risk and improve profitability in conjunction with programs outlined above to diversify and increase the availability of financial products targeted towards the agriculture sector.

Food Quality Certification. Both domestic consumers and international buyers need to have confidence in the quality and safety of food products produced in Kosovo. In order to increase consumer confidence and thus market value of items produced in Kosovo, those products must carry a trusted seal of certification attesting to food safety and quality attributes. The MAFRD is the logical Ministry to perform this function for the agriculture sector by establishing food standards, testing food quality and issuing product certifications that meet the same standards as Western Europe (such as GlobalGap), so products produced in Kosovo are accepted in European markets.

Develop New Products. MAFRD should lead efforts in research of better seed varieties, production methods, disease control and identifying innovations and new high-value products. Establishing and operating model test farms is one way to achieve results. For example, few places have experienced as rapid a pace of development in productivity, quality and value of agriculture products as Israel. Many of those innovations are the direct result of test farming operations establish at several key locations representing the growing environment in various regions of the country. A Kosovo example of the need for research was described by the Director of a local MFI. An MFI consultant tested saffron growing potential and discovered that the climate around Prizren is perfect for saffron production. However, developing and commercializing a high-value product line, such as saffron, needs the support of MAFRD to test production methods, provide technical expertise to farmers and certify product quality.

Agriculture Extension. Increasing food quality and establishing new products on a commercial basis assumes ongoing technical dialog, training and support for farmers. Knowledge about best agricultural practices must be disseminated to farmers through the support of committed extension agents. Agriculture Ministries in most countries provide services to advance agriculture

[4] As a recent comparison, similar type conferences were successfully employed in the West Bank, resulting in bank financing and private sector investments of $10 million for greenhouses to produce herbs, peppers and tomatoes for buyers in the US, Western Europe, Russia and Gulf States.

development. In the past, MAFRD's extension agents did not provide value added support for farmers. So, while the concept was good, the MAFRD needs better trained and more effective agents available for all farmers.

Review/Renegotiate Trade Agreements. In the food and agriculture sectors of Kosovo, it is widely believed that neighboring countries (such as Macedonia where farmers supposedly receive Government subsidies) are "dumping" products in Kosovo at depressed prices, sometimes below cost of production. The GoK needs to support its farmers and provide protection against low cost, subsidized imports. Secondly, Serbian products are allowed into Kosovo, but Kosovo products cannot be exported to Serbia. Even worse, Kosovo farm products cannot legally be transported through Serbia to reach Europe, a blocked transit route that is especially damaging to marketing fresh products (such as peppers and tomatoes) because limited product shelf life does not allow for the time needed to transit through Montenegro, Bosnia or Croatia. The GoK needs to review and renegotiate trade agreements so Kosovo farm producers are not at a competitive disadvantage to farmers in neighboring countries.

Irrigation Investments. Several farm representatives pointed out that the state owned irrigation system is not functioning because it has not been maintained. The GoK needs to make investments in renovating the irrigation system as an agriculture development effort to increase farm production and reduce the risk of crop loss due to lack of rainfall. This is a type of development that increases credit availability because it reduces production risk and thus lowers repayment risk on loans.

"Buy Domestic" Program. One suggestion for increasing demand of locally produced products was for the GoK to support a "buy domestic" program by giving a sales tax break to retailers that are selling domestically produced products. This would encourage grocery stores and food distributors that are selling products they buy from external markets to find locally produced sources.

Investment Tax Credits. Governments wanting to attract investors to target development of a specific economic sector commonly utilize tax incentives to encourage business investments. The GoK could encourage investments in agriculture by providing tax incentives (e.g. reducing custom and sales tax) on the purchase of agriculture and food processing equipment.

Opening New Markets. USAID and MAFRD could provide assistance to identify new international buyers. An ideal way to bring buyers and producers together is through food exhibitions (such as Fruit Logistica in Berlin Germany). Instead of just attending, Kosovo needs to have a display booth and identify potential buyers prior to attending the event. Interviews in North Mitrovica, for example, suggested an opportunity for USAID and MAFRD provide technical assistance to connect emerging raspberry and blackberry farms in the region to buyers. To ensure high quality of the product, consultants could work through processors or raspberry associations to organize farmers for group financing and deliver extension services on best production practices. This would benefit all of the mountain growing regions in Kosovo and would have a high impact on agriculture development in North Mitrovica where the Eko-Voca Association of Raspberry Producers would be a local focal point to establish up to 100 new raspberry farms.

Cold Storage Facilities. USAID could help develop storage facilities for fresh vegetables at key locations, such as the 5 collection points, to reduce quality deterioration and extend the shelf-life of fresh produce, thereby directly benefiting farm producers.

Organize Farmer Cooperatives. Land fragmentation is a problem that causes serious inefficiencies in Kosovo's agriculture sector. Land is traditional divided among all heirs, resulting in land plots becoming smaller over time. This makes it difficult to achieve efficiencies in production or introduce mechanization practices. One means of offsetting the negative impact of land fragmentation is by organizing farmer cooperatives to share equipment, arrange quantity purchases of inputs and organize marketing channels.

THE LANDSCAPE FOR AGRICULTURAL FINANCING IN KOSOVO

INTEREST RATE STRUCTURE, COLLATERAL REQUIREMENTS, AND ENABLING ENVIRONMENT

Interest Rates. According to statistics published by the CBK, the average loan interest rate was 13.0% in June 2010, down a full 2 percentage points from 15.0% the year before. The average deposit rate of 3.8% in June 2010 compares to a rate of 4.7% the previous year, a decline of 0.9 percentage point. As a result, the interest spread narrowed to 9.2 percentage points from 10.3 the year earlier. In CBK's opinion, one reason that deposit rates held firmer than lending rates is because of the impact of privatization of the state telecom company (PTK) and competition for it 280 million euro in deposits.

In spite of the decline in loan interest rates and the narrowing interest margin over the past year, interest rates remain painfully high for a low profitability industry such as agriculture. There is widespread mistrust in the business community that banks in Kosovo are colluding to maintain lending rates at levels higher than would otherwise persist. This belief is so pervasive that the Commission on Anti-Monopoly is investigating the interest rate structure in Kosovo.

To get an indication of whether there is any substance to the common belief that interest rates on loans are higher in Kosovo than neighboring countries, we accessed publicly available Central Bank and Statistical Databases for the March-July 2010 period. The results, shown in the table below, indicate that lending rates in Kosovo are indeed higher than neighboring countries; in fact, the average loan interest rate in Kosovo was highest for the region. This cursory review is susceptible to comparison error because the data covers a 5 month period and only looked at average published rates. Therefore, instead of comparing the absolute level of loan interest rates, the interest spread (loan rates minus deposit rates) is a better indication of various country rate structures because the loan and deposit rates represent the same point in time. Once again, the spread for Kosovo stands for being so wide, supporting the common perception that lending rates in Kosovo exceed those of other countries and puts agriculture in Kosovo at a competitive disadvantage in the region.

Country	Average Loan Interest Rate	Average Deposit Rate	Average Interest Rate Spread
Kosovo	14.6%	3.4%	11.2%
Albania	14.0%	6.2%	7.8%
Croatia	10.6%	2.2%	8.4%
Serbia	10.4%	4.4%	6.0%
Macedonia	9.8%	7.3%	2.5%

When agribusiness owner/managers were asked what lending rate their bank charged, agriculture processors quoted bank loan rates of 14.4%-to-16.0% on short-term (e.g. overdraft) credit. This is consistent with the rates quoted by banks of 12%-to-14% plus a fee up to 2%. However, on small loans to farmers, the bank lending rates go as high as 23% with upfront fees up to 2%. Micro-loans from MFIs and NBFIs, the typical source of loans for small farmers, carry interest rates in the 20%-to-30% per annum ranges.

While these loan rates may be tolerable on short term 6 month loans, common for the working capital needs of agriculture, the cost of capital in Kosovo is clearly an impediment to long term capital investments in agriculture. One example is Mr. Bejtush Gashi, owner of EuroFruit Company, a company with over $1 million in turnover annually, who wants to add additional cold storage and is qualified to receive a long term loan, but, according to Mr. Gashi, he will not use long term credit because the interest cost is too high.

Collateral. CBK does not specify the type of collateral required to secure loans; it's all about the individual bank lending policy. From the CBK standpoint, both real estate and moveable assets are acceptable forms of collateral. While CBK's Rule IX on provisioning for loan losses is more conservative than international bank standards, none of the commercial banks interviewed believed that the CBK rules were constraining lending; instead, they all said that lending and collateral requirements were driven by internal bank policies. That being said, the CBK was agreeable to the idea of being less conservative on agriculture loans, if development of the agriculture sector was identified by the countries leaders as a national priority.

CBK's Rule IX definition of how collateral is valued states: "The fair market and liquidation values of collateral should be documented by a current appraisal made by a competent party. The bank's ability to access and liquidate the collateral within a reasonable period must be considered." This definition is very clear, but conflicting perceptions of fair value is central to the debate about whether banks require excessive amounts of collateral on loans in rural areas. Compounding the valuation problem, there are no certified independent appraisers in Kosovo to fairly value assets.

In general, borrowers around the world tend to place an exaggerate value on their assets pledged as collateral; that is, an estimated value greater than what banks would ever receive in a liquidation environment. Equipment utilized in an on-going concern is always more valuable than the price it would bring at a liquidation fire sale. Borrowers' estimates are typically based on cost or "on-going concern" value while banks base their recovery estimate on liquidation value. However the perception gap between borrower and banker expectations of asset value is driven farther apart by lengthy foreclosures and resale constraints that exist in Kosovo. Bank Risk Managers regularly made the point that land in rural areas is not very valuable because it is not saleable. Even when banks are able to successfully foreclose on real estate property, no one in the community will buy the property. Banks, MFIs and Leasing Companies are all in agreement on this opinion. One Senior Officer put it this way, "Collateral in rural areas is worthless because it is part of a community that will not allow foreclosed property to be sold."

All of the banks said that they were not collateral lenders. They base lending decisions on cash flow analysis and business experience. One banker said that collateral is not as much of a problem as people believe in loan approval, and, another banker made the point that the main problem is low profitability in agriculture.

Collateral is used to protect against loss in the event a borrower does not repay. Banks accept real estate and moveable assets as collateral. Normally they want collateral valued at about 150% of loan value, but lower amounts are accepted when there is a 3rd party guarantor on the loan. Only on very large loan do some banks require real estate. All of the banks said that sales contracts and purchase orders are important elements of the credit decision, but do not substitute for collateral.

Two of the top banks in Kosovo do not file moveable assets taken as collateral in the moveable pledge registry. The banks and MFIs that do use the moveable pledge registry think it works, but it needs to be more efficient and an on-line filing process. The Ministry of Trade & Industry runs the moveable pledge registry and a consultant from Israel is working to improve the registry filing system.

MFIs have good outreach and issue most of the small loans to farms (e.g. loans less than 5,000 euro). MFI's are more creative than banks in using 3rd party or group guarantees as substitutes for collateral, but this lending is concentrated on the very small credit lines that are issued at very high interest rates. For example, FINCA offers group loans which do not require collateral up to 3,000 euros. The value of field crops that are still growing are generally not used as collateral because crop production and crop revenues are too uncertain.

Legal framework. If low profitability in agriculture is the number one reason constraining loan approvals to farmers, then a dysfunctional legal system is clearly a close second and the leading cause of high interest rates. Banks are reluctant to engage in rural lending because of uncertainty about speedy contract enforcement. In some municipalities the court system is complete broken and uncertainty about court enforcement of lending contracts is the main problem increasing the risk of lending in rural areas. According to almost all of the bankers interviewed, this is the main cause of high loan interest rates, especially on agriculture loans. In the opinion of one MFI Director, "High lending rates are a direct result of the inefficient court system.", and then added, "the biggest impact the GoK could make on increasing lending to agriculture is to fix the court system".

The inefficient legal system especially impacts the value of moveable assets because they quickly depreciate in value. If the courts were efficient and claims could be processed quickly, especially for moveable assets, it would substantially improve the borrower/bank relationship.

Business transactions are inhibited in Kosovo by the court system because it is so difficult to get timely contract resolution. Until legal rights are enforceable foreign investors will not invest in Kosovo. Since prospects for fixing the court system and resolving the backlog of cases is a long term effort, arbitration may be the solution, according to experts at the Alternative Dispute Resolution conference sponsored by the SEAD program. The Kosovo business community needs arbitration. Although most international investors would require arbitration in a venue outside of Kosovo, it is an important element in attracting Foreign Direct Investment. Weak investment, both domestic and foreign, is the main reason development of the agriculture is not progressing at a faster pace.

BORROWER PERSPECTIVES

Smallholder farmers. Production agriculture in Kosovo is dominated by very small family farms, operated by owners and workers with little education who often rely heavily on tradition to determine crop types and growing methods. These small farms are, for all practical purposes, not credit-worthy in terms of bank lending practices. Small farm operators face ongoing profitability problems, low crop income (due to planting local varieties of commodity-type crops such as peppers with no option except to sell at harvest time price lows), and high risk levels because of external factors such as weather and insects. Having few, if any, farm records, very little in the way of asset wealth, and small credit needs, these farmers are ill-prepared to obtain or demand commercial bank credit. For their most basic financing needs, these small farmers turn to the strong MFI sector that exists in Kosovo, which provides short term microloans at high interest rates (typically 25-30%) that reflect the costs of extending expensive credit to small, rural borrowers. Typically, smallholders' basic financing needs are being satisfied by the microfinance sector.

Smallholders looking to scale up and improve profitability may demand financing beyond the basic microloans that MFIs already provide. They must first, however, become more viable customers for commercial banks. Smallholders in Kosovo that are able to access financing outside of MFIs typically do so through agriculture processors using smallholder farms to source products, suppliers willing to partially finance farm inputs in order to generate sales, or salary-based bank credit, if one of the family members is fortunate enough to have steady off-farm employment in a salaried position. Individually, these small farm units lack the ability to innovate, introduce new technology, or utilize mechanization, but together they could act in cooperative structures to share equipment, purchase inputs, operate collection points, and identify marketing channels, making their collective business more profitable and appropriate for commercial financing that would allow them to grow.

Agro processors and commercial farmers. Agriculture processors in Kosovo are typically privately owned. The owner-manager is educated, well known in the local community and well connected with business and donor communities. All of the owner-managers of agriculture processing companies interviewed for this assessment had received grant assistance from one or more donors. There is a small, but growing trend for processors to provide inputs (such as seed) or extend credit to farmers that supply the processor with products. This maturing of the business relationship between suppliers and processors provides an opportunity to work through the processor to administer input credits and provide technical assistance to smallholder farmers. Agriculture processors are generally creditworthy and able to obtain bank credit, but almost universally, they either do not obtain bank financing or limit the amount of bank financing they use to as little as possible. None of the processors used long-term investment credit. The unanimous reasons given by the processors were: 1) the cost of credit is too high, and, 2) banks will not structure loan terms to meet the needs of agriculture. Several of the processors that did use credit limited it to short-term overdraft credit lines, quoting bank interest rates of 14.4%-to-16.0%. However, it was difficult to determine how much their negative opinion about bank interest rates is influenced by the fact that much of their external investment capital historically has been obtained in the form of grant funding from donors. It's clear that when investment capital is needed they seek the most desirable arrangement by sourcing as much as possible from donors in the form of grant funding.

Agriculture processors identified two critical problems limiting profitability and therefore growth of agriculture in Kosovo: 1) "unfair" trade agreements, and, 2) limited transit routes. The Government of Kosovo has trade agreements with neighboring countries that put local farm producers at a competitive disadvantage. First, they pointed out that agriculture production in Macedonia is heavily subsidized and products from Macedonia are "dumped" in the Kosovo market at prices that are sometimes below the local cost of production. Second, the trade agreement with Serbia allows Serbian products to be imported into Kosovo, but Kosovo products cannot be sold in Serbia. Even worse, Kosovo trucks cannot legally transit through Serbia to reach Europe. This is especially damaging to the high-value fresh produce market. Because of the short shelf-life of fresh produce, there is not enough time to ship through Montenegro, Bosnia or Croatia. Transiting through Serbia is the only route that allows fresh products to reach Europe in high-quality condition.

All of the agriculture processors indicated that there was enormous, almost unlimited, demand from European buyers for vegetable and fruit products such as pickled peppers, pickled cucumbers, frozen blueberries, frozen raspberries and dried mushrooms. Several processors identified cultivated raspberries and cultivated blackberries as major opportunities for high-value farming in Kosovo. An MFI Director also pointed out the opportunity for producing saffron as a high-value crop. Fresh sweet peppers, fresh tomatoes and fresh berries could penetrate the high-value European markets if refrigerated trucks were allowed to transit through Serbia. Unfortunately, without being able to transit through Serbia, the shipping time is too great to sell fresh products.

Agriculture processors are willing to administer credit lines for their farm suppliers with cross guarantees among the farmers and assignments that would allow the processor to withhold loan repayments from crop proceeds. However, one processor thought longer-term credits for capital improvements would have to be as low as 5% per annum with a grace period on principal for the first year. Processors are also a logical focal point to organize farmer training programs and deliver extension services. Views on the MAFRD are mixed, but there is widespread opinion that MAFRD Extension Agents have never helped local farmers.

Processors need short term operating credit for 6-to-8 months because they pay farmers cash when products are delivered, but do not receive income from international buyers until the products are delivered. In addition to helping obtain low cost, short term financing, agriculture processors had several other suggestions for assistance from USAID/MAFRD that would help develop agriculture and increase farm income (see box at right).

Suggested Areas of USAID/MAFRD Technical Assistance
• USAID could help to develop cold storage facilities for fresh vegetables (presumably at collection points) so the shelf life of fresh produce is extended for farmers; • USAID could provide targeted technical assistance to establish raspberry farms; • MAFRD could provide quality extension services to all farmers; and, • Both MARRD and USAID could provide assistance with marketing products to international buyers, including attending agriculture food exhibitions/trade fairs in Italy, Germany and other European countries.

LENDER PERSPECTIVES

Commercial Banks. There are 8 licensed commercial banks in Kosovo, but ProCredit Bank dominates SME and agriculture lending activities. Although agriculture loans represent less than 10% of ProCredit's loan portfolio, it is about 90% of all bank loans to agriculture. Two of the leading banks stated that the default rate on agriculture loans is no greater than the loan portfolio at large, so statistically speaking, agriculture loans are not more risky than other types of lending. However, representatives of the commercial banking sector identified several common risks associated with agricultural financing in Kosovo as well as constraints to the sector's profitability and development:

Common Constraints to Agricultural Lending among Commercial Banks	
Risks Limiting Financing to Agriculture	**Constraints to Agricultural Profitability**
• Uncertainty regarding legal enforcement of contractual rights. To increase credit availability and lower interest rates, the GoK must fix the broken legal system. Because the legal system is dysfunctional, it increases the risk of lending and results in higher interest rates, especially on agriculture loans; • Real estate ownership uncertainty in rural areas and the inability to resell foreclosed property; • Inefficient foreclosure rights can result in moveable assets having limited value, even if the bank is successful at repossessing the assets; • Agriculture is a low profit industry and that makes it much more difficult to qualify for credit; and, • Cost of servicing agriculture loans is very high.	• The GoK is not providing enough leadership in agriculture development. A central planning committee consisting of banks, donors, MAFRD, and agriculture producers/processors should meet regularly; • Weak and poorly structured GoK policies that result in trade imbalances. For example, Serbia is allowed to ship goods into Kosovo, but Serbia does not allow open trade or products to be shipped through Serbia; • Land fragmentation causes inefficiencies in agriculture. Land is traditional divided among all heirs, so individual farm plots become smaller through the generations. This makes it difficult to achieve efficiencies in production, introduce mechanization or achieve economies of scale; • Lack of interest among businessmen or investors in the agriculture sector; • Farmers need access to new markets; USAID and MAFRD should provide more assistance to opening new markets for agriculture products; • Moveable pledge registry is inefficient; and • High interest rates and fluctuating prices.

Liquidity is not restricting lending to agriculture. None of the banks indicated that liquidity was a problem. In fact, one bank indicate that excess liquidity was hurting bank earnings and the bank was searching for good loans to employ excess funds. For the banking sector in total, CBK statistics indicate that liquidity in the banking system is not constraining lending. Overall, there is good, maybe even excess, liquidity in the banking sector and the sector is more liquid than a year ago. The loan-to-deposit ratio for the banking system was 80% in June 2010, compared to 85% in June 2009.

All bank managers interviewed for this assessment expressed a strong desire to lend to the agriculture sector, however it was repeatedly expressed that they receive very few loan applications from farmers or agribusiness.

Microfinance institutions (MFIs). MFIs are active participants in lending to farmers in Kosovo using traditional micro-lending practices. Loans are typically small (i.e. less than 5,000 euro) with interest rates in the 20%-to-30% per annum range. The larger MFIs do not have problems accessing funds, but it comes at a high cost because they have lines of credit with development banks (e.g. EBRD) that charge interest rates around 10%. This compares to banks' cost of funds from deposits at an average cost of 3%-to-4%. Therefore, the MFIs have successfully pushed the CBK for regulations that would allow them to become deposit taking institutions. MFIs view their major strength as outreach to the farming community and believe that they are best suited to serve the needs of rural borrowers. They typically have local community representative that rely heavily on experience and character of rural borrowers to determine credit approval. Commercial banks do not want to lend to this market segment because of the broken court system, unclear collateral rights, relatively small size of credit and high cost of delivery.

In order to increase lending to agriculture at lower interest rates, MFIs, especially the larger ones, need more attractive terms on their sources of funding. If the GoK, MAFRD and USAID want to increase lending to farmers, they need to help supply MFIs with funds by providing grants or loans at low interest rates targeted for agricultural lending. One way to provide MFIs with low is for the GoK to issue targeted agricultural development bonds. Another way is for MAFRD to buy down interest rates. USAID could also provide additional grants to MFIs

Other issues that MFIs identify as being major impediments to development of agriculture in Kosovo are summarized below.

Common Constraints to Agricultural Lending Among MFIs
• The GoK must support their own farmers and stop allowing low cost products to be dumped in the Kosovo market. The GoK does not provide any protection against low priced imports. For example, Macedonia has economies of scale in farming and farmers receive heavy Government subsidies and they sell products in Kosovo at depressed prices, sometimes below the cost of production; • MAFRD must establish food standards, conduct testing and issue certifications that meet the same standards as Europe, so products are accepted in international markets; • MAFRD should engage in product testing and operate a model test farm to develop high-value products. For example, it was an MFI consultant that tested saffron and discovered that the climate around Prizren is perfect for saffron production. Developing high-value products like saffron needs the support of the MAFRD to provide technical expertise to farmers and be able to test and certify the quality of the product; • Agriculture is the largest industry in Kosovo but the GoK is not making any investments in agriculture development. For example, the GoK owns the irrigation system, but they do not maintain it. There are not making investments in technology, not making investments in opening new markets and not making investments to integrate international standards, such as GlobalGap; • The GoK needs to support a “buy domestic” program to increase local demand by connecting with grocery stores and food distributors and give a sales tax break to retailers selling domestically produced products. This would encourage wholesalers and retailers that are selling products they buy from external markets, like Macedonia, to find locally produced sources. • The GoK needs to encourage investments in agriculture by providing tax incentives on the purchase of agriculture equipment.

Non-bank financial institutions (NBFIs). Several new lending arrangements are being introduced that could increase credit availability for agriculture, at least marginally. Crimson Capital is a non-bank financial institution and specializes in Purchase Order Financing, a lending product designed to meet the working capital needs during the production of goods to fulfill a sales contract (i.e. purchase order). It is well designed for meeting the needs of agriculture processors that pay cash to farmers but do not receive payments from their international buyers until many months later. It could also be adopted to meet the input credit needs of farmers that are specifically producing under contract for agriculture processors. However, interviews with both agriculture processors and farmer associations suggest that they will not be willing accept Crimson Capital’s interest rates which are over 20% per annum. The high rate of interest was the main complaint from agriculture producers/processors during the interviews.

TEB bank, a newcomer to Kosovo not actively involved in agriculture lending, is coming out with two new lending products. The first is a SPOT loan program structured for businesses dealing with sales contracts, purchase orders or pronounced seasonality. With a SPOT loan, all interest and principal is repaid in one balloon payment at loan maturity, which is timed to match the cash inflow from the sales contract or harvest season. The second lending program is called Direct Debit Business lending, designed for a lead company (e.g. such as a processor) that deal with a network of smaller companies. The loan is made to the lead company based on the credit needs of the entire network. This could be ideal credit for a processor sourcing from a network of small farmers.

FEASIBILITY OF PROPOSED FINANCIAL PRODUCTS

Loan guarantee programs. In 2006/07, USAID introduced a Development Credit Authority (DCA) loan guarantee program through Raiffeisen bank in an attempt to increase lending to agriculture by reducing onerous collateral requirements and lowering interest rates. The $5 million DCA guarantee was fully utilized by Raiffeisen to support agriculture lending of $10 million based on the 50/50 loan loss arrangement. Bank Directors and Credit Officers believe that the DCA loan guarantee scheme worked very well and highly recommend that it should be repeated. According to Raiffeissen’s Credit Officer, agriculture borrowers that received a loan backed by DCA guarantee coverage received a 1 percentage point reduction in interest rate, the amount of loan collateral required by Raiffeisen was reduced and moveable assets could be used to fulfill remaining collateral requirements beyond the DCA guarantee. On some small loans, no extra collateral from borrowers was required. Raiffeisen welcomed the training and technical assistance received from 2 consultants provided by the DCA program. Recently, in September 2010, Raiffeisen submitted a small claim for $90 thousand to cover loan losses. This was the first loss claim submitted since the DCA guarantee began operating in 2007. The program was viewed by the bank as being very successful, but it did not reduce loan interest rates as much as hoped by USAID when the program was first implemented.

Raiffeisen and many of the other banks in Kosovo are interested in the prospects for a future DCA loan guarantee program. Although, under DCA procedures, Raiffeissen may not be eligible for repeat guarantee assistance, other interested banks could easily subscribe to an aggregate guarantee program about twice as large as the initial $5 million program for Raiffeissen. This would have a quick impact on increasing the amount of credit extended to agriculture. After the success of the initial program, it is probable that the loss share could be reduced to 40% or lower so that a $5 million DCA guarantee would support a $12-to-$15 million agriculture loan portfolio. The loan activity should be specifically targeted for agriculture investments in equipment and facilities. Several examples are: i) to establish greenhouses to extend the vegetable season, ii) to install irrigation and seedlings for high-value crops like raspberries, blackberries and saffron, iii) to processors for equipment, packaging and storage to sell to both domestic and export markets, and, iv) for cold storage facilities at collection points and improvements in cold chain development, including refrigerated trucks. Also, a specific interest rate reduction, more aligned with the reduced risk exposure, should be negotiated up front. A 3 year loan at a 9% interest rate would seem reasonable.

The MAFRD is also considering introducing a loan guarantee program to advance credit availability to agriculture. However, a government run (as apposed to donor run) guarantee program received a completely opposite (negative) response compared to the favorable response for USAID DCA guarantee. No one interviewed for this assessment study thought that it would be a good idea for the MAFRD to administer a guarantee program. The reasons were as follows: i) the Ministry itself discovered that giving loan guarantees to the private sector was prohibited by law; ii) the CBK did not think it was a good idea for a Government Ministry to use public money to participate in risk sharing with private enterprises, iii) the lending community (i.e. banks/MFIs/NBFI) does not believe that MAFRD could effectively administer an operational-type program, and, iv) some believed that MAFRD could spend the money in more productive activities. In addition to all of the above, there was a feeling that favoritism or corruption would be involved in the lending/guarantee process.

Crop insurance. While theoretically appealing as a product to reduce risk and thereby increase credit availability, crop insurance is a double-edged sword that cuts both ways because it can increase the cost of credit and become an obstacle to obtaining financing, with little or no economic benefit to farmers. Agriculture insurance is a complex and difficult product to deliver in a sustainable manner5. If the GoK is interested in promoting agriculture insurance, it should guard against making it mandatory to access credit or guarantee programs because when it becomes mandatory, the insurance product can quickly convert into becoming "bank insurance", beneficial mainly to banks and not farmers. The GoK needs to evaluate whether spending money on agriculture insurance produces a better risk management outcome than directing money for better farm production tools and improved farm management practices, both of which can substantially reduce crop production risk. For example, renovating the state's irrigation systems would substantially reduce the production risk of relying solely on rain fed crop production. Another example would be the availability of skilled extension services to update farmers on new crop types and production methods.

Crop production loss as a result of natural disaster is referred to as a low frequency – high consequence risk event in The World Banks report titled "Managing Agricultural Production Risk"6. The term, "low frequency-high consequence" means that while these events (such as weather calamities or insect infestation) do not happen often, when they do the losses can result in extremely large financial exposure to the insurance company. Especially in developing countries, pricing this type of insurance product is difficult because there is limited information about the likelihood of disaster. Uncertainty caused by lack of information tends to add costs because insurers raise premium rates when there is ambiguity surrounding the actual likelihood of the event.

Another problem is that traditional crop insurance to protect against production loss attempts to measure individual farm yields, and determine the amount of loss that is specific to the insured disaster versus loss associate with poor farm management. Thus, it has a high transaction cost that makes it nearly impossible to be priced at a level that is affordable or economically beneficial for small farmers.

A common attribute of low frequency-high consequence events are that farmers typically underestimate the likelihood of disaster, while at the same time insurers with little empirical information add extra cost to premium rates to cover uncertainty. Thus there is a large expectation gap with regard to the "fair" price of coverage, resulting in a reduced willingness among farmers to pay for insurance.

Surprisingly, most banks and MFIs operating in Kosovo do not express a strong desire for crop insurance as a tool to reduce credit risk. Only one bank thought the GoK should push insurance companies to offer crop insurance, while one MFI thought crop insurance would be beneficial. Of course, "at an affordable and economically beneficial cost to farmers" was implied in their responses. Three banks thought it would be difficult to administer and one bank thought that crop insurance would not be very helpful at all. The largest MFI believes that crop insurance would not

[5] "Agriculture Insurance Revisited" by Mark Wenner, Senior Financial Specialist, Rural Development Unit, Inter-American Development Bank, Reference No. RUR-05-12.
[6] "Managing Agricultural Production Risk", The World Bank, Agriculture and Rural Development Department, Report No. 32727-GLB.

resolve the access to credit problem and indicated that crop insurance would be near the bottom of his list of priorities for improving agriculture.

A new concept in crop production insurance is a “weather-indexed” insurance product. It is based on the concept that temperatures and rainfall closely correlate with crop production and therefore, the insurance is based solely upon these variables. Transaction costs are reduced substantially because it does not attempt to measure individual farm yields (and losses) and insurance companies can typically obtain substantial amount of historical data to calculate an actuarially “fair” premium price.

Leasing. Two leasing companies operate in Kosovo: Factor Leasing and Raiffeisen Leasing. Neither has made substantive inroads into agriculture equipment leasing. Factor Leasing tested the agriculture equipment market with leases on seven tractors, but the experience was disappointing. The disappointment began when the lessee defaulted on the lease agreement and the situation deteriorated from there because the court did not respond with a speedy judgment (courts are suppose to issue a judgment on lease foreclosures within three days of filing).

There are two types of leases: operating leases and financing leases. With operating leases, the leasing company purchases vehicles or equipment directly and maintains ownership throughout the life of the lease. At the end of the lease term, the lessee typically has a purchase right for a nominal value. A major problem in Kosovo with regard to operating leases is the GOK’s reluctance to return VAT taxes to the lessor.

Finance leases (as apposed to operating leases) are just a financing arrangement from a lease company and the lease agreement gives the lessor speedy repossession rights in the event of default. There are three primary weaknesses in Kosovo preventing a more ideal environment for agriculture leases:

1. As mentioned above, the courts are not responsive to repossession requests;
2. Uniqueness of agriculture machinery and equipment makes resale difficult; and,
3. Vehicle and equipment dealerships are not widespread in Kosovo, making initial sales, maintenance and resale more difficult.

ANNEX A – BASELINE SURVEYS

AGRICULTURE BUSINESS

Four leading agriculture firms were interviewed for this assignment to gain an understanding of their perspectives on agriculture growth prospects, financing activities, lending requirements and banking relationships. Below is a brief synopsis on the interview results at each of these companies.

Etlinger Company - Located in South Kosovo, the company is owned and managed by Tahir Kokollari. It is a canning and marketing company for locally produced products. Its 4 main pickled products are cucumbers, hot peppers, sweet peppers and stuffed tomato peppers. The canning operation is well organized but very labor intensive. Etlinger Co. directly employs about 80 workers and sources 1,400 tons of fresh products from about 500 farmers and farm labors. Etlinger provides the seeds to the farmers for free so they grow the product type needed for canning. Canned products are marketed through an Austrian company located in Vienna, Kolm Pfluger. Demand is high and Mr. Kokollari said they can sell as much as is produced. Still, farm level prices are very depressed and the higher product prices by selling in Austria are not “trickling down” to the farm level. During the visit it was the peak of the pepper harvest and the farm level price was only 1 euro for 5 kgs of peppers.

Much of Etlinger Co. start up cost for capital items was cover by grant funding from various donors. The initial investment to build the canning factory was supported by Economic Initiative for Kosovo (ECIKS) with financial assistance from the Austrian Development Agency (ADA). Since start up, Mr. Kokollari received $30,000 of assistance for equipment from InterCooperate, a Swiss aid project, and a grant of $35,000 from USAID through the KPEP project. The local municipality provided the land on which the factory is located.

Access to financing is a problem and he needs financing to purchase equipment. Everything so far was self-financed and donor financed. Mr. Kokollari said that he does not quality for bank loans for Etlinger operations because the land is owned by the municipality and therefore cannot be pledged as collateral for a loan. He has applied at Raiffeisen, ProCredit and NLB banks. However, even if he did quality for a bank loan, he would be reluctant to take a loan because the interest rate of 16% is too high.

There is much growth potential for Etlinger and the farmers producing for his factory. Etlinger uses locally grown products to produce what appears to be very good food products. The Etlinger canning/marketing company could be the nucleus for assisting small farmers growing for Etlinger. Donor organization in terms of extension support could be organized through Etlingers. Bank financing for the smaller farmers is much more likely if the credit lines were cross guaranteed and assignments were given to Etlinger to withhold payments for crops and send them directly for loan repayments. There are lots of possibilities for higher value farm products (e.g. fresh red/yellow bell peppers sales to Western European markets) and more advanced producer technology (e.g. greenhouses to extend the production season and irrigation systems to increase production levels).

Mr. Kokollari believes that the possibilities for selling vegetable production to Austria is enormous. The one recommendation for USAID is to help develop storage facilities for fresh vegetables so the shelf life of fresh produce is extended for farmers.

Mr. Kokollari has a very negative opinion of the MAFRD. He believes they are corrupt and only in their positions to benefit themselves. He thinks the MAFRD personnel allow imports into Kosovo in return for personal benefits. MAFRD extension agents have never helped the local farmers.

AS-Promet. Located in North Mirovica, AS-Promet is owned and managed by Ivan Lukojicic. He has a modern cold storage, drying, sorting and packaging center for wild products collected in the mountain forests: bilberries, mushrooms, elderberry leaves, blackberries and juniper berries. He also markets frozen raspberries that are grown by 13 local farmers. These 13 raspberry farmers and Mr. Lukojicic are members of the Association of Raspberry Producers (called Eko-Voca). In total AS-Promet sells 300-to-400 tons of wild products and raspberries per year to international buyers, primarily in Europe.

AS-Promet's facility and equipment are only several years old and the initial cost was about 150,000 euros when erected, of which 30,000 was financed with a grant from USAID and the rest with Mr. Lukojicic's own savings. He did not take a bank loan to finance the initial investment cost because at the time, he could not get credit from any of the banks. However, even if he could have obtained a bank loan, he said that he probably would not have done so, because the cost of credit was prohibitive.

When asked about collaboration with USAID projects and the prospects for agriculture development in N. Mitrovica, Mr. Lukojicic believes that advancing raspberry farming offers huge potential. He said that there is huge demand for frozen raspberries in Europe, especially Germany, and he can sell all that he can produce. He believes that up to 100 additional farmers in the local communities of North Mitrovica are interested in producing raspberries. At the current farm level price of 1.4 euro per kg, these 100 farmers together would generate about 1 million euro of family income.

To establish additional raspberry farms, Mr. Lukojicic believes that USAID should work through the Eko-Voca Association of Raspberry Producers or AS-Promet to organize the farmers and deliver extension services. Also, it could be that same for banks to manage any credit lines. To establish raspberry farms, some start-up credit would probably be needed for drip irrigation systems, seedlings, mulch, and support posts. Start up cost would be about 5,000 euro per farm plot. Some farmers would have their own capital, but some would welcome bank financing.

Mr. Lukojicic banks with Serbian banks because money transfer fees are cheaper and the money transfers are much faster than Kosovo banks. However, the bank's service quality is poor. Belgrade licensed banks operating in North Mitrovica are Commercial Bank, Yugobanka and Dunovt. They don't provide business credit in North Mitrovica because the area is unstable.

Mr. Lukojicic's business success with AS-Promet now makes him "credit worthy" and he could obtain a bank loan. However, he has not used credit because the cost of credit is too high and bank loans are not structured to the natural cash flows of the farming business. However, with the support of USAID, he would be willing to administer a group credit line for the Raspberry Association members in order to establish additional raspberry farms. To meet the needs of the raspberry farms, which take two years before plants produce, he would like a long term (e.g. 3 year) loan at 5% per annum with a grace period on principal payments for the first year.

Mr. Lukojicic also described the need for operating credit to grow his business. Since he pays cash to farmers, he needs a 50,000 euro loan at the beginning of the season, to be repaid 6 months later (at the end of the season) when sales revenues are received from international buyers. However, he cannot borrow at the current interest rate levels (which he believes is about 10% per annum). In actuality, interview with banks indicate that for agriculture loans, the interest rates are in the 15%-to-20% range; and MFIs are in the 25%-to-35% range.

Mr. Lukojicic's business knowledge and success sets that stage for additional assistance initiatives. He has a very good business character; he is energetic, successful, clear thinker and lifelong member of the local community. With targeted technical assistance to establish raspberry farms, a credit line could be administered through Eko-Voca or AS-Promet. The results could have a high development impact on export sales and rural family well-being in North Mitrovica.

APC Agroproduct Commerce – Located in Podujeve, this company is owned and managed by the Shabani family. Ardian Shabani, who directs sales & marketing efforts for the company was interviewed for this assignment. APC's core business line is similar to that of AS-Promet (see above), collecting and selling wild products such as mushrooms, bilberries and blackberries in addition to marketing cultivated, locally grown raspberries. APC has a collection network and sells about 300 tons of dried and frozen products. Most of the wild products are sold to buyers in Italy; frozen raspberries and small amounts of fresh products are also sold to buyers in Germany. In June 2010, APC started operating a frozen vegetable line for locally grown vegetables. They are having difficulty getting supermarkets in Kosovo to carry their frozen vegetable line because they already have established suppliers importing frozen vegetables from Europe. APC needs a market entry plan and would welcome technical assistance to penetrate the domestic supermarket and restaurant markets.

APC banks with Raiffeisen, where APC has an overdraft arrangement for short term credit needs. This financing is very important because APC pays farmers in cash when products are received and need short term financing until they receive payments from international buyers. Use of credit is limited and only used for short-term trade financing. When asked if longer term investment loans were available for equipment and transport vehicles, Mr. Shabani replied, "Not really, we check for the availability of grant funds through projects like InterCooperation and KPEP".

According to Mr. Shabani, the biggest problems facing agriculture in Kosovo are marketing channels and trade agreements with neighboring countries. The first problem is that selling fresh products to Europe is extremely difficult because Kosovo companies cannot ship through Serbia and it takes too long going through Montenegro, Bosnia or Croatia. APC tried shipping through the Albanian seaport in Durres, but it was so problematic that they will never use that route again. Secondly, Mr. Shabani points out the unfair trade arrangements allow Serbian products to be imported into Kosovo, but Kosovo products cannot be either sold in Serbia or transported through Serbia. Thirdly, Mr. Shabani pointed out the aggressive price competition from Macedonia. Macedonia ships into Kosovo at depressed product prices.

When asked what type of assistance would be most needed from USAID or MAFRD, and Mr. Shabani's response was that they need assistance with marketing products to international buyers. In additional, Mr. Shabani believes that the climate and soil type in Kosovo is almost perfect for raspberry production, and farmers need technical assistance and extension services to help establish and grow raspberries.

EuroFruti Company – Located in Mramor, Prishtine, EuroFruti advertises itself as a company for collection and processing of forest fruits. Owned and managed by Bejtush Gashi, EuroFruiti has the same business model as AS-Promet and APC companies (see above). EuroFruiti markets 700-to-800 tons annually of dried, frozen and brined products to Europe. Main products are mushrooms, bilberries and raspberries (both wild and cultivated). EuroFruiti has a modern facility with large cold storage capacity, partly financed by grants from Swiss InterCooperation ($15,000) and KPEP ($24,000). EuroFruiti is currently in the process of obtaining HAACP certification.

Mr. Gashi believes that the best potential for agriculture development in Kosovo is to encourage more berry production. Many local farmers are interested in raspberry and blackberry production, but are moving slowly because of their reluctance to depart from traditional crops and farming practices. Also, Mr. Gashi believes that sweet chestnuts grown in Western Kosovo would be very much in demand in Italy and Germany; no one has yet organized the collection and marketing for this high value product. Mr. Gashi finds buyers by attending trade fairs in Italy, Germany and other European countries.

EuroFruti uses NLB banking services and does not have a problem accessing credit. The company has an overdraft approval for up to 100,000 euro at an interest rate of 14.4% per annum. Interest is charged on a daily basis on the outstanding overdraft amount. Mr. Gashi is very satisfied with the banking services provided by NLB. Even though they could get a long-term loan of 3-to-4 years, they do not use long term credit because the interest cost is too high.

FINANCIAL INSTITUTIONS (COMMERCIAL BANKS, MFI'S, NBFI'S)

Lending Officers and Senior Managers at 5 of the 8 banks operating in Kosovo were interviewed for this assessment: ProCredit, Raiffeisen, Banka Ekonomike, TEB and NLB banks. Common issues across all banks on why bank lending to the agriculture sector was anemic were:

- Profitability - Agriculture is a low profit industry
- Court System – Lack of ability for speedy contract enforcement, real estate ownership uncertainty in rural areas and inability to resell property, and, inefficient foreclosure and repossession rights, especially with regard to moveable assets.

ProCredit bank holds about 90% of all the loans to the agriculture sector. They are the only bank with a proven program that is successfully delivering credit to agriculture; therefore, its lending policies establish the norm for sectoral lending.

Below is a summary of the perceptions about the agriculture industry and lending initiatives based on interviews of bank managers:

ProCredit Bank – The largest and most dominant bank in agriculture lending, it has about 90% market share of bank lending (not including MFI, NBFI or informal credits to the agriculture sector). However, agriculture loans represent less than 10% of ProCredit's total loan portfolio.

Agriculture lending is defined at ProCredit as loans to firms engaged in the production of agriculture products (traditional definition of farming) and firms processing raw products close to the farm level (such as pickling cucumbers), but it is worth noting that the definition of "agriculture lending" does not include loans to food retailers or trading companies. With this definition is mind, it is interesting to point out that the Agro Manager at ProCredit bank made the observation that, "agro loans are statistically no more risky than non-agro loans".

ProCredit Bank's perspective on the key issues regarding bank lending:

- Liquidity – liquidity (or lack thereof) is not a problem limiting credit to agriculture.
- Collateral – maximum requirement is 150% of loan, but can be less if the borrower has a personal guarantee. It is not as much of a problem as people perceive it to be. ProCredit is a cash flow based lender and evaluates repayment capacity of the borrower as the basis for the credit decision; it is not mortgaged based lending based on the value of collateral. ProCredit also accepts moveable assets as loan security but does not use the moveable pledge registry because they believe the credit registry is sufficient.

- Sales Contract or Purchase Order financing – ProCredit will accept a sales contract or purchase order as the bases for extending or securing credit, but it is seldom requested by the borrower. With regard to loan security, ProCredit has other procedures instead of taking an assignment on a sales contract; instead they would ask for a third party loan guarantee.
- Growing (i.e. future) crop production is not accepted as collateral because crop production is too uncertain.
- Crop Insurance – is not available in Kosovo and the Loan Officer was of the belief that it was not allowed in Kosovo. In any regard, implementing crop insurance would be very difficult because there is no market information available and because of price fluctuations.
- USAID DCA – This loan guarantee scheme would be of interest to ProCredit, but it would depend on the details of the risk sharing arrangement. And, in general, donor guarantees may not be good because they can create the perception that borrowers do not have to repay.
- MAFRD Loan Guarantee – Definitely this is not a good idea because the Ministry is weak, and peoples perception about not having to repay, will mean the program would fail.
- Financial Statement (FS) requirements - ProCredit does not require audited or even formal FSs. The bank's ag loan officers are very knowledgeable about agriculture and they conduct an interview with the borrower, cross check data, and use an agriculture loan spreadsheet to construct financial statements for internal use, analysis and decision making.
- Outreach and Targeted Support for Agriculture – ProCredit employs Loan Officers that are specialists in agriculture and they know the agriculture community.
- Interest Rates & Lending Terms – Interest rates are based on the loan size, not the duration of the loan. The interest rate on agriculture loans starts around 12.6% per annum plus an upfront fee of up to 2%.
- Leasing – ProCredit bank does not have a leasing program.
- Main Issues with regard to Agriculture Development:
    - The biggest problem is weak and poorly structure GoK policy that is resulting in a trade imbalance; Serbia is allowed to ship goods into Kosovo, but Serbia does not allow open trade or products to be shipped into Serbia from Kosovo.
    - Secondly, land fragmentation is a big problem causing inefficiencies in agriculture. Because land is traditionally divided among all heirs, individual farm plots are getting smaller. It is difficult to achieve efficiencies in production, introduce mechanization or achieve any economies of scale.

Raiffeisen Bank – The second largest bank in Kosovo, it has only a small portfolio of agriculture loans, many of which were made under the DCA guarantee provided by USAID. In 2007, Raiffeisen was given a DCA credit guarantee of $5 million, which covered loan loss risk on a 50/50 basis, therefore supporting $10 million of agriculture lending. The program was fully utilized and loan loss was minimal as of September 2010 when this interview was conducted. Raiffeisen was very appreciative of the program and would like additional DCA guarantees.

Raiffeissen has 3 broad loan portfolio classifications: Micro loans, which are less than 100,000 euros; SEs, which are 100 thousand-to-1 million euros; and, Corporate loans, which are those greater than 1 million euro. Agriculture lending is defined at Raiffeissen as loans to farmers and small processors. They fall into the micro loan classification (i.e. < 100 thousand euros). The Head of Micro Segment that was interviewed made the point that, "micro loans at Raiffeisen represent less than 10% of the total loan portfolio, but 97% of the businesses in Kosovo are micro credits". Less than 10% of

Raiffeisen's portfolio is to the micro loan sector, and less than 10% of the micro loans are to agriculture, even though, there is no greater default on agriculture loans compared to others.

Raiffeisen Bank's perspective on the key issues regarding bank lending:

- Liquidity – lack of liquidity is not a problem limiting credit to agriculture. In fact, Raiffeissen has a loan-to-deposit ratio of less than 65%, so excess liquidity is the situation at Raiffeisen.
- Collateral – Raiffeisen accepts real estate, moveable assets and 3rd party guarantees as loan security. Officially they would not accept a sales contract or purchase order as loan security, but these would go into the analysis of the credit decision. Not normal for small producers. Only on large loans (the top 10%) is real estate the only collateral allowed; for loans of up to 30,000 euro, Raiffeisen accepts moveable assets. Raiffeisen does not use the moveable pledge registry and does not know very much about it.
- Crop Insurance – banks need the GoK to push insurance companies to offer crop insurance. Currently, crop insurance does not exist in Kosovo.
- USAID DCA – This DCA loan guarantee scheme worked very well and should be repeated. Borrowers under the DCA coverage received a 1 percentage point reduction in interest rate, collateral requirements were lowered, moveable collateral was allowed and on some small loans, no collateral at all was required. Raiffeisen welcomed the training and technical assistance received from 2 consultants provided by the DCA program. The $5 million DCA guarantee supported additional agriculture lending of $10 million based on the 50/50 loan loss arrangement. Recently, in September 2010, Raiffeisen submitted a small claim for $90 thousand. This was the first loss claim submitted since the DCA guarantee was started in 2007.
- MAFRD Loan Guarantee – The Ministry can do more in other areas than trying to run a guarantee program. The MAFRD needs to be a coordinator among the various players. The MAFRD needs to set the rules for agriculture that is fair and promotes development.
- Financial Statement (FS) requirements - Raiffeisen does not require audited FSs for small loans. A borrower's own business figures are fine as long as the numbers can be supported.
- Outreach and Targeted Support for Agriculture – Raiffeisen has special agriculture loan offices in all of their branches. Raiffeissen has a good network throughout Kosovo to support the agriculture sector.
- Interest Rates & Lending Terms – Interest rates on Raiffeisen's micro loans, including agriculture, is in the 12%-to-23% range with and application fee of 0.5%-to-2.0%. The interest rate on agro loans are always 1 percentage point less than standard loans. Only for agro loans, Raiffeissen allows a grace on principal payments for up to 12 months.
- Leasing – Raiffeisen's leasing program includes agro equipment, but this is a separate institution that is just getting started.
- Main Issues with regard to Agriculture Development:
  - The biggest problem is the legal system. The courts are functioning terribly. The dysfunctional court system, more than any other problem, is increasing the risk of lending and causing high interest rates, especially on agriculture loans.
  - The agro sector has been under served for a decade; there is weak demand and no real businessmen or investors have been interested in the agriculture sector. Raiffeisen is ready to lend more to this sector, but it needs good credit applications.
  - The best things USAID could do are more DCA programs and help open new markets. Also, developing a functioning moveable pledge registry would be a good initiative for the donor community.

- There is no leadership coming from either the MAFRD or the GoK. There needs to be coordination meetings that bring the parties together. These need to be monthly meeting. It should be the GoK that coordinates and provides leadership for agriculture development.
- There needs to be a central planning committee consisting of the banks, donors, MAFRD and agriculture producers/processors. In Macedonia, the agriculture sector has improved much, much better than in Kosovo and it is believed to be at lease partly due to better Government support for agriculture development.
- Raiffeisen would like to have more agriculture loans as well, but it needs good applicants. It is currently reviewing its interest rate policies and areas to improve agriculture lending.
- In agriculture, not much has improved in the past 10 years with regard to agriculture lending, in spite of the fact that there is no greater default on agriculture loans than other loans.

Banka Ekonomike – One of the smaller banks in Kosovo, Banka Ekonomike believes that agrees that agriculture is an important economic sector that is underserved by the banking community. Reasons why Banka Ekonomike is not engaged in more agriculture lending is because they do not have internal agriculture expertise, lack of Loan Officers with technical experience in the agriculture sector, and, perceived high risk of lending to agriculture. As an example of the higher risk level, a large loan of 200,000 euro that they made to a dairy processor is now in foreclosure.

Banka Ekonomike is implementing a program for agriculture supported by the Norwegian Association of Local & Regional Authorities (NALRA). The NALRA places funds on deposit at Banka Ekonomike. Borrowers that receive loans from these funds are charged a subsidized interest rate of only 8% per annum, compared to the standard loan interest rate of about 12.5%. The interest income of 8% is split with 4% going back into the fund and 4% going to the bank. The NALRA funded loan portfolio is approximately 500,000 euros for 151 loans, of which 95% are being repaid on time.

Banka Ekonomike's perspective on the key issues regarding bank lending:

- Liquidity – lack of financing going to the agriculture sector is not caused by a shortage of liquidity at Banka Ekonomike.
- Collateral – For small loans, Banka Ekonomike takes only moveable assets as collateral and registers the moveable assets at the pledge registry, which works fine. Banka Ekonomike usually requires collateral valued at 1.5-to-2.0 of the loan amount.
- Crop Insurance – There is no crop insurance in Kosovo and did not have a strong opinion either way about the need for crop insurance.
- USAID DCA – Banka Ekonomike would be very interested in participating in a DCA guarantee program at the 1-to-2 million euro level.
- Financial Statement (FS) requirements - Banka Ekonomike uses the same 5 Cs of Credit approach that was taught on the Kosovo Business Finance project and used at the American Bank of Kosovo. Audited financial statements are not required for agriculture loans.
- Outreach and Targeted Support for Agriculture – Banka Ekonomike only special program targeting agriculture is the NALRA program (described above). No other special programs for agriculture. Of Banka Ekonomike's micro enterprise loans (SME loans), less than 1% are to agriculture. There just are not many agriculture loan applications being requested or submitted to the bank.
- Interest Rates & Lending Terms – Standard interest rate is about 12.5%.
- Leasing – Banka Ekonomike does not have a leasing program.
- Main Issues with regard to Agriculture Development:

- Court enforcement of lending contracts is the biggest problem. The court system in some municipalities are completely broken.
- Banka Ekonomike is interested in participating in a DCA guarantee program at the 1-to-2 million level.
- Banka Ekonomike needs professional technical training, agriculture expertise and Loan Officer training and would welcome USAID assistance with technical training in agriculture credit.
- Although not stated in the interview, Banka Ekonomike would appear to benefit from a B2B agriculture business conference bringing together bankers and agriculture borrowers/investors.
- Banka Ekonomike believes that the MAFRD should provide subsidies for agriculture, either in the form of interest rates subsidies or crop price subsidies.

TEB Bank – A newcomer to Kosovo, TEB bank is not actively involved in agriculture lending, but TEB does finance agro trading companies. TEB has engaged in a completive analysis of the banking sector. While this is not available for the public, several of observations on banking in Kosovo were: 1) while interest rates on general business loans average around 14%, interest rates on agriculture loans are in the 15%-to-24% range; 2) ProCredit is lending to individuals, some are business owners and some are farmers (which classify as agro loans). ProCredit lends small amounts at very high interest rates, just like the MFIs; and, 3) Raiffeisen individual loans are only to salary makers and they take a lien on salary payroll to repay loans. Individuals can get either a loan or overdraft through the individual loan program.

TEB is coming out with several innovate lending programs, not specifically for agriculture, but they are business loan programs that can serve agriculture as well. The first product is TEB's SPOT loan program structured for businesses dealing with sales contract, purchase orders or pronounced seasonality. After the loan is made, all interest and principal is repaid in a single balloon payment at the end of the loan term (with the loan being structured to match the timing of when funds are received from the buyer). The second lending program being introduced is called a Direct Debit Business loan. It is designed for lead companies that deal with a network of smaller companies. The loan is made to the lead company based on the credit needs of the entire network.

NLB Bank – NLB is not very active in agriculture financing. The business environment is not very favorable for agriculture. Small farmers are facing profitability problems and the business of farming is very risky because of external factors such as weather. When asked if the loan loss provisions required by the Central Bank of Kosovo (CBK) were restricting agriculture lending, the answer was no. Instead, risk exposure is set by internal bank policy.

NLB Bank's perspectives on the key issues regarding bank lending are listed below. These relate to sole proprietor operations, large agriculture companies are much more bankable:

- Liquidity – Lack of financing going to the agriculture sector is not caused by a shortage of liquidity at NLB bank. Even if the bank had excess liquidity, it would not want to change its risk profile by increasing lending to the agriculture sector.
- Collateral – Land in rural areas is not valuable because it is not saleable. If a bank forecloses on property, no one in the community will buy the property. NLB bank uses the moveable pledge, but they are not engaged in asset based lending. Also, there are no professional appraisers in Kosovo.
- Crop Insurance – Crop insurance in Kosovo will probably not be very helpful, if it works at all. Farmers will not use insurance unless it is required, and if it is required, it may become an additional obstacle to obtaining financing. For example, insurance on vehicles is only used when it became required by law.

- USAID DCA – May have potential but would need more details to form an opinion.
- Financial Statement (FS) requirements – Farmers do not have proper financial reports or accurate farm records.
- Main Issues with regard to Agriculture Development:
  - The number one issue is the lack of profitability in the agriculture sector as a whole.
  - The legal system is the second major problem because it is very inefficient. This especially impacts the value of moveable assets. If the courts increased efficiency and claims could be processed quickly, especially with regard to moveable assets, it would substantially improve the borrower/bank relationship.
  - NLB has banks throughout Eastern Europe and it perceives Kosovo as a higher risk environment, especially because of the inefficient court system. Serbia and Macedonia have much more efficient court and better financial statement requirements, and interest rates are lower.
  - An immediate solution to encourage additional bank financing to agriculture would be GoK or USAID guarantees with cash covered loans.

Micro Finance Institutions (MFI)s, Non-Bank Financial Institutions(NBFIs) and Leasing Companies

Directors and Managers of 5 leading MFIs, NBFIs and Leasing Companies were interviewed for this assessment: Crimson Capital, Factor Leasing, KEP, KosInvest and FINCA. Below is a summary of the perceptions about serving the agriculture industry based on these interviews:

Crimson Capital – A NBFI licensed by the CBK, Crimson Capital provides short term working capital to SMEs through its self-described invocative lending product call Purchase Order Financing (POF). All of Crimson's lending activity is to the SME sector, with about 20% of the loan portfolio to agriculture or food companies, for example, extending credit to flour mills that in turn on-lend to small wheat farmers that are the wheat suppliers.

POF is working capital financing to pay for inputs and working capital costs during the production and transit stages product deliver against a sales contract (purchase order), with the loan terms matching the natural cash flows of the business transaction: loan funds are available when purchase orders are received and principal loan repayment is structured to match the cash inflow when buyer payments are received. In the banking world, this would be considered a trade financing loan product, but the intensity that Crimson has in marketing its financing for trade contracts is refreshing. If banks pursued clients and lending with the same high level of energy that Crimson displays, banks would not be perceived as being so out-of-touch with the business community. While this lending product is very useful in financing trade transactions (including agriculture trade), it does little to increase the availability of financing for capital investments in the agriculture sector.

The standard POF terms & conditions are short-term (i.e. up to 12 months) loans of 10-to-100 thousand euro at effective rates of 20%-to-30% per annum. Crimson rightly points out that the interest rate is not prohibitive for short term financing, but it is at levels considered expensive by the agriculture community at large and is extremely cost prohibitive for investment capital needs. To address part of these limitations, Crimson recently received approval for $1.5 million of assistance from USAID targeted specifically to agriculture; one-half devoted to working capital and one-half of the funds devote to lease financing. Crimson participated in the construction of leasing laws in Kosovo and this new area of financing could advance equipment financing.

Crimson's criticism of traditional bank lending in Kosovo is that it is primarily overdraft approval, using salary based lending analysis, and the lending decision is a 3-to-6 month process. Instead, cash flow analysis needs to set the basis for lending and loan repayment structure.

When asked if a GoK or MAFRD type guarantee program could increase the availability of financing for agriculture, the response was negative because: 1) the MAFRD is not set up to effectively implement an operational program, 2) it would not result in a sustainable solution, and, 3) the potential for either real or perceived corruption in the guarantee process.

Factor Leasing - Factor Leasing's only exposure to agriculture is that they leased 7 tractors to an agriculture company. The experience has been disappointing because the lessor has default on the lease agreement and Factor Leasing is in the process of acquiring its lease assets. It has retrieved 4 tractors but have not been successful at repossessing the remaining 3 tractors.

In the view of Factor Leasing, the court system in Kosovo is the main problem, especially with regard to enforcement of contracts. Ineffective courts are the main impediment why Factor Leasing cannot repossess their tractors, and, as a result, will not do any more leasing to the agriculture sector.

Factor Leasing points out that collateral in rural areas is worthless because it is part of a community that will not allow the foreclosed property to be sold. While the Credit Registry operated by the CBK is good, but the problem is that farmers do not have a credit history.

According to Factor Leasing the main solution would be to establish a separate court division to work with banks and leasing companies.

KEP - KEP is the largest MFI in Kosovo and has a $43 million loan portfolio. KEP has been operating for 11 years. It was started with donor funds and now obtains loan capital through loans from development banks (such as EDRD).

KEP's perspectives on the key issues regarding financing are listed below:

- Liquidity – KEP agrees that agriculture is very much under-financed but not because of liquidity. KEP has established lines of credit with development banks. However, the cost of obtaining funds is high (10%) and that drives up the cost of credit to borrowers.
- New MFI Regulations for Deposit Taking – The new MFI regulations will have a significant impact and it is critical to the success of MFI lending. Currently, KEP is borrowing from development banks and the cost of funds is about 10%. With deposits, they can lower the cost of funds to 3%-or-4%.
- Collateral – In general, KEP will take moveable assets (such as equipment), but not livestock. KEP will also accept 3rd party guarantees from relatives or business partners. As a general practice, KEP will register moveable collateral with the moveable pledge registry. However, at 5 euros per loan, it is too expensive for very small loans. Therefore, for small loan amounts, they don't register. As an alternative, they check the credit registry to see if the borrower has other outstanding loans.
- Crop Insurance – Lack of crop insurance is not the problem. It may help slightly, but would only solve part of the problem. Crop insurance would not be close to the top of KEP's priority list of things that would advance lending to the agriculture sector.
- Targeted support for agriculture - KEP has specialized agriculture lenders in the local communities. These agriculture lenders are like community organizers. Commercial banks do not know how to make micro loans because agriculture micro borrowers need outreach.

- Loan Products - KEP uses very standard loan products. MFIs in Kosovo have done a good job with outreach, but not with the development of new loan products.

KEP gives small micro loans to farmers (up to 2,000 euro, for up to 2 years) and repayment is very good. Usually, KEP will lend to a farmer in cycles, start small and grow larger. The loans are fixed, both the interest rate and the monthly payment amount. The loans do not reflect the seasonality of the business, and this is something that can be improved upon.

KEP is exploring getting into dealer input credit and buyer credit (supply chain credit).

KEP has a 43 million euro portfolio and around 50% of the portfolio is to rural areas. For the overall loan portfolio, the over 30-days past due is 7.5% of the portfolio.

- Financial Statement (FS) requirements – Audited, or even formal, financial statement are not required by KEP. Instead, KEP Loan Officers construct the financial statements through an interview with the farmer.
- Leasing - KEP does not offer leasing. Leasing requires a license. GOK has not provided incentives for leasing, like exists in other countries.
- Main Issues with regard to Agriculture Development - Agriculture development is the main way to alleviate poverty in rural areas. The problems in Kosovo are:
    - Land: registration; fragmentation; and, cadastre office;
    - Irrigation system: it used to be state owned and now it is broken;
    - Technology & development of sector: needs more cooperatives to achieve economies of scale because individual small farmers cannot introduce new technology;
    - Supply-chain: when ex-Yugoslavia was dismantled, so was the supply chains for agriculture and therefore there are no cold chains;
    - GoK has not provided any protection against inputs: For example, Macedonia has economies of scale and Government subsidies, so it has lower prices and if they dump in Kosovo it puts the local producer out of business;
    - No support from the GoK: For example, the GoK owns the irrigation system but does not maintain it. There is no protection against foreign products. There is no resolution of land issues. There are no investments in technology or know-how. Working to integrate certifications such as GLOBALGAP.
    - Ag financing: All of the above listed factors are risks that lead to lack of financing. Farms are not real businesses, they are just small family farmers that are very informal. Financial institutions lack an understanding of agriculture. Scale is another problem – very small loans and therefore, more in the MFI area than bank loans. Banks charge over 20% interest for small agriculture loans, similar to MFIs. In agriculture rural areas, there are no alternative sources of income. There are no guaranteed buyers.
    - The agriculture sector needs a lot of development: know-how, clusters, registration.
    - Agriculture micro borrowers need outreach and that is something the MFIs are good at.

KosInvest – Is part of the World Vision group with MFIs operating in more than 60 countries. It is a rural lending MFI with a 3.5 million euro portfolio. KosInvest started with donor funds generated by USDA food monetization and support from USAID, and now obtains loan capital through loans from micro finance lenders with an average cost of around 9.5%.

KosInvest's perspectives on the key issues regarding financing are listed below:

- New MFI Regulations for Deposit Taking – KosInvest does not meet the regulatory standards to become a deposit taking MFI.
- Collateral – Loan security is based on guarantors. Land (real estate) collateral is no good.
- Crop Insurance – No one can insure anything. Crop insurance would be beneficial.

  Loan Products – KosInvest makes micro loans of less than 1,200 euros; micro plus loans in the 1,200-to-5,000 euro range and SME loans in the 5,000-to-7,000 euro range. In meeting the needs of agriculture loans, KosInvest allows a grace period on interest & principal for up to 6 months. The average loan interest rate is 23%, and as part of it outreach, works at the local level with rural communities.
- Financial Statement (FS) requirements – Financial statement are not required.
- Leasing – Does not offer leasing.
- Main Issues with regard to Agriculture Development and Assistance from MAFRD and USAID.
  - MAFRD must issue food standards and certifications. Certification must begin so food products meet the same standards as Europe so products are accepted in external markets. And, locally produced milk needs special testing and certification to insure food safety.
  - Agriculture is the biggest industry in Kosovo, but does not receive any budgetary support from the GoK. The GoK must support their own farmers and stop letting milk and cheese come into Kosovo from other countries.
  - MAFRD needs to do more product testing. For example, KosInvest tested saffron production (a new product in Kosovo) and the climate around Prizren is perfect for saffron production. The test plots produced some of the best saffron in the market and U.S. buyers are interested in buying from Kosovo. But, to develop this product will need the support of the MAFRD and donors like USAID to provide technical expertise to farmers and be able to test and certify the quality of the product.
  - Greenhouse production has a lot of potential because of the high demand for vegetables in the winter months.
  - MFIs work closely with the rural communities and they have a role in rural areas to provide financing, but donors need to provide more grants or a cheap source of loans for MFIs.
  - If the GoK, MAFRD and USAID want to increase lending to farmers, then they need to support MFIs by providing grants for agriculture lending.

FINCA – The second largest MFI in Kosovo has about a 20 million euro loan portfolio, with 60% in micro and small business loan and 7% to agriculture. Started with donor funds, it now obtains loan capital through loans from MFI development agencies and individual funds. The average cost of capital is close to 11%.

FINCA's perspectives on the key issues regarding financing are listed below:

- Liquidity – FINCA has establish lines of credit so access to funds is not the problem, however, the cost of obtaining funds is very high, close to 11%.
- New MFI Regulations for Deposit Taking – FINCA plans to become a depository institution.
- Collateral – FINCA offers group loans which do not require collateral up to 3,000 euro.
- Main Issues with regard to Agriculture Development:
  - The biggest thing the GoK can do is fix the court system. That is the main reason for high interest rates. Kosovo has much higher interest rates than Bosnia because the court system is dysfunctional and inefficient. The average court

settlement takes 700 days in Kosovo, compared to 300 days for the average in Eastern Europe and only 70 days in Western Europe.
- MFIs, especially the big ones, need more attractive terms on source of funding. Banks especially don't want to lend in rural areas because of the broken court system, unclear collateral and high cost of delivery. MFIs are best suited to serve the needs of rural borrowers. The best thing that USAID could do is to provide funds to MFIs (either grants or loans) at low interest rates targeted to rural lending.
- Another problem is the lack of domestic demand. Wholesalers and retailers are selling products they buy from external markets like Macedonia. The GoK needs to connect with grocery stores and food distributors and promote the consumption of local producers by giving a sales tax break to retailers selling domestically produced products. The GoK needs a "buy domestic" program.
- The GoK needs to encourage investments in agriculture by providing tax incentives on the purchase of agriculture equipment.

CENTRAL BANK OF KOSOVO

This section summarizes the CBK perceptions about the credit environment with regard to agriculture in Kosovo. For definitional purposes, agriculture is described by the banking sector as loans to finance production agriculture and maybe some processors that are very close to the production end, such as pickling cucumbers. Agriculture receives very limited amounts of bank credit in Kosovo, while new lending overall in on the rise. New bank loans of 65.5 million euro were issued during the Jan-June 2010 period, compared to 61.9 million euro in new loans for the same period the year before. Outstanding bank loans as of June 2010 were 1.4 billion euro, up 12.5% from the year before. Bank deposits in June 2010 were 1.8 billion euro, up 19.1% from year earlier.

CBK's perspective on the key issues regarding bank lending:

- Liquidity – Liquidity in the banking system is not the problem constraining lending to agriculture. Overall, there is good, maybe even excess, liquidity in the banking sector and the sector is more liquid than a year ago. The loan-to-deposit ratio for the banking system was 80% in June 2010, compared to 85% in June 2009. Two other indicators of liquidity are: 1) the Capital Adequacy Ratio was 18.9% in June 2010, up 1.3% points from the year before, and exceeding the regulatory minimum of 12%; 2) Liquid Assets-to-Total Assets ratio was 33.9% in June 2010, compared to 25.3% in June 2009.
- Collateral – The CBK's rule #9 on loan provisions is more conservative than International Standard (IS) #39 because in Kosovo there is no lender of last resort. The CBK cannot print money to bail out bank failures. Therefore, it is warranted that Kosovo have a more conservative policy regarding loan loss provision.

Borrowers tend to place an exaggerate value on collateral, a higher value than what the banks could receive if liquidated. Part of the valuation problem is that there are no certified independent appraisers in Kosovo to fairly value the assets.

The CBK does not specify the type of collateral that banks must take; it's all about the individual bank's lending policy. Both real estate and moveable assets are acceptable collateral in accordance with CBK regulations.

The Ministry of Trade & Industry runs the moveable pledge registry. It is not working very well. A consultant from Israel has been contacted to work on this.

The CBK would be willing to be less conservative in its supervision of agriculture loans, if development of the agriculture sector was a national priority. But, the GoK needs to provide leadership.

- USAID DCA – CBK was not aware of the DCA program, however they liked the concept and would recognize the DCA as securing loans and cooperate with banks to promote lending to agriculture utilizing a DCA guarantee. If there is a USAID guarantee on loans, the CBK is very willing to treat this portion of the portfolio differently and lower the loan provision requirements because it is 50% guaranteed by USAID.
- MAFRD Loan Guarantee – The CBK does not think it is a good idea for the MAFRD to participate with risk because it is public money. If the MAFRD wants to do something quickly to help agriculture, maybe they should subsidize interest rates on agriculture loans.
- Financial Statement (FS) requirements - CBK requires audited financial statements only for loans greater than 500,000 euro. CBK does not require audited financial statements of loans less than 500,000 euro, but if financial statements are not audited, the CBK requires 1% additional provision for loan losses.
- MFI Regulations – A new bank credit law is being prepared in cooperation with the IMF. UNMIK will be removed from the law. Also, this new law will address MFI regulations and, in the future, there will be two types of MFIs; one type will remain as is, as a non-depository NGO; a second type of MFI will be allowed to take deposits. The deposit-taking MFIs will have the same standard-of-safety requirements for depositor as the banks. The only difference is that the deposit-taking MFIs have less stringent ownership requirements with regard to establishing ownership. The move to establish a deposit-taking MFI regulation was pushed by KEP and FINCA, the largest MFIs operating in Kosovo.
- Interest Rates & Lending Terms – Overall interest rates have declined. The effective average loan interest rate was 13.0% in June 2010, compared to 15.0% the year before; the average deposit rate was 3.8% and 4.7%, respectively. The resulting average interest spread is 9.2 and 10.3 percentage points, respectively. So, there has been a slight improvement in the cost of credit. The average deposit rate has been impacted by the privatization of the state telecom company (PTK) because it had 280 million euro in deposits.
- Main Issues with regard to Agriculture Development:
    - There is a Commission on Anti-Monopoly and it is investigating whether banks are colluding to set high interest rates. The Commission is currently examining the interest rate comparisons with other countries in the region.
    - Improvements in the effectiveness of the courts are needed to improve the lending environment for agriculture.
    - Required reserves on bank deposits are 10%. 5% is kept on deposit at the CBK and earns an interest rate of 0.25% (1/4 of 1 percent). The other 5% is kept on deposit at the bank.
    - If it is a national interest to develop agriculture, the CBK will support that strategy and will work with the commercial banks to encourage agriculture lending. But it should be a national movement backed by the GoK
    - For agriculture development, the GoK should encourage land owners to merge plots of land and operate as a cooperative in order to promote efficiencies.

Ministry of Agriculture, Forestry and Rural Development (MAFRD):

This section summarizes the MAFRD's perceptions about the state of agriculture, credit conditions and MAFRD's initiatives in Kosovo. New leadership at MAFRD is eager to implement programs that produce positive incentives for agriculture, increase profitability and promote a faster pace of development. The MAFRD has 1 million euro to establish a model program to benefit farmers, and needs a complete, applicable model to deliver this assistance. The Minister wants creative thinking to best serve the needs of agriculture and protect local producers. MAFRD believes that agriculture is the path to economic development for Kosovo and has high expectations for USAID's New Opportunities in Agriculture (NOA) program. Incentive services are crucial to farmers right now. MAFRD is looking for direction on how to proceed, especially with increasing accessibility to credit. Credit is very difficult to obtain, especially without owning real estate, because agriculture is seen as high risk.

- Loan Guarantee – The MAFRD want to promote lending to agriculture. One option that the Ministry initially explored in order to increase credit availability was creating a MAFRD loan guarantee program, similar to the successful USAID DCA guarantee program. However, that option is all but dead because it was later discovered that the MAFRD cannot give loan guarantees because it is prohibited by law.
- Grants – MAFRD already administers a 50/50 grants program for startups to encourage new businesses and get new land into vineyards, orchards, horticulture and greenfields. In addition, the EC contributed 5 million euro for a 25%/75% cost-share grant program for food processing, and the World Bank has given 15 million euro for 20-to-100 thousand euro loans. One obvious question is, given the amount of donor funding and grants going to agriculture, why would a farm business want a loan?
- Coordinate Donor Support – With all of the donors programs operating in Kosovo, it is important to have a coordinated strategy to maximize results, so a Donor Committee is being developed.
- Trade – Kosovo is not a UN member, but it does receive preferential status of entry without customs. However, it must meet the appropriate food safety standards.
- Extension Services – The way it has been done in the past is no help at all to farmers. Extension services are very weak, and the question is, how should extension services work with regard to running a good agriculture business?
- Other Ideas – The MAFRD is willing to accept recommendations on a range of ideas such as restoring the irrigation system, providing crop price subsides, trade certifications, information dissemination on opening new markets and how to register in the trade business.

DONOR SUPPORT PROGRAMS

The following comments represent the views of three donor support programs and one farm association that were interviewed: 1) Kosovo Private Enterprise Program (KPEP); 2) Business Enabling Environment Program (BEEP); 3) InterCooperation and 4) Perdrini Farmers Association. In addition, information on contract resolution was obtained from the Alternative Dispute Resolution conference organized by the Systems for Enforcement Agreements and Decisions (SEAD) program.

- Credit – Agriculture processors can obtain bank financing, but agriculture producers cannot obtain financing. Although still small, there is some growth in the trend of agriculture processors extending credit to farmers that are their suppliers. One example of that is Pestova Potato Company.
  Another view is that bank financing is more available but farmers and ag businesses are unwilling to apply for credit because the terms and conditions are so unfavorable (high

interest rates and not structures for agriculture). It is a common belief that the commercial banks operate like a cartel because they all have the same terms and conditions. It is also a common belief that interest rates are much higher than neighboring countries. MFI interest rates are about 22% and bank rates about 14%. Interest rates are too high to be used in agriculture.

- Grants – MAFRD grant program for greenhouses and apple orchards was ranked very poor by farmers.
- Leasing – Since collateral is largely unacceptable, unavailable, or already pledge, leasing would be a good alternative.
- Collection Centers – There will be 5 collection centers operational this season to organize farm marketing. However, there are many improvements needed by these centers, such as cold storage.
- Development Needs – Development of the agriculture sector needs three things: 1) investment capital, 2) trade barriers to protect local producers from neighboring countries like Macedonia and Serbia, and, 3) extending the season with greenhouses.
- Crop Insurance – One donor is examining crop insurance as a means to controlling the risk level of farming and therefore making the sector more attractive for banks.
- Farmers are very skeptical of the MAFRD. Many view it as a corrupt agency that has done nothing to help agriculture.

- The court system is almost universally considered to be dysfunctional. Because it is so difficult to get timely contract resolution, it inhibits business transactions. Foreign investors will not invest in Kosovo until business contract rights are enforceable. One answer could be arbitration. Although most international investors would require arbitration in a venue

ANNEX B – QUESTIONNAIRES

AGRIBUSINESS QUESTIONNAIRE

Preface: There is a general belief among farmers and the agribusiness community that banks are not providing enough credit on favorable terms and conditions. The perception is that banks are mostly to blame but bankers point to the risk of agriculture production and the lack of quality financial information. We are trying to determine where the problems lie.

Our objective is to examine the reasons for low rates of financing and make recommendations on how the lending environment can be improved for those businesses in the agriculture sector. As a business in the agriculture sector, we are particularly interest in your point of view about this perception and ways to improve the situation. Please be as open as possible with us because our goal is to provide more detailed recommendations to USAID on specific assistance that will increase the availability of lending for agriculture production, processing and trade.

1. **Current Level of Ag Lending:** Do you believe in the general perception that agriculture does not receive the amount of credit that is deserves and is needed for sectoral growth.

2. **Loans:** Have you ever applied for a business credit? If you, were you approved? If yes, what type of credit did you get and what did you use the money for? Were you able to repay on time? Could you tell us which bank and what was the process like?

3. **Collateral:** Everyone believes that the amount of collateral required by banks is a major obstacle for the agriculture sector. The perception is that banks require excessive collateral of 2 to 3 times the loan amount, with a strong preference for real estate collateral. Many development people believe banks are constraining growth of the agriculture sector. This raises a whole series of questions:
    - **a.** When you applied for a loan, what was the approximate amount of the loan request and what was the approximate amount of collateral that the bank required?
    - **b.** Did the banks require the collateral to be real estate or could you use moveable assets, such as equipment? Did the bank allow you to use legal agreements such as sales contracts and purchase orders as collateral. What about an item like future crop production; would that have met the bank's collateral requirement?

4. **Crop Insurance:** Is crop insurance available? In your opinion, would crop insurance make you more willing to obtain a loan?

5. **USAID Support:** What would you recommend to USAID with regard to assistance for development programs, such as farmer business training, new products for high-value markets, market development, technical assistance for banks, etc.?

6. **Financial Statement Requirements:** Everyone in the development community believes that there should be a greater emphasis placed on financial statements, especially cash flow, as the basis for lending and less emphasis on collateral. Then, the discussion progresses to the quality of the financial information. Farmers especially, but most small businesses in agriculture or food products have very basic business records. They are almost never audited financial statements. What level of financial statements do you possess?

7. **Loan Products:** Could you briefly describe the types of loan products you need, such as trade financing, production credit, revolving credit, equipment loans, long-term investment in greenhouses, irrigation system, grain storage, buildings and other real estate financing? If you ever received a bank loan, what are the general loan application requirements with regard to financial statements, collateral, guarantors, etc? What are the approximate range of fees, interest rates and terms of the various loan products?

8. **Other Lending Products:** Have you ever used what are sometimes considered creative financing schemes, such as dealer credit programs or assignment credit programs?

9. **Leasing:** Have you ever used a leasing program for such things as equipment and tractors?

10. **MFI:** In Have you ever received financing from an MFI?

11. **Concluding Remarks:** We covered some very specific areas that we needed to follow up on because they have previously been identified. However, we value your opinion and welcome any additional comments that can help us both understand and improve the agriculture credit situation? In your opinion, why is agriculture getting such a low amount of financing? What are some the most important changes (solutions) that could help to increase credit availability for agriculture and food processing and food trading industries?

12. **Future Cooperation:** Access to finance has to come from the providers of credit. However, there are many things that donors and the GoK can and want to do if you want to more aggressively target agriculture. What are your recommendations on the type of things that you would want and support, such as the guarantee programs, technical assistance to agriculture, assisting borrowers with business plan development, assisting the bank with loan product development? Whatever types of products or services that you think would be beneficial.

BANK/MFI/NBFI QUESTIONNAIRE

Preface: There is a general belief by private business and the economic development community, including the MAFRD and USAID, that agriculture is seriously underfinanced. They point to statistics such as agriculture's 20% contribution to GDP while receiving only 4% of the financing. The perception is that banks are at least partially to blame in not serving the needs of agriculture, but it may be that you are just the most visible target.

Our objective is to examine the reasons for low rates of financing and make recommendations on how the lending environment can be improved for those businesses in the agriculture sector. As a provider of credit, we are particularly interested in your point of view about this perception and ways to improve the situation. Our work is building upon the previous AgCLIR study conducted in November 2009 and our goal is to provide more detailed recommendations to USAID on specific actions and loan products to serve agriculture production, processing and trade.

Obviously, if your interested in increasing your lending activities in the agriculture area, you may be interested in staying up-to-date on what we are doing because there may be USAID-funded projects for assistance in the form of guarantee programs, technical assistance, training for agribusiness and maybe even technical assistance for the bank, if that would be something you would want.

All of the information you provide to us will be kept strictly confidential. Not that we will ask for any private information, but I just want you to know that we will not attach your name with any of the information you give us.

1. **Current Level of Ag Lending:** Does the above situation approximately represent your portfolio; that is, that only a small amount of lending is to the agriculture sector? I want to be sure that part of that perception is not definitional in nature. Could you tell me a little about your definition of an agriculture loan when classifying your portfolio for the CBK. Does agriculture include farming, processing and trading in food products? For example, if you make a loan to a farmer, it would clearly be an agriculture loan. But what about a loan to a grocery store; would that be classified as an agriculture loan? Are loans to the food trading business, such as exporters, importers, buyers and other 3rd party intermediaries dealing with food based products considered agriculture loans?

2. **Liquidity:** The previous study pointed out that, according to the bankers interviewed, bank liquidity was not a problem restraining lending. It seems that there is plenty of liquidity in the banking system in Kosovo. Do you agree with that position?

3. **Collateral:** Everyone believes that collateral is a major “credit access” obstacle, specifically for the agriculture sector. The perception is that banks require excessive collateral of 2 to 3 times the loan amount, with a strong preference for real estate collateral. Many non-bank development people believe banks are too conservative and constraining growth of the agriculture sector. This raises a whole series of questions:
    a. Do CBK regulations restrict the amount and type of collateral you will accept ?
    b. What is your typical collateral requirement? Or, do you have information on the loan-to-collateral ratio for your bank?
    c. Does your definition of collateral include real estate and moveable assets? Does it allow legal agreements such as sales contracts and purchase orders to be used as collateral. What about an item like future crop production; would that meet your collateral requirement?
    d. Do you use the moveable pledge registry to establish a security claim on non-real estate assets? If not, why? What’s you opinion of how the pledge registry functions. Is this an area where USAID supported technical assistance would be beneficial? Would a more effective moveable pledge registry encourage you to use non-real estate assets as collateral? Would a better pledge registry positively increase the availability of credit for agriculture?
    e. Do you have any comments about the cadastre office and the ability to use real estate to secure loans?

4. Development Credit Authority (DCA): In 2006, USAID tried to reduce the collateral obstacle by setting up a $5 million credit guarantee for targeted credits to the agriculture sector. It was administered by Raiffeisen bank and was fully utilized, resulting in a $10 million ag loan portfolio. Everyone thinks it worked well and expanded lending to agriculture. Do you have any opinions about whether it lowered borrowers’ collateral requirements? In your opinion, did it encourage $10 million of additional lending to the agriculture sector, or, would these loans have been made anyway and the guarantee was just an opportunity that Raiffeisen used to lower loan risk and reduce allowance requirements? USAID is considering additional DCA guarantee programs, is this something you think is needed? Would additional guarantee funds expand the amount of money lent to agriculture?

5. **Proposed MAFRD Loan Guarantee:** There is a proposal that the MAFRD might administer a loan guarantee scheme. This is one of the areas that we are supposed to explore. In your opinion, is a government-run loan guarantee a good idea to increase credit availability to agriculture? Should the GoK get involved in this area?

6. **Crop Insurance:** Crop insurance is another product that has been suggested to increase the amount credit available to production agriculture. In your opinion, would crop insurance make you more willing to give loans to farmers? If so, would USAID assistance to develop a loan program be your top priority, or would you recommend other activities for development programs, such as farmer business training, new products for high-value markets, market development, technical assistance for banks, etc.?

7. **Financial Statement Requirements:** Everyone in the development community believes that there should be a greater emphasis placed on financial statements, especially cash flow, as the basis for lending and less emphasis on collateral. Then, the discussion progresses to the quality of the financial information. Farmers especially, but most small businesses in agriculture or food products have simplistic business records. They almost never have audited financial statements. What is your banks position with regard to cash flow analysis? Are well-prepared cash flow statements acceptable or do you require audited financial statements? Do you consider yourself a predominately cash-flow or collateral based lending?

8. **Targeted Support for Agriculture:** Does your bank have a special program specifically targeting lending to the agriculture sector? What about outreach and support with the loan application process? Does your bank believe that agriculture is a special industry that requires special loan products?

9. **Loan Products:** Could you briefly describe the types of loan products you offer to the agriculture sector such as trade financing, production credit, revolving credit, equipment loans, long-term investment in greenhouses, irrigation system, grain storage, buildings and other real estate financing? What are the general loan application requirements with regard to financial statements, collateral, guarantors, etc? What are the approximate range of fees, interest rates and terms of the various loan products?

10. **Purchase Order Financing:** Have you heard of a new term called Purchase Order Financing? If so, how is it different from traditional trade financing?

11. **Other Lending Products:** Do you offer what are sometimes considered creative financing schemes, such as dealer credit programs or assignment credit programs?

12. **Leasing:** Do you have a leasing program for agriculture in the area of equipment (such as tractors)?

13. **New MFI Regulation (only for MFIs):** In the previous AgCLIR report, it stated that a new CBK regulation will allow MFI's to start taking deposits. Could you tell us a little more about this program? Do the MFI's have to meet the same standards as banks to protect depositors? Since MFIs traditionally serve farmers and small SMEs, will this change noticeably expand credit the availability of credit for these groups?

14. **Concluding Remarks:** We covered some very specific areas that we needed to follow up on because they have previously been identified. However, we value your opinion and

welcome any additional comments that can help us both understand and improve the agriculture credit situation? In your opinion, why is agriculture getting such a low amount of financing? What are some the most important changes (solutions) that could help to increase credit availability for agriculture and food processing and food trading industries?

15. **Future Cooperation:** Access to finance has to come from the providers of credit. However, there are many things that donors and the GoK can and want to do if you want to more aggressively target agriculture. What are your recommendations on the type of things that you would want and support, such as the guarantee programs, technical assistance to agriculture, assisting borrowers with business plan development, assisting the bank with loan product development? Whatever types of products or services that you think would be beneficial.

CENTRAL BANK OF KOSOVO (CBK) QUESTIONNAIRE

Preface: There is a general belief in the private business sector, government Ministries and the economic development community, including the MAFRD and USAID, that agriculture is seriously underfinanced. They point to statistics such as agriculture's 20% contribution to GDP while receiving only 4% of the financing in Kosovo.

Our Scope of Work is to examine the reasons for low rates of financing and make recommendations on how to improve the lending environment for the agriculture sector of Kosovo. In this regard, we are interviewing the providers of financing (banks and MFIs), MAFRD, farmers, agribusinesses and others that can provide us with specific information on financing constraints and suggestions for improving the amount of credit available for agriculture. As the regulator of banking and finance, we are particularly interested in your point of view about this perception and ways to improve the situation, especially with regard to new credit products or approaches.

Our work is building upon the previous AgCLIR study conducted in November 2009 and our goal is to provide more detailed recommendations on specific actions and loan products to serve agriculture production, processing and trade.

All of the information you provide to us will be kept strictly confidential and we will not attach your name with any of your opinions. However, we would like to use some of the CBK's statistics in our report.

1. **Current Level of Financing:** Is the above situation approximately correct, that only 4% of credit in Kosovo goes to the agriculture sector? And, if so, could you tell me a little bit about how the classification that it is an agriculture loan is determined. Does it include farming, processing or trading in food products? For example, a loan to a farmer would clearly be an agriculture loan, but what about a loan to a grocery store; would that be classified as an agriculture loan? Are loans to the food trading business, such as exporters, importers, buyers and other 3rd party intermediaries dealing with food based products considered agriculture?

2. **Liquidity:** The previous study pointed out that bank liquidity was not the problem, according to comments made by several of the banks. Do you agree with that position and does the CBK have any statistics on the level of liquidity in the banking system that would clearly display the current liquidity situation?

3. **Collateral:** Everyone points to collateral requirements as a major obstacle. The perception is that banks require excessive collateral of 2 to 3 times the loan amount, with a strong preference for real estate collateral. Many people believe that is constraining growth of the agriculture sector. Is this driven by CBK regulations on the amount and type of collateral bank supervision will accept on loans? Do you have any publicly available information on the loan-to-collateral ratio in the banking sector? Does the CBK have a definition of collateral and does it allow for sales contracts, purchase orders and future crop production to meet bank supervisions collateral requirements?

4. **Financial Statement Requirements:** Everyone in the development community believes that there should be a greater emphasis placed on financial statements, especially cash flow, as the basis for lending and less emphasis on collateral. Then, the discussion progresses to the quality of the financial information. Farmers especially, but even most agribusinesses, generally have simplistic business records and they almost never have audited financial statements. What is the position of the CBK on this matter? Are well-prepared cash flow statements that can be supported by the business acceptable or does the CBK only recognize audited financial statements during its bank review?

5. **New MFI Regulation:** In the previous AgCLIR report, it stated that a new CBK regulation will allow MFI's to start taking deposits. Could you tell us a little more about this program? Do the MFI's have to meet the same standards as banks to protect depositors? Since MFIs traditionally serve farmers and small SMEs, will this noticeably expand the availability of credit for these groups?

6. **Development Credit Authority (DCA):** In 2006, USAID tried to reduce the collateral obstacle by setting up a $5 million credit guarantee for targeted credits to the agriculture sector. It was administered by Raiffeisen bank and was fully utilized, resulting in a $10 million ag loan portfolio. Everyone thinks it worked well and expanded lending to agriculture. Did the CBK examine this portion of Raiffeisen's portfolio separately and do you have any opinions about whether it lowered borrowers' collateral requirements? In the opinion of the CBK, did it encourage $10 million of additional lending to the agriculture sector, or, are these loans that would have been made anyway and the guarantee was just an opportunity that Raiffeisen used to lower loan risk and reduce allowance requirements.

7. **Proposed MAFRD Loan Guarantee:** The DCA guarantee is perceived as being so successful that now there is a proposal that the MAFRD might administer a loan guarantee. This is one of the areas that we are supposed to explore. In your opinion, is a government-run loan guarantee a good idea to increase credit availability to agriculture?

8. **Concluding Remarks:** We covered some very specific areas that we needed to follow up on because they have previously been identified. However, do you have any addition comments or opinions that can help us both understand and improve the ag credit situation? In your opinion, why is agriculture getting such a low amount of financing? What are some the most important changes (solutions) that could help to increase credit availability for agriculture and food processing and food trading industries?

MAFRD QUESTIONNAIRE

Preface: There is a general belief that agriculture is seriously underfinanced because of statistics such as agriculture's 20% contribution to GDP while receiving only 4% of the financing in Kosovo. Our Scope of Work is to examine the reasons for low rates of financing and make recommendations on how to improve the lending environment for the agriculture sector of Kosovo. In this regard, we are interviewing providers of credit, MAFRD, farmers, agribusiness firms and others that can provide us with information on perceived problems, constraints and suggestions for improving the situation. Our work is building upon the previous AgCLIR study conducted in November 2009 and our goal is to provide more detailed recommendations on specific actions and loan products to serve agriculture production, processing and trade.

1. **Current Level of Financing:** Is it also your feeling that agriculture is underfinanced and therefore slowing economic development or do you have a different view of the situation?

2. **MAFRD Programs:** What are the main MAFRD programs to support agriculture production (farmers), processing and trade? How do these programs increase the ability of the agriculture community to access financing to grow their business and expand markets? Given that resources are limited, is it more important for the MAFRD to support small farmers, open new high value markets, or have clear food safety policies, excellent services (such as issuing phytosanitary certifications) and extension support (such as HACCP and GLOBALGAP best practices?

3. **Guarantee Program:** There have been some discussions about a government-run loan guarantee program as one of the things that the GOK could do to improve access to finance. As part of our broader study on ag finance in Kosovo, we would like to understand this concept better.
    a. What is the MAFRD's position on the government-run loan guarantee program?
    b. Loan guarantee programs can be difficult to structure and maintain. Does MAFRD have the capacity to implement an activity that is as operationally demanding as a guarantee program?
    c. Is there a natural "conflict of interest" between the GOK, the private sector banks, and, the private sector businesses that benefit from a guarantee program?
    d. In a worst case situation where the economy is on a down cycle and many businesses cannot repay, does the MAFRD actually have the monetary resources to cover the cost of these guarantees?

4. **Collateral:** Everyone points to the level of collateral required by lenders as a major obstacle to accessing credit. The perception is that banks require excessive collateral of 2 to 3 times the loan amount, with a strong preference for real estate collateral. Many people believe that is constraining growth of the agriculture sector. Is this also the belief of the MAFRD?

5. **Financial Statement Requirements:** Everyone in the development community believes that there should be a greater emphasis placed on financial statements, especially cash flow, as the basis for lending and less emphasis on collateral. Then, the discussion progresses to the quality of the financial information. Farmers especially have simplistic or no business records. In the US, USDA has over the years put a lot of effort into making information available about the farming sector. I used to work in a bank and we used statistics such as average cost of production, prices received by farmers, and typical cash flow and balance sheets of the farming sector in the lending process. Is this type of information available in

Kosovo and should such information be produced to increase the knowledge level of the state of agriculture.

6. **Concluding Remarks:** Do you have any addition comments or opinions that can help us both understand and improve the ag credit situation? In your opinion, why is agriculture getting such a low amount of financing? What are some the most important changes (solutions) that could help to credit availability for agriculture and food processing and food trading industries?

7. **Future Cooperation:** Access to finance has to come from the providers of credit. However, there are many things that donors and the GoK can and want to do to target the development of agriculture, including greater access to financing. What are your recommendations on the type of programs that you would want support from the donor community, especially with regard to increasing market information, guarantees, opening high-value markets in Western Europe and other initiatives all of which increase the development and attract more credit and investments in the agriculture sector.

ANNEX C – LIST OF INTERVIEWEES

NAME	POSITION	INSTITUTION	CONTACT INFORMATION	DATE OF INTERVIEW
Ministry of Agriculture, Forestry and Rural Development (MAFRD)				
Uran Ismaili	Senior Adviser to the Minister	MAFRD	Uran.ismaili@ks-gov.net Office: +381 (0)38 211 374	Mon, 9/20
Fiton Peja	Chief Financial Officer	MAFRD	Fiton.peja@kujtesa.com Mobile: +377 (0)45 500 240	Wed, 9/22
Central Bank of Kosovo (CBK)				
Gani Gerguri	Deputy Governor	Central Bank of Kosovo	ganigerguri@bqk-kos.org Tel: +381 (0)38 222 243	Wed, 9/22
Nexhat Kryezio	Deputy Governor	Central Bank of Kosovo	nexhatkryeziu@bqk-kos.org Mobile: +377 (0)44 506 751	Wed, 9/22
Commercial Banks of Kosovo				
Kastriot Kepuska	Agro Manager	ProCredit Bank	kkepuska@procreditbank-kos.com Mobile: +377 (0)44 188 500 Mobile: +386 (0)49 555 069	Mon, 9/20
Shpend Nura	Head of Micro Segment	Raiffeisen Bank	Shpend.nura@raiffeisen-kosovo.com Mobile: +377 (0)44 778 000	Tues, 9/21
Burim Ibishi	Agro Lending Specialist	Raiffeisen Bank	burim.ibishi@raiffeisen-kosovo.com Mobile: +377 (0)44 508 397	Tues, 9/21
Fisnik Kepuska	Deputy CEO	Banka Ekonomike	Fisnik.kepuska@bekonomike.com Mobile: +377 (0)44 100 445	Tues, 9/21
Liza Marku	Head of Retail & Product Development	TEB Bank	Liza.marku@teb-kos.com Mobile: +377 (0)44 611 356	Tues, 9/28
MFI's & NBFI				
Michael Gold	Managing Director/CEO	Crimson Capital	Michael.gold@crimsoncapital.org Mobile: +377 (0)44 175 238	Thurs, 9/16
Arben Berbatovci	Director	Factor Leasing	Arben.berbatovci@factor-leasing.com Mobile: +377 (0)44 169 604 Mobile: +386 (0)43 444 000	Fri, 9/17
Elvis Ziu	Group General Manager	KEP MFI	eziu@keponline.net Mobile: +377 (0)44 423 104	Wed, 9/22
Rusudan Kharabadze	Director	KosInvest	Rusudan_kharabadze@wvi.org Mobile: +377 (0)44 120 679	
Agribusiness Companies				
Tahir	Owner/Manager	Etlinger	Mobile: +377 (0)44 205 908	Fri, 9/24

Kokollari				
Ivan Lukojicic	Owner/Manager	AS-Promet		Sat, 9/25
Ardian Shabani	Owner/Sales & Marketing	APC Agroproduct Commerce	ardian@apc-kosova.com Mobile: +377 (0)44 166 855	Mon, 9/27
Bejtush Gashi	Owner/Manager	EuroFruti	eurofruti@hotmail.com Mobile: +377 (0)44 173 331	Mon, 9/27
Donor Support Projects				
John MacKillop	Agriculture Sector Lead	Kosovo Private Enterprise Program (KPEP)	jmackillop@usaidkpep.org Mobile +386 (0)49 236 464	Mon, 9/20
Arben Musliu	Agribusiness Specialist (Livestock)	Kosovo Private Enterprise Program (KPEP)	amusliu@usaidkpep.org Mobile +386 (0)49 236 463	Tues, 9/21
Musli Berisha	Ag Marketing Assistant (Fruits & Vegetables)	Kosovo Private Enterprise Program (KPEP)	mberisha@usaidkpep.org Mobile +386 (0)49 236 462	Tues, 9/21
Samir Riza	Agriculture Consultant (Fruits & Vegetables)	Kosovo Private Enterprise Program (KPEP)	samir.riza@gmail.com Mobile +377 (0)44 237 982	Tues, 9/21
Terry Slywka	Chief of Party	Business Enabling Environment Program (BEEP)	tslywka@usaidbeep.org Mobile: +386 (0)49 443 004	Thurs, 9/23
Marian Mishriki	Credit Consultant	Business Enabling Environment Program (BEEP)	mmishriki@usaidbeep.org Mobile: +386 (0)49 442 994	Thurs, 9/23
Ardian Kryeziu	Deputy Chief of Party	Business Enabling Environment Program (BEEP)	akryeziu@usaidbeep.org Mobile: +377 (0)44 132 125	Thurs, 9/23
Shkumbin Saneja	Credit Coordinator	Business Enabling Environment Program (BEEP)	shsaneja@usaidbeep.org Mobile: +377 (0)44 131 620	Thurs, 9/23
Faton Nagavci	Project Manager	InterCooperation	Faton.nagavci@intercoopkos.org Mobile: +377 (0)44 500 549	Fri, 9/24
NGOs Supporting Agriculture				
Selami Hoti	Advisor	Perdrini Farmers Association	Salami_hoti@hotmail.com	Fri, 9/24

ANNEX D – ILLUSTRATIVE AGENDA

AGENDA
Agriculture Growth and Development Forum
Business-to-Business Opportunities

A. Regional Growth Opportunities
   a. Greenhouses – provide the opportunity to extend the growing season, especially in valley regions.
   b. Domestic Berry Cultivation – provides the opportunity to increase production, especially in mountain regions.
   c. Fruit and Vegetable Collection Centers – organizing marketing channels.
   d. Business Model of Successful AgriBusiness Companies
      i. APC Agroproducts Commerce
      ii. EuroFruti
      iii. Etlinger
      iv. Potato Company

B. Bank Financing Availability
   a. Lending Products Overview by Banks
      i. ProCredit
      ii. Raiffeisen
      iii. TEB
   b. Lending Overview by MFIs/NBFIs
      i. KEP
      ii. FINCA
      iii. Crimson Capital
      iv. KosInvest

C. Advancing Trade
   a. Ministry of Trade and Industry – Trade Agreements with Macedonia and Serbia
   b. Ministry of Agriculture, Forestry and Rural Development – Marketing in the EU, How to register, and crop certifications required.

D. Donor Support
   a. KPEP
   b. InterCooperation